



Monetary policy REPORT

september 2020



NATIONAL BANK OF KAZAKHSTAN



The Monetary Policy Report is a quarterly publication of the National Bank which contains the analysis of key macroeconomic indicators 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 of macroeconomic indicators was prepared on the basis of statistical information as at **21.08.2020**, and the analysis of macroeconomic indicators – as at **01.09.2020**.

CONTENTS

ABOUT PUBLICATION OF THE MONETARY POLICY REPORT.....	5
PREAMBLE.....	6
I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION.....	8
1.1. Forecast Assumptions.....	10
1.2. Dynamics of Economic Development under the Baseline Scenario.....	13
1.3. Alternative Forecast Scenarios.....	16
1.4. Risks in the Medium Term.....	17
II. THE MONETARY POLICY.....	20
2.1. Decisions on the Base Rate.....	22
2.2. Money Supply.....	23
2.3. Money Market.....	24
2.4. Foreign Exchange Market.....	25
2.5. Stock Market.....	27
2.6. Deposit Market.....	29
2.7. Credit Market.....	30
III. MACROECONOMIC CONDITIONS.....	32
3.1. External Sector.....	34
3.2. Economic Activity and Domestic Demand.....	35
3.3. Inflation.....	48
3.4. Labor Market.....	55
3.5. Fiscal Policy.....	55
BASIC TERMS AND DEFINITIONS.....	62
BOXES	
Box 1. Stable Creditworthiness Level.....	40
Box 2. The Pandemic’s Effect on the Real Sector of the Economy in Kazakhstan..	42
Box 3. Assessment of Financial Condition of Enterprises in the Real Sector of the Economy for the First Half of 2020.....	43
Box 4. KASE Index and Kazakhstan’s Economy.....	45
Box 5. Pricing of Medications and Personal Use Products.....	53
Box 6. Analysis of Compliance with Fiscal Rules not Related to the Government Debt.....	59



ҚАЗАҚСТАН РЕСПУБЛИКАСЫНЫҢ ҚАЗАҚСТАН БАНКИ

About Publication of the Monetary Policy Report

Since the time of transition to the inflation targeting regime, communication has been an integral part in the activities of the National Bank of the Republic of Kazakhstan. A special focus is made on explanation of the decision-making process and the substance of taken measures in the field of monetary policy.

With an aim to further improve the communication policy and to increase information transparency in its activities, the National Bank is proceeding with publication of the Monetary Policy Report on a quarterly basis.

The purpose of the Monetary Policy Report, just as of the previously published Inflation Report, is to furnish the public at large with a detailed explanation of the factors which are fundamental for a decision made on the base rate. At the same time, as distinct from the Inflation Report, the structure and the content of the new document have undergone some changes.

A section devoted to the monetary policy and actions by the regulator has been broadened in the Monetary Policy Report. Description of the existing forecast environment including the analysis of the global economy, of the economic situation in the trading partner countries and commodity markets, development of the domestic economy, fiscal policy and inflationary processes are presented in a separate section, "Macroeconomic Environment".

Alongside with that, a central role is assigned to the explanation of prospects in the development of the economic situation and inflation risks that are key for the decision made on the monetary policy. The practice of publishing certain thematic boxes on current issues is still used.



PREAMBLE

On September 7, 2020, the National Bank made the decision to retain the base rate at **9.0%** per annum with the interest rate band of **+/- 1.5 pp**.

The global economy is still experiencing a considerable adverse effect of the COVID-19 pandemic. The fact that the lockdown was upheld in many countries worldwide during the second quarter of 2020 has driven a significant curtailment of the economic activity both in developed countries and in the emerging economies. In turn, the situation in the countries – Kazakhstan’s main trading partners was evolving differently. The Chinese economy, after its exit from the lockdown, continues to recover; however, the Russian economy and economies in the European countries kept shrinking after the fall in the industry, investments, foreign trade and a sluggish domestic demand. After their contraction in 2020, economies in the countries - Kazakhstan’s main trading partners will come back to a positive growth path in the environment of the low base of this year and an anticipated lifting of restriction measures.

Kazakhstan’s economy is still under a negative effect of the COVID-19 pandemic. The imposition of lockdown and tightening of quarantine restrictions in July 2020 amidst a dramatic deterioration of the epidemiological situation in the country exerted a negative effect on the economic activity. A scheduled reduction in oil production rates within the framework of the OPEC+ arrangements appeared to be an additional factor.

So, **at the end of seven months of 2020, Kazakhstan’s GDP decreased by 2.9% in annual terms (during January-June 2020 – a 1.8% reduction)**. The increase in negative dynamics of the economic activity was driven by a deep decline in the services sector, in trade and transport in particular. In addition, there was a slowdown in the sector of goods production because of contraction in the mining industry.

The annual inflation keeps building above the target range of 4-6% set for 2020-2021. In August 2020, the annual inflation was 7.0%, which was generally in line with the National Bank’s assessments. The rise in food prices caused by persistently high growth rates of producer prices was offset by the stable dynamics of the non-food and service inflation components against a pent-up consumer demand caused by the falling real money income of the population as well as by the observance of quarantine measures.

Assessments of inflation expectations by the population went up.

In August 2020, a quantitative assessment of inflation one year ahead accounted for 6.9%. The percentage of respondents who noted a more rapid price growth over the last 12 months went up to 65% (in July – 64%).

Given some improvement of the situation in the global economy and the lifting of restriction measures in fighting COVID-19, the situation in the commodity markets started to improve. In August 2020, Brent oil price was 44.7 US Dollars per barrel on average, which is by 3.5% higher than in July and by 2.4 times higher than in April 2020. Better dynamics of the global consumption and the decreasing volumes of global oil production as a result of operation of the agreement on reduction of oil production by OPEC+ countries and poorer oil production in the USA and Canada, contributed to the rise in oil prices. Nonetheless, given a great degree of uncertainty about future dynamics of the demand and high volatility in the global commodity markets, **Brent oil price of 40 US Dollars per barrel on average in 2020-2021 is considered as a baseline scenario** within the frames of the “August-September 2020” forecasting round; the oil price was revised upwards by 5 US Dollars per barrel as compared to previous estimates and the projection for 2021 has not changed.

According to the National Bank’s forecasts, **the annual inflation is expected to accelerate further to 8.0% before the end of 2020, closer to the lower boundary of the previous inflation forecast of 8.0-8.5%**. Inflationary processes will accelerate because of a persistently high growth in food prices and some acceleration of inflation of paid services. By the end of 2021, the annual inflation is expected to decelerate to the upper boundary of the target range of 4-6% given a high base of 2020 and more moderate growth in food prices.

The National Bank decreased its expectations regarding the economic growth rates by the end of 2020; this was caused by a deeper retrenchment in the economic activity in the second quarter of 2020 as well as by re-imposition of the lockdown in July 2020. According to the National Bank’s updated forecasts, in 2020 Kazakhstan’s GDP will go down by 2.0%-2.3%.

It will be related to a decline in the domestic consumer and investment demand amidst restrictive measures, reduction of real income of the population and a worsening situation in the labor market. Observance of the OPEC+ agreement, feeble external demand and decreasing oil prices will be conducive to reduction in exports. At the same time, government measures aimed to stimulate the economic activity and imports that are more moderate will enable to mitigate a negative impact of the COVID-19 pandemic on the dynamics of economic activity. In 2021, given a low base of 2020, the improving epidemiological situation and increasing external demand for Kazakhstan’s export products, positive rates of the economic growth will recover.

As compared to the previous forecasting round, risks for inflation on the part of internal and external factors slightly decreased but are still high. So, despite some improvement in the epidemiological situation worldwide, risks of the coronavirus second wave are persisting. This will result in a weaker economic activity in the countries- Kazakhstan’s main trading partners, in reduction of demand for export products and the risk appetite of global investors. Apart from those, significant risks of possible acceleration of inflationary processes may include a further toning up of sanctioned rhetoric in relation to Russia and escalation of trade standoffs between the USA and China.



КӨКБӨРІ



РЕСПУБЛИКА

ҚАЗАҚСТАН

000

ТЕНГЕ
2018

REPUBLIC OF KAZ

КЕТА

50

ЕН

2018

Ag 995 31.1



100
ТЕНГЕ
2018



2

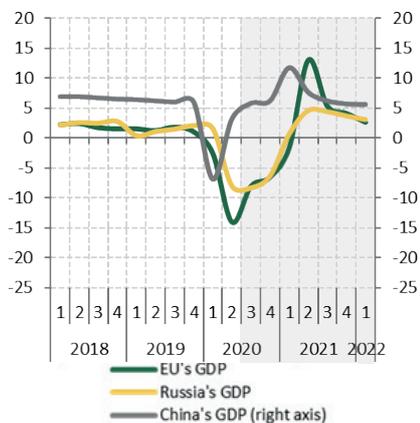


I.

PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

1.1. Forecast Assumptions

Figure 1. GDP Growth Rates in China, EU, Russia in Real Terms
*, YoY, %



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs.

Prospects of the development of the global economy are still fraught with a high degree of uncertainty. Amid of recurrent virus outbreaks, the economic activity has been recovering at a lower pace thus deferring the process of economic restart and restoration of the pre-crisis levels of production. Nonetheless, international organizations believe that the largest recession of the global economy had realized in the second quarter of 2020, and already in 2021, the global economic growth rates would turn positive. In general, during 2020, the global GDP is expected to decline by 3.7-4.5%, and the annual growth would exceed 5% by 2021.

In the environment of recurrent COVID-19 outbreaks and the need to preserve quarantine restrictions, the European Union would be recovering slower than it was earlier expected.

In 2020, contraction of the EU economy will account for 7.8%¹ (YoY) (a previous assessment of May 11, 2020- 7.2%) (Figure 1). The economic downswing will be driven by a feeble domestic demand against the expected reduction of employment and the increasing propensity to save on the part of households because of uncertainty about future earnings as well as a wave of bankruptcies and the absence of an agreement with Great Britain. In 2021, the EU economy will recover and the economic growth will account for 5.3% (YoY).

The growth rates of the Chinese economy as at the end of 2020 will slow down to 2.1%² (a previous assessment of May 11, 2020- 1.4%) (Figure 1). A higher upturn will be limited by a sluggish foreign trade because of a slower economic restart amid of COVID-19, by the deteriorating economic relations with the USA and the EU as well as due to a recent heavy flood, which affected a large territory of the country. The economic growth forecasts for 2021 are 7.8% (YoY).

In its turn, the Russian economy in 2020 is projected to decline by 5.1%³ (YoY) (a previous assessment of May 18, 2020 – 5.0%), being influenced by an anticipated reduction of business activity, of the domestic and external demand due to a longer duration of restrictions in Russia and in other countries than it was earlier expected (Figure 2). In addition, a negative contribution to the growth will be made by the lower price dynamics as compared to the pre-crisis period. In 2021, the growth is expected to recover to 3.4% (YoY).

¹ Forecast by Consensus Ecs. of August 10, 2020

² Forecast by Consensus Ecs. of August 10, 2020

³ Forecast by Consensus Ecs. of August 17, 2020

Over the forecast horizon, the external inflationary pressure on consumer prices in Kazakhstan is limited and will be contingent on the fact that inflation in the countries - Kazakhstan's trading partners will be below the targets (Figure 2).

As compared to the previous forecasting round, the inflation forecast in the EU member countries has not undergone significant changes.

A sluggish consumer demand will be exerting a restraining effect on prices until the end of 2020.

Apart from that, a downward pressure might be also put by moderate growth of labor costs due to a large number of unemployed individuals who are searching for jobs as well as by reduction of the value-added tax in Germany. Along with that, some upward pressure might be exerted by disruptions in the global production and distribution chains as well as by social distancing measures adopted in the EU member countries. By 2021, as the economic growth recovers, the pressure on prices will be increasing. An indirect effect on the price growth will be also produced by an anticipated rise in oil prices.

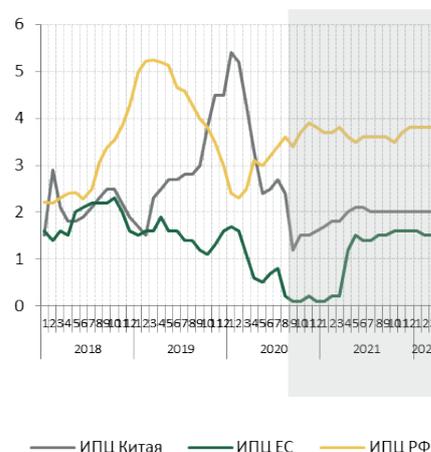
The annual inflation in China in 2020 will account for 2.7% on average, and in 2021 – 2.0%. According to expectations, the existing growth in food prices will stabilize. In addition, despite an anticipated dramatic economic upturn, the consumer demand will be recovering slowly thus exerting a restraining effect on the price surge in the country.

Inflationary processes in Russia, after their short-term acceleration in 2020, will be slowing by the end of the year. In 2021, the annual inflation will be below the Russian Central Bank's target. Disinflationary pressure on the rise of consumer prices will be put by a feeble economic growth, a relatively stable exchange rate of the ruble as well as an expected rich harvest.

Given the developing macroeconomic conditions, **further actions of central banks (the US Fed, ECB, and Bank of China) will be aimed to support the economic activity** and a speedy exit from the crisis by countries. In turn, based on the actions of the Bank of Russia, because of persistently negative impact of the pandemic, the market expects another reduction of the key rate and a further pause due to the risk of enhanced inflation background.

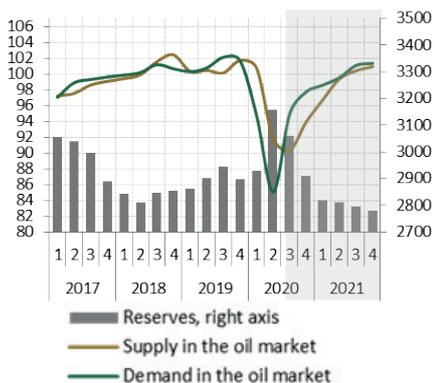
Easing of quarantine restrictions and removal of the lockdown imposed because of COVID-19, predictably, had a positive effect on the global oil market that is manifested in the reduced volatility

Figure 2. Inflation in China, EU, Russia, YoY, %



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Central Bank of Russia, Consensus Ecs., European Commission

Figure 3. Dynamics of the Global Oil Market, million barrels a day

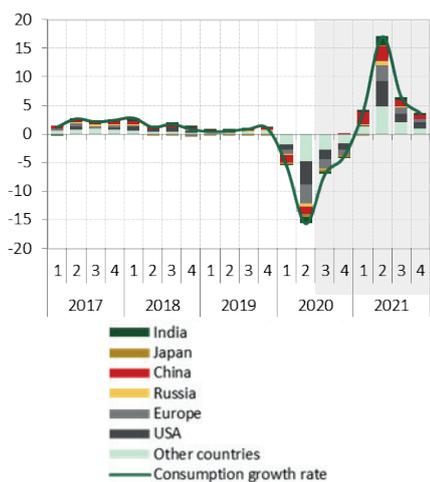


Source: EIA

of oil prices and an increased level of oil consumption. It is projected that starting from the third quarter of 2020, the demand will begin to exceed the supply thus supporting the price growth and enabling a reduction in oil reserves accumulated since the beginning of the year (Figure 3).

According to EIA's assessments, the global oil consumption will be increasing during the forecast period. However, according to assessments of international organizations, the demand for oil will recover to its pre-crisis level of 2019 not before 2022; it would be affected by a long reconstructive process in aviation and in the economy as a whole. In addition, according to assessments of international organizations, even in case of a full-scale recurrent virus outbreak the impact on the demand for oil would not be as destructive as during the first shock in April 2020, since the countries are better prepared to fight infections. Therefore, the global demand for oil in 2020 will reach 93.1 million barrels a day, and in 2021 – 100.2 million barrels a day.

Figure 4. Global Oil Consumption, YoY

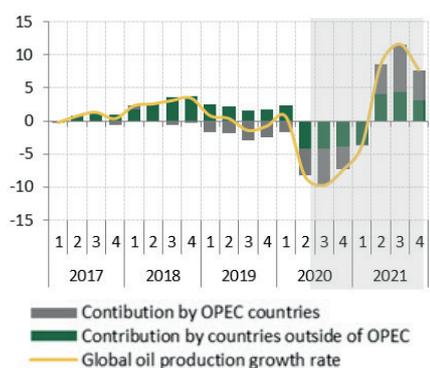


Source: EIA

A positive contribution to the growth in consumption will be made by China, the USA, India and the EU member countries (Figure 4).

The global oil production will continue to go down. In the third quarter of 2020 as compared to the previous quarter, a reduction of 1.5 million barrels a day is anticipated, and at the end of 2020 – a reduction of 6.4 million barrels a day as compared to 2019. In general, the weaker dynamics of oil production in 2020 is explained by the decreased production as part of the agreement to cut oil production by OPEC+ member countries as well as by lower oil production rates in the USA and Canada as compared to 2019. In 2021, the average annual rate of global oil production will go up to 99.4 million barrels a day from 94.2 million barrels a day in 2020 (Figure 5).

Figure 5. Global Oil Production, YoY, %



Source: EIA

Taking account of the current situation in the global oil market and updated forecasts of international organizations, the **National Bank**, in designing the macroeconomic forecasts for the period from the third quarter of 2020 to the first quarter of 2022, **considers three scenarios of the economic development: baseline, pessimistic and optimistic.**

Under the baseline scenario, the Brent oil price will be 40 US Dollars per barrel on average and will be standing at this level throughout the entire forecast period.

Under the pessimistic scenario, the oil price is assumed to be at 30 US Dollars per barrel on average in 2021; this will be driven by a

lengthier recovery of the global economy and by the excessive oil supply over demand.

Under the optimistic scenario, in 2021 the oil price is assumed to be at 50 US Dollars per barrel on average given a more rapid recovery of the global economy and formation of a shortage in the global oil market thus putting an upward pressure on prices.

1.2 Dynamics of Economic Development under the Baseline Scenario

Adherence to the OPEC+ deal to cut the oil output and the increased demand for energy products amidst removal of quarantine restrictions encouraged the reconstructive growth of oil quotations. However, given a high degree of uncertainty about the further dynamics of demand and high volatility in the global commodity markets, Brent oil price at 40 US Dollars per barrel on average is considered for 2020-2021 within the frames of the “August-September 2020” forecasting round. As compared to the “May-June 2020” forecasting round, the average annual oil price for 2020 was revised upwards by 5 US Dollars per barrel, and it has not changed in 2021.

The National Bank decreased its expectations regarding the dynamics of economic activity by the end of 2020. According to the National Bank’s forecasts, in 2020 Kazakhstan’s GDP will go down by 2.0%-2.3%.

Deterioration in the forecasts of GDP dynamics is associated with expectations of a deeper recession of the domestic demand (consumer and investment demand) than it was earlier expected. Contraction of the consumer demand will be caused by reduction in real money income of the population against the decline in business activity in the real sector that intensified because of a re-imposition of quarantine from July 5, 2020.

Socially-oriented government measures will be able to support but not accelerate the household consumer activity. The largest contraction of the domestic consumption is anticipated in the second and third quarters of 2020. The lockdown imposed in July 2020 and the remaining restrictions applied during the week-ends will be constraining the realization of demand by the population.

Additional restraining factors will include a weaker exchange rate of the tenge against the US Dollar as compared to prior periods as well as acceleration of the annual inflation. In the course of adaptation to a new environment a slight recovery of household spending will be observed by the end of 2020 due to realization of the deferred demand on the part of population.

The decreased investment activity in the economy will make a negative contribution to the gross formation. The largest decline is expected in the second and the third quarters of 2020 followed by a gradual recovery to the weakly negative pattern by the year-end due to the high dynamics of oil prices and some resumption of large-scale works in the mining industry. A positive impulse is anticipated on the part of infrastructure projects as a result of implementation of the government business support programs. However, there is still uncertainty regarding the deadlines and pace of resumption of construction at the TCO, which increases the risks of a greater decline of the fixed capital formation in the case if projects are postponed or frozen.

Contraction of the domestic demand, both consumer demand and investment demand, would

reflect on the dynamics of imports. The largest decline is anticipated on the investment and interim imports whose recovery would be dependent on the dynamics of investment activity. A low domestic demand and depreciation of the tenge will be restraining the consumer imports. Therefore, in 2020 real imports are expected to go down thus making a positive contribution to the GDP dynamics and limiting its reduction.

Real exports are projected to decrease substantially because of the anticipated reduction in production of oil and gas condensate. In 2020, the oil output is estimated to amount to 85 million tons. The pricing dynamics in the global oil market and the reduced demand on the part of trading partners, specifically the European Union countries as the main consumer of the domestic mineral resources will serve as an additional negative factor.

A positive contribution will be observed from the government consumption given the counter-cyclical measures implemented by the Government. Payroll expenses and spending on current consumption of goods and services are expected to increase.

In 2021, given a low base of 2020 and the improving epidemiological situation, positive economic growth rates will recover to 3.5%-3.8%.

Forecasts about the GDP growth in the medium term have not undergone significant changes as compared to previous estimates. The increasing consumer activity will be accompanied by a reconstructive growth of real income of the population and the consumer lending, by the improving situation in the labor market and normalization of the epidemiologic background. The investment activity will be growing amidst the expanding domestic and external demand as well as due to implementation of delayed investment projects. The increase in exports will be associated with expansion of the external demand given the recovery of positive dynamics of the business activity in the countries – Kazakhstan’s trading partners. The government consumption, owing to the allocation of 1 trillion tenge of earmarked transfers from the National Fund of the Republic of Kazakhstan in 2021 will continue to demonstrate positive dynamics; however, the growth rates will decelerate as compared to 2020.

At the same time, a restraining effect on the dynamics of economic activity will be exerted by the increase in imports accompanied by the recovery of domestic consumer and investment demand.

According to the National Bank’s forecasts, the annual inflation is expected to accelerate further to 8.0% before the end of 2020, closer to the lower boundary of the previous forecast of 8.0-8.5%.

Expectations regarding some release of inflationary pressure are connected with a feebler consumer demand. Inflationary processes will accelerate because of a persistently high growth in food prices and some acceleration of inflation of paid services (Figure 6).

On the short-term horizon, acceleration of food inflation will be related to a disruption of supply chains, the rise in producer prices given appreciation of primary products in terms of price and the growing prices of imported products. By the end of the short-term forecasting horizon, the annual food inflation will be slowing as high monthly values of 2019 will be withdrawn from the calculation and because of the anticipated comeback of monthly growth rates to their natural dynamics.

Reduction of the FAO Cereal Index will be a constraining factor for inflation in the environment of

expected growth in stocks caused by an outstripping growth of production over consumption.

Realization of the defreed effect of the tenge exchange rate pass-through onto prices coupled with exhaustion of the supply of commodities sold at pre-crisis prices will be the main reason for the rise in prices of non-food products. It is expected that recovery of the economic activity against a gradual easing of quarantine measures will lead to the rise in the cost of fuel and lubricants.

A pent-up consumer demand in the environment of reduced purchasing capacity of the population and deceleration of real money income will be curbing the surge in prices of non-food products.

On the short-term horizon, prices for paid services are expected to grow moderately. The pricing in the market of regulated services is contemplated to retain its existing dynamics.

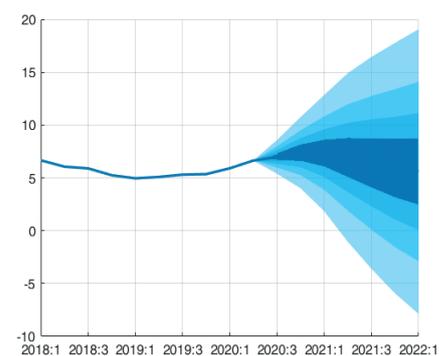
A weak dependence of the cost of services on external factors as well as a sluggish consumer demand alongside with the shift of a sizeable portion of expenditures on foodstuffs and non-food products will be putting a downward pressure on inflation of paid services. The increase in the cost of raw materials and supplies used for provision of services will be offset by a feeble demand for certain types of services.

Assessments about the medium-term pattern of the annual inflation have not undergone significant changes as compared to the previous forecast. It is expected to decelerate to the upper boundary of the target range of 4-6%.

Inflationary processes will be decelerating amid of a high statistical inflation base, which had formed in 2020, and a weak external inflationary pressure. An additional disinflation pressure will be produced by normalization of food price growth.

At the same time, a persisting rigidity in pricing, the return of the output gap to the neutral zone in the environment of recovering economic activity and the growing world food prices will be curbing the disinflation dynamics (Figure 6). In addition, a weakly positive fiscal impulse in 2021 given the allocation of an earmarked transfer of 1 trillion tenge from the National Fund will support the consumer and investment demand in the medium term.

Figure 6. Inflation, Quarterly Average, YoY, %



Source: NBRK's forecast

1.3 Alternative Forecast Scenarios

Due to the existence of risks related to prospects of the development of the global economy and the corresponding demand for primary products, in addition to the baseline scenario the National Bank considered alternative scenarios of oil prices.

The National Bank considered a scenario where oil prices fall to 30 US Dollars per barrel in 2021 as the pessimistic scenario.

Realization of this scenario may be caused by a slower recovery of the global economy in connection with a negative development of the COVID-19 pandemic worldwide. Apart from that, the increased supply in the oil market is anticipated because of a gradual advancement in the production of shale oil due to the increase in the number of drilling units and a poor discipline in observing the OPEC+ agreement by its member countries.

If the pessimistic scenario develops, the external demand would deteriorate thus negatively affecting the export volumes. Because of the expected decline in profitability of business as a consequence of slack demand and low oil prices, enterprises in the mining sector would cut their production and investment activity; this would have an adverse effect on allied sectors and on the economy as a whole. In addition, the declining real incomes of the population would be negatively affecting the consumer demand. As a result, recovery of Kazakhstan's economy in 2021 as compared to the baseline scenario will be more modest. **In 2021, the real GDP growth given a low base of 2020 will account for 2.9-3.2%.**

Despite a pent-up consumer and investment demand, consumer prices will rise higher than under the baseline scenario as a result of depreciation of the tenge because of low oil prices, a corresponding growth of inflation expectations and a possible disruption of imports in the lockdown environment. **In 2021, the annual inflation will be above the target range.**

Under the optimistic scenario, oil prices would be recovering faster and would stay at 50 US Dollars per barrel throughout 2021.

Such dynamics of oil prices would be promoted by a faster recovery of the global demand for oil as long as the global economy goes out of recession and a strict adherence to the OPEC+ agreement on reduction of oil production by the member countries, which would enable to reach equilibrium in the oil market sooner.

The more positive dynamics of the internal and external demand under such scenario would be conducive to higher growth rates of the economy than under the baseline scenario. So, **in 2021 the GDP growth rates will accelerate to 4.0-4.3%.** Nonetheless, a higher demand for investment and consumer imports will limit the economic growth to some extent.

Given a stronger behavior of the tenge and smaller inflation expectations related to that fact as well as less imports from Russia as the main trading partner, the inflation path will be building lower as compared to the baseline scenario. **By the end of 2021, inflation will come back to the target range of 4-6%.**

1.4 Risks in the Medium Term

As compared to the previous forecast round, risks for inflation on the part of internal and external factors given recovery of the domestic and global economy slightly decreased but are still high (Figure 7).

Forecast-related risks are primarily associated with the spread of coronavirus infection. Taking account of the current statistics on COVID-19 cases, a recurrent outburst of COVID-19 and associated slower and lengthy recovery still represent a key risk for the global economy. So, the increased incidence of the coronavirus worldwide can still slow down the processes of economic recovery in a significant way, lead to the decline in prices of raw materials and limit the delivery of goods and services between the countries, thus resulting in an accelerated inflation in Kazakhstan.

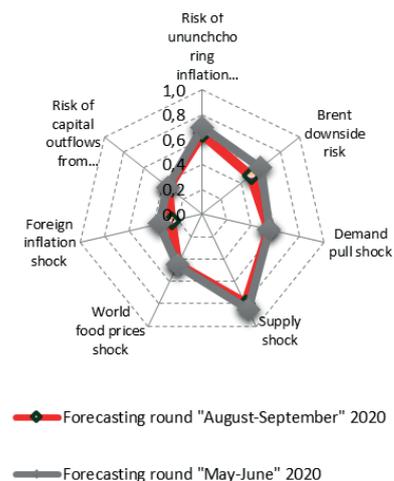
Due to a gradual recovery of the global economy and owing to an overall adherence to the OPEC+ agreement, oil prices have stabilized at the level above 40 US Dollars per barrel. The said factors reduce the risk of a further fall in oil prices. Nonetheless, this risk remains because of the existing uncertainty about the development of COVID-19 pandemic and its impact on the global economy and the demand for oil. The key risks pertaining to a further development of the oil market also include a gradual resumption of oil production in the USA and Canada, maintenance of global oil reserves at persistently high levels, a lingering restart and recovery in key oil importers as a result of possible recurrent outbursts of the coronavirus.

The risk of import of external inflation from the countries - Kazakhstan's trading partners also slightly decreased, primarily given the current dynamics of inflation in Russia and expectations about its staying below the target until the end of 2021. This circumstance, alongside with a low non-food inflation in the EU and China, reduces the risk that the external inflationary pressure would intensify.

The risk of acceleration of external food inflation remains unchanged; however, its realization is more probable in the medium term so far as the demand for cereals used for industrial purposes recovers, and a possible reduction in stocks in case of a limited supply.

At the same time, the risk of capital outflow from developing markets in favor of developed countries remains high. As before, except for the USA, the most dramatic situation with the prevalence

Figure 7. Judgement-based Risk Map of Inflation for the Forecast Period



Source: NBRK's calculations



of coronavirus is observed in developing countries (Brazil, Russia, India, and Latin American countries). Besides, political and/or economic controversies between some of the EU countries on the one hand and Turkey, Belarus and Russia, on the other hand as well as between the USA and China are observed or may be aggravated. These factors may lead to depreciation of currencies in developing countries, including Kazakhstan.

Among internal factors, the risk of inflationary pressure on the part of demand is generally persisting; however, realization of this risk is more probable in the medium term. Given that at present the dynamics of consumer demand is pent-up because of perdurance of certain restriction measures for business, reduction in real income of the population and contraction of the consumer lending, realization of purchases by the population delayed in the time of crisis and the effect of government economic support measures might increase inflationary pressure in the economy in 2021.

Owing to positive cereal yield prospects in 2020, the risk of acceleration of food inflation in 2021 is somewhat decreasing. However, a possible retention/re-imposition of quarantine measures within Kazakhstan and abroad may lead to disruptions in the supply of products. This, in the long run, may cause imbalances between the demand and supply in certain commodity markets and the corresponding price growth.

Risks of unanchoring inflation expectations somewhat lessened due to an anticipated deceleration of food inflation; however, the existing high inflation and persisting risks of the tenge depreciation under the impact of external and internal factors may prevent inflation expectations from settling within the target range.



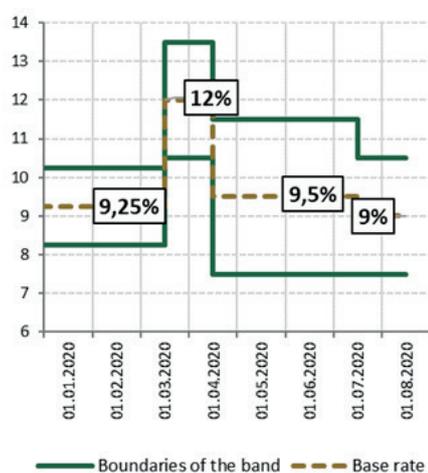


II.

THE MONETARY POLICY

2.1. Decisions on the Base Rate

Figure 8. Base Rate Band in 2020, %



Realization of the external shock at the beginning of 2020 that was associated with the spread of COVID-19 and the decline of prices in the global commodity markets made a negative impact on the dynamics of macroeconomic indicators of the country. This was largely determining the National Bank's decisions as part of the monetary policy implemented.

At the end of the first quarter of 2020, the National Bank started to take measures aimed to ensure macroeconomic stability and reduce the impact of external shock on Kazakhstan's economy. On March 10, 2020, the National Bank made an extraordinary decision to increase the base rate to 12.0% with the widening of the interest rate band to ± 1.5 pp (Figure 8). The decision was intended to prevent the spreading of consequences of the external shock on the country's economy and to protect assets in the tenge. It also helped to reduce the pressure on the exchange rate by staving off the growth of inflation expectations and the exchange rate pass-through effect onto prices.

Starting from the second quarter of 2020, taking into account the risk of a significant slump in the economy amidst the deteriorating external and internal environment, the National Bank began to gradually ease monetary conditions. On April 6, 2020, the decision was made to reduce the base rate to 9.5% with the widening of the interest rate band to ± 2 pp. In conjunction with other implemented anti-crisis measures, this decision was aimed at smoothing negative consequences of coronavirus and supporting the business activity.

Based on the next two decisions made on April 27 and June 8, the base rate was retained unchanged due to a relative stabilization of situation in external markets and the persistently negative dynamics of economic activity in the country as a result of quarantine measures in effect.

On July 20, the National Bank made another decision to reduce the base rate to 9.0% with the narrowing of the interest rate band to ± 1.5 pp. This decision was necessitated by two fundamental factors. First, there was a slacking of pro-inflation risks on the part of the external sector (deceleration of inflation in the countries – main

trading partners) and the domestic economy (a pressure on the aggregate demand amid of the slowing investment and consumer activity). Second, the updated data on GDP showed a stronger than expected contraction of the economic activity. At the end of the first half of 2020, Kazakhstan’s GDP decreased by 1.8% in annual terms against a projected reduction of 1.5%.

The real interest rate calculated as the difference between TONIA rate and the projected inflation rate a year ahead is building below its long-term level.

Given reduction of the base rate in April and July and the annual inflation forecast in 2020, the base rate in real terms accounted for 0.5-1%. This is lower than the equilibrium stated rate of 3-3.5%. Therefore, the monetary policy has a stimulative nature.

2.2. Money Supply

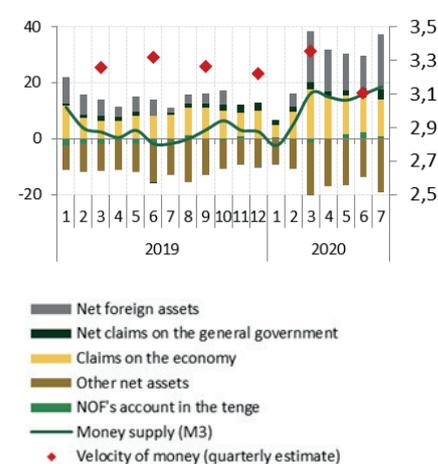
The growth in money supply remains high owing to implementation of anti-crisis measures as well as the increase in retail loans.

Money supply in the economy is growing in case of a decreasing money multiplier and velocity of money as well as with the growth of reserve money that is overrunning the expansion in the money supply. This will contribute to the persistence of the to maintain liquidity surplus in the money market against the decreasing domestic demand and the feeble dynamics of lending.

In the medium term, there is a risk of a deferred money supply pass-through onto prices in the course of recovery of business activity in the economy.

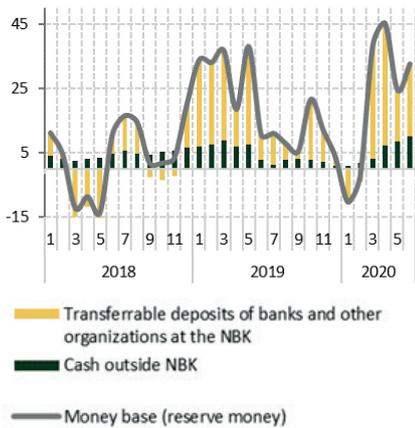
The growth in money supply remains at a high level after a surge in March 2020. The main positive contribution to the growth in money supply is made by the increase in claims of the banking system on the economy, the government and the non-bank financial sector in particular, because of capitalization of the “Kazakhstan Sustainability Fund” JSC in order to finance lending programs. The increase in loans to households in annual terms also has a positive influence on the growth in claims on the economy (Figure 9).

Figure 9. Money Supply, as % YoY



Source: NBRK

Figure 10. Reserve Money, as % YoY



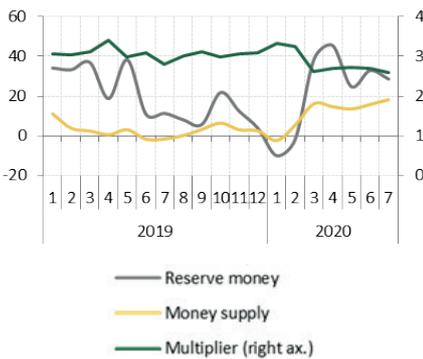
Source: NBRK

The increase in money supply is happening in the environment when the velocity of money in the economy is going down due to the slowing business activity.

In the structure of money supply, there is an increase of deposits (by 17.1%) because of the exchange rate revaluation as well as of cash in circulation (by 29.0%) given the growing social benefit payments to support the population.

The reserve money has been keeping its high growth rate since March 2020 (in July – 28.5% YoY) due to the increasing capitalization of the “Kazakhstan Sustainability Fund” JSC and net foreign assets. Within the structure of reserve money, bank deposits at the NBRK and cash outside the NBRK increased (Figure 10).

Figure 11. Growth of Monetary Aggregates, YoY



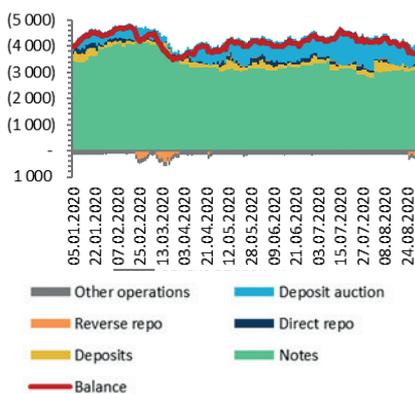
Source: NBRK

As a result of a faster growth in the reserve money against the money supply, the money multiplier has decreased since March 2020 (Figure 11).

2.3. Money Market

Liquidity surplus was exerting a downward effect on the money market rates to the lower boundary of the base rate band, except for certain periods. Interest rates in different segments of the money market were setting close to the level of operating target with the widening of spread in the periods of volatility.

Figure 12. Exposure on the NBRK’s Operations in the Domestic Market



Source: NBRK

The money market continues to function in the environment of liquidity surplus. The excess liquidity is withdrawn through short-term notes, direct repo as well as deposit operations including deposit auctions (Figure 12).

In June-July, liquidity withdrawal volumes through deposit auctions were going up whereas the volumes of the NBRK’s notes were going down. The reduction in volumes of the NBRK’ notes was furthered by a suspension of issuance of notes with maturities of one year. Along with that, after reduction of the base rate, the balance on the National Bank’s operations was decreasing, first of all, because of deposits. At the end of August 2020, a net balance on the NBRK’s operations went down by 11.3% from 4.2 trillion tenge to 3.7 trillion tenge.

The suspension of issuance of one-year notes in the third quarter of 2020 resulted in reduction of the share of 6-month and 12-month notes from 77% at end-May 2020 to 52% as at the end of August 2020.

The TONIA rate was setting closer to the lower boundary of the interest rate band as a result of a growing supply of the tenge liquidity. In doing so, the growth of interest rates to the upper boundary was observed in certain periods given the increased demand for liquidity (Figure 13).

The money market rates with maturity over one day are less volatile and are setting primarily around the base rate (Figure 14).

Interest rates in the swap market were building closer to the TONIA rate with the widening of spread in the periods of the growing rates in the repo market and the increasing demand for the tenge liquidity (Figure 15).

2.4. Foreign Exchange Market

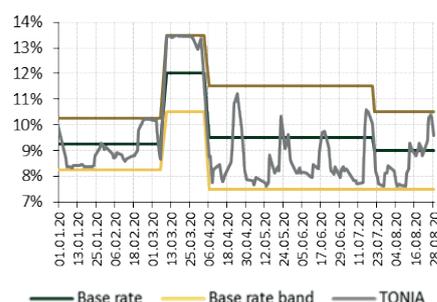
In June-August 2020, despite the favorable price dynamics in the commodity market, an overall depreciation of currencies in emerging economies, including the Russian ruble, had a significant downward effect on the tenge.

The re-imposition of restrictive quarantine measures impinged the volumes of foreign exchange operations.

The positive dynamics of oil quotations is building up against the recovering demand for energy resources as a consequence of active resumption of the business activity worldwide, contraction of oil reserves in the USA as well as adherence to allowances for cutting oil production by OPEC+ member countries. In doing so, on July 15, 2020, the OPEC+ updated the agreement increasing the output due to a moderate recovery of energy consumption. In June-August 2020, the price of oil has been fixed at above 40 US Dollars per barrel, going over 45 US Dollars per barrel in certain periods.

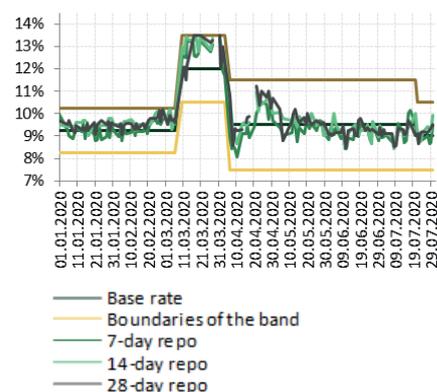
The rise in oil prices is also promoted by the decline in the US Dollar

Figure 13. Interest Rate Band and TONIA Rate



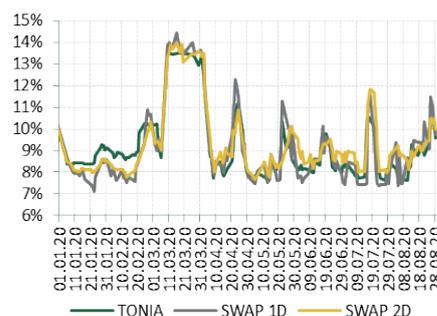
Source: NBRK, KASE

Figure 14. Interest Rates



Source: NBRK

Figure 15. Dynamics of the Money Market Rates



Source: KASE

Figure 16. Dynamics of the US Dollar Index and Gold, US Dollar per Ounce



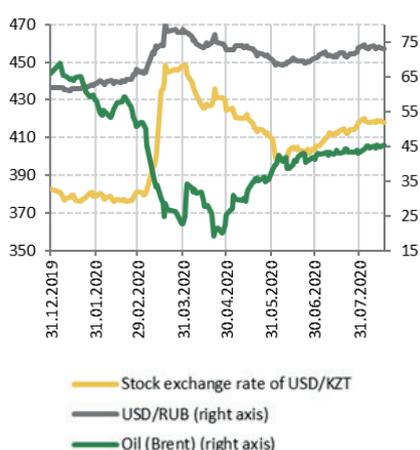
Source: Thomson Reuters

Index (DXY). The pressure on the US currency creates anticipations that a reduced fiscal support would slow the US economy down and would force the US Fed to ease the monetary policy further, thus resulting in a subsequent reduction in yield on the US government bonds. So, the US Dollar Index went down from 98.34 at end-May to 92.14 points on August 21, 2020 (Figure 16).

The weakness of a world reserve currency also contributes to the growth of gold as an alternative saving asset. In August 2020, gold was traded at a price above 2000 US Dollar per ounce, which is a historical maximum.

The shift in investor interests towards safe assets was also nurtured by the contamination of COVID-19 in many countries, which compromised forecasts made by experts regarding the accelerating recovery of the global economy. As a result, currencies of developing countries demonstrated a general depreciation. So, from the beginning of June through August 31, 2020, the Turkish lira depreciated by 7.6%, Brazilian real – by 2.9%, and Argentine peso – by 5.3%.

Figure 17. Dynamics of the Russian Ruble, Tenge and Brent Oil



Source: Bloomberg, KASE

Because of the general trend, the Russian ruble depreciated by 4.3%, which, among other things, was caused by reduction in foreign exchange sales by the Russian Central Bank as part of the fiscal rule; by exit of investors from the government bonds after the lowering of the key rate, as well as by the conversion of dividends of Russian companies received by investors into foreign currency (Figure 17).

The balance of the demand and supply in the domestic foreign exchange market was supported by conversion of the National Fund's assets as part of the allocation of the guaranteed transfer to the Republican budget, as well as by prolonged measures for the mandatory sale of a part of foreign exchange export proceeds by companies from the quasi-government sector. Meantime, the National Bank did not conduct currency interventions.

In the environment of an overall lowering of the investor risk appetite, since the beginning of June 2020 the tenge has depreciated by 2.1% from 411.55 tenge to 420.11 tenge per US Dollar as at the end of August 2020 (Figure 18).

In connection with re-imposition of quarantine measures in July-August and a slackening business activity, the demand for foreign exchange in the country somewhat reduced.

In the first half of 2020, the tenge was also supported by the current account surplus, which, according to preliminary data, amounted to 2.1 billion US Dollars due to the decreased returns payable to direct investors (by 3.5 times as compared to the first half of 2019) and relatively high prices and volumes of oil supplies at the beginning of 2020.

The key risks for the tenge remain in connection with a possible second wave of coronavirus in 2020, which increases the risks of reduction in the demand for energy resources and, thus, of the fall in the oil price. In addition, risks of instability in the markets of main trading partners – Russia and China – persist, including in view of political and economic confrontation with the USA.

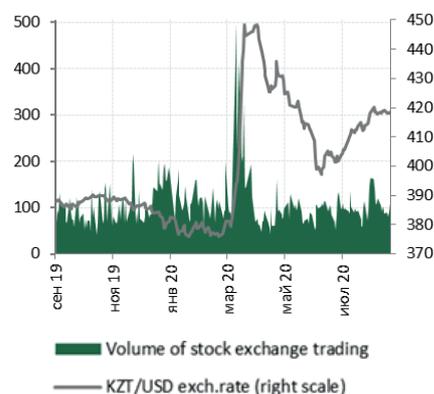
2.5. Stock Market

The Ministry of Finance has been actively issuing government securities in the short-term segment, which resulted in liquidity rebalancing from the National Bank's notes to the government securities of the Ministry of Finance and the shift in the yield curve to the level of February 2020. Yields on corporate bonds, after their high values in March-April 2020, are going down following the base rate, despite a widening spread between them.

In the government securities market, since May 2020 the Ministry of Finance ("the MOF") has been actively placing short-term government securities with maturities from 1 to 3 years.

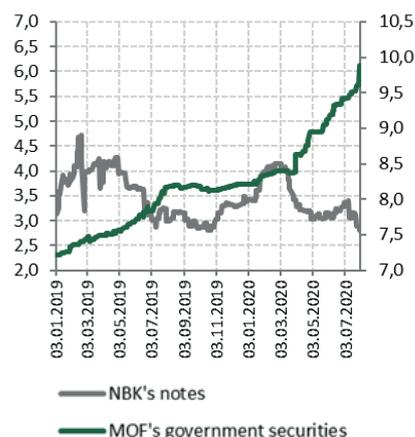
This was furthered by the changes made into the issuance schedule of government securities by the MOF RK in May 2020, which provide for the issuance of government securities with maturities of 1 to 3 years worth 1 trillion tenge by the end of 2020. In May-July 2020, first auctions under the new Schedule had been conducted where the market showed a heightened demand. In this environment, there was an overflow of available funds from the National Bank's notes to the government securities of the MOF RK. However,

Figure 18. Exchange Rate Dynamics and the Volume of Stock Exchange Trading in the Foreign Exchange Market, million US Dollars



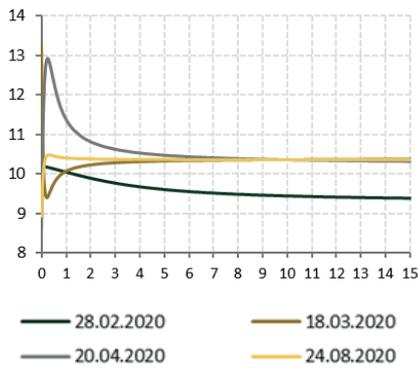
Source: KASE

Figure 19. Government Securities in Circulation, trillion tenge



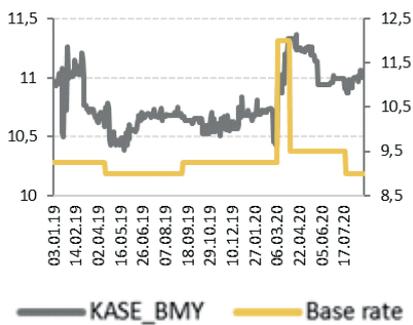
Source: KASE, NBRK

Figure 20. Change in the Risk-Free Yield Curve, %



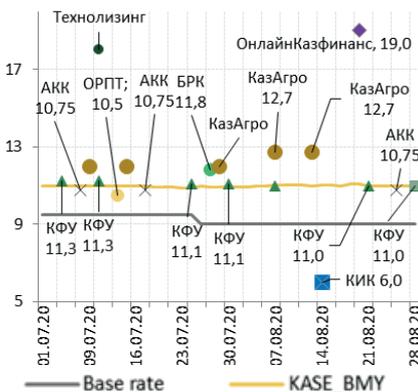
Source: KASE

Figure 21. Dynamics of Yields on Corporate Bonds and the Base Rate, %



Source: KASE

Figure 22. Annual Returns of Issuers in July 2020, %



Source: KASE, NBRK

rebalancing of the government securities market does not fully exclude the possibility that in future the liquidity will be invested again into the National Bank’s instruments.

As a result, the volume of government securities of the MOF RK in circulation is increasing (9 846.8 billion tenge by end-July 2020) (Figure 19). Since the beginning of 2020, government securities of the MOF RK have grown by 19.9%. In general, during January-July 2020, the volume of securities placements in the primary market made up 1 826.7 billion tenge, having increased significantly by 53.5% as compared to the same period of the last year (1 190.2 billion tenge).

The MOF RK funnels the attracted resources to finance the increasing budget deficit in view of necessity to implement anti-crisis measures on supporting the employment and ensuring social and economic stability in connection with the coronavirus pandemic.

Given the ease of monetary conditions, the yields on bonds of the Ministry of Finance demonstrated a decline. As a result, in August 2020 the yield curve is shifting down in the medium-term segment as compared to this April when yields on bonds were high. However, the yield curve level remains above that of February 2020 (Figure 20).

In the corporate bond market, the yields, after their high values in March-April 2020, in May-June demonstrated a decline following the base rate. However, despite a further reduction of the base rate in July 2020, the yield on corporate bonds in July-August 2020 slightly increased due to the growing credit risks in the economy, thus increasing the cost of borrowing in the bond market. As a result, the spread between the base rate and KASE_BMY has widened (Figure 21).

The major issuers in the corporate bond market include the development institutes, organizations in the quasi-government sector as well as the Kazakhstan Sustainability Fund. In June-August 2020, the trend of issuing longer liabilities was seen. If in July, the weighted average yield on the issued corporate bonds made up 11.53%, in August it fell to 7.6% as a result of the bond issuance of the “Kazakhstan Mortgage Company” Mortgage Organization JSC totaling 200 billion tenge at 6.02% (excluding the placement by the “Kazakhstan Mortgage Company” Mortgage Organization JSC, the weighted average interest rate accounted for 11.06%) (Figure 22).

2.6. Deposit Market

Deposit rates have stabilized and are smoothly decreasing after their growth at the end of the first quarter of 2020. The annual growth of deposits remains high given the increasing contribution on the part of retail and corporate deposits in the tenge against the declining effect of revaluation. Dollarization of deposits is gradually going down.

After the increase of the base rate and the money market rates in March 2020, interest rates on short-term corporate deposits in the tenge with maturity of less than one month went up and stabilized at 7.5-7.6% (Figure 23). This segment accounts for a major portion of attracted deposits (89.4% in July 2020).

Along with that, interest rates on corporate deposits in the tenge with maturities of 3-6 months and with maturities of 1 to 5 years are approximating the level of interest rates on corporate one-month deposits in the tenge. As a result, the gap between interest rates on short-term deposits and those with longer maturities has shrunk significantly.

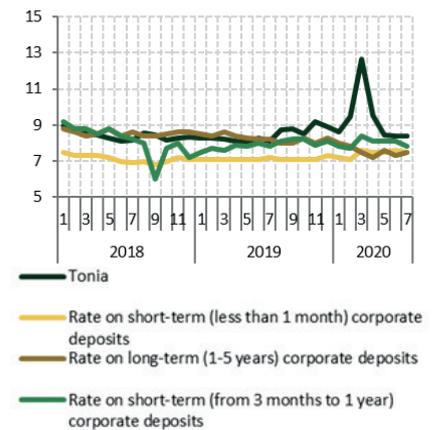
In addition, from April to July 2020, the percentage of long-term corporate deposits with maturities of one to five years decreased by more than half – from 7.5% to 3.6% and the share of short-term loans increased. Depositors shifted to deposits with shorter maturities given the levelling of their return.

Interest rates on retail deposits, after their hike in the first quarter of 2020, started to pivot downwards from May 2020 due to a gradual lowering of the KDIF's maximum rates (Figure 24).

The annual growth of deposits is still high (a 17.1% growth at the end of July 2020 to 20.7 trillion tenge). An increasing contribution on the part of retail and corporate deposits in the tenge against the reduced revaluation effect has been observed (Figure 25).

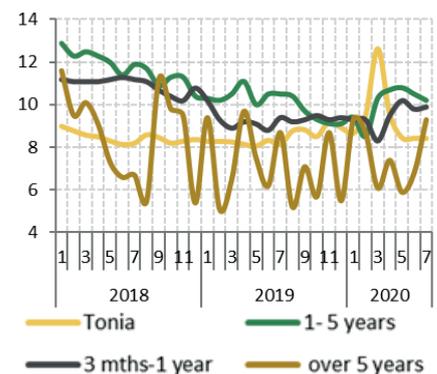
Owing to relatively high interest rates on deposits in the tenge, there is an inflow of resources to retail deposits in the tenge. Retail deposits in the domestic currency from May to July 2020 went up by 427.9 billion tenge or by 7.8%.

Figure 23. Interest Rates on Corporate Deposits



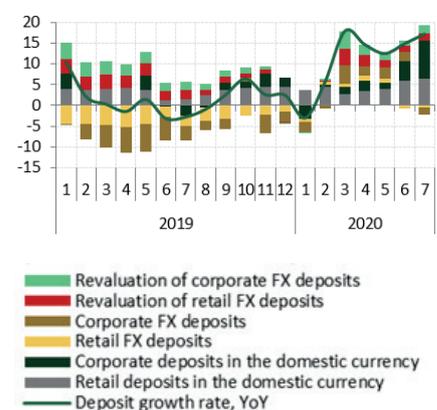
Source: NBRK

Figure 24. Interest Rates on Retail Deposits



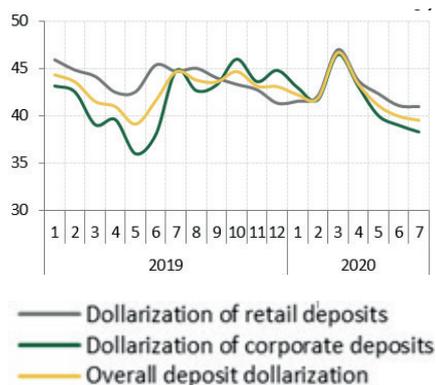
Source: NBRK

Figure 25. Contribution to the Growth in the Deposit Volume by Components



Source: NBRK

Figure 26. Deposit Dollarization,



Source: NBRK

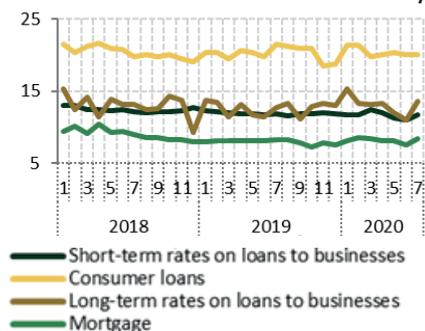
The foreign currency portfolio that has been going down from April to June 2020, demonstrated growth in July 2020. Nonetheless, from May through July 2020, foreign currency deposits went down by 347.8 billion tenge or by 4.1%.

As a result of contraction in the foreign currency portfolio against the growth of deposits in the tenge, the dollarization level continued to decrease and accounted for 39.5% at the end of July 2020 (Figure 26).

Generally, after March 2020 the dedollarization process was underway.

2.7. Credit Market

Figure 27. Interest Rates on Loans in the Domestic Currency,



Source: NBRK

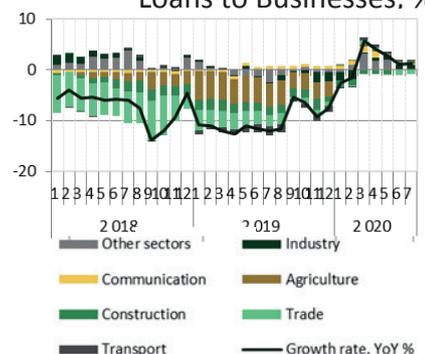
The cost of credit resources has not undergone substantial changes. The growth of the bank loan portfolio is slowing down. The key factor in the corporate segment is the reduction of loans in the trade sector, and in the retail sector – of consumer loans to the population.

Interest rate on short-term tenge loan to businesses in the second quarter of 2020 was setting lower as compared to the same period of 2019 and was formed at 11.4%. Implementation of the SME Concessional Lending Program that was in effect from April through June 2020 was conducive to that fact (Figure 27). Concessional loans were provided to support the working capital of the SMEs that have suffered as a result of the coronavirus pandemic, with a tenor of up to 12 months at the rate not exceeding 8% per annum. In July 2020, the Program was at the stage of inter-departmental discussions in respect of its further prolongation. Taking this into account, in July 2020 the interest rate on short-term tenge loans to businesses approximated the level of July 2019 (11.7%).

Interest rates on long-term loans to businesses in the tenge are forming in a similar way to the dynamics of 2019 at 13% on average.

In the retail segment, interest rates on consumer and mortgage loans are forming on average by 10 basis points higher than in 2019 (on consumer loans – 20.5%, on mortgage loans – 8.2%).

Figure 28. Contribution by Sectors to the Annual Growth in Loans to Businesses. %



Source: NBRK

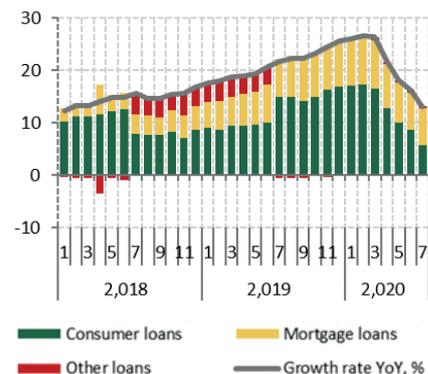
The interest rate on mortgage loans keeps setting below the base rate

level owing to the subsidizing under different government programs. More than 95% of provided mortgage loans fall on Zhilstroysberbank and banks which participate in the “7-20-25” Program.

As at the end of July 2020, the annual growth of the corporate loan portfolio slowed to 1.3% (Figure 28). Given the tightened requirements and the decreased demand for unsecured consumer loans, the growth rates of loans to the retail sector are declining. In July, the annual growth of the retail loan portfolio slowed to 13.1% (Figure 29).

According to a survey conducted among banks, the demand for consumer lending is going down because of uncertainty of consumers regarding the debt servicing, which leads to reduction in the demand for durable goods.

Figure 29. Contribution by Components to the Annual Growth in Retail Loans, %



Source: NBRK



БУРАН

ЛУНОХОД-1
1970-20

1961-2011
ТҮНГҮРІШ ҒАРЫШКЕР *Tatyana* - ПЕРВЫЙ КОСМОНАВТ

АПОЛЛО

ЭЛИТЕ OF THE EARTH
-2007

РЕПУБЛИКА КАЗАХСТАН
Rg92514
Ta 26.8g

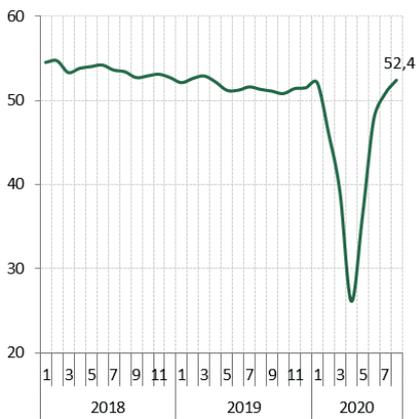
SPACE -2006-



III.

MACROECONOMIC CONDITIONS

Figure 30. Global Composite Purchasing Managers' Index



Source: Bloomberg

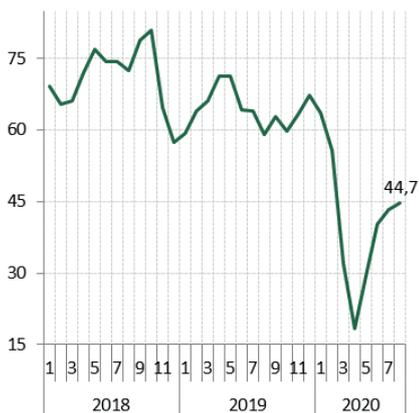
* – when the index is above 50, it means its growth, when it is less than 50 – its decline, and when it is equal to 50 – its invariance

3.1. External Sector

The COVID-19 pandemic keeps having a significant negative influence on the global economy's development.

The fact that the lockdown regime was continued during the second quarter of 2020 in many countries as part of fighting the COVID-19 pandemic, pre-conditioned a **significant contraction of the business activity both in developed countries and in emerging economies.** Nonetheless, in June-August 2020, up-to-date statistical data and leading indicators started to signify a gradual recovery of the global economy. For the first time since January 2020, the industrial sector and the services sphere fixed their growth, which is evidenced by the most recent data on business activity - PMI (Figure 30). The decline rates of the global trade given the growing export orders decelerated. Improvement in the situation is observed in aviation, the number of both commercial and cargo flights is increasing. The situation in the US labor market as the region that was the most affected by the pandemic is also improving.

Figure 31. Brent Oil Price, US Dollar (monthly average)



Source: U.S. Energy Information Administration (EIA)

In turn, **the situation in the countries- Kazakhstan's main trading partners has been developing differently.** The Chinese economy, after the exit from lockdown, keeps recovering; this is evidenced by performance of the industrial sector, services and foreign trade. Along with that, economies of the EU member countries and Russia are still suffering from the COVID-19 pandemic. The downturn in the industry, investment and foreign trade is persisting. An additional pressure is also produced by a sluggish domestic demand against the declining household income and the growing number of unemployed.

In the environment of enduring coronavirus pandemic and the decreased inflationary pressure, large central banks continue to pursue a softer monetary policy. So, the US Fed, ECB and the Bank of China at the most recent sessions retained their policy rates at the existing levels. The Bank of Russia, given a significant decline in the business activity in the country because of the pandemic, once again made the decision to lower the key rate.

In view of some improvement of the situation in the global industry and a gradual restart of economies after restriction measures because of COVID-19, **the situation in the commodity markets begins to improve little by little** (Figure 31). So, over the last three months volatility of oil prices in the global oil market decreased considerably. In August 2020, the cost of one barrel of Brent oil made up 44.7 US Dollars on average, which is by 2.4 times higher

than in April 2020. Stabilization of oil prices was promoted by the improved dynamics of global oil consumption and the decrease in the global oil output as a result of the effect of agreement on reduction of oil production by OPEC+ member countries and a low oil production in the USA and Canada.

3.2. Economic Activity and Domestic Demand

Kazakhstan's economy is still adversely affected by the COVID-19 pandemic. At the end of May – June 2020, given the easing of quarantine measures, the signs of recovery of the economic activity were observed. At the same time, the imposition of lockdown and enhancement of quarantine restrictions from July 5, 2020 as a result of a sharp deterioration of epidemiological situation in the country have adversely affected the economic activity.

An additional factor had been the planned reduction in oil output as part of Kazakhstan's adherence to OPEC+ arrangements. Contraction of the economy as at the end of seven months of 2020 accounted for 2.9% in annual terms (in January-June 2020 – a 1.8% reduction) (Figure 32).

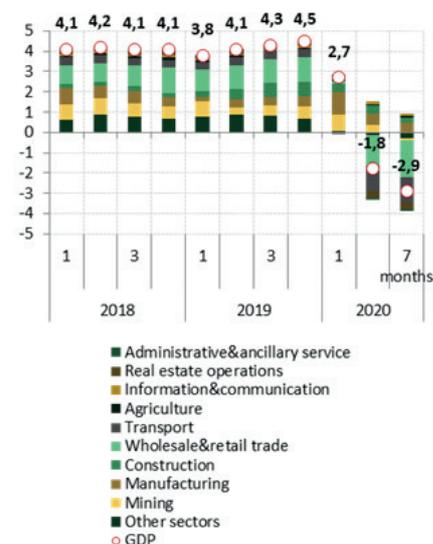
Quarantine measure associated with coronavirus had caused a decline in the sectors of trade and transport to the largest extent. Consumer sentiment somewhat improved in June; however, given the re-imposition of quarantine restrictions in July, it deteriorated.

This resulted in contraction of retail sales, including non-food products. Construction volumes also demonstrated a falling off which was driven by a sizeable reduction of construction works in July.

The sector of goods production showed deceleration because of curtailment of production in the mining industry. The leading business sentiment indicator of enterprises in the real sector was also negative after a minor recovery in July (Box 1).

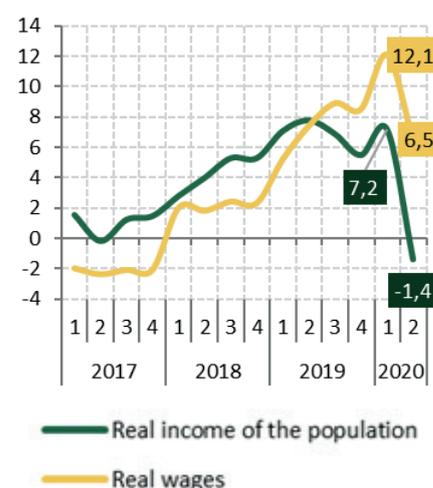
Real income of the population decreased by 1.4% in annual terms given the reduced economic activity and a temporary suspension of operations of the real sector enterprises in the second quarter of 2020 (Figure 33). Reduction in earnings was largely associated with a dramatic deceleration of annual wages from 12.1% in the first quarter 2020 to 6.5% (excluding the employees of small businesses engaged in entrepreneur activities) (Figure 34). In the structure of personal income, earnings from hired labor account for 59% (the first quarter of 2020).

Figure 32. GDP by the Production Method (GDP Decomposition by Industry-Based Inputs), cumulative YoY, %



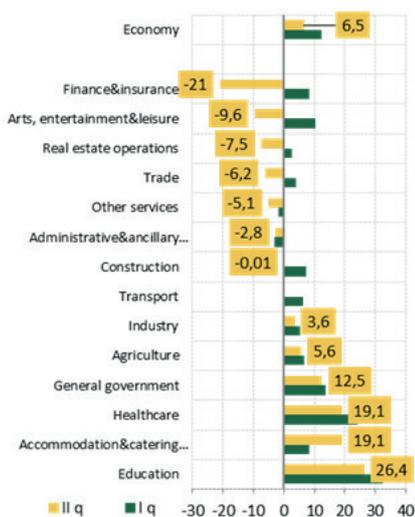
Source: CS MNE RK

Figure 33. Real Income of the Population and Real Wages, YoY, %



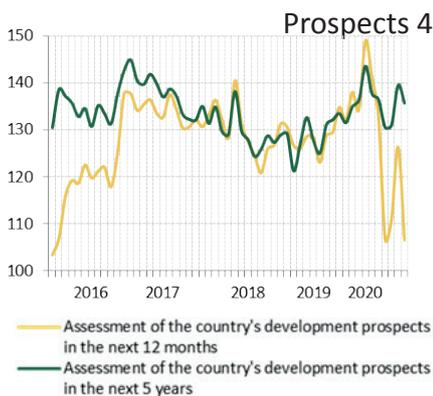
Source: CS MNE RK

Figure 34. Real Wages in the First and Second Quarters, YoY, %



Source: CS MNE RK

Figure 35. Assessment of Economic Development Prospects 4



Source: Fusion LAB

⁴ The assessment of the economic development prospects is conducted on the basis of questions "Speaking about the country's economic conditions in general, what kind of time would be the next 12 months and the next 5 years for the country, in your opinion?" The numerical value represents the balance of responses that are calculated as the difference between the percentage of positive responses and negative responses +100. The values of indices may change within the range from 0 to 200, the value above 100 – predominance of positive assessments, below 100 – of negative assessments

⁵ The assessment of the ease of big purchases is conducted on the basis of the question "In your opinion, is the present time generally good or bad for big purchases/expenditures?"

The positive dynamics is largely supported by a significant acceleration of wages in the public sector. So, in the second quarter the state budget spending went up by 38.6%, against this backdrop the real wages in the sector of education grew by 26.4%, in healthcare – by 19.1%, and in public administration and defense – by 12.5%. The positive dynamics of real wages is persisting in the branches of industry, agriculture and accommodation and catering services; the rest of branches in the real sector are demonstrating negative dynamics of real wages.

Retirement benefits account for 24% in nominal income of the population (the first quarter of 2020); their indexation this year helped to support earnings and curbed an even larger reduction in real income of the population.

The government spending on social welfare and social security increased by 13.9% in January-June 2020. These measures helped to support the consumer demand for foodstuffs and basic goods. At the same time, as a result of a comprehensive review and revision, the number of recipients of the subsistence allowance (SA) and its average amount decreased significantly. So, in January-June 2020, the number of SA recipients went down by 59.1% (YoY) while its average amount declined by 40.5% (YoY).

Reduction in personal income, imposition of the lockdown with the closure of sales outlets led to deterioration in the people's sentiment. Households were especially pessimistic about how the existing economic situation would develop. In May-June, sentiment somewhat improved; however, because of the enhanced quarantine in July, assessments worsened again. Meantime, it should be noted that there is still a better optimism regarding economic prospects for the next five years (Figure 35).

Consumer sentiment of the population also deteriorated. This is evidenced by the current balance of assessments of the ease of big purchases that is in the negative zone and has been staying at historically minimum levels (Figure 36).

Deterioration of consumer sentiment is proved by retail sales performance. It is worth mentioning that at the end of May – June 2020, the signs of recovery began to show due to the easing of quarantine measures.

So, the volumes of retail sales in June 2020 grew by 1.6% in annual terms after a historical maximum fall in April and May 2020 by 44.7% and 30.8% in annual terms, respectively. At the same time, imposition of the lockdown in July 2020 resulted in the reduction of retail sales

in July by 7.5%, YoY. On the year-to-date basis, the annual rates of decline in retail sales accounted for 11.7% (Figure 37).

The decline in consumer lending also had a negative impact on the dynamics of retail sales of non-food products (the drop of 19.4%, YoY, since the beginning of the year). At the end of January-June 2020, consumer loans went down by 17.9% (YoY). Taking account of a high share of imports in the consumption of non-food products (in 2019 the share accounted for 56%), the non-food imports decreased.

The retail sales of foodstuffs, after a minor reduction of 0.9% in the first half of the year, at the end of January-July 2020 resumed their growth rates to 3.9% due to the increasing production of foodstuffs.

Imposition of the lockdown also deepened the reduction of investment activity in the economy. In July 2020, the annual contraction of fixed capital investments accounted for 16%, since the beginning of the year investments decreased by 5.2% (Figure 38).

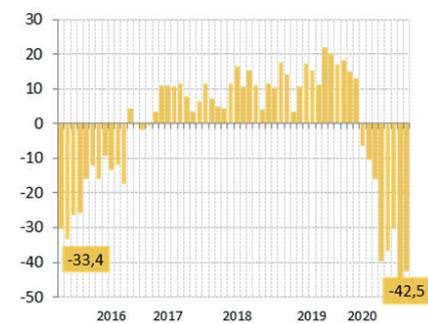
The main contribution to the negative dynamics of investments is still being made by the drop-off in investments into the mining industry by 17.2% because of suspension of a large investment project in the Tengiz oil field. There is still negative dynamics of investments in the sectors of trade (a 44% drop), transport (by 5%), construction (by 47.1%) and professional scientific and technical activities (by 47.9%). In other branches of the real sector and in the public sector, fixed capital investments are growing (Figure 39).

In the structure of fixed capital investments in January-July 2020, the growth of expenditures was only retained in construction and major overhaul (by 12.4%), which accounted for 54% in total investments. Investments into machinery, transport and equipment went down. Other expenditures including the costs for design and estimate works, upkeep of the directorate of buildings under construction, preparation of sites for construction, which had been the growth drivers for investments into the economy over the last two years have made a negative contribution.

At a regional level, 33% of all fixed capital investments have been implemented in Atyrau oblast, where in January-July 2020 investments declined by 20% in annual terms. The main investment project in Atyrau oblast is the construction of a third-generation plant at the TCO. In 2019, due to construction of the Saryarka gas plant in Kyzylorda oblast a high base had been built; this had driven a reduction of investment in the region in January-July 2020 by 37.1% in annual terms.

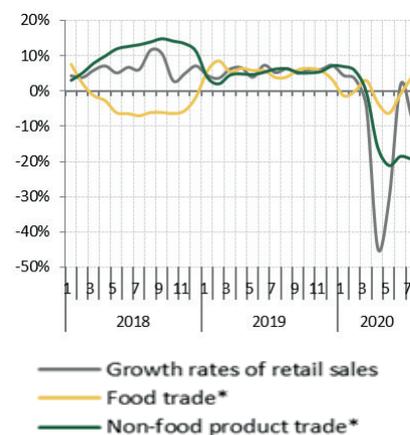
The growth rates of investments into residential construction

Figure 36. Assessment of the Ease of Big Purchases (Balance of Responses) 5



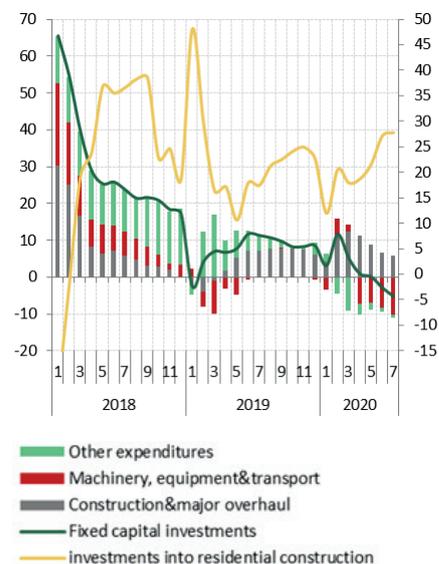
Source: Fusion LAB

Figure 37. Retail Sales, cumulative, YoY, %



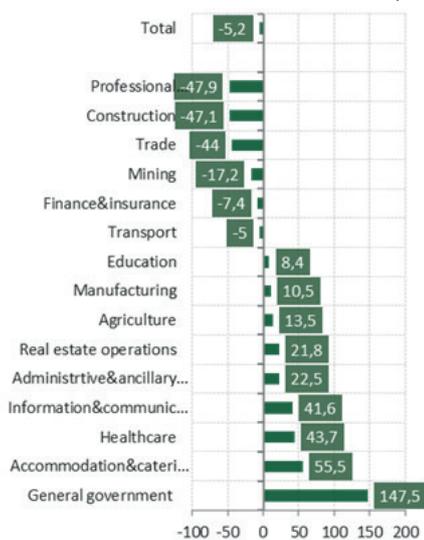
Source: CS MNE

Figure 38. Investment Activity Indicators, cumulative, YoY, %



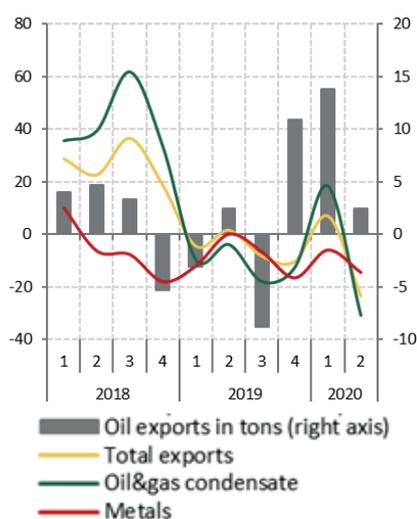
Source: CS MNE

Figure 39. Fixed Capital Investments by Type of Economic Activity, cumulative, YoY, %



Source: CS MNE

Figure 40. Exports in Value Terms Broken Down by Commodities and Oil Exports in Kind, YoY, %



Source: NBRK

accelerated and accounted for 27.7% since the beginning of the year (YoY). A decline in investments into residential construction is only observed in Atyrau (by 51.3%) and Turkestan (by 1.6%) oblasts.

Recession of the global economy because of the COVID-19 pandemic, a significant drop of prices in the global commodity markets coupled with the disruption of production and logistics chains had an adverse effect on Kazakhstan’s foreign trade turnover. In the second quarter of 2020, foreign trade turnover decreased by 18.4% in annual terms and amounted to 20.9 billion US Dollars.

Export of goods in value terms decreased by 20.8% (YoY) as a result of reduction in exports of oil, gas condensate, metals and other export items (Figure 40).

Oil exports in value terms in the second quarter of 2020 decreased by 30.7% (YoY) as a result of falling world oil prices. As per the country-based breakdown, the major fall in the oil exports in value terms was in the EU countries, where exports went down by 36.1% (to the Netherlands – by 43.2%, to Italy – by 29%, and to Switzerland – by 33.7%). However, physical volumes of oil exports in the second quarter of 2020 grew by 2.5% in annual terms, including to Italy by 7.2% (YoY), to India – by two times (YoY), and to China – by 91.2% (YoY). At the same time, the crude oil production in kind in Kazakhstan reduced in June 2020 by 21%, and in July 2020 – by 20% because of keeping up of OPEC+ limitations on daily oil production (Figure 41).

The lessening of external demand and imposition of quarantine measures in fighting the spread of coronavirus infection resulted in deceleration of metal ores production to 2.3% (YoY) from year-to-date. In July 2020, a curtailment in production of ferrous and non-ferrous metals in annual terms made up 21.6% and 2.6%, respectively.

Since the beginning of 2020, exports of aluminum in kind decreased by 11.5% (in annual terms), of zinc – by 6.7%, and of lead – by 9.3%. At the same time, exports of copper in kind increased by 9.2% against the reduction of its volume in value terms by 1.6%. Such dynamics was determined by the reduced supplies of aluminum to Italy, of lead to the Netherlands and of zinc to Russia and China alongside with a fall in price for these commodities.

In the first half of 2020, export of metals and metal products decreased by 12.7% (YoY) in value terms, while physical volumes of export of ferro-alloys, flat-rolled products, iron rods increased because of supplies to China.

During January-June 2020, import of goods declined by 3.2% in annual terms (in the first quarter 2020 it decreased by 0.7%, and in

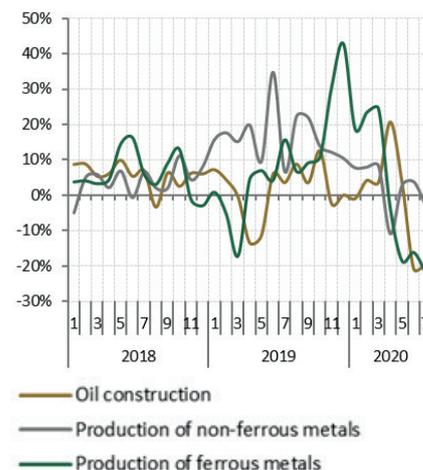
the second quarter – reduction of 5.9%).

In the second quarter of 2020, imports of interim, investment and non-food products were decreasing while imports of foodstuffs were growing (Figure 42). Within the commodity structure, imports in value terms of chemical production, timber and construction materials increased. There were less imports of machinery, equipment, transport vehicles, devices and instruments (in the second quarter of 2020 the reduction accounted for 6.5% in annual terms), of metals and metal products (by 15.8%); this was connected with production stops and the reduced investment activity.

A sluggish consumer demand, coupled with the shutdown of sales outlets engaged in trading of non-food products, had driven a reduction in imports of textile and textile products (by 18.7%) as well as footwear (by 22.6%) in the second quarter of 2020.

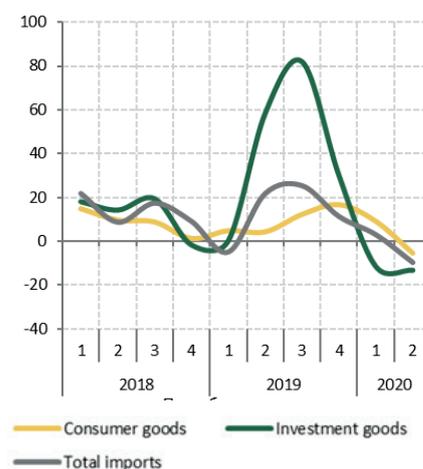
At the same time, given a dramatic growth in the number of people infected with coronavirus and pneumonia in Kazakhstan in June 2020, the demand for medications and personal care products increased significantly, thus leading to the growth in physical volumes of imports of medications by 45.5%, and of health and beauty aids – by 2.9 times, in the second quarter of 2020.

Figure 41. Production of Crude Oil, Ferrous and Non-Ferrous Metals, YoY, %



Source: CS MNE

Figure 42. Imports in Value Terms, by Commodities, YoY, %



Source: NBRK

Box 1. Stable Creditworthiness Level

The National Bank, jointly with the Government of the Republic of Kazakhstan, have regular consultations and discussions with large international credit rating agencies such as Fitch Ratings, S&P Global Ratings and Moody's Investor Service, to assess Kazakhstan's sovereign rating.

Based on the published press releases of Fitch Ratings and S&P Global Ratings, the Republic of Kazakhstan retained its credit rating at BBB and BBB-, respectively, with stable outlook.

Generally, rating agencies point that, despite the shocks caused by oil prices and the spread of coronavirus pandemic, Kazakhstan keeps the level of government debt low and has a significant volume of fiscal reserves that is sufficient to mitigate external shocks. Such factors as successfully implemented structural reforms, which strengthen the government's commitment to the economy and increase the level of institutional preparation for securing predictability and effectiveness of the economic policy, as diversification of the economy, a further build-up of fiscal and external buffer reserves might positively influence the increase in Kazakhstan's future credit rating.

Kazakhstan's sovereign ratings have been retained by these agencies despite the fact that ratings of many countries have been downsized across the board (*USA, Canada, Japan, the UK, France, Italy, Kuwait, Oman, Armenia, Azerbaijan, Georgia, etc.*); the situation regarding sovereign positions of countries with a rating similar to that of Kazakhstan (*India, Mexico, Russia, South Africa*) looks as follows:

Countries/Rating agencies	S&P Global		FitchRatings		MOODY'S	
	Before the pandemic	Current	Before the pandemic	Current	Before the pandemic	Current
 Kazakhstan	BBB-	BBB-	BBB	BBB	Baa3	Baa3*
 Russia	BBB-	BBB-*	BBB	BBB	Baa3	Baa3*
 India	BBB-	BBB-*	BBB-	BBB-*	Baa2	Baa3
 Mexico	BBB+	BBB	BBB	BBB-	A3	Baa1
 South Africa	BB	BB-	BB+	BB	Baa3	Ba1

*- Confirmation based on credit opinion (rating decision pending)

Fitch Ratings

On August 21, 2020, the international rating agency Fitch Ratings confirmed Kazakhstan's sovereign credit rating at BBB, with stable outlook.

In the Agency's opinion, the stable outlook reflects strong fiscal and external balances supported by accumulated oil budget revenues, but on the other side, a heavy reliance on the primary sector and lower scores in terms of the quality of corporate governance as compared to the peer BBB-rated countries.

According to Fitch Ratings, the exchange rate flexibility is an essential factor that helps to improve the economic situation. In this case, a free floating exchange rate policy implemented by the National Bank enabled to absorb shocks caused by the spread of coronavirus infection.

As follows from the report, the government's anti-crisis measures have partially neutralized a negative impact on the economic growth. However, as per the rating agency's projections, the drop in oil prices may have a negative effect on short-term investments into the oil and gas industry.

Even though the analysts anticipate deterioration in the quality of bank assets in today's environment

of drop-off in the economic activity, they note that Kazakhstani banks entered into the crisis with stronger positions after resolutions of problems banks and several years of restructuring, including the recent completion of the AQR and corrective measures taken.

Fitch Ratings project that the country's economic growth will recover to 5% in 2021.

S&P Global Ratings

On September 4, 2020, the international rating agency S&P Global Ratings confirmed Kazakhstan's sovereign credit rating at BBB-, with stable outlook.

In the rating agency's opinion, a stable outlook reflects S&P Global Ratings' expectations that in the next two years fiscal and foreign economic indicators of Kazakhstan will remain strong. S&P Global Ratings project a moderate recovery of the economic growth in 2021 owing to the expansion of oil output and the increasing oil quotations as well as due to the recovering growth rates in the non-oil sector.

S&P Global Ratings point that the exchange rate in Kazakhstan provides certain flexibility and will be helping to reduce the external pressure. Taking account of the progress in transition to the inflation targeting, the expected budget consolidation and the rise in oil prices, S&P Global Ratings believe that the growth rates of inflation will decelerate in future. However, analysts note the existence of limited independence of government agencies and a relatively weak development of the banking system in Kazakhstan.

Experts hold to the view that the Government's measures to minimize negative implications of the crisis will curb the economy's downturn and will contribute to its further growth.

Moody's Investor Service

On August 20, 2020, the international rating agency Moody's Investor Service published its updated credit opinion on Kazakhstan.

Experts from Moody's Investor Service emphasized that a positive outlook reflects their assessment of the fact that the economic sustainability in Kazakhstan is increasing, being supported by sustainable medium-term growth prospects in both the oil and non-oil sectors as well as by a rise in revenues. Based on the report, the analysts noted a low government debt and a significant level of international reserves, which represent a sizeable buffer to neutralize the impact of adverse external shocks.

In the perception of Moody's Investor Service, a relatively high level of revenues and steady improvement of effectiveness of the macroeconomic policy are the key factors for maintaining the country's economic sustainability.

In addition, it was highlighted that further economic reforms combined with effective administration of fiscal buffers can improve future creditworthiness ratings of Kazakhstan. However, analysts point at insufficient diversification of the economy, persisting vulnerability of the banking sector as well as reliance of the country's economy on the oil sector.

In the medium term, the agency's analysts anticipate that the economic growth will recover to 3% in 2021, suggesting that the economic activity would normalize in the quarters to come.

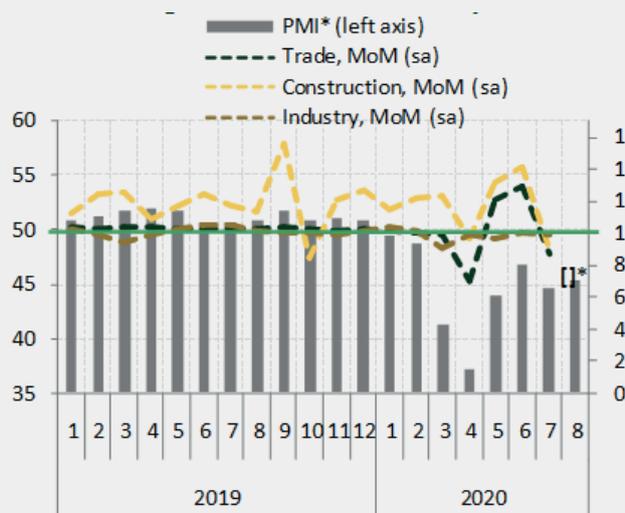
Box 2. The Pandemic's Effect on the Real Sector of the Economy in Kazakhstan⁶

This year, economies of many countries had been influenced by factors associated with the spread of coronavirus infection (COVID-19). Restriction measures taken by the governments worldwide, including in Kazakhstan, as well as their implications caused a significant deterioration in the economic activity. Assessments of enterprises in the real sector that demonstrated deterioration are also indicative of the fact. According to the surveys conducted by the NBRK, the majority of enterprises note that the strongest deterioration in the business activity occurred in April 2020. So, the purchasing managers' index ("the PMI") has declined to 37.2 for the first time since September 2016. (Figure 1).

A record-high reduction was also observed among the index components: the index in the sphere of services made up 34.8, in the construction sector – 36.5, and in the industry – 42.1 (Figure 2). A downfall was driven by the imposition of the state of emergency in the country from March 16, 2020 and the lockdown in the cities of Nur-Sultan and Almaty from March 19, 2020. The list of cities and oblasts where the lockdown was imposed was expanding as new cases of infection were detected; this paralyzed the operation of the majority of entities in the real sector. In May–June 2020, as the lockdown regime was being eased, economic processes were recovering. So, according to assessments by enterprises, after the PMI's maximum downswing in April 2020, it recovered in June to 46.8%.

Due to deterioration of the epidemiological situation in the country, the lockdown was re-imposed in July 2020 and lasted until August 17. This translated into deterioration of sentiment among enterprises in the real sector resulting in another drop of the PMI to 44.7 in July and a minor growth in August to 45.4.

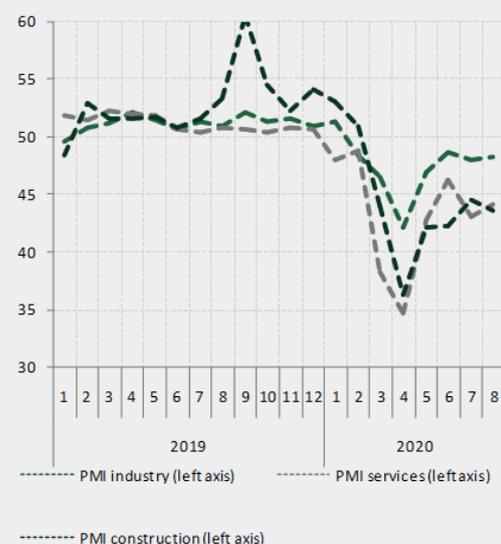
Figure 1. Consolidated Purchasing Manager's Index in the Economy



*The index value above 50 means a positive change, below 50 – a negative change. sa – means seasonally adjusted data (X-12-ARIMA)

⁶ Based on surveys conducted among enterprises participating in the real sector monitoring process conducted by the National Bank on a monthly basis

Figure 2. Purchasing Managers' Index, by Sectors



Box 3. Assessment of Financial Condition of Enterprises in the Real Sector of the Economy for the First Half of 2020

Since 2000, the National Bank of the Republic of Kazakhstan has been conducting the enterprise surveys on a quarterly basis with a view to examine the business climate in the real sector of the country's economy and to assess the economic market environment. The survey encompasses more than 3000 enterprises in various sectors from all regions of the country.

Alongside with assessments of conditions of doing business and their expectations and intentions, enterprises provide the data from their financial statements which, when explored, enable to make a comprehensive review of the state of economy not only at the macroeconomic level but also at the microeconomic level. A discriminate function analysis is performed with the use of quantitative data that allows identifying more informative indicators of enterprise financial condition and determining the imminence of a critical situation at an enterprise and thus to monitor the dynamics of change in the enterprises' financial condition.

Enterprises are divided into groups based on the extent of their soundness with the help of classification functions designed with the use of data of more than 2000 enterprises that have been consistently participating in the National Bank's surveys over the last three years. As a result, enterprises were divided into three groups (sound, normal and critical) based on the dynamics of 3 indicators, which are included into classification functions: a growth rate of income from realization of production per one employee, financial independence ratio and the equity growth rate.

Despite the fact that the percentage of sound enterprises is gradually decreasing in the economy

Figure 1. Dynamics of Financial Condition of Enterprises, Share in %

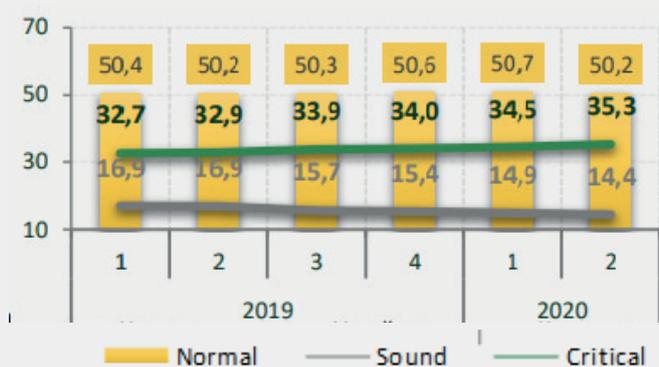
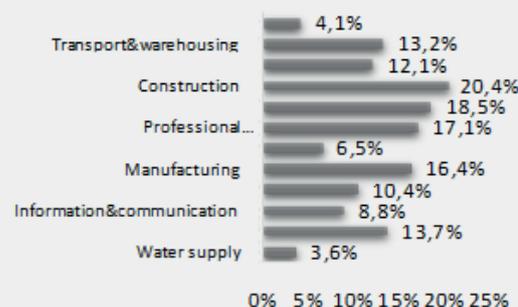


Figure 2. Percentage of Sound Enterprises



as a whole and the percentage of enterprises with a critical financial condition is increasing, the situation by sectors looks different. A dramatic increase in the percentage of enterprises with a critical financial condition was observed in the sector of "accommodation and catering services" (from 29.0% in the fourth quarter of 2019 to 40.3% in the first quarter of 2020), in the mining industry (from 31.1% in the fourth quarter of 2019 to 35.8% in the first quarter of 2020) and in trade (from 40.9% in the fourth quarter of 2019 to 42.0% in the second quarter of 2020). If in the second quarter of 2020, the percentage of enterprises with a critical financial condition in the mining industry decreased quite insignificantly (from 35.8% in the first quarter of 2020 to 35.3%), the decline was notable in the sector of "accommodation and catering services" (from 40.3% in

Figure 2. Percentage of Enterprises with a Critical Condition



the first quarter of 2020 to 37.1%). This is explained by the lifting of the state of emergency and easing of the quarantine. The improvement in the situation was only noted in the construction sector where the percentage of enterprises with a critical financial condition went down (from 41.8% in the fourth quarter of 2019 to 38.6% in the first quarter of 2020 and to 37.2% in the second quarter of 2020). In the first quarter, in the sector of “transport and warehousing” the percentage of enterprises with a critical financial condition decreased (from 27.9% to 27.2%), but it increased sharply in the second quarter of 2020 to 31.8%.

Since a great part of large enterprises in the sector provides services of transportation of oil and petroleum products along the main pipelines, deterioration of situation in the mining industry had an impact on the industry as a whole.

In the second quarter of 2020, the largest percentage of enterprises with a sound financial condition falls on the construction sector (20.4%), the largest share of enterprises with a critical financial condition is in the sector of trade (42.0%), and the largest percentage of enterprises with a normal financial condition – in the sector of water supply (88.3%). In all sectors, the percentage of enterprises with a critical financial condition is greater than the percentage of enterprises with a sound financial condition.

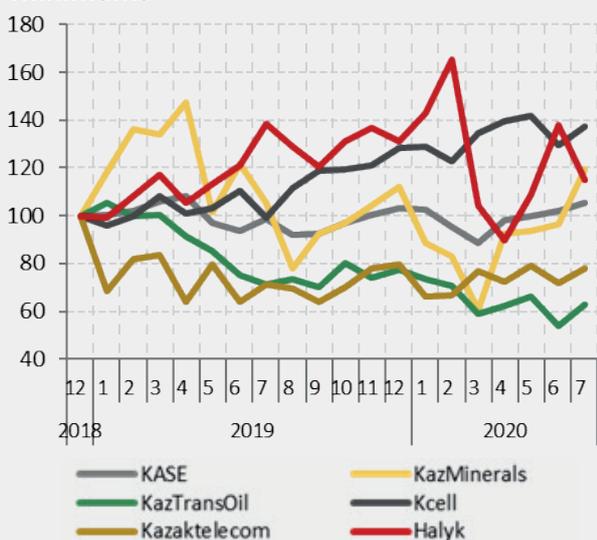
Box 4. KASE Index and Kazakhstan's Economy

Alongside with the indicators that are based on the enterprise surveys and public polls regarding expectations about the economic development, the dynamics of stock market, equity market in particular, may act as a leading indicator of the business activity. Fundamentally, the pricing of shares depends on future cash flows on issuer's shares and to a certain extent reflects investor expectations about a company's growth outlook, and for a broad-based stock index – development prospects of the sector and the economy in general. In this connection, a deeper insight into the dynamics of KASE Index and the search of its relations with the industry-based indicators of Kazakhstan's economy are of interest.

KASE Index as at a certain date is a change in the tenge market capitalization of shares of companies from the representative list as compared to its value at the starting point – September 28, 2007. The representative list is comprised of shares of eight companies⁷: Bank CenterCredit (weight – 4.3%), "KAZ Minerals" (15.2%), Halyk Bank (15.0%), "Kcell" (15.0%), "KEGOC" (12.1%), "Kazatompom" NJSC (15.2%), "Kazaktelecom" (14.7%), "KazTransOil" (8.5%). In case of a change in the representative list as well as in case of different corporate events affecting the number of free-float shares, the value of index at the starting point is subject to recalculation.

The monthly dynamics of KASE Index as well as indices of some shares during 2019-2020 are presented in the Figure (the basis month – December 2018). The index was assigned a maximum or a minimum value in any given month depending on whether the closing price of the month is smaller or larger as compared to the previous month, respectively. Such adjustment generally does not change the index dynamics but enables to better see the range of variations, especially in the times of

Figure 1. Dynamics of KASE Indices and Certain Shares from the Representative List Adjusted for Monthly Maximums and Minimums



Source: NBRK's calculations based on KASE's data

crisis. However, the dynamics of the stock price indices on other issuers in the representative list had not fully reflected the new conditions connected with the pandemic, therefore Bank CenterCredit, "Kazatompom" NJSC, "KEGOC" will not be considered, cumulative percentage – 31.6%).

The maximum drop in KASE index fell on the first three months of 2020 as the quarantine restrictions had been enhanced worldwide. In April 2020, due to the accepted OPEC+ agreements on reduction of oil production and the beginning of recovery of the Chinese economy and shortly afterwards – the entire global economy, KASE Index started to regain and by July its reached its pre-crisis values of the beginning of 2020. In terms of shares, the negative dynamics was demonstrated by

⁷ Data on the representative list and weights of companies in the index is taken from the KASE's official web-site as at end-August 2020

issuers in the primary sector and in the banking sector; however, positive conditions for provision of communication services given the teleworking regime of the population supported telecom shares (in January-July 2020, the annual growth of communication services accounted for 8.7%) and limited the nose-diving of KASE Index. Along with that, Kazakhstan's adherence to reduction of oil production within OPEC+ framework during 2020-2021 had driven the persistence of pent-up dynamics of stock prices in the oil and gas sector, despite the recovering share prices of other issuers and KASE Index as a whole.

If a standard correlation analysis is performed (Table 1) with different lags from October 2007 through July 2020, because of a different weight structure of industries in KASE Index and in the short-term economic indicator (STEI), no clear simultaneous correlation between the indicators is found (sample correlation coefficient is equal to 27%). Correlation between STEI and backward-looking lags of KASE Index appear to be smaller than between forward-looking lags; largely, this deflates the assumption about some leading nature of KASE Index in relation to STEI⁸. The same consistent pattern is shown by the relation between the Kcell stock index (henceforth, the basis month is October 2007 or the first month when the share was included in the representative list) and the index of communication services provision. So, with a simultaneous correlation between the indicators about 51%, the degree of linear dependence between the index of communication services and backward-looking lags of Kcell Index is also smaller than between the forward-looking lags. Correlation between shares of Halyk, Kazaktelecom, Kazminerals and the real sector indicators either does not manifest itself or becomes negative. Nonetheless, KazTransOil shares may act as a certain leading indicator for the oil production industry. Thus, when simultaneous correlation between the index of these shares and the oil production index is at 46%, the correlation between the oil production index and backward-looking lags of the KazTransOil Index is greater than between forward-looking lags. This fact, coupled with the recent feeble dynamics of the index of KazTransOil shares, may indicate a slow expected recovery of oil production in Kazakhstan given the country's observance of the OPEC+ agreement and incorporation of this factor in the stock prices.

Table 1. Sample Correlation Coefficients between Certain Indicators of the Real Sector of the Economy and Stock Indices from the KASE Representative List

Variables/Lags	-12	-9	-6	-3	0	+3	+6	+9	+12
STEI and lags of KASE Index	8%	14%	20%	25%	27%	32%	37%	45%	48%
Oil production and lags of KazTransOil stock index	69%	68%	67%	58%	46%	35%	26%	17%	11%
Communication services and lags of Kcell stock index	-3%	12%	31%	42%	51%	57%	60%	67%	58%
Metals extraction and lags of Kazminerals stock index	23%	34%	30%	26%	15%	-3%	-19%	-34%	-47%
STEI and lags of Halyk stock index	-66%	-64%	-60%	-58%	-58%	-58%	-58%	-57%	-56%
Communication services and lags of Kazaktelecom stock index	-6%	-6%	-3%	1%	-2%	4%	7%	10%	12%

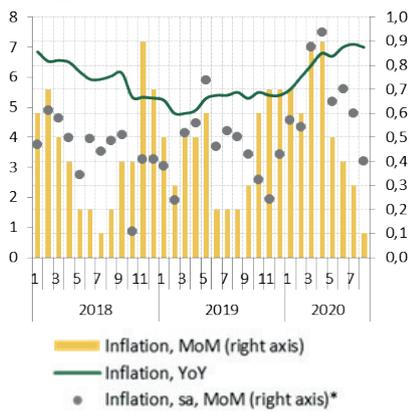
Source: NBRK's calculations base on the data from the KASE and CS MNE RK

⁸ From this point onward, it is worth mentioning that in order to provide a more precise assessment of mutual influence of the two indicators, a VAR-type model needs to be designed. The work in this area will be continued and its outcomes will be published later

Finally, if one compares the stock market of Kazakhstan and that of Russia as the country with a similar structure of the economy, in Russia the stock market of shares is presented broader. So, in addition to the main index - RTSI⁹ expressed in the US Dollars, there are also sub-indices on key sectors: oil and gas production, metals extraction, consumer sector, banking sector, transport services, electricity consumption. Here, the linear correlation between the OIBTEA (output index on basic types of economic activities) and RTSI goes up with the increase of lags behind and goes down in the reversed direction, thus indicating some leading nature of the stock index over the business activity. In particular, the stock index of consumer sector versus the retail sales has the most evident nature.

⁹ In Russia, they also calculate the MOEX Index and its sub-indices by sectors expressed in the Russian rubles; however, these indices reflect business cycles in the Russian economy to a lesser extent

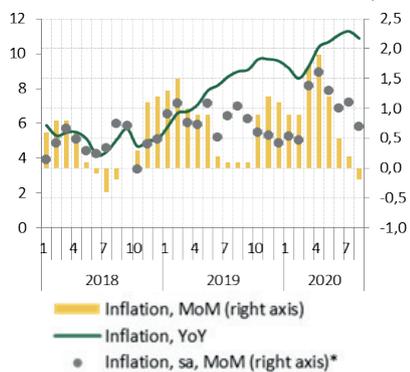
Figure 43. Inflation Dynamics



Source: CS MNE,

*Seasonal adjustment has been performed by using the X-12-ARIMA method from 2011 till present¹⁰

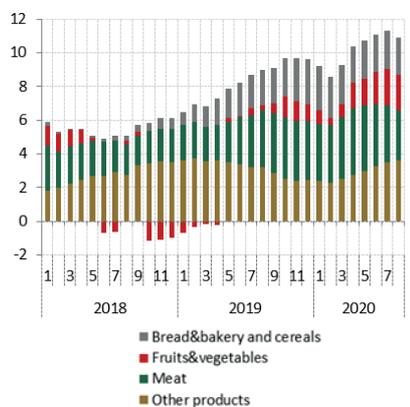
Figure 44. Dynamics of the Food Inflation, %



Source: CS MNE

Figure 45. Distribution by Commodity Groups. Impact of the Pandemic

Figure 46. Inputs by Groups of Food Inflation, YoY, %



Источник: КС МНЭ, расчеты НБРК

3.3. Inflation

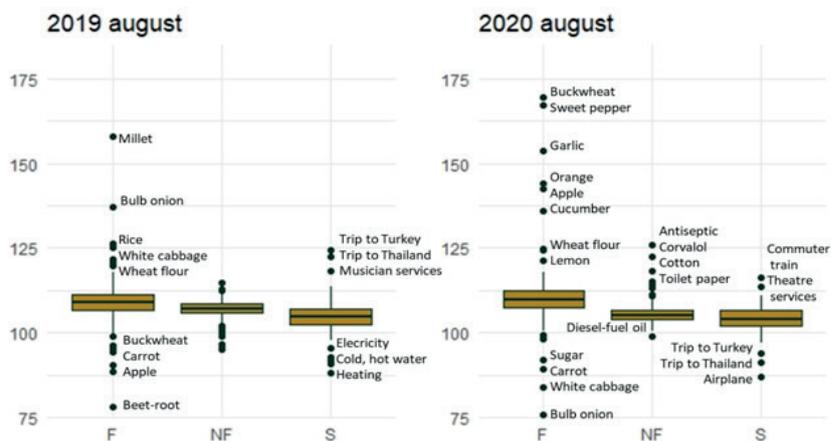
In August 2020, inflation had formed above the target range of 4-6%, accounting for 7.0% (Figure 43). However, its dynamics was in line with the National Bank’s projections.

As expected, the rise in food prices caused by persistently high growth rates of producer prices was offset by stable dynamics of the non-food and service components amid of pent-up consumer demand driven by the decline in real money income of the population as well as by observance of quarantine measures.

The main contribution to acceleration of inflation is still being made by the **growth in prices of foodstuffs**, which increased by 10.9% in annual terms (Figure 44).

The inflation dynamics was forming under the impact of imposed quarantine measures because of the spreading coronavirus infection and a subsequent increase in the demand for certain goods.

So, the heightened demand was observed for fruits and vegetables, especially for immune-enhancing products such as apples, lemons, oranges. Besides, the demand for buckwheat as a durable product has also gone up while in the previous year it was demonstrating deflationary dynamics. In April, as well as in July 2020 as a result of re-



Source: NBRK’s calculations based on the data from CS MNE

imposition of the lockdown and deterioration in the epidemiological situation, the demand for antiseptics and certain medications (anti-fever) increased. Meantime, closure of the borders and reduction in the number of international flights led to the decline in prices for air services, tourist services as well as other types of services (services of fitness centers, dry-cleaners, and beauty salons). As a result of pent-up demand, prices for such goods and services demonstrated a feeble growth or decline (Figure 45).

¹⁰You can find out more details about the algorithms of seasonal adjustment in the study “Specifics of Seasonal Adjustment of the Consumer Price Index for Kazakhstan” at the National Bank’s web-site in the research section.

Note: A horizontal line in each box represents the median in each component, upper and lower verges of each box show the upper and lower quartiles; and vertical lines denote a range between the upper and lower deciles, dots represent outliers. F – foodstuffs, NF – non-food products, S – paid services, price indices, and a month versus the corresponding month of the previous year

The dynamics of the non-food and service inflation remains moderate. The annual rise in prices of non-food products accounted for 5.5%, of paid services – 3.4%.

In August 2020, prices of **foodstuffs** decreased by 0.2%, being futedered by sustained growth in prices of meat due to the weakening of domestic demand, the existing ban to export live cattle and to put to grass as well as the decline in prices of vegetables due to a new harvest (Figure 46).

The absence of monthly food deflation typical for June and July is indicative of the existence of overall pro-inflationary pressure associated with the persistently high annual growth rates of food producer prices (August 2020 – a 11.3% growth). At the same time, the physical volume of food production index in January-July 2020 went up by 4.2% in annual terms.

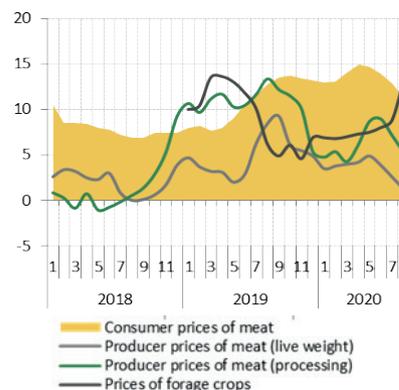
The main contribution to acceleration of the food inflation is still being made by the growth in prices of fruits and vegetables and milling products as well as by high cumulative annual inflation indicators for meat, which is largely explained by a significant share of these products in the food basket – about 59%.

In August 2020, prices of meat and meat products increased by 0.4%, and they slowed to 11.3% in annual terms given deceleration of the growth in producer prices of meat in live weight and in the manufacturing industry to 1.3% and 5.4%, respectively (Figure 47).

In August 2020, because of the accelerating growth in producer prices of flour and cereal products (August 2020 – by 22.2%, YoY) and high growth rates of wheat prices (24.4%, YoY), the level of prices for flour and cereal products remains high – 13.4% in annual terms (Figure 48).

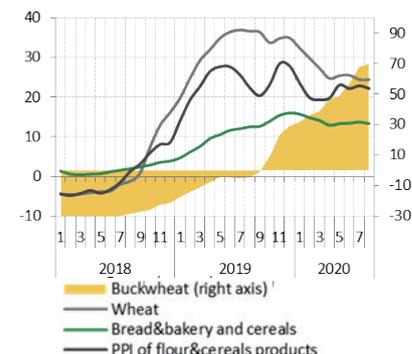
Curtailment of the acreage planted in buckwheat and of gross output in Kazakhstan nearly by half in 2019 because of low profitability and labor-intensive harvesting of buckwheat caused a hike in prices for this product. So, in August 2020 the annual inflation of buckwheat accounted for 69.5%. A similar situation is also observed in Russia where the annual price growth of this cereal in August 2020 made up 73%.

Figure 47. Consumer Prices and Meat Producer Prices, YoY, %



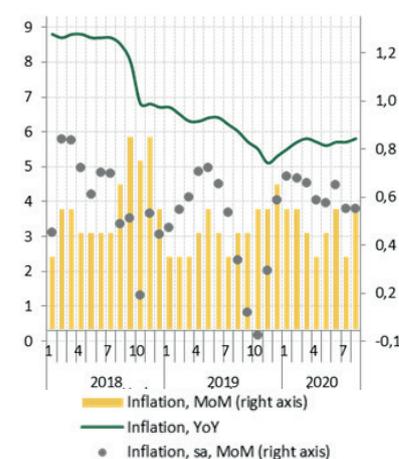
Source: CS MNE

Figure 48. Flour and Cereals Products, YoY



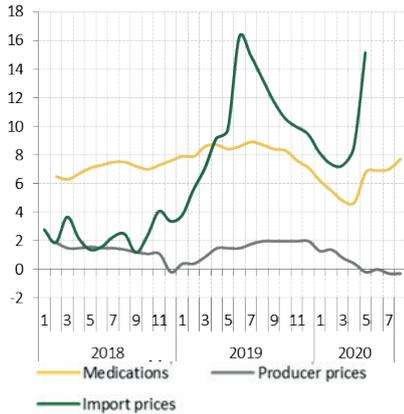
Source: CS MNE

Figure 49. Dynamics of Non-Food Inflation



Source: CS MNE

Figure 50. Dynamics of Prices for Medications, YoY



Source: CS MNE, NBRK's calculations

Despite a monthly deflation in prices of fruit and vegetable production, the annual price growth remains positive. So, during May-August 2020, vegetables cheapened by 17.8%, however, in annual terms in August 2020 the growth accounted for 3.8%, where pepper appreciated in terms of price by 67.4%, garlic – by 53.7%, cucumbers – by 35.9%, and tomatoes – by 24.4%.

A significant annual rise in prices of fruits is persisting (22.1% YoY), specifically in the prices of oranges (44%), apples (42.4%, YoY) and lemons (24.5%). The growth in prices of fruits and vegetables is driven by both a heightened demand for these vegetables and fruits on the part of the population with a view to prevent the coronavirus infection and by the increase in prices of imported products, the rise in producer prices, wholesale prices, and disrupted supplies because of the closed borders.

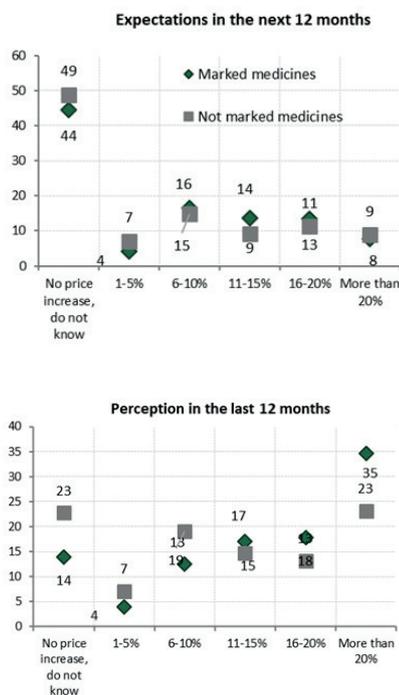
A restraining effect on the annual food inflation is still exerted by deflation of sugar (in August 2020 – a 7.7% reduction, YoY) given the accumulated low statistical base despite a monthly price growth.

In August 2020, the **non-food inflation** made up 5.5% in annual terms (Figure 49). The growth rates of prices for the majority of non-food products is at the pre-crisis levels despite the rising prices of imports. This is stemming from a sluggish consumer demand caused by re-imposition of quarantine restrictions for the operation of trading facilities in July 2020 and by the drop in real money income of the population by 1.4% in annual terms in the second quarter of 2020.

At the same time, the growth rates of prices for non-durable goods is accelerating, in particular, the rise in prices of pharmaceuticals accelerated to 8.7% given a 15.2% increase in prices of imports in May 2020 and the heightened demand because of deterioration of the epidemiological situation. The maximum annual price surge was observed among prices for medications and goods used in the treatment and prevention of coronavirus infection: sanitizers appreciated in terms of price by 26.1%, corvalolum – by 22.4%, anti-fever medications – by 14.8%, and syringes – by 8.9% (Figure 50).

It is worth mentioning that according to the data on inflation expectations from public polls, in July 2020 the percentage of respondents who noted the rise in prices of medications went up dramatically – to 23% (before – 2.5-3% on average, in June – 3.5%). The perception of price growth over the last year as a whole was higher among such respondents (Figure 51).

Figure 51. Perception and Expectations about Price Changes among Respondents Who Noted the Growth in Prices for Medications in July, share, %



Source: NBRK's calculations based on data from FusionLab

The annual increase in prices for detergents and cleaning products accelerated to 9.4%, where the rise in prices for soap made up 10.9%, for shampoo – 10%, and toothpaste – 9%. The growth in prices for this group of goods is related to realization of the exchange rate pass-through effect onto prices due to free sale of such goods in foodstores that continued to operate during the lockdown.

A downward pressure on the non-food inflation was put by by decelerating annual growth rates of gasoline prices (deceleration to 2.4% in August from 3.9% in March 2020) and annual deflation of prices for diesel fuel (in August 2020 – a decline of 1.2%) in the environment of modest demand and the growing domestic production. (Figure 52).

At the same time, the trade down trend among the population is persisting in favor of cheaper imported products, thus putting an additional disinflationary pressure. So, according to the data from the CS MNE, in January-June 2020 as compared to the same period of 2019, physical volumes of imports of non-food products (clothes, footwear, medications, furniture, household utensils) were growing faster than the value of imports. Along with that, the imports from China increased in the cost structure.

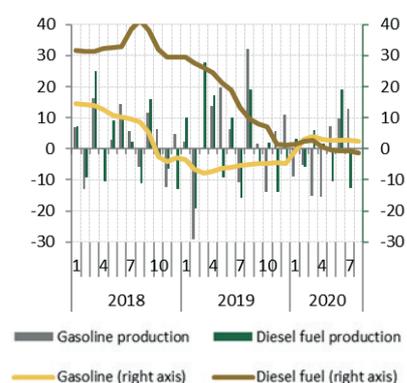
In August 2020, **the annual inflation of paid services to the population accelerated** to 3.4%. In the structure of service inflation, a negative contribution of regulated utility services continued to decrease after their reduction in April and May 2020 (Figure 53).

So, in June-July 2020, there was a significant annual growth in prices of wastewater removal services (by 3.7%), water supply (by 3.6%) and electricity (by 2.1%), which promoted acceleration of the annual inflation of regulated utility services (Figure 54).

At the same time, observance of quarantine measures factored into deceleration of annual price growth of services related to the travel business. So, in August 2020, the cost of air services decreased by 13.2% (YoY), services of package holiday operators – by 4.9% (YoY), the rise in prices of hotel services slowed down to 1.7%, public catering services – to 4.5% (Figure 54). Along with that, passenger turnover in the air transport in January-July 2020 versus the corresponding period of 2019 decreased by 48.6% and cargo turnover – by 36.7%.

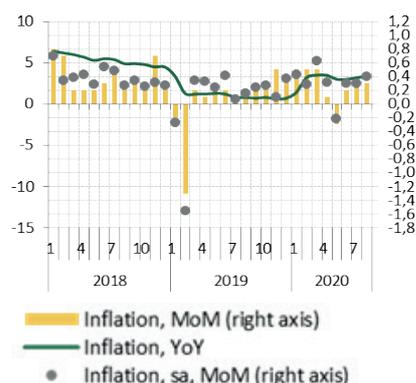
In July 2020, the annual core inflation (excluding prices of fruits, vegetables, regulated services and fuel and lubricants) accounted

Figure 52. Gasoline and Diesel Fuel, YoY, %



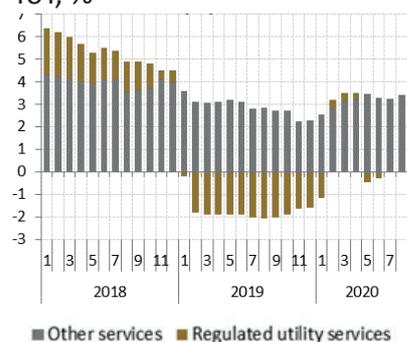
Source: CS MNE

Figure 53. Dynamics of the Service Inflation, %



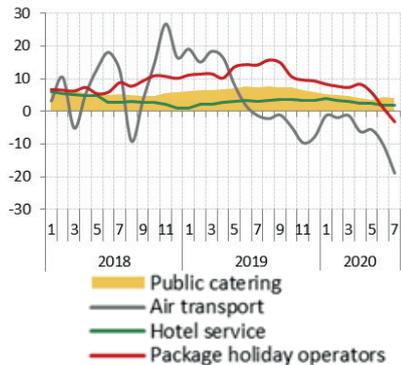
Source: CS MNE

Figure 54. Contributions to the Service Inflation by Groups, YoY, %



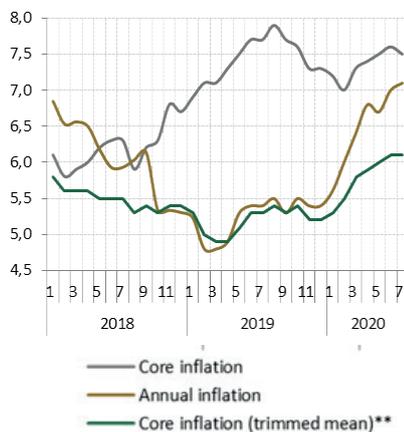
Source: CS MNE, NBRK's calculations

Figure 55. Services Related to the Travel Business, YoY, %



Source: CS MNE

Figure 56. Inflation and Core Inflation*, YoY, %

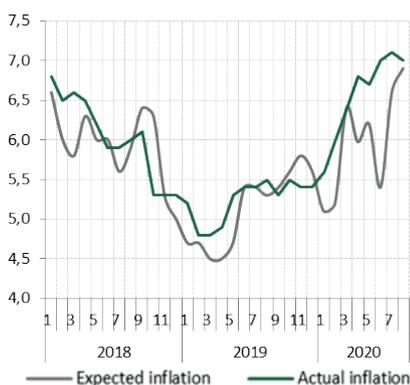


*Excluding prices of fruits and vegetables, utilities (regulated), railway transport, communication, gasoline, diesel fuel and coal

** All goods and services excluding the price changes of eight percent of maximums and minimums

Source: CS MNE, NBRK's forecasts

Figure 57. Inflation and Expected Inflation, YoY, %



Source: CS MNE, Fusion LAB

for 7.5% because of the rise in prices for basic food (Figure 55). However, the core inflation still exceeds the headline inflation.

The core inflation trimmed mean (with exclusion of eight percent of maximum and minimum changes in prices) is still below the headline inflation. In July 2020, it accelerated to 6.1% in annual terms.

Since the beginning of 2020, the annual core inflation trimmed mean significantly accelerated, thus reflecting the enhanced pro-inflationary pressure not only in certain commodity markets but also in the consumer basket as a whole.

Assessments of inflation expectations by the population in July-August increased. Deterioration of the epidemiological situation in the country, a heightened demand for medications followed by a limited supply of some medications and the tightening of quarantine measures appeared to be the main factors that impacted the outcomes of the public poll.

In August 2020, the quantitative assessment of inflation for a year ahead accounted for 6.9% (Figure 57).

In August 2020, the percentage of respondents who noted a more rapid price growth over the past 12 months increased significantly to 65% (in June – 56%). This has been the maximum since 2017.

It should be noted that volatility of indicators of inflation expectations had significantly increased during the crisis caused by the coronavirus pandemic. This was driven by a frequent change in the sentiment of respondents due to an unstable epidemiological situation both in Kazakhstan and worldwide, by the growing uncertainty and deterioration of the economic condition. Re-imposition of the lockdown in July after easing of restrictions at the end of May-June had negatively affected the responses of interviewed individuals.

Box 5. Pricing of Medications and Personal Use Products

At present, there is a system of reference pricing for medications in the pharmaceutical market in Kazakhstan. Regulation is carried out separately for medications that are subject to the wholesale and retail realization, and separately for pharmaceuticals to be used in the provision of the guaranteed amount of free medical aid (GAFMA) and mandatory social health insurance (MSHI). The government price regulation is implemented by setting marginal prices and mark-ups on medications that are determined regressively depending on their cost. It is worth mentioning that such pricing system has been in effect since 2019 only; before that, the prices of medications to be used in the provision of GAFMA had been exceptionally subject to regulation.

Despite an on-going production growth in the pharmaceutical industry, the share of imports in resources remains significant (at the end of 2019, the share of imports in resources of pharmaceuticals accounted for 51.8%, vitamins and pro-vitamins – 97%). As at the end of 2019, Kazakhstan was buying the largest portion of imports in physical volumes in Russia (32.6%), China (15.7%), India (7%) and in Germany (8.7%). This being said, medications from the EU countries are more expensive than those imported from the countries – main suppliers of medications (Russia, China, India). As a consequence, the final price for medications in Kazakhstan depends on producer prices, prices of imports and mark-ups determined by the government.

In the second quarter of 2020, producer prices of medications had demonstrated the annual deflation despite the heightened demand for medications given the increased number of COVID-19 cases (Figure 1). There was a rise in prices of imports, which led to acceleration of price growth for pharmaceuticals. At the end of the first year-half, import of medications in kind went up by 16.5%, and in terms of value – by 19.3%. Country-wise, the structure of imports has not changed significantly as compared to 2019, however, medications from China and India were imported at higher prices as compared to the corresponding period of 2019. For example, physical volumes of imports from China went down by 33.5% with the growth in total value by 47.2%, and in-kind imports of medications from India grew by 2.9% only against the growth of 32.7% in terms of value.

Figure 1. Prices for Pharmaceuticals

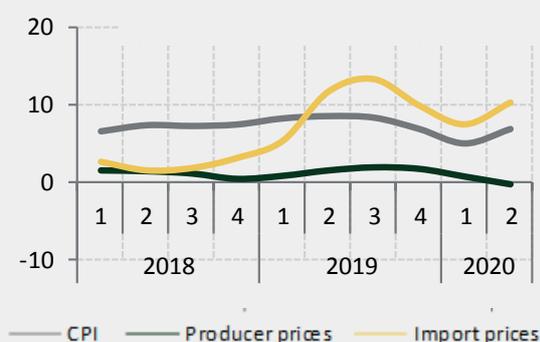
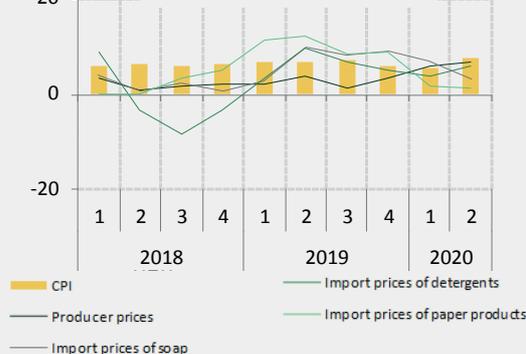


Figure 2. Prices for Personal Use Products



The pricing of personal use products is formed on the basis of foreign prices since the share of domestic production in resources on this group of goods, except soap, accounted for 28% in 2019, and personal care products made from paper – 24%. In 2019, over 95% in consumption of oral hygiene products, detergents, beauty products and other personal care products were provided owing to imports.

In 2020, the spread of COVID-19 resulted in a heightened demand for products of that category that resulted in a two-fold growth of physical volumes of imports as at the end of the first half of 2020 (2.6 times increase in imports from Russia, the share of imports – 83%). Along with that, imports in value terms decreased by 4.1%, causing a deceleration in imports except the prices of detergents (Figure 2). **Therefore, acceleration of price growth for personal care products in the period of coronavirus pandemic in Kazakhstan was largely driven by a heightened consumer demand and the rise in import prices of detergents.**

¹¹ Национальный центр осуществляет референтное ценообразование на лекарственные средства (ЛС) согласно утверждённых Приказом Министра здравоохранения Республики Казахстан от 19 апреля 2019 года № КР ДСМ-42 Правил регулирования цен на лекарственные средства.

3.4. Labor Market

Restriction measures undertaken to fight the spread of coronavirus pandemic in Kazakhstan keep exerting a significant negative influence on the labor market.

The unemployment, after staying at 4.8% for some time, increased to 5% in the second quarter of 2020. The numbers of employed population for the first time since 2016 reduced by 0.7% in annual terms against a 2.8% increase in the unemployed population (YoY).

In the structure of employed population, there was reduction both in the number of employees (by 0.2%, YoY) and in the self-employed population (by 2.2%, YoY). According to the CS MNE, alongside with the decreased employed population, in the second quarter of 2020 the number of the temporary unemployed went up dramatically (Figure 58).

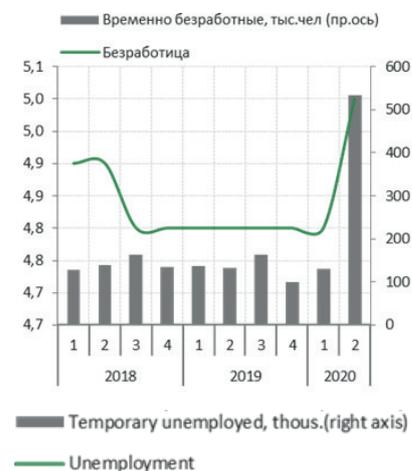
So, in the first quarter of 2020, the number of temporary unemployed individuals was 129 thous., while in the second quarter over 500 thous. individuals appeared to be temporary unemployed.

A sharp increase in the number of the unemployed in connection with the coronavirus crisis had caused a growth in the **people's applications to the public employment authorities**. So, in May 2020, the number of individuals who applied to the public employment authorities exceeded 70 thousand, in June 2020 – 92 thousand (in 2019, the average number of applications did not exceed 50 thousand) (Figure 59).

As per the industry-based breakdown, the decline in employment in annual terms was observed in all branches of the real sector except the sector related to provision of other services (activities of membership organizations, repair of computers and household appliances, provision of individual services). The largest downturn was observed in the sector of arts, entertainment and leisure (by 6.3%), real estate operations (by 5.7%), activities related to administrative and ancillary service (by 4.3%). In the public sector, the employment is growing. In terms of regions, employment was decreasing in all regions except Turkestan oblast and the city of Shymkent.

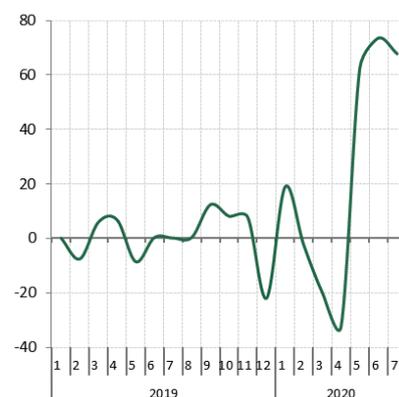
According to the National Bank's assessments, based on the data from the CS MNE, **the labor productivity in the first half of 2020**

Figure 58. Unemployment Rate and the Temporary Unemployed Population



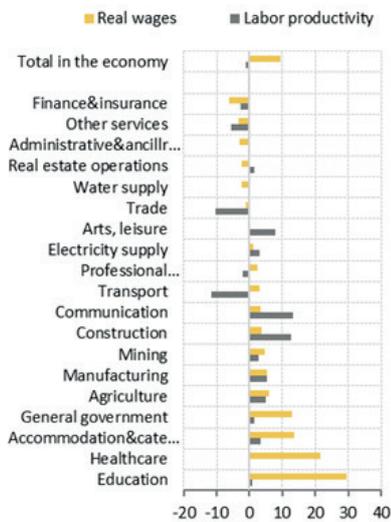
Source: CS MNE

Figure 59. Individuals Who Applied to the Public Employment Authorities as Job Seekers, YoY, %



Source: CS MNE

Figure 60. Labor Productivity and Real Wages, YoY cumulative, %

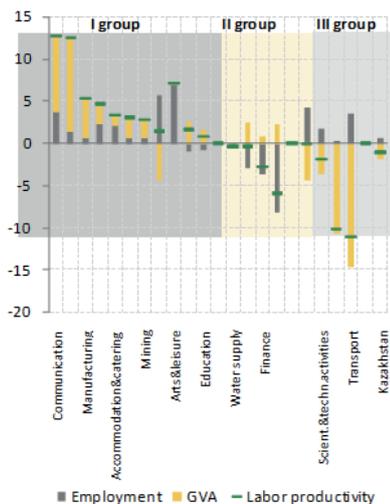


Source: CS MNE, NBRK's calculations

decreased given a concurrent reduction of the gross value-added in the economy and the employment. The real wages (excluding small businesses) demonstrate positive dynamics (Figure 60). The growth rates of real wages are overrunning the increase of labor productivity in the public sector branches, in agriculture, accommodation and catering services, in the mining and the manufacturing industry, creating pro-inflation risks in these sectors on the supply side.

Reduction in the labor productivity was observed in the sectors of transport, trade, financial and insurance activities, professional and scientific and technical activities, activities related to administrative and ancillary service, in water supply, healthcare and other sectors. In the branches included into the third group (Figure 61), the decline in labor productivity resulted from reduction in the gross output because of the drop in employment. Along with that, the decline in labor productivity in branches of the second group stemmed from the outstripping growth of employment over the growth rates of output. In the first group, except for public administration and defense and education, the labor productivity was increasing due to the outstripping growth in output over the growth rates of employment.

Figure 61. Labor Productivity by Types of Economic Activities for the First Half of 2020, %



Source: CS MNE, NBRK's calculations

*- the rates of change in employment are taken with an opposite sign, i.e. the increase in employment against the unchanged GVA leads to the decreased labor productivity

3.5. Fiscal Policy

This year, amid of deteriorating business activity because of restriction measures taken to curb the spread of coronavirus infection in Kazakhstan, the fiscal policy has a social focus.

This was accompanied by the growing budget spending on social welfare and social security, education and healthcare. As part of support to the economy and of anti-crisis measures, transfers from the National Fund have been increased substantially.

In January-July 2020, the state budget deficit amounted to 1.5 trillion tenge, having increased by 2.1 times as compared to the corresponding period of 2019. Expansion in the budget deficit, first of all, was driven by the outstripping growth of expenditures (by 23.1%) as compared to the increase in revenues (by 11.2%) in annual terms.

The non-oil budget deficit (budget deficit excluding transfers from the National Fund) in January-July 2020 amounted to 5.1 trillion tenge, having increased by 80.8% as compared to the corresponding period of 2019 (Figure 62).

During January-July 2020, a guaranteed transfer of 3.6 trillion tenge was allocated to the budget from the National Fund, whereas in 2019 the guaranteed transfer was 1.7 trillion tenge and the earmarked transfer amounted to 370 billion tenge (in 2020, the planned amount of the guaranteed transfer from the National Fund was 4.8 trillion tenge).

During January-July 2020, the state budget revenues went up by 11.2% as compared to the same period of the previous year and totaled 6.7 trillion tenge (Figure 63). The main reason for such growth was the increase in official transfers by 67.5% (the share in state budget revenues accounted for 58.7%).

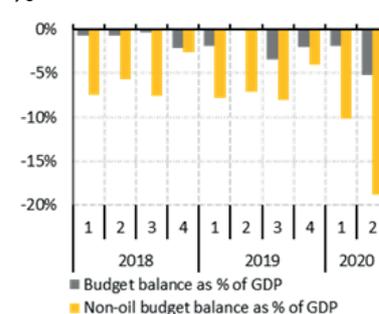
In January-July 2020 as compared to the corresponding period of 2019, **there was a reduction in tax revenues** (by 25.9%) and in proceeds from fixed capital sale (by 80.3%) because of imposed restriction measures in fighting the spread of coronavirus and the declined economic activity.

Reduction in tax revenues occurred as a result of measures of Kazakhstan’s Government taken to support the business and household income, under which from April 1 to October 1, 2020 small and medium-sized businesses in the most affected sectors of the economy (retail trade, road freight transport, airport operations, restaurant business, cinemas, consultancy, travel business, education, private medical establishments, real estate operations, health resort services, activities of theaters and concerts, hairdressers and beauty saloons) were exempted from taxes and other mandatory payments to the budget from the payroll fund (personal income tax, social tax, MSHI and pension contributions). Large enterprises (retail trade, passenger air transport, hotel business, and real estate operations) were also exempted from the above taxes and deductions but for a shorter period – from April 1 to July 1, 2020. In addition, premiums, shares of employees engaged in the epidemic prevention activities are exempted from all taxes and social payments from the payroll fund.

A 26.3% growth in tax revenues was furthered by a significant increase in dividends on the government’s stake of government property (Figure 63).

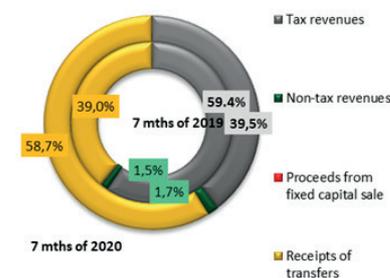
During January-July 2020, the state budget spending increased by 23.1% as compared to the corresponding period of the previous year and amounted to 7.7 trillion tenge. The main contribution to

Figure 62. Overall and Non-Oil Deficit of the National Budget, %



Source: Kazakhstan’s Ministry of Finance, NBRK’s calculations

Figure 63. Structure of the State Budget Revenues



Source: Kazakhstan’s Ministry of Finance

the growth in the national budget spending has been traditionally made by expenditures in social welfare and social security (the share – 28.6%), whose increase due to the indexation of retirement benefits, social benefits and subsistence allowances accounted for 22.5%. The rise in expenditures for healthcare (by 38.9%, the share – 12.1%) was driven by the epidemic prevention activities in fighting the spread of coronavirus (extra payments to the medical and other personnel, construction of medical modular facilities, purchases of laboratory equipment and COVID-19 detection test systems, personal protective clothing, disinfectants, medications and medical products). Also, there was an increase in expenditures related to education – by 44.4% (the share – 6.3%) due to the raise in salaries to teachers, in official transfers – by 34.4% (the share – 17.3%), debt servicing – by 18.9% (the share – 7.5%).

Box 6. Analysis of Compliance with Fiscal Rules not Related to the Government Debt

At present, Kazakhstan has the following fiscal rules:

1. Non-oil deficit of the national budget should not exceed the values specified in Table 1.
2. The amount of guaranteed transfer from the National (Oil) Fund of the Republic of Kazakhstan (“the NOF RK”) to the national budget is a fixed amount and is set at 2.7 trillion tenge in 2019-2021; from 2022, such amount will be reduced to 2 trillion tenge. Earmarked transfers from the NOF RK shall be allocated only upon the decision of the President of the Republic of Kazakhstan.
3. The minimum required balance of the NOF RK’s resources is set at 30% of the projected GDP at the respective year-end.
4. The amount of Government’s external debt (including the external debt guaranteed by the government) and the external debt of the quasi-government sector should not exceed the amount of total foreign currency assets of the NOF RK.
5. Expenses related to the government debt servicing and redemption should not exceed 15% of the national budget revenues, including transfers from the NOF RK.

Within the frames of this analysis, compliance with the first three rules not related to the government and quasi-government debt was studied.

Table 1. Marginal Values of Non-Oil Deficit of the National Budget for 2017-2025 as Approved in Line with the Concept Paper on Formation and Use of Resources of the National Fund of the RK (“the Concept Paper”) dated December 8, 2016, Values of Non-Oil Deficit from the Draft Law on the National Budget (“the Law on the NB”) and the Forecast of Social and Economic Development of the RK (“the FSED”), as % of GDP

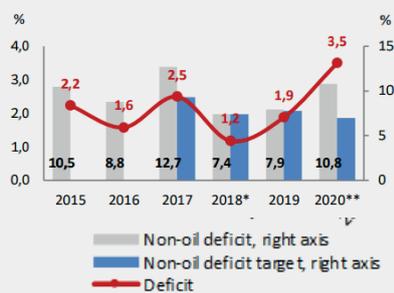
	2017r.	2018r.	2019r.	2020r.	2021r.	2022r.	2023r.	2024r.	2025r.
The non-oil deficit from the Concept Paper	9,3	7,4	7- 8,5	7,0	6,6	6,5	6,4	6,1	6,0
The non-oil deficit from the Law on the NB and the FSED	-	-	-	10,8	9,1	6,3	5,5	-	-

1. Limits for Non-Oil Deficit of the National Budget until 2025

A close relationship between the non-oil deficit and overall deficit suggests the necessity for a low-key review of the dynamics of overall deficit. Over the last five years, overall deficit of the national budget has been within 1-3% of GDP. The build-up of overall deficit within such limits is explained by a high portion of transfers from the NOF RK in the revenue side of the budget. In 2015-2019, transfers from the NOF RK accounted for 29-46% of total national budget revenues.

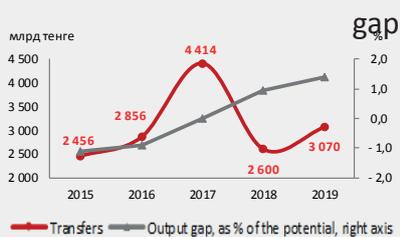
For reference. According to the most recent changes to the Law on the National Budget for 2020-2022, transfers account for 40.7% of total budget revenues in 2020.

Figure 1. Deficit and Non-Oil Deficit of the National Budget, as % of GDP



*for 2018, the average non-oil deficit target was calculated from the stated range of 7.0-8.5%
 **-values for 2020 represent the Government's forecast
 Source: MOF RK, FSED for 2020-2022

Figure 2. Transfers from the National Fund and the output gap



Source: NBRK, CS MNE, NBRK's calculations

Figure 3. Tax revenues, transfers from the NOF RK and budget spending, YoY, in real terms



Source: MOF RK, NBRK's calculations

At the same time, despite a low level of overall deficit, non-oil deficit for the same period did not fall below 7% of GDP, exceeding its targets in some periods. So, in 2017 the actual non-oil deficit was significantly exceeding its target – 12.7% of GDP versus 9.3% of GDP, respectively. In 2019, the non-oil deficit accounted for 7.9% of GDP and was staying within the target range of 7.0-8.5% of GDP. This target range was approved in 2019, whereas the earlier planned amount was 7.2% of GDP (Figure 1).

2. Fixed Amount of the Guaranteed Transfer from the NOF RK to the National Budget in 2019-2021 Followed by Subsequent Reduction to 2 Trillion Tenge from 2022

From time to time, the amount of guaranteed transfer from the NOF RK was revised upwards. After initial approval of the amount of annual guaranteed transfers for 2018-2020 (2.6 trillion tenge – in 2018, 2.3 trillion tenge – in 2019, and 2.0 trillion tenge – in 2020) their volumes, starting from 2018, have been revised on an annual basis. In 2019, the guaranteed transfer was revised again, and its amount of 2.7 trillion tenge was approved for 2019-2021. The growth in withdrawals from the NOF RK in the periods when the economic activity was in recession reflects a counter-cyclical nature of the fiscal policy and helps to mitigate a negative effect of certain factors on the economic activity. At the same time, the amount of transfers from the NOF RK increased in the periods when the economy was above its potential values (Figure 2). The year 2019 may be used as an example of a pro-cyclical nature of the fiscal policy. When oil quotations came back to 60 US Dollars per barrel accompanied by the positive dynamics of economic activity in the range of 3.8-4.5%, in 2019 real tax revenues grew by 14%. Nonetheless, despite a high growth of tax revenues, rates of increase in revenues in 2019 were lower than the growth rates of expenditures (Figure 3).

For reference. As per budget items, in 2017-2019, the growth of real wages in the sector of healthcare on average accounted for 8.4%, in social security – 25.4%. In turn, the share of expenditures on social security in the total national budget spending increased from 23.6% in 2015 to 28.5% in 2019.

In 2020, the amount of transfers was revised from 2.7 trillion tenge to 4.8 trillion tenge as a result of deterioration of internal and external conditions in connection with the spread of viral epidemic. As opposed to 2019, the increased volumes of transfers from the NOF RK, despite the absence of fiscal discipline, are associated with the counter-cyclical policy aimed at mitigation of negative implications of coronavirus.

3. The Minimum Required Balance of the NOF RK Resources at 30% of GDP

During the last five years, because of excess in withdrawals over receipts, the NOF RK's resources in the US Dollar terms have been demonstrating a downward path, except for 2019. Nonetheless, the rule on the minimum required balance of the NOF RK's resources at 30% of GDP has been complied with in light of the fact that a significant portion of the NOF RK's resources is funneled in the US Dollar-denominated instruments and depreciation of the exchange rate of the tenge promotes the compliance with the rule. So, in 2015, this indicator increased significantly to 58.0% of GDP accompanied by a concurrent depreciation of the exchange rate of the tenge against the US Dollar by 86.5%; however, in the US Dollar equivalent, the NOF RK's resources went down by 15.5% versus 2014. In turn, in 2018, despite a 15.6% depreciation of the tenge versus 2017, the NOF RK's resources slightly reduced (Figure 4).

Figure 4. National Fund's resources, at period-end



Source: NBRK, CS MNE, NBRK's calculations

Therefore, compliance with the reviewed fiscal rule is largely determined by the dynamics of the exchange rate of the tenge.

Summing up the analysis of three fiscal rules not related to the government debt, one might note the following:

- non-oil budget deficit is staying at above 7%, and there is no tendency that it would gradually go down within the framework of the fiscal rule. In turn, the overall national budget deficit does not exceed 3% of GDP; however, its low values are associated with a high share of transfers in the revenue side of the budget;
- the amount of guaranteed transfer from the NOF RK to the national budget is revised upwards from time to time, speaking for a low level of fiscal discipline. In addition, the upward revision of transfers occurs in the periods when the economy is above its potential growth rates indicating a pro-cyclical nature of the fiscal policy in particular years;
- the rule of minimum required balance of the NOF RK's resources at 30% of GDP is complied with; however, this is essentially related to depreciation of the exchange rate of the tenge. Along with that, in dollar terms, except for 2019, there is a trend of reduction in resources.

BASIC TERMS AND DEFINITIONS

Core Inflation – means the inflation which excludes transitory price changes subject to certain factors of administrative, event-related and seasonal nature. The base rate – is the National Bank's key monetary policy instrument which enables to regulate nominal interbank interest rates in the money market. By setting the base rate level, the National Bank determines a target value of the targeted interbank short-term money market rate in order 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 tangible non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

FX Swap means a foreign exchange transaction which involves the concurrent purchase and sale of a certain amount of one currency in exchange of another currency with two different value dates.

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 non-government 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 the population in the domestic 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 domestic 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 in the overall price level of goods and services purchased by the population for consumption. The consumer basket of Kazakhstan used for calculation of inflation reflects the structure of household spending and contains goods and services which represent the largest portion in the consumption of 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 previous (base) period. The index is calculated by the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan.

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

Composite Indicator – is a generalizing indicator which is used to reflect short-term

trends in the development of the real sector of the economy. Composite indicator as possessing the forward-looking feature is used to reflect a cyclical change and to identify turning points when recovery and downturns in the economy occur and change. A composite indicator is built on the basis of the outcomes of survey among enterprises which participate in the market research conducted by the National Bank.

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 line 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.

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 and also as the basis to determine the purchasing capacity of currencies.

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 intervene in the foreign exchange market in order to smooth out the volatility of the domestic currency exchange rate or to prevent its dramatic movements as well as to ensure the financial system.

Output Gap. 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.

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.

Narrow Reserve Money is the reserve money excluding other deposits of banks at the National Bank.





LIST OF KEY ABBREVIATIONS

bp – basis point

GDP – gross domestic product

GPIID – the Government Program for Industrial and Innovation Development

EU – the European Union

ECB – the European Central Bank

CPI – consumer price index

CS MNE – the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan

KASE – the Kazakhstan Stock Exchange

KSF – the “Kazakhstan Sustainability Fund” JSC

NBRK – the National Bank of the Republic of Kazakhstan

VAT – value-added tax

OPEC – Organization of the Petroleum Exporting Countries

Rosstat – the Russian Federal State Statistics Service

REER – real effective exchange rate

IMF – the International Monetary Fund

bln. – billion

mln. – million

MNE – the Ministry of National Economy

MoA RK – the Ministry of Agriculture of the Republic of Kazakhstan

MED – the Ministry of Economic Development of the Russian Federation

thous. – thousand

TCO – Tengizchevroil

CB RF – the Central Bank of the Russian Federation

FAO – Food and Agriculture Organization of the United Nations

US Fed – the Federal Reserve System



NATIONAL BANK OF KAZAKHSTAN