



National Bank of the Republic of Kazakhstan

INFLATION REPORT

June 2019

Almaty, Kazakhstan

The **Inflation 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 **15.05.2019**.

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SUMMARY

Since the time of release of the previous Inflation Report in March 2019, the National Bank has made two decisions regarding the base rate. In April 2019, the base rate was reduced to 9.0%, and in June of this year the base rate was retained at the same level with the unchanged band of +/-100 basis points.

In May, the annual inflation accounted for 5.3%, staying in the middle of the target band of 4-6%. The actual dynamics of monthly inflation in February-April was building below the numbers that were anticipated a quarter before as a result of the decline in prices of regulated services. Deceleration of the non-food inflation component was accompanied by the decreasing prices of petroleum products. At the same time, the growth in prices of foodstuffs accelerated given the realization of shocks in the market of meat products, bread and bakery, confectionery products and fish.

In April 2019, the inflation anticipated in 12 months accounted for 4.5%, being below the level of actual inflation and having updated its minimum for all the time of surveys. Deceleration of inflation was driven both by expectations of the population and by the slowing growth of consumer prices. Stabilization of inflation expectations in proximity of this level and their increasing stability in the short term will help to achieve the inflation goal in 2019.

According to the National Bank's assessments, under the baseline scenario which assumes a gradual decline in the price of oil (Brent) in the near term to USD 60 per barrel, in 2019 the annual inflation will be within its target band of 4-6%. As compared to the previous forecast round of February-March 2019, a short-term inflation path was adjusted slightly upwards.

In 2020, there is a probability that risks which have an upward pressure on inflationary processes will be realized. First, the growth in prices of certain foodstuffs is accelerating, and such acceleration may intensify if the supply-side shocks realize. Second, a positive effect from reduction in tariffs of regulated services and gasoline will be exhausted in the medium term. Third, the pro-inflation pressure on the part of consumer demand will persist amidst the growing real cash income of the population. Fourth, the impact of the increase in salaries of the public sector employees from June 1 2019 is taken into account in addition to the raise of minimum wages and reduction in the personal income tax for low-paid employees which is assessed to be within 0.3% of a further inflation boost.

As compared to the previous forecast round, the risk profile was revised. Risks of inflation pressure on the part of domestic demand, fiscal impulse as well as risks associated with the supply-side shocks in certain commodity markets have intensified. Given the anticipated slowdown in the global economy, the risk that the oil price will go down has increased. At the same time, the risk of capital outflow from developing markets has lessened against a milder rhetoric of the US Fed regarding future federal funds rates. Besides, the risk that the external inflation background would deteriorate in view of contemplated disinflation in Russia had subsided.

The output gap will be remaining positive over the forecast horizon owing to the growth in the domestic demand and exports.

In 2019-2020, Kazakhstan's real GDP growth is anticipated to be 3.0-3.5%. The factors which determine the dynamics of economic activity in the near-term and medium-term periods will not be significantly different. In 2019, the consumer demand is expected to grow higher as compared to the previous forecast round as a result of step-up of social support measures on the part of the government. The positive dynamics in the growth of investment activity and exports is expected to persist. The growth of investment activity will be driven by the project implementations in the mining sector. The increase in exports will be related, in the first instance, with the growing exports of metals. Apart from that, the uprise in real government spending will be observed and

will be accompanied by the increase in wages of the public sector employees. In 2020, in the face of more positive expectations about the uprise in exports related to the increase in overall oil extraction volumes, the GDP growth rates will slightly accelerate.

Monetary conditions remain neutral. The base rate in real terms is at a level which ensures that inflation will stay within its target band of 4-6% over the forecast horizon of 2019-2020 and sustainable economic growth rates will be maintained.

The future balance of risks is shifting towards a higher part of the interest rate movements.

I. FORECASTS OF KEY MACROECONOMIC INDICATORS

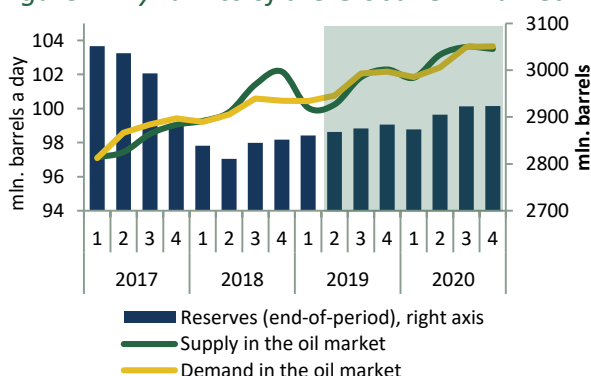
1. External Forecast Assumptions

According to forecasts of the U.S. Energy Information Administration, in 2019 the global oil reserves will be under the pressure of the growing demand and a slower growth of the oil production. In 2020, given high oil prices and the recovering economic situation in some countries the extraction of oil is expected to gradually increase. The global oil market will approach the balance.

In the first quarter of 2019, the global oil reserves decreased, being affected by reduction in oil extraction and its delivery interruptions in some countries, both outside of OPEC¹, and in OPEC member countries² (Figure 1).

As a result of the decreasing reserves, oil prices, after their fall in December 2018, started to recover gradually. In the first quarter of 2019, the price of oil (Brent) made up USD 63.2 per barrel on average during the quarter. In April, the price continued to rise and was USD 71.2 per barrel at the end of the month.

Figure 1. Dynamics of the Global Oil Market

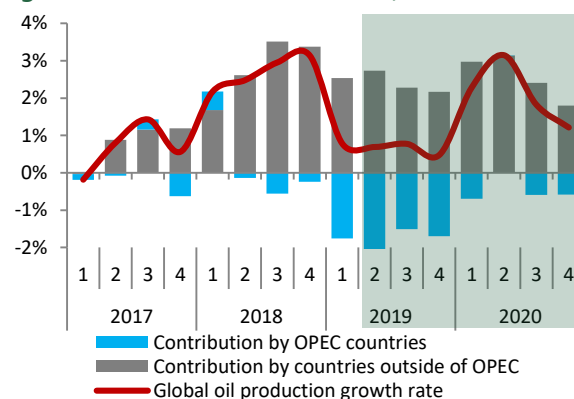


Source: EIA

The growth rates of oil production in 2019 will be slightly slowing as a result of anticipated reduction in production volumes in Venezuela, Iran, Libya, Brazil, Mexico, some European countries and Canada. By

2020, due to the buildup of oil production on the part of the USA, Canada, Saudi Arabia, Russia and other exporting countries, its growth rates will recover (Figure 2).

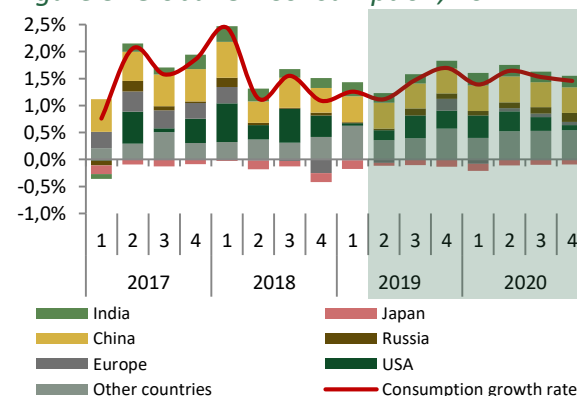
Figure 2. Global Oil Production, YoY



Source: EIA

The global oil consumption will continue to gradually accelerate (Figure 3). China, India and the USA are dominating in the global demand.

Figure 3. Global Oil Consumption, YoY



Source: EIA

Over the forecast horizon, the global oil market will be influenced by factors associated with escalation of trade wars and intensification of global geopolitical risks, by the US sanctions policy against Iran and Venezuela, and by deceleration in oil importing countries. According to the forecasts of international organizations, the price of oil (Brent) in 2019 will be USD 66.7 per barrel on average, and in 2020 it will slightly go up to USD 67.3 per barrel (Table 1).

¹ USA, Canada, the EU countries

² Saudi Arabia, Iran, Venezuela

Table 1. Forecast of the Oil Price (Brent), USD per barrel

| | 2019 | 2020 |
|------------------------|-------------|-------------|
| Thomson Reuters* | 68.5 | 68.1 |
| IMF** | 61.8 | 61.7 |
| World Bank** | 69.0 | 69.0 |
| Bloomberg*** | 67.5 | 70.0 |
| Consensus forecast**** | 66.9 | 67.7 |
| On average | 66.7 | 67.3 |

* The forecast median based on data at 31.04.2019

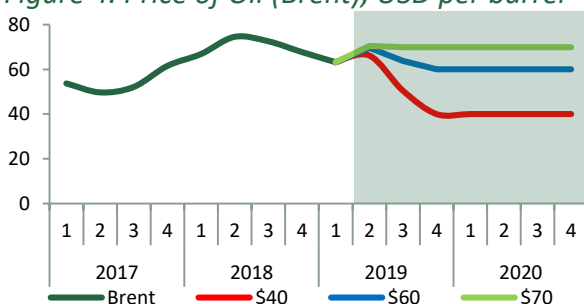
** The IMF's (April 2019) and the World Bank's (January 2019) forecast is based on the averaging of oil price of such oil brands as U.K.Brent, Dubai Fateh, and West Texas Intermediate crude oil

*** The forecast median based on data at 09.04.2019

**** Survey of 15 April 2019

Taking account of the current dynamics of oil prices, forecasts of international organizations and future assumptions in the development of the global oil market, in the context of the "May-June 2019" forecast round for the forecast period from the second quarter of 2019 to the fourth quarter of 2020 the NBRK considered the scenario with an oil price of USD 60 per barrel as the baseline scenario. The optimistic scenario assumes the price of oil to be at USD 70 per barrel, and the pessimistic scenario – USD 40 per barrel (Figure 4).

Figure 4. Price of Oil (Brent), USD per barrel



Source: EIA

1.1 Foreign Economic Situation

The IMF revised its forecasts regarding the global economic growth for 2019 downwards from 3.5% to 3.3%, the forecast for 2020 remained at 3.6%. A slower growth of the global economy is anticipated in connection with deterioration of the growth prospects in the USA and large European economies. The upturn will be supported by an expected acceleration of the economy in

some of developing countries, in China, India, Turkey and Argentina, in the first instance.

Deceleration of the global economy may result in a further slowdown in the growth of the global trade and industry, the decreased business and consumer certainty, an outflow of capital from developing markets followed up by depreciation of currencies of these countries.

The economy in the EU member countries will continue growing at a moderate pace. According to expectations, escalation of trade conflicts as well as a forecasted feeble growth in developing countries, for instance in China, will be hindering the increase in exports, private investment and productivity as a whole. An additional constraining effect will be made by the persisting uncertainty about Brexit, the accruing government debt coupled with a low domestic demand in Italy, a sluggish consumer demand and accelerating unemployment in the Netherlands. The increasing number of the ageing population also will negatively affect the growth prospects of the EU economy. A strong labor market and an anticipated raise of wages will be supporting the uprise of consumer spending and favorable financing terms will be stimulating the investment activity and will be increasing the confidence on the part of the business community. The growing government spending as well as reduction of tax burden in some European countries will provide a significant support to the economy.

The Chinese economy will be gradually slowing its pace but the growth will be still sustainable. The main features of the slowdown include the decrease in private investments, lending and the domestic consumption as well as exports because of the increase in tariffs by the USA. Given a slowing domestic demand and reduced lending, the real estate market will be also characterized by sluggish dynamics.

In order to mitigate the implications, the Chinese authorities began to actively introduce stimulative measures. These

measures are associated with the abatement of value-added tax, contributions to the social security as well as the personal income tax for individuals and corporate entities. Implementation of these measures is expected to compensate the sluggish trade and demand.

Russia's Economy. According to Rosstat's initial assessment, the economic growth rates in the first quarter of 2019 slowed to 0.5% after 2.7% in the previous quarter which represented the maximum since 2012. The major contribution to a slowdown in GDP was made by the reduced economic activity amidst a feeble demand caused by the increased value-added tax as well as by deceleration in the mortgage lending and the persistently low rates of corporate lending.

The NBRK expects that the economic growth rates in Russia in 2019 will account for 1.4% given the implications of the increased VAT rate as well as of the exhausted effect of the time factors of 2018. Meantime, in 2020 a minor acceleration of the GDP growth rates is anticipated which is connected with the foreseeable growth of fixed capital investments. In accordance with the forecasts made by the Russian Ministry of Economic Development, if the baseline scenario is realized, Russia's GDP in 2019 would slow down to 1.3%, and in 2020 it will accelerate to 2% (Figure 5).

Figure 5. Real GDP Growth of China, EU, Russia, YoY



Source: Eurostat, National Bureau of Statistics of China, Rosstat, MED RF, Consensus Ecs., European Commission, NBRK's forecasts

1.2 External Inflation Dynamics

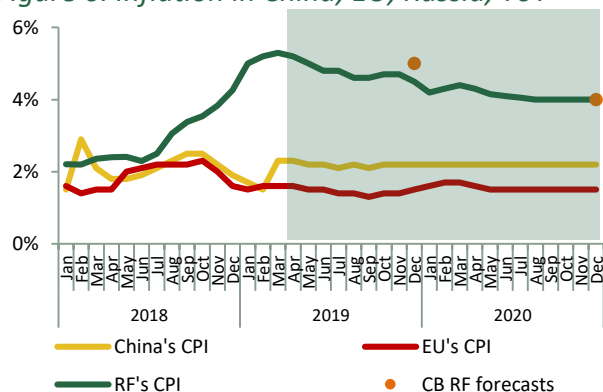
During the forecast period, inflation in the EU and China will be staying within the targets. Inflation in the Russian Federation, after its acceleration in 2019, will start to decelerate by 2020 and will come close to the targeted rate.

Inflation in the EU in 2019 will slow down to 1.3%, which will be reflecting a weak pressure of the aggregate demand and lower energy prices, to a large extent. In 2020, inflation is expected to accelerate to 1.5%.

Inflation in China, after its dramatic acceleration in the first quarter of 2019 because of the growing prices of meat as a result of the swine fever outbreak, will remain approximately the same over the forecast horizon. It is expected that the factor of African swine fever will continue to support the food price growth. Appreciation of some services in terms of prices will remain serving as an additional inflation factor.

Inflation in Russia at the beginning of 2019 continued its acceleration that was caused by the increase in the VAT rate. The peak of price growth was hit in March 2019, when the annual inflation rate reached 5.3%. Actual data on inflation turned out to be below expectations being supported by a more moderate effect of the VAT increase, appreciation of the ruble at the beginning of 2019, as well as stabilization of prices of fuel and lubricants. At present, the effect from the intensified tax burden has been realized to a large extent. The inflation is expected to decelerate further and to attain its targets in the first half of 2020. According to forecast of the Central bank of Russia, inflation in Russia will slow down to 4.7-5.2% at the end of 2019. In 2020, it will gradually decelerate to 4% (Figure 6).

Figure 6. Inflation in China, EU, Russia, YoY



Source: Eurostat, National Bureau of Statistics of China, Rosstat, CB RF, Consensus Ecs., European Commission, NBRK's forecasts

1.3 Monetary Conditions in the External Sector

As compared to the previous forecast round, expectations regarding a further tightening of the monetary policy of central banks of the trading partner countries have significantly slackened.

At its last session, the US Fed retained the interest rate unchanged. Such decision is associated with the fact that the economic growth in the USA and the growth rates of creation of new jobs since the beginning of the year had been above the Fed's forecasts; on the contrary, inflation had been below the forecast. The decision made was also influenced by some signs of improving situation in Europe and China over the recent months. The US Fed's rhetoric in respect of the interest rate behavior in 2019-2020 became more low-key, and the interest rate is expected to remain unchanged over a longer horizon.

Given a slackening growth of the global economy and economies in the EU, the ECB continued to pursue a more adaptive monetary policy. According to the ECB's decision, interest rates will be kept at zero, at least till the end of 2019. The monetary authorities also announced the introduction of new Targeted Long-Term Refinancing Operations (TLTRO). The Program will be in effect from September 2019 to March 2021.

In China, monetary conditions for supporting the economic activity somewhat weakened. In addition to reduction of

minimum reserve requirements for banks, new special purpose instruments are introduced that are aimed to increase lending to small businesses, micro-businesses and private companies. To achieve this goal as well as to replenish the capital of commercial banks, the Central Bank of China launched irredeemable bonds and on-bill financing.

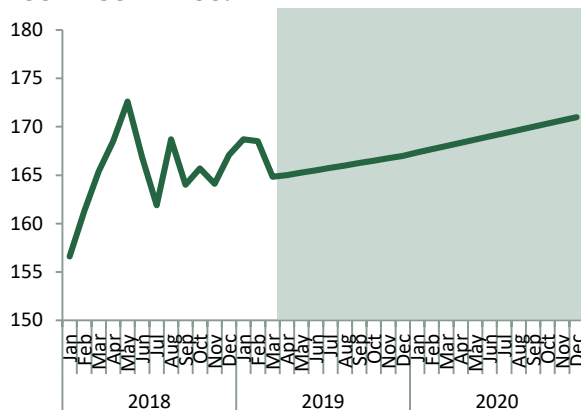
Given that in 2019 the dynamics of inflationary processes in Russia has been below expectations of the Central Bank of Russia, and in 2020 inflation will decelerate to its targets, the CB RF is anticipating a minor easing of monetary conditions in the second-third quarters of 2019, provided there are no shocks and the baseline scenario is realized.

1.4 Commodity Markets

The FAO cereal price index which is a proxy for the food component of inflation, in April 2019 as compared to the same period of the previous year went down by 5%. The decline in the indicator is associated with a large volume of supply and deceleration in trade.

In 2019, the UN Food and Agriculture Organization forecasts the growth in production and consumption. However, the decline in reserves will lead to reduction in the ratio between cereal stocks and their consumption to 30.1% (the lowest ratio over the last five years). In 2019, this will represent one of the main reasons for a minor growth in the price of cereals. It is also worth mentioning that the food consumption of wheat will be in line with rates of the population growth; consequently, restriction on expansion of planted acreage will serve as the factors of a further reduction of cereal stocks. In the medium term, this will significantly affect the growth in world prices of cereals (Figure 7).

Figure 7. FAO Price Index,
2002-2004 = 100%

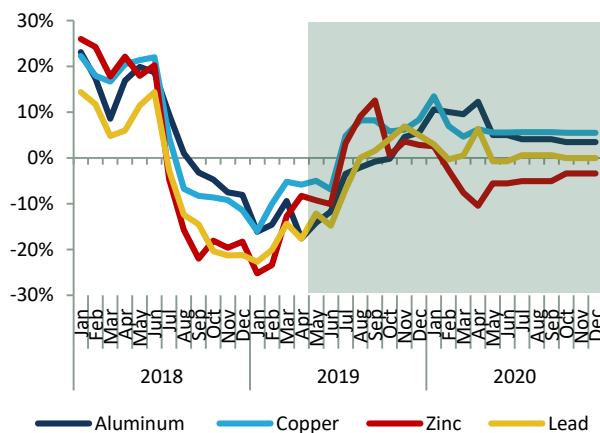


Source: the UN Food and Agriculture Organization (FAO)

Further pricing prospects in the non-ferrous metals market will be depending on the development of trade relations between the USA and China as well as on the production trends. The sanctions policy, foreign exchange movements and the US Fed's monetary policy continue to be of importance.

Throughout the forecast period, relative price stability is anticipated in the non-ferrous metals market (Figure 8). The prices of aluminum, copper and lead are expected to grow from the second half of 2019. In 2020, amidst an overall economic meltdown, prices of these metals will slightly decline but will still keep demonstrating growth. The price of zinc will be going down from the beginning of 2020.

Figure 8. Dynamics of Metal Prices, YoY



Source: Reuters, Consensus Ecs.

2. Development Prospects of the Economic Situation under the Baseline Scenario

2.1 Inflation

In the short term, forecasts regarding food prices were slightly revised upwards. As before, dynamics of prices of paid services will be moderate, having immaterial effect on the buildup of the headline inflation.

In the near term, inflation will be determined both by internal and external factors.

The external inflation background will be outlining against the growth of world food prices. The inflation pressure on the part of inflation in the countries of trading partners somewhat decreased, being predicated by the imminent disinflation process in Russia. The inflation in Russia is expected to decelerate to its targets by mid-2020.

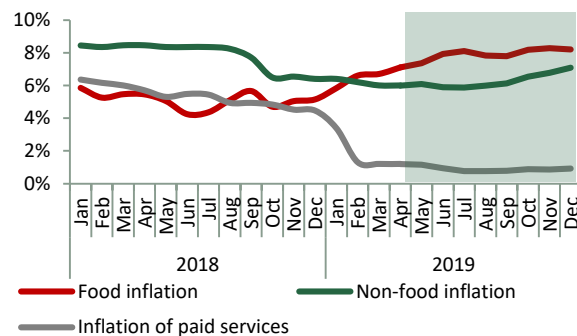
Among internal factors, the expansion of domestic demand stemming from the growth in wages and social expenditures of the state budget should be mentioned.

In case of the supply-side shock in certain food markets (flour, meat, fish, and sugar) which will cause the shortage of goods, the growth in prices of foodstuffs that has been observed since the beginning of 2019 may intensify.

A downward trend in the price of fuel and lubricants against a favorable pricing environment in the global energy markets will be having a constraining effect on the growth of the non-food component in the CPI in the short-term period.

In 2019, the rise in prices of non-regulated services is expected to remain at the existing rates. It is assumed that tariffs for services of natural monopolies, after their decline at the end of 2018 – beginning of 2019, will be kept at a stable level. Therefore, moderate dynamics of prices of regulated services will serve as the main factor for deceleration of inflation of paid services (Figure 9).

Figure 9. Forecast of Inflation Components for 2019, YoY



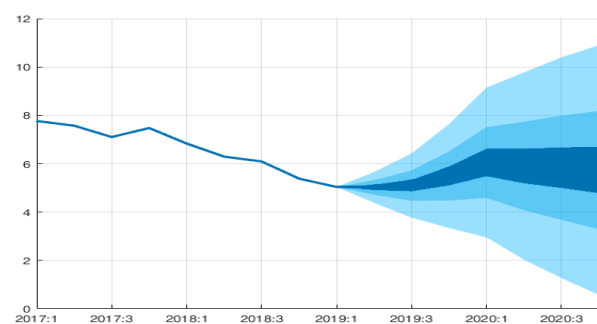
Source: NBRK's forecasts

In the medium term, the consumer demand will be exerting main influence on inflationary processes. Positive dynamics of the household consumer spending is expected to persist given the increasing cash income of the population.

The growing global food inflation of cereals serves as an additional factor affecting the dynamics of inflationary processes in 2020. According to forecasts of the UN Food and Agriculture Organization, in the 2019-2020 agricultural season, world cereal stocks will decrease by 0.7% as compared to the last season in connection with the outstripping growth of consumption over production. Besides, a positive effect from reduction in tariffs for regulated services and gasoline on inflationary processes is expected to be exhausted in the medium term.

Nonetheless, the annual inflation in 2019-2020 will stay within the target band of 4-6% (Figure 10).

Figure 10. Inflation, Quarterly Average, YoY, %



Source: NBRK's forecasts

2.2 Economic Activity

In 2019-2020, Kazakhstan's real GDP growth will account for 3-3.5%; the output gap will be still in a positive zone throughout the forecast horizon due to the increasing domestic demand and supply.

The main driver for the GDP growth in the near term will be the expansion of consumer demand. The household consumption will be demonstrating high growth rates which are associated with the accelerating ramp-up of real cash income of the population as a result of the social support measures (raising minimum wages, abating personal income tax for the low-paid employees, increasing salaries to the public sector employees and the amount of social benefits to the population).

The general government consumption will demonstrate growth against the expanding budget deficit and the low base of 2018 (in 2018 the government spending on consumption went down by 14%). The increase in gross formation will also have a positive influence on the dynamics of economic activity as a result of implementation of the project on future expansion at the TCO and of infrastructure projects.

A constraining effect on the economic growth will be made by the sluggish dynamics of real exports because of reduction in the production of oil and gas condensate. First, Kazakhstan's largest oil fields will be shut down for major overhaul. Second, the need to observe OPEC+ agreements on a daily limit of oil production (for Kazakhstan it is 1 860 thousand barrels or 255 thousand tons) restrains Kazakhstan's capacities in ramping up production (in January and February 2019, the daily output was 259 thousand tons, and in March – 245 thousand tons). Third, the majority of Kazakhstan's oil fields are at the phase of natural depletion, curbing the growth of overall production volumes of petroleum products. In addition, in some EU countries the economic activity at the beginning of 2019 was slowing down reflecting a feeble

demand for exports of Kazakhstani petroleum products.

In 2019, basing on the positive dynamics of consumer and investment demand, imports will be growing having a constraining effect on the GDP growth.

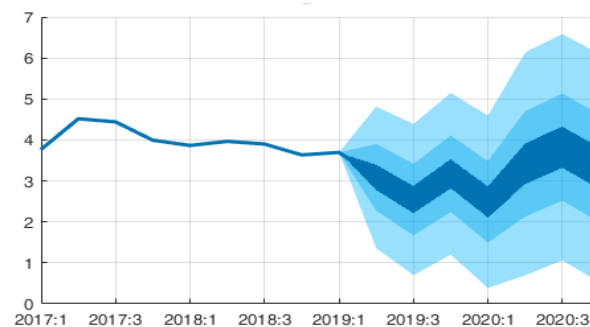
Given the upswing in key economic sectors, the GDP growth by the production method will be also demonstrating positive trends in the near term. The feebler dynamics of the mining industry accompanied by the blackout period at large oil fields in connection with their major overhaul will have a constraining effect on the economic growth. Following the decline in production of oil and gas condensate, more moderate rates of growth in the wholesale trade of petroleum products are anticipated.

The upturn in the manufacturing industry will be accelerating owing to recovery in the metallurgical industry and high growth rates in the engineering sector.

A high growth is expected in the construction sector; mainly, it is related to the construction of a third generation plant in Tengiz oil field, of the “Saryarka” gas pipeline, the Big Almaty Ring Road, an integrated gas and chemical complex in Atyrau, and construction of residential buildings within the framework of the “7-20-25” residential mortgage program.

In 2020, the consumer demand will continue to expand against the persisting positive dynamics of real cash income of the population. Implementation of major infrastructure projects and projects in the mining sector will help to boost the investment activity. Due to more positive expectations about the uprise of exports associated with the increase in overall oil production volumes as compared to 2019, the GDP growth rates will slightly accelerate (Figure 11).

Figure 11. Dynamics of GDP Growth, YoY, as %, cumulative



Source: NBRK's forecasts

2.3 Fiscal Policy

In the near term, as a result of an upward adjustment of the expenditure side of the budget the national budget deficit will be expanding.

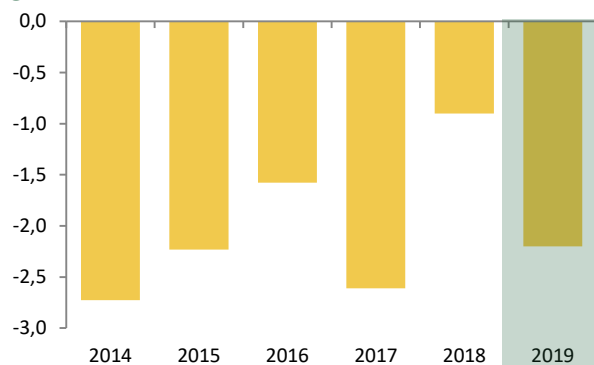
In 2019, the budget revenues will be growing, especially tax revenues as a result of the improved customs administration and the increased proceeds from export customs duties for key export commodities of the country.

An additional impact on expansion of the revenue side of the budget in 2019 will be made by the increase in transfers from the National Fund from the earlier planned KZT 2.45 trln. to KZT 3.07 trln.

The main contribution to the growth in the expenditure side of the budget in 2019 will be made by the increased expenses for social care and social security given the increase in the targeted social support and in the amount of a monthly government parent allowance for a disabled child as well as the increase in salaries of the public sector employees. An additional contribution to the growth will be made by expenditures for healthcare, education, defense, debt service and other items.

The outstripping growth of the expenditure side of the budget over the revenue side will entail the expansion in the budget deficit (Figure 12).

Figure 12. National Budget Deficit, as % of GDP



Source: Kazakhstan's Ministry of Finance, NBRK's forecasts

As a result, the fiscal impulse in 2019 will be positive, which is indicative of the upward pressure on the pricing processes on the part of the budget policy.

2.4 Balance of Payments

In case if oil prices decline smoothly to USD 60 per barrel (the average price in 2018 – USD 71.6), the balance of payments current account deficit of 1.3-1.7% of GDP is expected in 2019. A stable inflow of resources of foreign investors³ is anticipated and, according to the forecast, the impact of the current account on the macroeconomic environment in Kazakhstan is assessed as neutral.

The growth in exports of goods is limited by the expected scenario-based decline in the oil prices; however, such effect will be mitigated by positive expectations on non-oil exports that will be supported by the increased physical volumes of metal supplies (in 2018 the share in exports was 13.9%) and final goods (5.8%). The increasing imports of equipment and component parts needed to implement investment projects in the oil and gas sector as well as the growing payouts of returns to foreign direct investors on joint

investment projects are considered as constraining factors for the current account improvement within the frames of the forecast.

The key risks in the forecast of the balance of payments include a deviation of oil prices and the volumes of oil extraction from the scenario-based assumptions, acceleration of the rates of investment project implementations as well as the dividend policy of large enterprises in respect of accrual of returns to foreign direct investors.

2.5 Risks in the Medium Term

As compared to the previous forecast round, the balance of risks has undergone minor changes. A mitigation of external risks and some intensification of internal pro-inflation risks should be mentioned.

The risk profile as regards external factors has mitigated as a result of the improved external monetary environment and deceleration of external inflation. Revision of anticipated rates of the monetary policy tightening by the US Fed and by central banks of other developed countries reduced the risks of capital outflows from developing markets. The external inflation pressure is slowing down given deceleration of inflation in Russia and the persistently moderate rates of consumer price growth in China and in the EU member countries.

As compared to the previous forecast round, the assessment of risks of the world food price rise remained unchanged but remains high because of the outstripping growth rates of global consumption over production and reduction in stocks.

Risks of uncertainty about a further behavior of oil prices and their possible decline to USD 40 per barrel remain moderate. They are determined by a potential escalation of trade disputes between the USA and China and by expected global economic slowdown as well as by the increase in oil production in the USA and hidden oil exports from Iran.

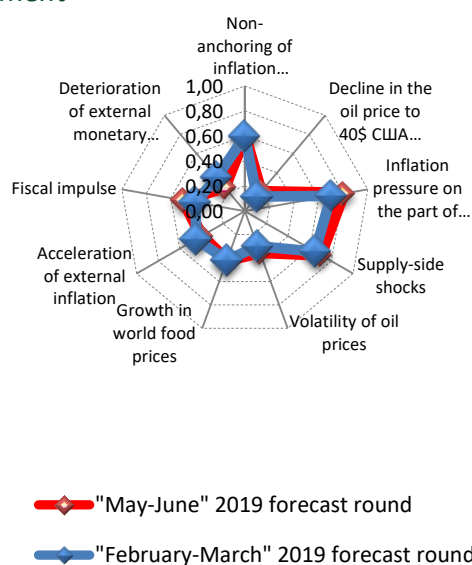
³ FGP/WPMP; "Saryarka" gas pipeline; major overhaul at TCO, Kashgan and KPO oil fields; establishment of special pints of quantitative and qualitative control of petroleum products at oil refineries; investments into KPO (KGDBN, KEP); Integrated Gas and Chemical Complex in Atyrau jointly with Borealis; BAKAD; LRT in Nur-Sultan city; renewal and upgrade of the flying stock at "Air Astana" and "Fly Arystan", etc.

On the part of internal factors, inflation risks are intensifying as a result of acceleration of the consumer and investment demand and the growth in the budget spending. Such risks are stemming from the rise in real cash income of the population and from expansion of social support measures on the part of the government (increasing minimum wages, abating the personal income tax for the low-paid employees, raising salaries to the public sector employees, uprising the social benefit payments to the population).

Risks of supply-side shocks in certain commodity markets remain high due to a significant portion of the import component in the structure of consumer goods. A possible recovery of the price dynamics for regulated services may put pressure on inflationary processes.

The assessment of risk of non-anchoring of inflation expectations has not changed. Nonetheless, the inertia of inflation expectations and their sensitivity to the rise in prices of certain goods and services and the dynamics of the exchange rate of the tenge still represent the risk factors for achieving a low and steady inflation (Figure 13).

Figure 13. Risk Map Based on the Expert Judgment



Source: NBRK's calculations

II. ANALYSIS OF THE EXISTING SITUATION

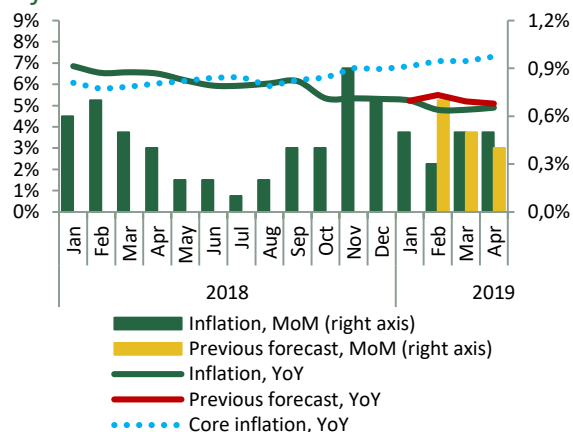
1. Pricing

1.1 Inflationary Processes

Based on performance in January- April 2019, the inflation was building below the forecasts; this was largely associated with a significant cut in prices of regulated services in February 2019 (Figure 14).

The major reassessment of inflation took place in February when the monthly inflation had been at 0.3%, whereas the forecast was 0.7%. Such a low inflation rate in that month had not been observed since February 2002, and on average from 2010 inflation in February accounted for 0.9%.

Figure 14. Dynamics of Actual and Forecasted Inflation

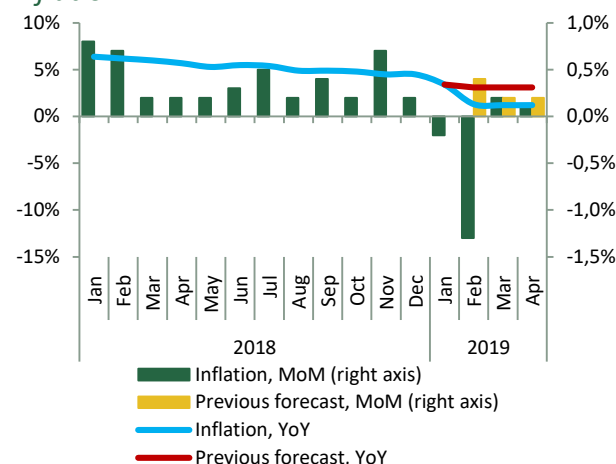


Core inflation excl. the growth in prices of fruits and vegetables, regulated services and energy resources.

Source: CS MNE, NBRK's forecasts

Moderate inflation growth rates in February 2019 are explained by a positive shock of the service component when prices and tariffs for services of natural monopolies declined. In general, tariffs for paid services decreased by 1.3%, which represented the maximum reduction in tariffs for paid services throughout the historical sample (Figure 15). This was the main reason for the overall deceleration of the annual inflation. In April 2019 the annual inflation accounted for 4.9% (in December 2018 – 5.3%).

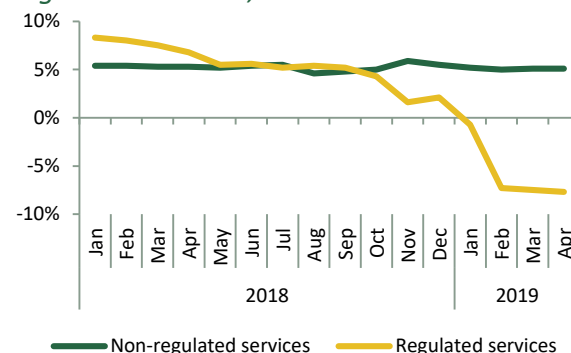
Figure 15. Actual and Forecasted Service Inflation



Source: CS MNE, NBRK's forecasts

The growth in prices of paid services in February 2019 was assessed at 0.4%. Taking account of the planned reduction in tariffs for regulated services and yet without precise data about parameters of such reduction, a zero change in the cost of regulated services was incorporated into the forecast. Meantime, actual monopolist prices in February 2019 declined by 5.2%, which is in line with the annual decrease in tariffs for regulated services by 7.3% (Figure 16).

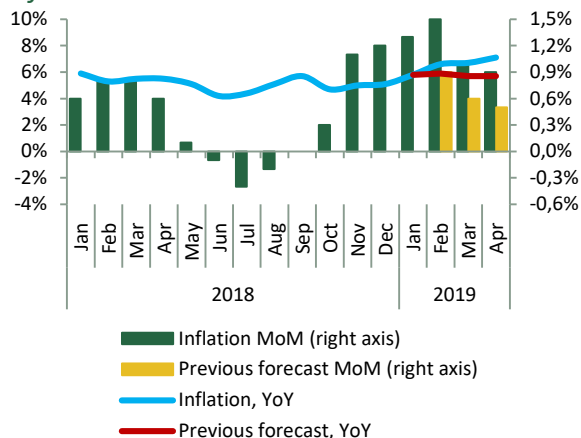
Figure 16. Dynamics of Regulated and Non-regulated Services, YoY



Source: CS MNE

Prices of foodstuffs in January-April 2019 were growing faster than predicted (Figure 17). The main reason for such dynamics have been the occurrence of shocks in the market of meat, bread and bakery, confectionery and fish products as well as the shift in the price seasonality of fruit and vegetable production given a rich harvest of 2018.

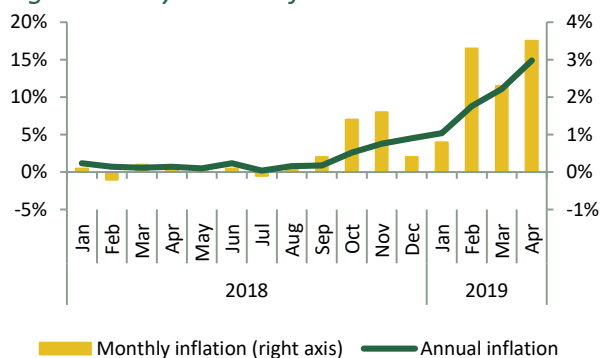
Figure 17. Actual and Forecasted Food Inflation



Source: CS MNE, NBRK's forecasts

Given the rising world cereal prices, the export volumes of wheat in Kazakhstan increased; this provoked the growth in prices of wheat. As a consequence, there was an increase in prices of flour (the growth in January-April accounted for 10.2%) and bread and bakery (bread – by 7.2%, macaroni products – by 5.4%, bakery and pastry – by 3.3%) in the domestic consumer market (Figure 18).

Figure 18. Dynamics of Flour Prices



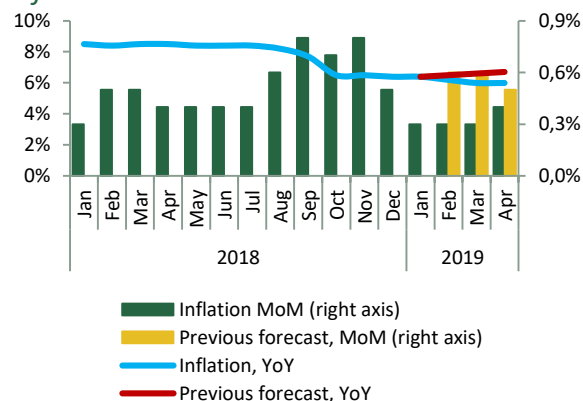
Source: CS MNE

During the first months of 2019, exports of meat increased considerably, especially meat of cattle and lamb (mainly exports to Iran). According to the data from resources and use of products of the manufacturing industry the sales of meat and meat products in the domestic market in January-March 2019 as compared to the same period of 2018 reduced by 7.9%; this was associated with the concurrent growth in exports by 33.2% and the decrease in imports by 50.3%.

As a result, the rise in prices of meat products began to gradually accelerate and that was observed in April 2019. In general, during January-April 2019, prices of beef increased by 1.6%, and prices of lamb – by 3.4%.

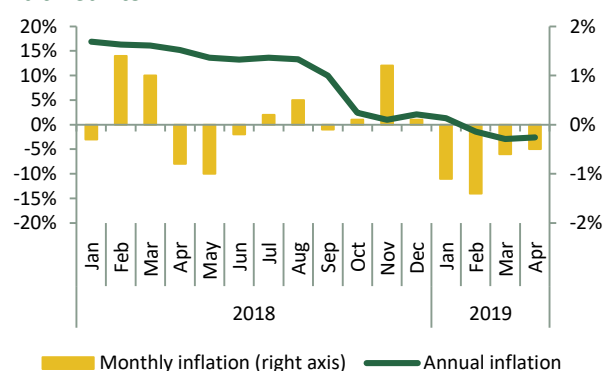
In February-April 2019, prices of non-food products were growing at a slower pace versus their forecasts (Figure 19). A continuing decline in the price of gasoline was heightened by reduction in the cost of diesel fuel after a steady growth in prices of this type of fuel. This appeared to be the factor for deceleration of the non-food component of inflation exerting direct and indirect influence on curbing the overall price growth (Figure 20).

Figure 19. Actual and Forecasted Non-Food Inflation



Source: CS MNE, NBRK's forecasts

Figure 20. Dynamics of Prices of Fuel and Lubricants



Source: CS MNE

Box 1. Dynamics of the seasonally adjusted inflation

The seasonality is an integral part of virtually any type of the time series which represents patterns that are regularly repeated from year to year. The presence of a seasonal pattern is related to the impact of a number of factors such as the time of the year, climatic conditions, days off and holidays.

An integral part of the data analysis is to identify and partial out the seasonal factor since the presence of seasonality in the time series may lead to false outcomes as well as imaginary dependence in designing econometric models. With a view to perform a seasonal adjustment, in many cases two of the most popular tools are used: X-11 (US Sensus Bureau) and TRAMO/SEATS (Bank of Spain) family.

When doing the seasonal adjustment of time series which consist of a large number of sub-components, a question may arise – how to perform a seasonal adjustment of the aggregated index. There are two methods of seasonal adjustment: direct and indirect. The direct method involves the partialling out of the seasonal factor directly from the aggregated index, which may result in a wrong de-seasonalization due to a different seasonality of composite components. De-seasonalization by the indirect method implies a separate adjustment of each component and their subsequent aggregation into the general index. The advantage of indirect method is related to a more precise assessment and partialling out of the seasonal factor.

Hence, in order to ensure a better insight into the current trends in inflationary processes, de-seasonalization was applied in respect of a monthly inflation indicator on 316 individual goods and groups of goods that is based on the indirect method (Diagram 1). Disaggregation by individual goods and groups of goods is in line with statistical test requirements and also ensures stable dynamics of the seasonal factor inflation. In doing so, an X-11 family approach is used as a de-seasonalization tool.

In April 2019, the monthly inflation rate was 0.5%; with a seasonal adjustment it equals 0.6%. At present, inflationary processes are accelerating under the impact of rising prices of some foodstuffs (meat, confectionary products and bread and bakery and fish). The contribution of

these products to the seasonally-smoothed inflation in April 2019 made up 0.3 pp (the average contribution of these groups of goods from 2011 to 2018 in April was 0.1 pp). If one assumes that the dynamics of prices of the above goods corresponded to the average historical values, the seasonally-smoothed inflation would make up 0.4 %.

Diagram 1. Dynamics of the Monthly Inflation Indicator



Source: NBRK's calculations, CS MNE

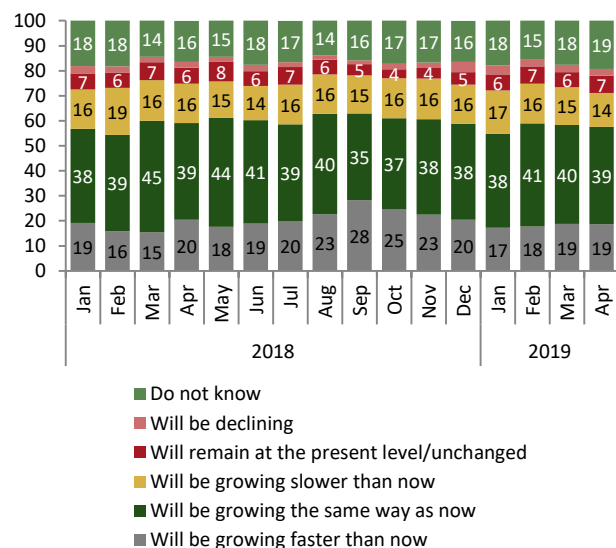
1.2 Inflation Expectations

In the first quarter of 2019, inflation expectations had locked up at the level of the end of the last year. Quantitative assessment of expected inflation continues to go down against the backdrop of low expectations of respondents and deceleration of the actual annual inflation. Perceived inflation retains its downward trend having reached the minimum at the end of this April.

Based on the public poll outcomes, the major percentage of respondents (39% in April) anticipates that inflation rates will persist. Along with that, the percentage of respondents who anticipate the decline in the price growth rates exceeds the percentage of those who expect that inflation will accelerate (23% versus 19% in April). Thus, responses of the interviewed were distributed in favor of a minor deceleration of expected inflation as compared to its present rate (Figure 21).

Figure 21. Assessment of the Price Growth in a Year

In your opinion, how much generally will prices of foodstuffs, non-food products and services change in the next 12 months?



Source: GfK Kazakhstan

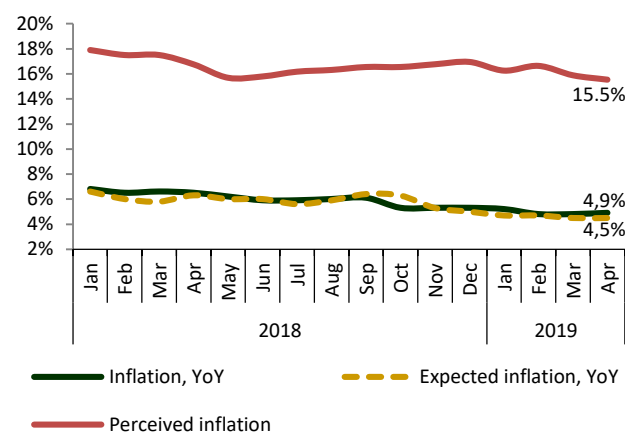
A quantitative assessment of inflation expected in one year⁴ at end-April 2019

⁴ The Methodology for calculating the quantification of inflation expectations is posted on the official Internet

made up 4.5% (Figure 22), being below the level of actual annual inflation and hitting a fresh all-time low. Its decline is determined both by expectations of the population and deceleration of actual annual inflation.

The downward trend of perceived inflation⁵ which is building up based on the subjective basket of goods of an individual had recovered after the growth at the end of the last year. The perceived inflation rate reached the minimum of 15.5% at the end of April. Therefore, a long-term downward trend of this indicator is persisting (Figure 22).

Figure 22. Expected and Perceived Inflation



Source: CS MNE PK, GfK Kazakhstan

2. Development of the Domestic Economy

2.1 Domestic Demand

In 2018, the growth of Kazakhstan's economy was accompanied by acceleration of export, expansion of consumer demand and the growth of investment activity. The increased imports and reduced general government consumption appeared to be the constraining factors.

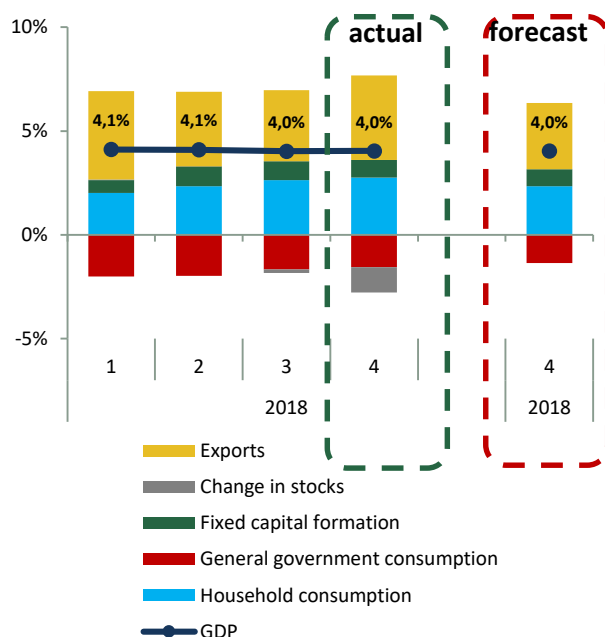
The growth of GDP by the final use method in 2018 was expected to be at 4.0%, thus corresponding to the actual GDP growth (Figure 23). Estimates regarding the

resource of the National Bank in the "Monetary Policy"- "Inflation and Inflation Expectations" Section

⁵ The median of the results of answers to the question "In your opinion, how much have prices of foodstuffs, non-food products and services grown over the past 12 months?" is used as perceived inflation.

consumer demand, general government spending and imports have proven to be the most precise. A more conservative forecast of the real exports offset the negative contribution of gross formation.

Figure 23. Actual and Forecasted GDP by the Final Consumption Method. GDP Decomposition Broken Down by Component Contributions, YoY, cumulative



Source: CS MNE, NBRK's forecasts

All assumptions included in the forecast of household spending, imports and general government spending have realized. As a result, the forecasts matched the actual data on the GDP growth almost in full.

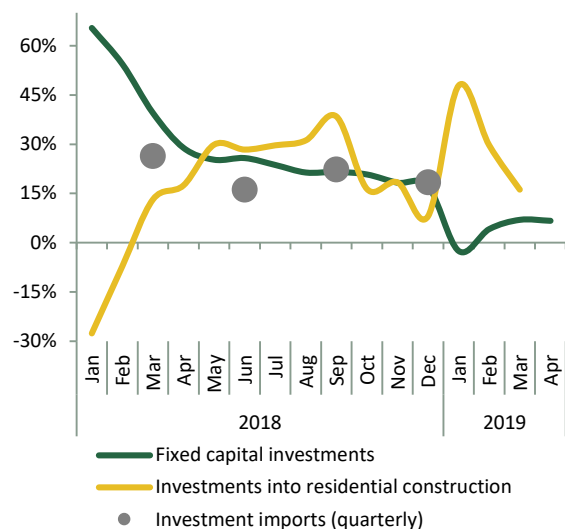
In 2018, real exports increased by 11.5%, with the forecast of 9%. Oil and gas condensate are still the main export commodities of Kazakhstan (their share in total exports in 2018 accounted for 68.6%), and their volumes are the key factor for exports. In 2018, 90.3 million tons of oil and gas condensate were extracted: this was completely in line with assumptions factored into the forecast (90 million tons). The main reason for discrepancies between the actual values and forecasts about the growth in exports appeared to be a lower price of oil included into the baseline scenario, USD 60

per barrel with the actual price of USD 71.1 per barrel in 2018.

In 2018, the investment activity in the economy was fading out. So, if in January 2018 fixed capital investments increased by 65.4%, at the end of 2018 their growth slowed to 17.2%. The largest deceleration was observed in the mining and manufacturing industry, in transport, and construction. Despite deceleration in the investment activity, its pace remained quite high thus furthering the growth of the gross fixed capital formation by 3.9% in 2018 (NBRK's forecasts – the growth by 3.6%). Meantime, in 2018 inventories decreased dramatically and significantly. The largest disposal of inventories was observed (in nominal terms) in the transport sector, construction, agriculture. As a result, a negative contribution from reduction in inventories exceeded the positive contribution made by fixed capital formation to the GDP growth, which was the main reason for the 1.3% decline in gross formation, with the forecasted growth of 3%.

During the first months of 2019, the growth rates of investment activity as compared to 2018 slowed down (Figure 24). The main reason for deceleration was curtailment of investments in the manufacturing industry given the completion of major overhaul at the Shymkent oil refinery. Projects in the mining sector (construction of the third generation plant at the TCO, major overhauls at oil and gas fields) still serve as the driver for the growth in fixed capital investments. In 2019, there was also an increase in investments into construction (40.7%), professional, scientific and technical activities (more than two-fold increase), information and communication (24.2%); however, the share of these sectors in investments remain low. Traditionally, a large portion of fixed capital investments was funneled to the industry (68%).

Figure 24. Investment Activity Performance, YoY, cumulative



Source: CS MNE

Investments into residential construction at end-January 2019 demonstrated a high growth of 47.9%, which was partly related to significant cut in investments in January 2018. In general, at the end of the first quarter of 2019, growth rates of investments into residential construction slowed to 16%. The growth in investments was observed in all regions except Western Kazakhstan (the drop of 18.9%), Karaganda (by 12.3%) and Kostanai (by 34.6%) regions as well as in Nur-Sultan city (by 32.5%). Positive features are observed in such regions as Atyrau and Eastern Kazakhstan regions where investments into residential construction showed a more than two-fold growth.

Box 2. Factors Affecting the Consumer Demand in Kazakhstan

in many countries, including Kazakhstan, the household spending on final consumption accounts for a significant share in the GDP structure. So, according to the data of the CS MNE, at the end of 2018 the share of the household spending on final consumption in the GDP structure made up 51.6%. Thus, the consumer demand is an important factor which influences the dynamics of economic activity.

In order to identify a long-term correlation between the consumer demand and certain macroeconomic variables, co-integration equations have been designed and analyzed (Table 1). Variables were divided into the following categories: indicators of the real and financial sector, the budget sector and external sector, the labor market as well as inflation and the population size.

Table 1. Consumer Demand Factors and their Categories

| Category | Item |
|--|---|
| Real sector performance | Gross domestic product Gross formation Fixed capital investments Profitability of all enterprises in the economy Income from sales of enterprises |
| Financial performance | TONIA in real terms Deposits in real terms Retail loans New consumer loans provided |
| Demographic and labor market performance | Number of employees Population Number of the economically active population Payroll Wages in the public sector |
| Living standard criteria | Real cash income Retirement benefit payments |
| Price indices | Inflation |
| Budget sector performance | Transfers from the National Fund of Kazakhstan |
| External sector performance | Nominal exchange rate of the US Dollar against the tenge Real exchange rate of the tenge against ruble Price of oil (Brent) in real terms |

A long-term correlation between the consumer demand and all reviewed macro-indicators was identified, except the size of an economically active population.

A quantitative assessment of impact made on the consumer demand by macroeconomic variables was performed on the basis of analysis of impulse responses built with the help of the vector autoregression model (VAR). The resulting impulse responses demonstrated sensitivity of consumption over time to the majority of reviewed factors. For those variables which mostly affect the consumer demand without lag, factor regression models (OLS) were also assessed with a view to determine the significance of coefficients with explanatory variables. According to obtained assessments, living standard criteria have a significant influence on the household consumer spending. In doing so, changes in real cash income and retirement benefits reflect upon the consumer demand in the same period.

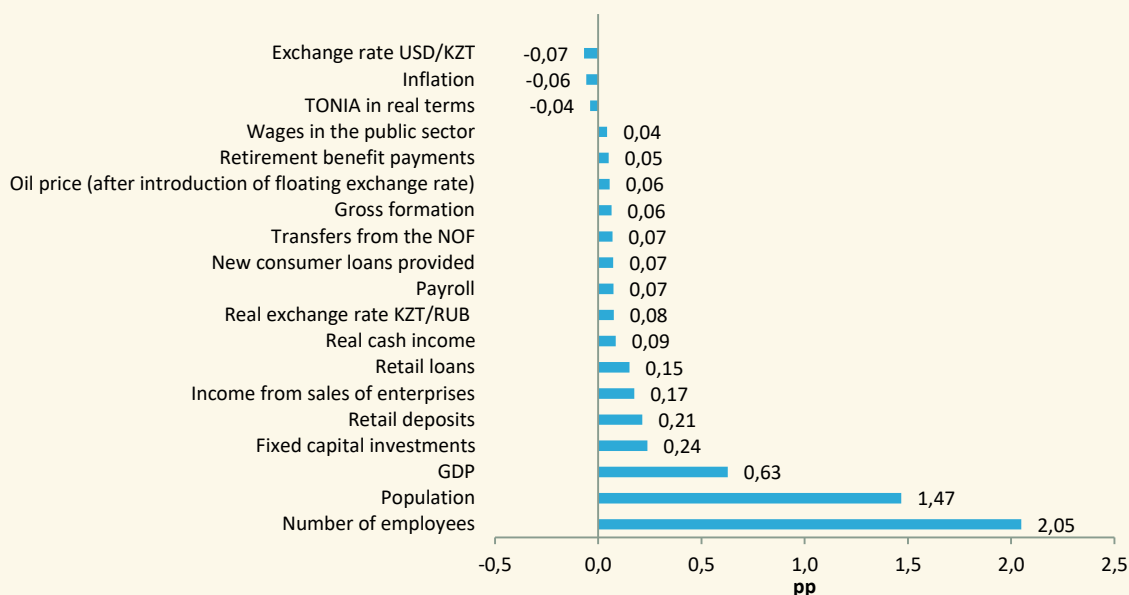
According to the results obtained with the help of impulse response assessments, the consumer demand in Kazakhstan has the largest sensitivity to the change in the number of employees and the population size. The increase in the number of employees due to reduction in the unemployed and self-employed population may affect the household consumer spending since an additional growth in employees may be viewed as a significant improvement in the household welfare. Considerable influence of the population size on the household consumer spending is explained by the fact that the main growth drivers for the population size in Kazakhstan are the increase in the birth rate and a high percentage of the young population in the

overall population structure. This being said, the potential for expansion in the consumer demand for younger generation and children is much larger than for the aged people.

The interbank overnight rate, TONIA, is also an indicator which influences the consumer demand in Kazakhstan. It decreases pro-inflation pressure in the periods when the consumer demand is overheated and ensures balanced growth rates of the business activity and of inflationary processes. A feeble impact of TONIA on the market rates and subsequently on the consumer spending is determined by a poor borrower quality as well as by a high level of risks inherent to the consumer lending.

Among the reviewed external factors, consumption has a low sensitivity to oil shocks after transition to the floating exchange rate regime of the tenge. One of the reasons for such result is the government support measures to the economy which partially offset negative implications of oil shocks. A significant dependence of consumption on transfers from the National (Oil) Fund of Kazakhstan as the tool for smoothing external shocks proves this assertion.

Diagram 1. Accumulated Impulse Response of the Household Consumer Spending (Based on the Two-Year Performance) to a Positive Shock of 1% on the Part of All Reviewed Factors Based on the VAR Model

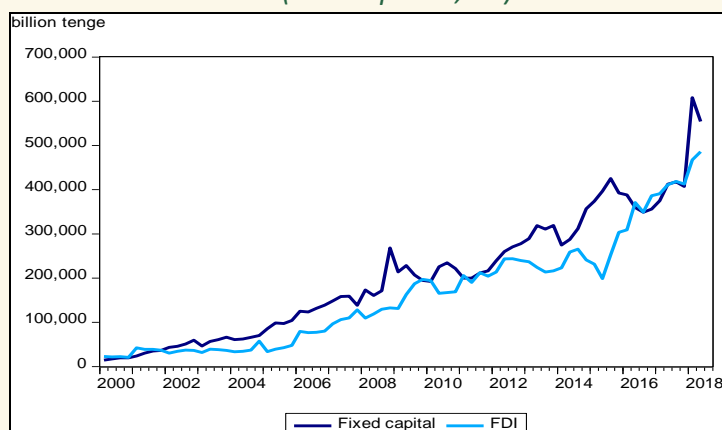


Source: NBRK's calculations

Quantitative assessments of the impact of all reviewed factors on the consumer demand in Kazakhstan are shown on the Diagram. A more detailed description of the outcomes of this effort is presented on the NBRK's Internet-resource at <https://nationalbank.kz/cont/NBRK-WP-2019-2-%20%D1%80%D1%83%D1%811.pdf>

Box 3. Impact of Investments on the Economic Growth in Kazakhstan

Diagram 1. Dynamics of Fixed Capital Investments and FDI (in real prices, SA)



Source: NBRK, CS MNE

KZT bln. Fixed capital investments; FDI

According to the accelerator principle, at favorable phases of the economic cycle the real GDP growth results in the expansion of real investments; this, in turn, leads to reciprocal increase in the gross output. The elasticity of economic growth to the change in investments depends on the macroeconomic and microeconomic policy, public finance, the state of the banking system and other elements of the country's economic environment. In general, investments which include domestic and foreign sources (foreign direct investments – FDI) are the

reason and consequence of the economic growth. In Kazakhstan, volumes of foreign investment are virtually equal to volumes of domestic investments (Diagram 1), and since they are functioning in one and the same environment they cannot but affect each other. Three types of their correlation are described in the economic literature: additive type – absence of relation between investments, synergetic type – complementarity of foreign and domestic investments, displacing type – one type of investments is displaced by the other. The type of interrelation between investments also reflects upon their ultimate influence on the economic growth. In order to determine the extent of interrelation between foreign investments and domestic investments as well as their contribution to Kazakhstan's economic growth, the empirical analysis with the help of panel vector autoregression model (PVAR) was performed.

The result of the econometric analysis showed that investments are significant for the economic growth of Kazakhstan; moreover, the input of FDI is much higher than the input from the fixed capital formation. Also, impact made by FDI is of a longer nature and its positive contribution begins later than that of fixed capital investments. In turn, the inflow of FDI does not displace domestic investments and produces the stimulative effect on fixed capital investments. A separate analysis of impulse responses in each sector showed inhomogeneity of effect made by investments on the output in the sector. A positive contribution on the part of investments is discernible in the oil and gas sector and its related branches. In these sectors, the inflow of FDI encourages the fixed capital formation in the medium- and in the long-term perspectives. But as the government share in the sector increases, the elasticity of aggregate output in the sector to the change in FDI decreases or foreign investments are not important for them in general. In certain sectors, foreign investments displace domestic investments. Based on the sectoral analysis as a whole, one can realize that there are several top-priority sectors in Kazakhstan which attract the largest portion of domestic and foreign investments.

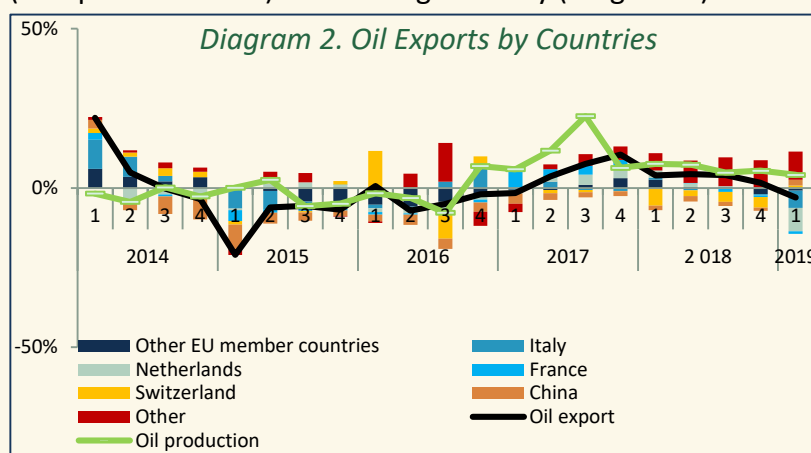
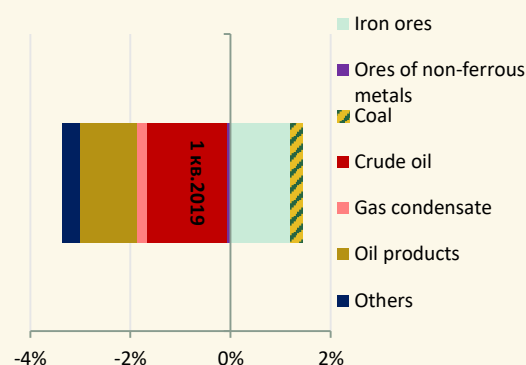
A more detailed description of the outcomes of this effort is presented in the Working Paper of Moldir Samat entitled "An Empirical Assessment of the Effect of Investments on the Economic Growth", Economic Research of the National Bank of Kazakhstan, No.2019-2, March 2019 (<https://nationalbank.kz/cont/NBRK-WP-2019-2>)

Box 4. Exports of Hydrocarbons

In the first quarter of 2019, the positive dynamics was persisting in the mining sector of Kazakhstan. Extraction of ores of non-ferrous metals, natural gas and crude oil increased. Along with that, in the environment of growing volumes of oil production and a favorable pricing in the global energy market, exports of crude oil in the first quarter of 2019 decreased (Diagram 1).

The main consumers of Kazakhstan's oil are the EU member countries (75% of Kazakhstan's total exports of crude oil), namely Italy, the Netherlands, France and Switzerland. In the first quarter of 2019, their demand (except Switzerland) reduced significantly (Diagram 2).

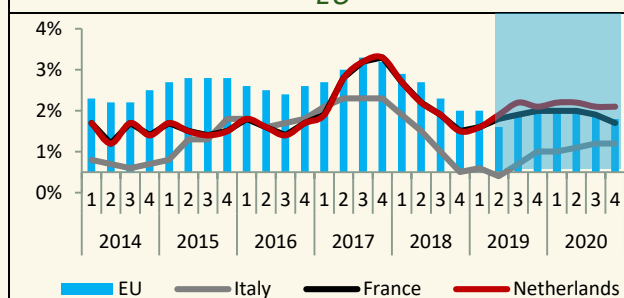
Diagram 1. Exports of Mineral Resources by Inputs in the 1st Quarter of 2019



Reduction in oil consumption by the EU member countries has been observed already since 2018; this is explained by an overall slowdown of economies in these countries as a result of the curtailed production in the industrial sector, trade and exports (Diagram 3, 4). According to the ECB's forecasts, the growth of economies in the EU member countries during 2019-2020 will

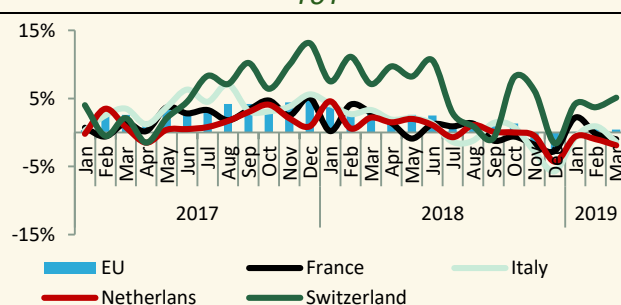
remain rather moderate given a sluggish external demand and low investment performance, which, in turn, may have a negative effect on the dynamics of Kazakhstan's exports.

Diagram 3. Growth Rates of Economies in the EU



Source: Eurostat, ECB

Diagram 4. Dynamics of the Industrial Sector, YoY

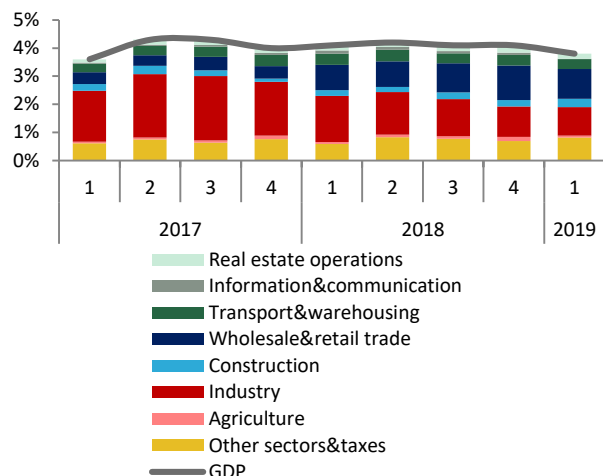


A positive contribution of Kazakhstan's oil to the growth in exports was secured by the accelerating imports on the part of other countries, namely South Korea, India, and Turkey, thus enabling to mitigate a negative effect of the EU member countries. The growth in demand for oil in these countries was partly caused by the US sanctions against Iran. Persistence of such sanctions may continue to exert positive influence on Kazakhstan's exports thus offsetting the anticipated sluggish demand on the part of the EU.

2.2 Domestic Supply

In the first quarter of 2019, the real GDP growth by the production method accounted for 3.8% as compared to the corresponding period of 2018 (Figure 25).

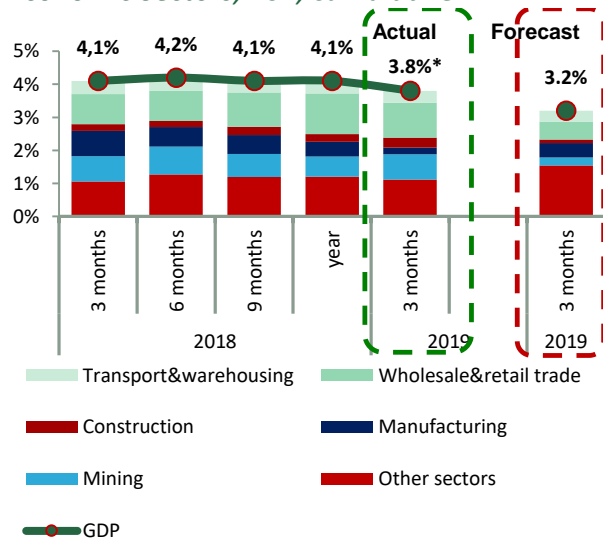
Figure 25. GDP Decomposition. Contribution by Economic Sectors to the GDP Growth, YoY, cumulative



Source: CS MNE, NBRK's calculations

Actual GDP growth exceeded the NBRK's projections by 0.6 pp. This was driven by more positive growth rates in the mining industry, construction and trade. At the same time, growth rates in the manufacturing industry were feeble as compared to the forecast (Figure 26).

Figure 26. Actual and Forecasted GDP by the Production Method. GDP Decomposition by Economic Sectors, YoY, cumulative



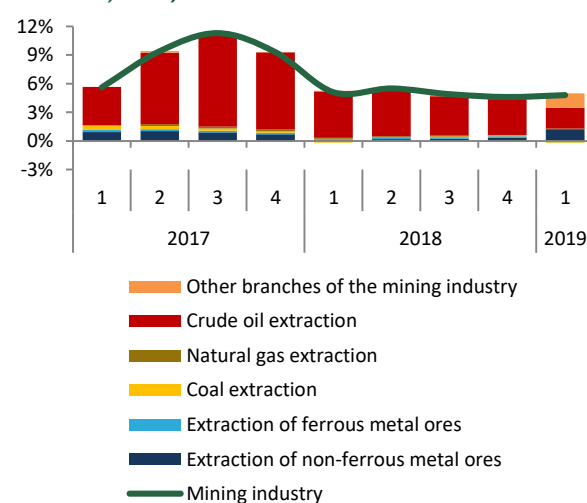
Source: CS MNE, *Estimates

The GDP growth in the first quarter of 2019 was accompanied both by the increase in volumes of production of goods by 3.7%, and services – by 3.7%.

The main contribution was made by branches of the industry owing to the extraction of mineral resources and their processing as well as by wholesale and retail trade, transport and real estate operations.

In the first quarter of 2019, the production expansion in the mining industry accounted for 4.8%, with the forecast of 1.5%. Low projections were associated with the anticipated decline in production of oil and gas condensate in view of the planned shutdown of large fields for major overhaul (Kashagan and TCO) in the first quarter of 2019. All large oil and gas fields in the country were operating at full capacity, oil production was going at an accelerating pace and the growth in the first quarter of 2019 accounted for 2.7% (in January 2019, 8.0 million tons of oil and gas condensate were extracted which is the maximum for the whole time of oil production in Kazakhstan). A positive contribution to expansion in the sector was made by the increase in the production volumes of metal ores, namely ores of non-ferrous metals by 16.3% (Figure 27).

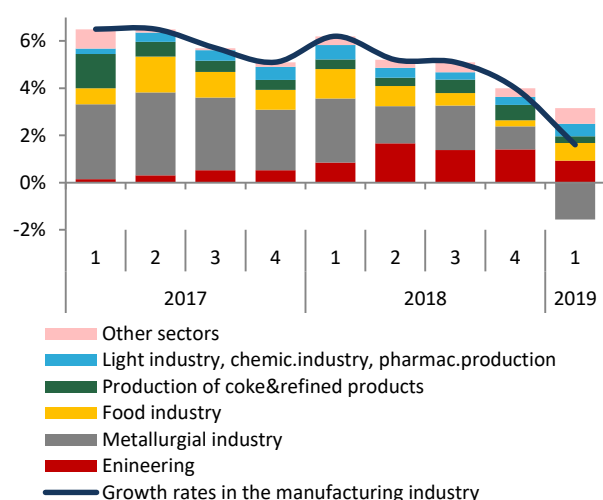
Figure 27. Decomposition of the Mining Industry. Contribution by Sectors to the Growth, YoY, cumulative



Source: CS MNE, NBRK's calculations

The growth in the manufacturing industry in the first quarter of 2019 accounted for 1.6% with the NBRK's forecast of 3.4%. The 3.3% reduction in the production volumes in the metallurgical industry, namely in the production of ferrous metallurgy by 14.2% (in January by 57.1% in Karaganda region) had been the main factor for the slowdown in the sector as compared to previous periods (Figure 28).

Figure 28. Decomposition of the Manufacturing Industry. Contribution to the Growth by Sectors, YoY, cumulative



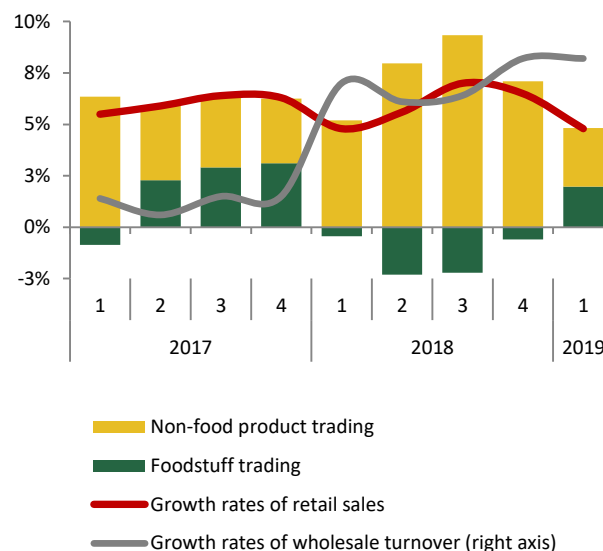
Source: CS MNE, NBRK's calculations

During the first quarter of 2019, production in the construction sector increased by 8.9%. In January-February 2019, the pace of development in the construction sector was generally in line with historical trends and forecasts. In March 2019, the growth rates accelerated significantly (the growth of 15.6%). This is explained by expansion of construction works on engineering structures (oil and gas pipelines), industrial and residential buildings as well as works on development of the country's transport and logistics infrastructure. By regions, the maximum uprise in the volume of construction works is observed in Karaganda, Atyrau and Aktope regions.

In the first quarter of 2019, volumes of trade increased by 7.2%, whereas the NBRK's forecasts were at a lower level. Positive dynamic in the trade sector is determined by

the growth in wholesale and retail trade by 8.2% and 4.8%, respectively (Figure 29).

Figure 29. Growth Structure of Retail Sales and Growth Rates of Wholesale Turnover, YoY, cumulative



Source: CS MNE, NBRK's calculations

The key factor for variance in the actual and forecasted dynamics of wholesale trade have been more conservative expectations regarding the sales of oil and petroleum products associated with the planned suspension of large oil fields for major overhaul (Kashagan and TCO) at the beginning of 2019.

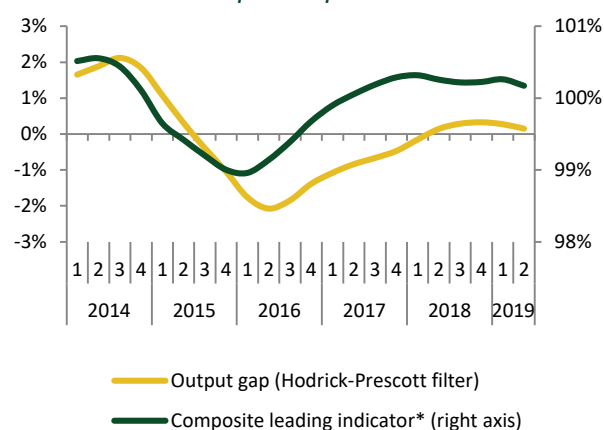
In retail trade, the variance is associated with expansion in the consumer demand, which was accompanied by the growth in sales both of foodstuffs (by 5.4%) and of non-food products (by 4.5%).

The stable dynamics of the real sector development in Kazakhstan is also evidenced by outcomes of the enterprise surveys which are conducted by the NBRK on a quarterly basis. A favorable environment in the global oil market as well as the recovering domestic consumption amidst the growing real cash income have positively reflected upon the demand for final products. The interviewed enterprises (in the industry, agriculture, transport, trade, construction) note the increase in the average return on sales, reduction of the average interest rate on loans received in the tenge. There was an

increase in the percentage of enterprises where the labor productivity has not diminished and in the production volumes and the number of employed.

In the first quarter of 2019, the composite leading indicator, which summarizes the assessment of the existing situation by enterprises participating in the NBRK's surveys, just as the output gap, is in the weakly positive zone. This is an indication of persisting growth of the business activity in the real sector and the existence of a minor pro-inflation pressure in the economy (Figure 30).

Figure 30. Behavior of the Composite Leading Indicator and Output Gap



Source: CS MNE, NBRK, NBRK's calculations

* the calculation of a composite leading indicator based on the OECD methodology

2.3 Labor Market

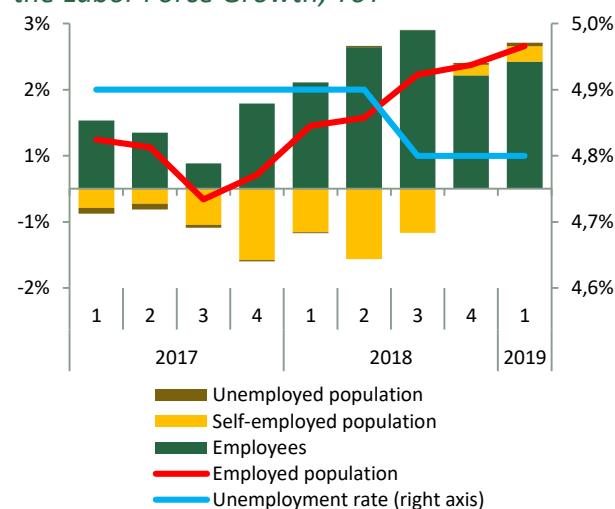
In the first quarter of 2019, the employed population was growing where both employees and the self-employed population increased in terms of their number.

The number of employees continues to grow in the public sector. Among branches of the real sector, a large contribution to the growth in employees was made by such sectors as "trade", "transport", "the manufacturing industry" as well as "construction". Given the accelerating growth in construction, employment in the sector increased for the first time in a long period. The growth in the number of self-employed population that has been observed

since the fourth quarter of 2018, in the first quarter of 2019 retained its pace. This being said, the self-employed population is concentrated in such sectors as agriculture (34.6%), trade (34.4%), transport (10.3%) and construction (6.7%). The growth in the self-employed was accompanied by the increase in the number of productively employed population whereas the number of non-productively employed population continues to go down.

The labor force increased by 2.2%. In its structure, there was an increase in both the unemployed population (by 1.1%) and the employed population (by 2.3%). At the same time, given the outstripping growth rates of the employed population as compared to the unemployed population (Figure 31), the unemployment rate remained at 4.8%. A high unemployment rate is still observed among the population aged 25-34 years old.

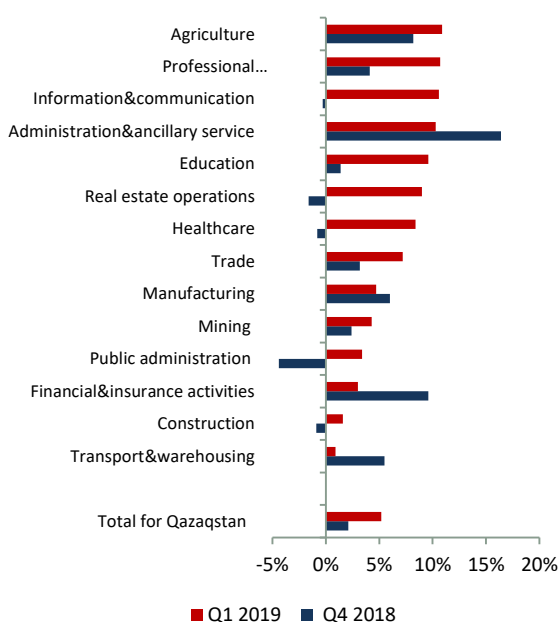
Figure 31. Unemployment Rate, Structure of the Labor Force Growth, YoY



Source: CS MNE

In the first quarter of 2019, real wages increased by 5.2% (Figure 32). Amidst the growing minimum wages, the growth in real wages is observed virtually in all sectors of the economy except accommodation and catering services, arts, entertainment and leisure as well as sectors engaged in providing other services.

Figure 32. Real Wages Broken Down by Sectors, YoY

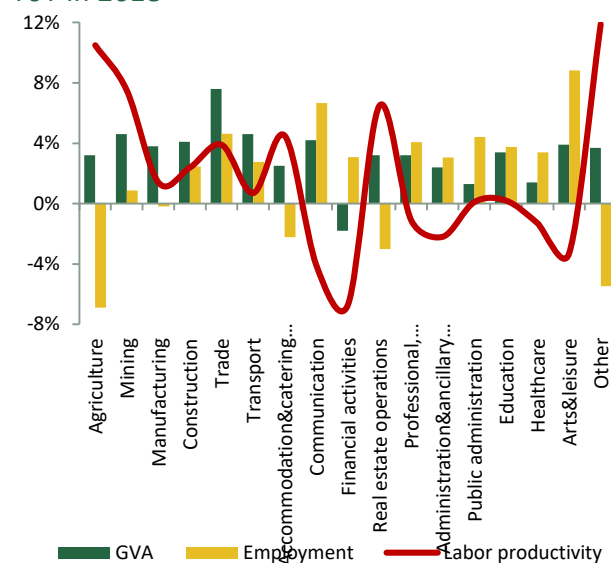


Source: CS MNE

Given that the largest number of employees whose salaries and wages were below KZT 42 000 was concentrated in such sectors as education (19% of employees in this sector), agriculture (14%), public administration (9%), and healthcare (9%), the effect from the increase in minimum wages had the strongest impact on the wage dynamics specifically in these sectors.

Based on performance in 2018, the labor productivity increased by 3.4%, including in the sector of goods production – by 6.8%, and in services production – by 1.6%. A two-digit growth in the labor productivity was recorded in agriculture and sectors of other services amidst the decreasing employment in these sectors. The largest drop in the labor productivity was recorded in the sectors of information and communication, in financial and insurance activities, arts, entertainment and leisure against the outstripping growth rates of employment over the growth rates of the added value in these sectors (Figure 33).

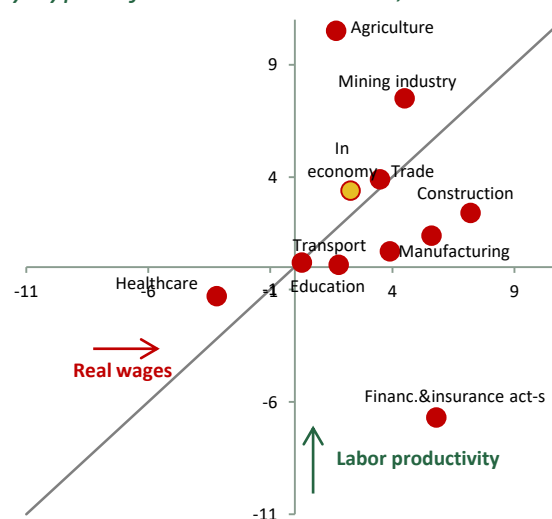
Figure 33. Labor Productivity and Employment by Types of Economic Activities, YoY in 2018



Source: CS MNE

In the economy as a whole, the growth in labor productivity continues to overrun the growth rates of real wages (Figure 34). In particular, the outstripping growth rates of labor productivity as compared to the growth rates of real wages are typical for the mining industry, agriculture, trade and healthcare.

Figure 34. Labor Productivity and Real Wages by Types of Economic Activities, YoY in 2018



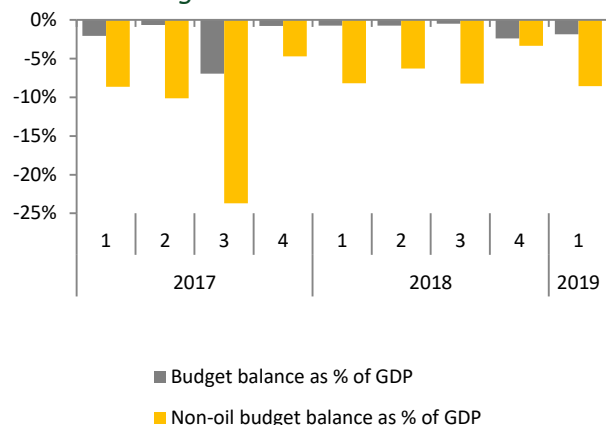
Source: CS MNE

3. Fiscal Policy

In the first quarter of 2019, the national budget revenues went up as compared to the previous quarter and the same quarter of the previous year. However, higher growth rates

of the budget spending fuelled the 2.8 increase in the budget deficit to KZT 240.4 bln. or 1.8% of GDP (Figure 35).

Figure 35. Overall and Non-oil Balance of the National Budget

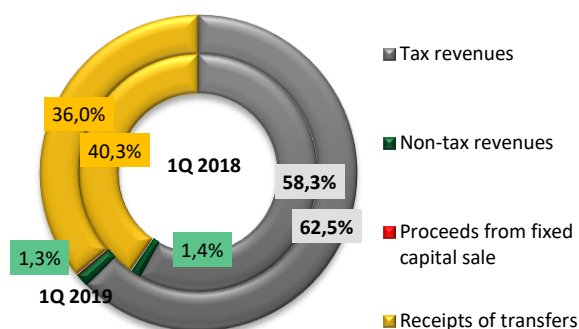


Source: Kazakhstan's Ministry of Finance

The non-oil budget deficit in the first quarter of 2019 made up KZT 1.1 trln. or 8.5% of GDP.

In the first quarter of 2019, the national budget revenues increased by 12.6% as compared to the corresponding period of 2018 and amounted to KZT 2.5 trln. or 18.6% of GDP (Figure 36). Such growth was to a larger extent secured by the rise in non-oil receipts, namely tax revenues which went up by 20.8%.

Figure 36. Structure of the State Budget Revenues



Source: Kazakhstan's Ministry of Finance

A positive influence on the growth in tax revenues to the budget was exerted by the growth in production of goods and services in key sectors of the economy and the rise in prices of key export items as well as by the

increase of the VAT (by 26.9%) and of the corporate income tax (by 19.1%).

In the first quarter of 2019, the national budget spending increased by 17.5% as compared to the first quarter of 2018 and amounted to KZT 2.5 trln. (19.0% of GDP). About a half of all expenditures fell upon expenditures for education (the growth by 49.0%), defense (by 25.5%), social welfare and social security (by 19.6%) and healthcare (by 5.9%).

4. Financial Market

4.1 Money Market

Liquidity surplus in the money market continues to have a downward impact on the cost of borrowing in the tenge. Nonetheless, monetary conditions remain neutral. The National Bank's operations ensure that the operating target is kept within the base rate band. However, there is still a significant spread between interest rates in different segments of the money market that is determined by a high demand for foreign currency liquidity.

De-escalation of risks in the first quarter of 2019 was in many respects ensuring stable quotations in the money market and foreign exchange market. As a consequence, monetary conditions were maintained at a neutral level along with the unchanged base rate. This April, a gradually improving balance of risks enabled the NBRK to reduce the base rate to 9.00%, with an equivalent response of the TONIA rate as an indicator of money market rates.

Monetary conditions remain neutral. The base rate in real terms, i.e. based on the inflation rate anticipated in 12 months was kept close to 3%, thus preserving control over the inflation background.

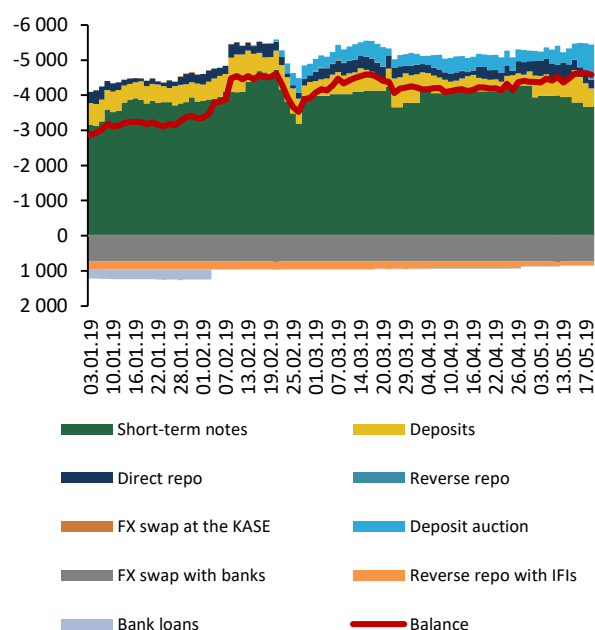
The situation in the money market has been progressing under the impact of the structural liquidity surplus which continues to be withdrawn by the NBRK's operations. The bulk of liquidity is withdrawn via short-term notes with 28-days maturity, direct repo as

well as deposit operations including deposit auctions (Figure 37).

Yields of short-term notes in March – May 2019 were building up close to the base rate level within the range of 8.63-9.00%, which helped to mop up liquidity with a view to limit inflation pressure on the economy on the part of the financial market.

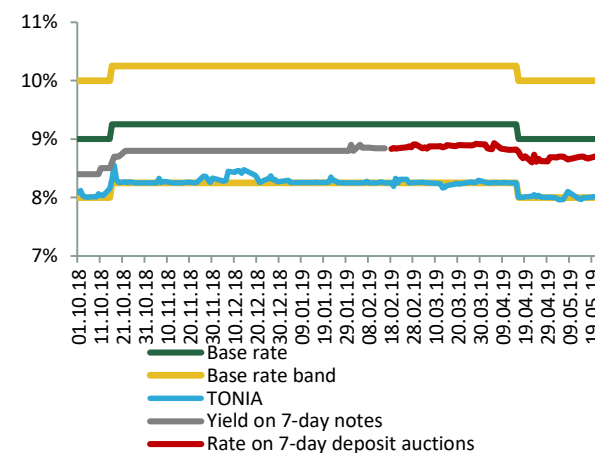
The TONIA rate was setting mainly closer to the lower boundary of the interest rate band (Figure 38).

Figure 37. NBRK's Operations in the Domestic Market (Exposure, KZT bln.)



Source: NBRK

Figure 38. Interest Rate Band and TONIA



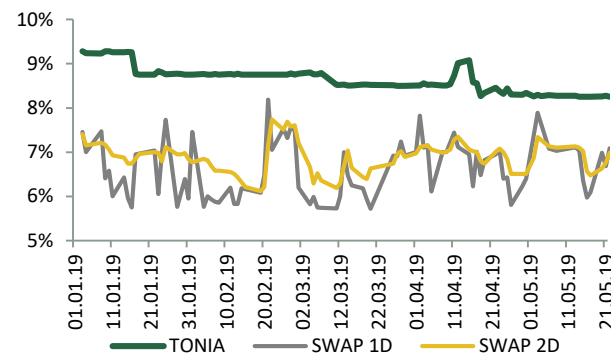
Source: NBRK, KASE

In certain periods, imbalance between the volumes of demand and supply by banks

in the market resulted in a break through the lower boundary of the interest rate band. In other periods, operations with the NBRK's standing facilities secured yields at the lower boundary of the interest rate band.

In the swap market, interest rates were setting under the impact of demand for foreign currency liquidity on the part of certain market participants (Figure 39). Interest rates were staying closer to the lower, "targeted", boundary, the spread between TONIA and SWAP 1D was widening (the maximum spread reached 263 bp).

Figure 39. Dynamics of the Money Market Rates



Source: KASE

The base rate impulse in all segments of the money market is transmitted at comparable levels (close to the lower boundary of the interest rate band). The demand for the tenge liquidity in the money market remains relatively low, which represents one of the factors that constrain effectiveness of the interest rate channel at the present moment.

4.2 Foreign Exchange Market

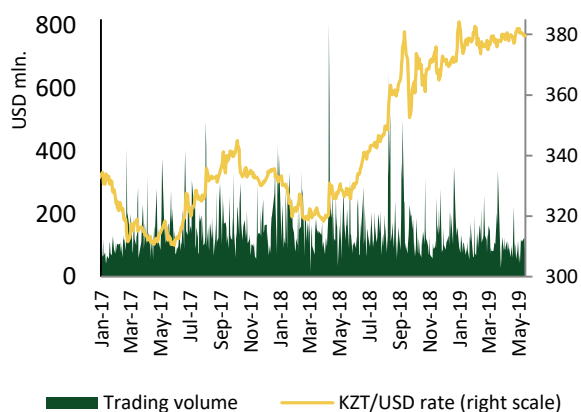
In January-April 2019, the tenge was appreciating given a favorable situation in the global oil market and appreciation of domestic currencies of Kazakhstan's trading partners. The price of oil has risen by 35.3%, and the Russian ruble appreciated by 6.8%.

Despite favorable tendencies in foreign markets, the tenge was demonstrating a feeble appreciation trend because of a low supply of foreign exchange in the environment of persisting demand for

foreign exchange on the part of the market participants.

In January-April, the exchange rate of the tenge against the US Dollar was moving in the range of KZT 373.56 and KZT 382.74 per US Dollar. The difference between the maximum and minimum reached 2.5% on average during the quarter. At the end of April, the stock exchange rate of the tenge against the US Dollar was KZT 381.08 per 1 USD, having appreciated by 0.8% on the year-to-date basis (Figure 40).

Figure 40. Exchange Rate Movements and Trading Volume in the Foreign Exchange Market



Source: KASE

Amidst general reduction of the exchange rate volatility, activity of the foreign exchange market participants somewhat decreased. The overall trading volume of USD/KZT currency pair dropped by 36.4% and amounted to USD 8.8 bln. (in January-April 2018 – USD 13.9 bln.).

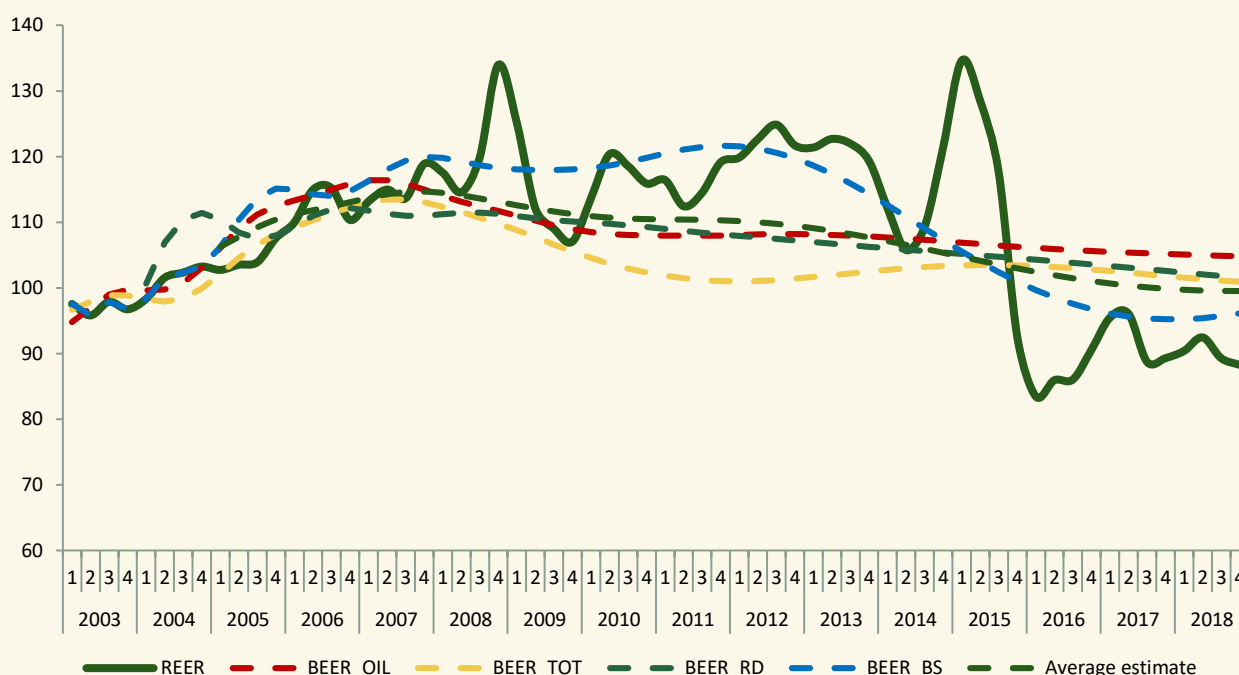
Following the political news about the transfer of power in the country on 20 March 2019, there was frenzy in the foreign exchange market. In order to stabilize the situation, the NBRK conducted foreign currency interventions of USD 304.0 mln. Later, the balance of interventions was restored again and at the end of the first quarter of 2019 the NBRK's net participation in the foreign exchange market was equal to zero.

Box 5. Behavioral Models of the Equilibrium Exchange Rate of the Tenge

In the international practice, deviation of the actual exchange rate from its equilibrium value is an important factor in terms of analysis of imbalances in foreign trade. So, an overestimated exchange rate leads to unsteady deficit of the current account and the risk of speculative attacks on the currency. On the other hand, underestimation of the exchange rate may result in an upward pressure on inflationary processes in the country via the increase in prices of imported goods in the environment of a significant share of foreign goods in the consumer and investment spending of economic agents.

The assessment of equilibrium values of the real effective exchange rate was performed based on key behavioral factors with the use of vector error correction models (VECM) (Diagram 1).

Diagram 1. Dynamics of Actual and Equilibrium REER Values (Q4 2002 = 100)



REER; Mean estimator

where BEER_OIL – equilibrium dynamics of REER on the basis of a model with the price of oil (Brent) as a behavioral factor;

BEER_TOT – equilibrium dynamics of REER on the basis of a model with the terms of trade as a behavioral factor;

BEER_RD – equilibrium dynamics of REER on the basis of a model with the relative demand differential as a behavioral factor;

BEER_BS – equilibrium dynamics of REER on the basis of a model with the wage and labor productivity differentials as behavioral factors (Balassa-Samuelson effect);

BEER_UIP – equilibrium dynamics of REER on the basis of a model with the real interest rates differential as a behavioral factor.

The mean estimator was obtained as a result of a simple averaging of three models: BEER_TOT, BEER_RD и BEER_BS⁶. Proceeding from the obtained results on the basis of fundamental factors, the historical REER dynamics may be divided into 4 periods:

⁶ The BEER_OIL model was not included into the calculation of mean estimator in connection with the fact that the behavioral model on the basis of the terms of trade (BEER_TOT) incorporates the dynamics of oil prices as regards the change in export prices.

1) 1st quarter of 2003 – 2nd quarter of 2008. Over this time interval, the actual REER path, except for certain periods, was at the levels close to the equilibrium ones. Appreciation of the REER over the reviewed time interval was accompanied by the outstripping growth of consumer prices in Kazakhstan as compared to prices in the countries-Kazakhstan's main trading partners;

2) 3rd quarter of 2008 – 1st quarter of 2009. From the second half of 2008, imbalances in foreign trade were intensifying; this is evidenced by the divergent dynamics of actual and equilibrium REER values. Accumulated imbalances resulted in the 25% depreciation of the domestic currency in February 2009, which allowed mitigating imbalances and helping the actual REER to go back towards its equilibrium values;

3) 1st quarter of 2010 – 3rd quarter of 2015. During the reviewed period, the REER was in the zone of revaluation against the equilibrium values (except for the coinciding dynamics of actual and equilibrium REER obtained with the help of BEER_BS), signaling the accumulation of imbalances in foreign trade. In 2015, amidst the transition to the floating exchange rate regime of the tenge and a significant decline in oil prices, a downward path of the actual REER towards its equilibrium values was observed;

4) 4th quarter of 2015 – 4th quarter of 2018. During this time period, the REER was in the underestimation zone relative to equilibrium levels. The main reason for a considerable underestimation of the REER at that time was a significant depreciation of the Russian ruble because of the sanctions imposed by the USA and European countries against Russia. Since Russia is the main trading partner of Kazakhstan, the dynamics of depreciation of the Russian ruble as a result of sanctions led to a similar depreciation of the nominal exchange rate of the tenge against foreign currencies.

Basing on the obtained results, the conclusion was made that the terms of trade have the strongest influence among the reviewed indicators on the equilibrium REER value. A 1% improvement in the terms of trade leads to appreciation of the equilibrium REER by 0.23%. In addition, the relative demand differential and oil prices are the significant variables that affect the equilibrium level of REER. The 1% increase in the differential between relative demand in Kazakhstan and relative demand of Kazakhstan's main trading partners leads to the 0.2% appreciation of the equilibrium REER. The 1% rise in oil quotations in the global primary markets implies the 0.16% appreciation of the equilibrium REER. However, at present the uncovered interest rate parity has a weak impact on the equilibrium REER value. So, the widening of a differential between the domestic interest rate in Kazakhstan in real terms and weighted real rate of its 3 main trading partners by 1 pp results in the 0.06% appreciation of the equilibrium REER.

4.3 Deposit Market

In April 2019, deposits with depository institutions decreased by 1.4% in annual terms or by KZT 237 bln., amounting to KZT 17.1 trln.

The outflow of foreign currency deposits was conducive to reduction in the deposit base (Figure 41). The largest deposit outflow in foreign currency was observed in the corporate segment. On a year-to-date basis, corporate deposits decreased by 30% or by KZT 1.4 trln. Hence, dollarization of the corporate sector accounted for 39.5% in April 2019 (Figure 42).

Figure 41. Contribution by Components to the Growth in the Deposit Volume

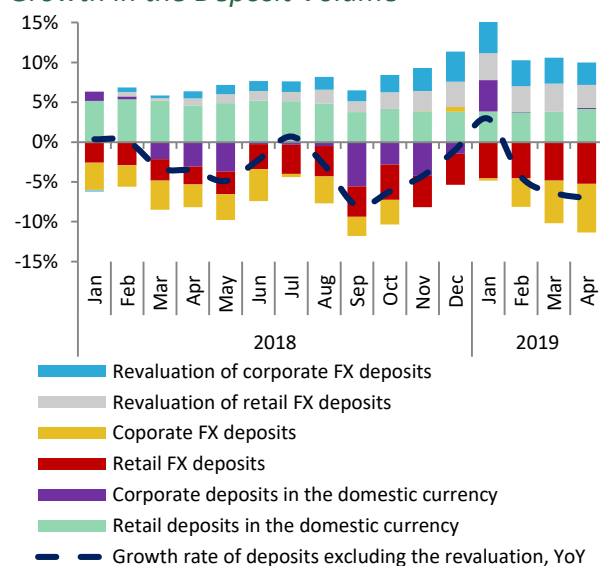
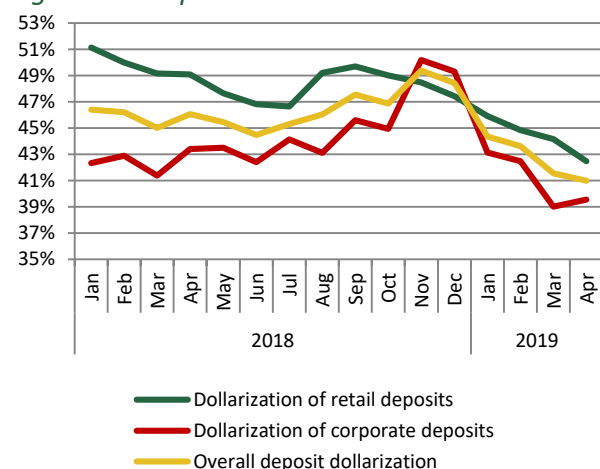


Figure 42. Deposit Dollarization



Dollarization in the retail segment of the deposit market keeps having a steady downward trend. Retail foreign currency deposits decreased by 12.4% or by KZT 508 bln. since the beginning of the year. The share of retail deposits in foreign currency accounted for 42.5%.

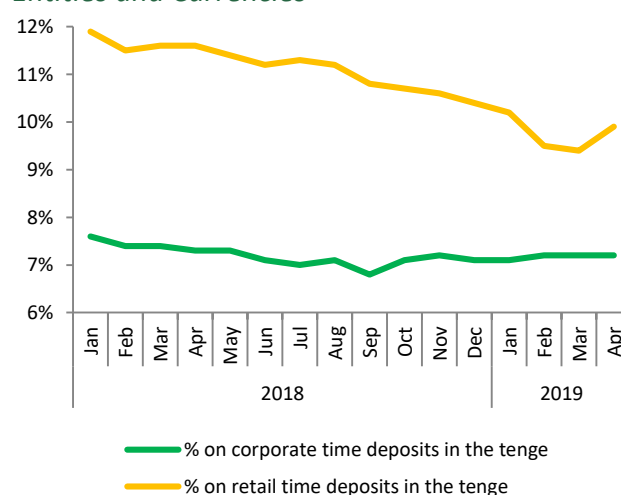
The contribution of retail deposits to the increase in total deposits remains positive: retail deposits increased by KZT 322 bln. or by 7.1% since the beginning of the year.

The growth was also observed in the corporate segment of the deposit market in the domestic currency – by 4.6% or by KZT 229 bln. since the beginning of the year.

Foreign currency revaluation keeps making a positive contribution to the change in the overall deposit volume. Reduction in deposits accounted for 7.1% excluding the effect of foreign currency revaluation.

Interest rates on corporate time deposits in the tenge have been staying at 7.2% since February 2019. The interest rate level on retail deposits in the tenge has been more volatile and has been in the range of 9.5-9.9% since the beginning of 2019 (Figure 43).

Figure 43. Interest Rates on Time Deposits by Entities and Currencies

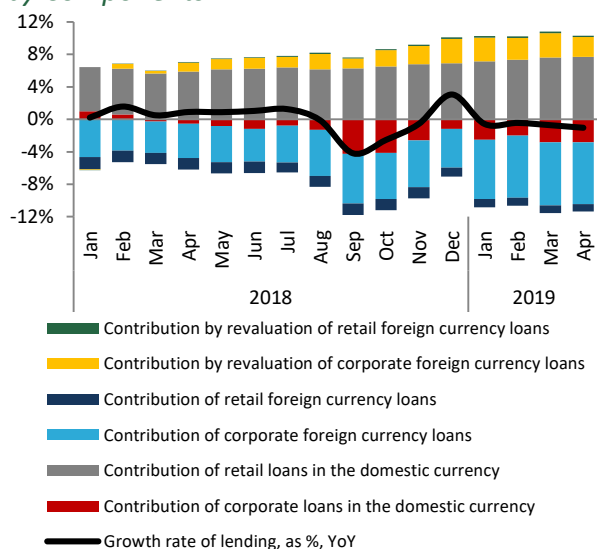


4.4 Credit Market

In January-April 2019, the lending market indicators went down because of the measures for rehabilitation of the banking sector.

In April 2019, the bank loan portfolio decreased by 1.1% in annual terms (Figure 44). This was caused by measures for rehabilitation and write off of a part of the loan portfolio of “Tsesna bank” JSC. As a result, the volume of bank credits to the economy made up KZT 12.6 trln. Excluding those banks whose licenses were revoked or suspended as well as those undergoing the restructuring process, the annual growth of the total loan portfolio of banks in April 2019 accounted for 10.3%.

Figure 44. Contribution to the Loan Growth by Components



Source: NBRK

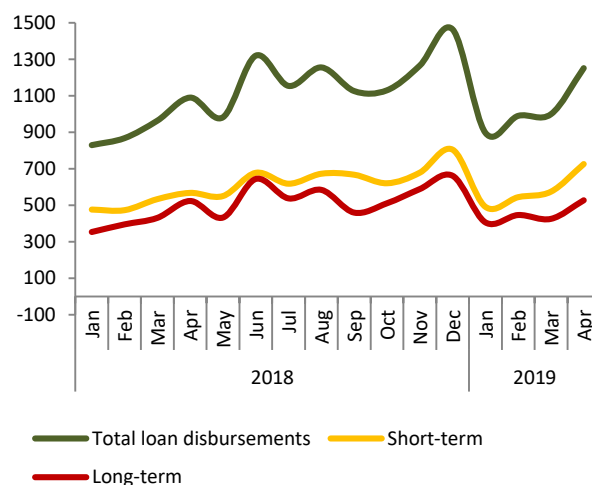
The retail segment (mainly loans for consumer purposes) still represents the factor of the growth in credits to the economy. In April 2019, loans of the retail sector increased by 19.0% or by KZT 882.6 bln. in annual terms, having reached KZT 5.5 trln., and their share in the total loan volume reached the historical maximum – 44.1% in the structure of total credits to the economy.

The loan portfolio in the corporate sector decreased because of liquidation of three banks and rehabilitation of Tsesna bank. In annual terms, loans to the business

reduced by 12.6% or by KZT 1 trln. to KZT 7.0 trln. Despite the fact that the physical volume of corporate loans in foreign currency keeps to follow a downward trend, their foreign currency revaluation makes a positive contribution to the growth in loans amidst depreciation of the exchange rate. This is related to the fact that foreign currency loans of enterprises account for about 1/5 of total bank loans. Excluding the portfolio of banks which are undergoing the restructuring process and are deprived of their licenses (Delta Bank, Bank of Astana, RBK, Qazaq Banki, Excimbank, and Tsesna bank), the annual growth of the loan portfolio to the business accounts for 2.1% or KZT 127.9 bln.

As compared to the last year, disbursement of new loans is gradually increasing (Figure 45).

Figure 45. Provision of New Loans, KZT bln.



Source: NBRK

According to the enterprise poll in the real sector of the economy conducted by the NBRK, in the first quarter of 2019 the demand of enterprises for bank loans somewhat declined given deceleration in the business activity typical for the beginning of the financial year. 19.9% enterprises participating in the NBRK's monitoring survey applied to banks for loans, of which 86.4% of enterprises (17.2% of the total number of respondents participating in the survey) obtained loans. Also, the respondents

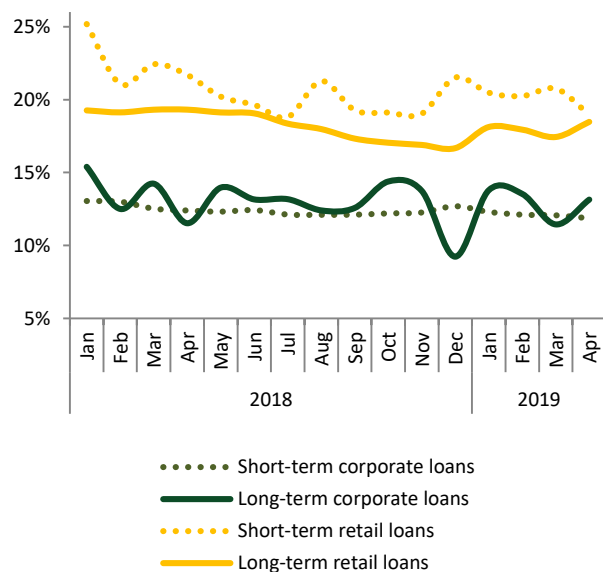
mention that interest rates on loans in the domestic currency are decreasing.

A gradual easing of monetary conditions helps to cheapen the cost of credit resources in the tenge. The interest rate on loans to business in the domestic currency is smoothly going down. The spread between the actual interest rate on loans and the rate which is acceptable for enterprises is narrowing as a consequence of the decreasing average interest rate on loans.

The weighted average interest rate on corporate loans in the domestic currency went down to 12.0% at end-April 2019 (Figure 46).

The interest rate on retail long-term loans is going down based on the easing of terms and conditions of home loans being supported by the “7-20-25” Program.

Figure 46. Interest Rates on Loans in the Domestic Currency



Source: NBRK

Box 6. Impact of Lending on Inflationary Processes

Lending is an integral part of the modern financial system. Disbursement of loans may feed on the economic growth in a country but at the same time excessive lending can cause acceleration of inflationary processes. In 2015 the NBRK moved to a new monetary policy regime – the inflation targeting which implies ensuring the price stability. Therefore, solid understanding of the credit channel functioning through assessment of impact on inflation by the lending processes will help in future in the well-thought decision-making regarding the achievement of inflation goals.

Within the frames of analysis of how loans affect inflationary processes in Kazakhstan, the vector error correction model (VECM) was used to identify a long-term relationship and also the vector autoregression model (VAR) was applied in order to assess a short-term relationship with the help of impulse responses.

According to the model for assessment of long-term relationship, loans in a long-term perspective result in acceleration of inflationary processes in Kazakhstan. Specifically, loans demonstrated a significant relationship with food prices as well as a moderate relationship with prices of non-food products. The impact of loans on service inflation appeared to be insignificant (Table 1).

Table 1. Long-term Elasticity of Inflation in Kazakhstan to the Volume of Disbursed Loans

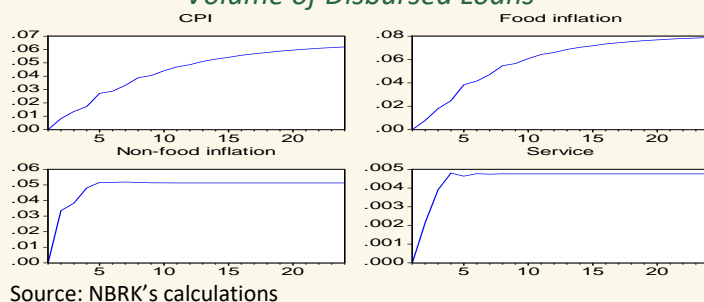
| | |
|------------------------------|------|
| All goods and services (CPI) | 0.08 |
| Foodstuffs | 0.19 |
| Non-food products | 0.04 |
| Services | 0.01 |

in lending volumes in the short run is mild. Specifically, the change in the volume of loans disbursed in the domestic currency has a moderate effect on the food and non-food inflation whereas prices of services demonstrate tepid responses (Diagram 1). Loans to businesses broken down by borrowers showed a more significant relationship as compared to the consumer lending. Lending to businesses has a direct significant impact on final prices of foodstuffs; however, the

drawdown of credit resources by businesses is quite lengthy and, therefore, affects final prices with a certain lag.

At the same time, prices of non-food products are the most sensitive to changes in volumes of the consumer lending. Individuals take loans mainly in order to buy durable goods. To that end, the growth of consumer lending increases the demand on the part of customers, thus bringing up the cost of

Diagram 1. Short-term Cumulative Elasticity of Price Level in Kazakhstan per 1-% Shock of the Monthly Volume of Disbursed Loans



such goods.

A more detailed description of the outcomes of this effort is presented in the Working Paper of Baikulakov Sh., Yerzhan I., entitled "An Assessment of the Effect of Credits to the Economy on Inflationary Processes in Kazakhstan", Economic Research of the National Bank of Kazakhstan, No.2019-5, March 2019 (<https://nationalbank.kz/?docid=3546&switch=russian>).

BASIC TERM AND DEFINITIONS

Core Inflation – means the inflation which excludes transitory uneven price changes subject to certain factors of administrative, event-related and seasonal nature.

Base Rate is a key monetary policy instrument of the National Bank that helps to regulate nominal interbank interest rates in the money market. By setting the level of the base rate, the National Bank determines a target value of the targeted interbank short-term money market rate in order to achieve the goal of ensuring 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 industrial 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 assets; and 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 is an indicator that reflects the market value of all final goods and services (i.e. designated for direct consumption) 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.

Money Base (Reserve Money) includes cash issued in circulation by the National Bank, other than cash at the cash departments of the National Bank (cash outside the National Bank), transferrable and other deposits of banks, and 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 legal entities – residents and households 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 general price level of goods and services. In Kazakhstan, inflation is measured with the use of consumer price index.

Consumer Price Index (CPI) – the change in the overall level of prices for goods and services purchased by the population for consumption. The consumer basket of Kazakhstan for calculation of inflation reflects the structure of household expenditures and includes goods and services which represent the largest relative share 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 survey findings among enterprises which

participate in the market research conducted by the National Bank.

Short-term economic indicator is calculated with a view to ensure efficiency and is based on the change in the output indices by key sectors: agriculture, industry, construction, trade, transport and communication accounting for over 60% of GDP. The indicator is built without recalculations for the unobservable economy and without other macroeconomic adjustments.

Credit Auctions mean the National Bank's auction for the securities buy/sell back.

Minimum Reserve Requirements (MRRs) mean the mandatory share of bank's liabilities which a bank is to keep in the form of cash in its cash department and monies on correspondent accounts with the National Bank in the domestic currency (reserve assets). The volume of reserved liabilities of banks is regulated by the MRR ratios.

Nominal Anchor for Monetary Policy. It is a certain indicator including a macroeconomic indicator which helps the National Bank to influence the ultimate monetary policy goal.

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 repos 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.

Transferrable Deposits refer to all deposits which: 1) can be converted into cash at face value at any moment in time without any penalties and restrictions; 2) are freely

transferable through a check, draft or endorsement orders; and 3) are widely used for making payments. Transferable deposits represent a part of the narrow money.

Other deposits primarily include savings and time deposits that only can be withdrawn on expiration of a certain period of time, or can have different restrictions which make them less convenient for use in the ordinary commercial transactions and, mainly, meet the requirements established for saving vehicles. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

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

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

Interest Rate Channel of the monetary policy transmission mechanism is the transmission mechanism channel which describes the impact of the central bank on the economy through the interest rate regulation.

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

Free Floating Exchange Rate. According to the current classification of the International Monetary Fund, 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 changes as well as to ensure the financial system stability.

Output Gap (GDP 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 frame. Serves as an indicator which reflects the effectiveness of resources utilized in the country. If an actual output exceeds the potential one (a positive output gap), other things remaining equal, the trend of acceleration in the price growth rates would be anticipated because of the overheating of the economy. The presence of a negative output gap indicates an expected slowdown in the price growth rates due to low economic activity. Output fluctuations around its potential level reflect business cycles in the economy.

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

TONIA Rate – (Tenge OverNight Index Average) represents a weighted average interest rate on one-day repo opening transactions made on the stock exchange with government securities in the automatic repo sector.

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

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

LIST OF KEY ABBREVIATIONS

GDP – Gross domestic product
GPIID – Government Program for Industrial and Innovation Development
EU – European Union
ECB – European Central Bank
CPI – consumer price index
CS MNE RK – Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan
KASE – Kazakhstan Stock Exchange
KSF – “Kazakhstan Sustainability Fund” JSC
NBRK – National Bank of the Republic of Kazakhstan
VAT – value-added tax
OPEC – Organization of the Petroleum Exporting Countries
UN FAO – Food and Agriculture Organization of the United Nations
RK – Republic of Kazakhstan
REER – real effective exchange rate
USA – United States of America
FAO – Food and Agriculture Organization of the United Nations
Fed – Federal Reserve System
Bln. - billion
Mln. - million
Thous. – thousand
USD – US Dollars