

National Bank
National Bank
of the Republic of Kazakhstan
of the Republic of Kazakhstan

Inflation Report
for the Fourth Quarter 2010

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Basic Terms and Definitions

In Section 1. Inflationary Processes

Inflation in the Republic of Kazakhstan is calculated based on the consumer price index (CPI) that characterizes changes in the overall prices for goods and services purchased by the population for personal consumption in the cities of Astana and Almaty, in all regional centers and in a selected number of towns and district centers. The consumer basket for calculation of inflation reflects the structure of household expenditures and contains 508 goods and services which represent the largest portion in the consumption of population.

Core inflation – is the inflation that excludes short-term uneven price changes under the influence of certain factors of an administrative, circumstantial, and seasonal nature.

Since 2004 the Statistics Agency of the Republic of Kazakhstan has been calculating core inflation using five different methods:

- core inflation-1: inflation that does not take into account the rise in prices for vegetables, fruit, gasoline, and coal;
- core inflation-2: inflation that does not take into account the rise in prices for vegetables, fruit, regulated services, and energy resources;
- core inflation-3: does not take into account the five largest and five smallest price hikes;
- core inflation-4: trimmed mean;
- core inflation-5: median CPI

– in the calculation of CPI all price changes are intercepted except for the one which is in the middle of the series ranged by the change in prices, i.e. static median. Median CPI will be equal to the change in the price of the first component which cumulative weight is equal to or exceeds 50%.

Inflationary expectations among enterprises in the real sector are surveyed within framework of **Enterprise Monitoring**, which has been performed by the National Bank since 2002. These surveys are characterized by qualitative estimates by the managers of the enterprises surveyed of the enterprises' production activity ("will rise," "will fall," "will remain unchanged"), including demand and prices for finished products and for the raw materials and supplies used in the previous quarter and the coming quarter.

The diffusion index is derived as the sum of "will rise" responses and half of the "remain unchanged" responses. This index is a generalized indicator that characterizes the trends in the change of a reviewed indicator. An index value above 50 means a positive change in the indicator, and the value below 50 means a negative change.

In Section 2. Inflation Factors

Proceeds for the budget include revenues (tax proceeds, non-tax proceeds, proceeds from disposal of capital assets), repayment of budget credits, and proceeds from disposal of the national financial assets.

Budget expenditures are the expenses (both current and capital expenditures), budget credits, and acquisition of financial assets.

In Section 3. Money Supply

Base Money (reserve money) includes cash issued by the National Bank excluding cash in till of the National Bank (currency outside the National Bank), transferable and other bank deposits, transferable deposits of non-bank financial institutions, and current accounts of public and private non-financial institutions in Tenge with the National Bank.

Narrow base money refers to base money not including other bank deposits with the National Bank.

The M1 Monetary Aggregate is calculated as the sum of cash in circulation and transferable deposits held by non-bank legal entities and the public in Tenge.

The M2 Monetary Aggregate is equal to the M1 monetary aggregate plus other deposits in Tenge and transferable deposits of non-bank legal entities and the public in foreign currency.

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 legal entities – residents and households – residents in the domestic and foreign currency.

Transferable 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 mechanisms. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

The **KazPrime Index** represents the average weighted rate of interest on interbank deposits with the banks that are the parties to the Agreement on Formation of the KazPrime Index of Kazakhstan Interbank Deposits with Banks. Each quotation includes the rate for the attraction and placement of funds to the deposit of one of the parties to the Agreement, as well as the volumes of attracted and place funds. The minimum quotation amount is KZT 150 mln. The maximum spread between quotations is one hundred basis point (1.00% per annum). The standard term for an interbank deposit was three months at the time when the project was launched.

In Section 4. Monetary Policy Instruments and Operations

The National Bank's **participation coefficient** in currency auctions on the Kazakhstan Stock Exchange (KASE) is calculated as the ratio of the National Bank's net participation (purchase minus sale of foreign currency) to the net volume of trading on the KASE.

The balance of the National Bank's operations in the money market is calculated as a sum of the change in the volume of short-term notes in circulation, deposit and correspondent account balances with the National Bank, and net operations on purchase and sale of government securities.

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Summary

At end-December 2010 the annual inflation was at 7.8% (in December 2009 – 6.2%). This inflation rate is in full compliance with the target band of 6-8% established by the National Bank for 2010.

The inflationary processes in Kazakhstan in 2010 were building up against the backdrop of minimal impact of monetary factors. So, the growth in money supply in 2010 was 14.1%, the reserve money expanded by 5.0% only.

The main factors of acceleration of the inflation in 2010 were related to the imbalance between demand and supply in the economy. Alongside with that, one of the main reasons for the expansion of absorption in the economy was the growth in cash income of the population, which in 2010 was supported not only by revived business activity but also by the increase in wages, social benefits and retirement benefits paid from the budget by 25% in April 2010.

In 2010 the Kazakh economy demonstrated quite high growth rates. Thus, the GDP growth during 9 months of 2010 accounted for 7.5%. Alongside with that, the growth in production was observed virtually in all industries including mining and manufacturing industry, trade, transport, communications and construction.

Another reason for non-decreasing inflation background in the economy in 2010 was the realization of external factors. The increase of world prices in the commodity markets, including the price for oil and metals, contributed to the growth in prices for industrial output of the Kazakh producers. Moreover, unfavorable weather conditions (drought, wildfires) in some countries resulted to the decreased production of certain food items including grains. This situation was conducive to the increase in inflationary expectations within Kazakhstan.

However, the anti-inflation policy implemented in 2010 by the joint efforts of the Government, National Bank local governments allowed maintaining a stable situation in the consumer market.

The National Bank took actions in line with the Monetary Policy Guidelines for 2010 intended to ensure the price stability, stability of the Tenge exchange rate and stability of the country's financial sector.

During 2010 the versus to the US Dollar remained in the middle of exchange rate band of KZT 150/US\$ (+)10% or KZT 15, (-)15% or KZT 22.5 with a minor involvement of the National Bank in the domestic foreign exchange market. At the same time, there was a tendency for the appreciation of the domestic currency.

In 2010 the interest rate band of the National Bank remained unchanged. The official refinancing rate remained at 7.0% throughout the year. The rate on deposits attracted from banks was 0.5% on 7-day deposits and 1.0% – on 1-month deposits.

The short-term liquidity in the money market was regulated by the National Bank through the issue of short-term notes and attraction of deposits from banks. The National Bank provided refinancing loans to support their current liquidity.

The mechanism of minimum reserve requirements as well as their ratios didn't change in 2010. The ratios of minimum reserve requirements for banks were 1.5% on domestic liabilities and 2.5% on other liabilities, and for banks undergoing the debt restructuring process – 0% on all liabilities of such banks.

Evaluation of the Inflation Forecasts for Q4 2010 and for 2010 as a Whole

The actual inflation rate (2.4%) in Q4 2010 was lower than the forecast (2.5-2.7%), published in the previous issue of the Inflation Report. The inflation in October was somewhat higher than the forecasted values whereas in November and December it was lower than expected.

The main increase in prices in Q4 2010 fell on the food products. Within their structure, the increase in prices for fruits and vegetables, dairy products, oils and fats, eggs, and sugar should be pointed out. In analyzing the dynamics of the prior years, one may mention that the increase in prices for fruits and vegetables, dairy products and eggs is common for such period since it's caused by the seasonality factor. The growth in prices for oils and fats, sugar as well as bread and bakery occurred because of unstable situation in the global commodity markets caused by adverse weather conditions.

According to estimate, the inflation in Q4 2010 excluding the increase in prices for food products was 1.6% instead of actual 2.4%.

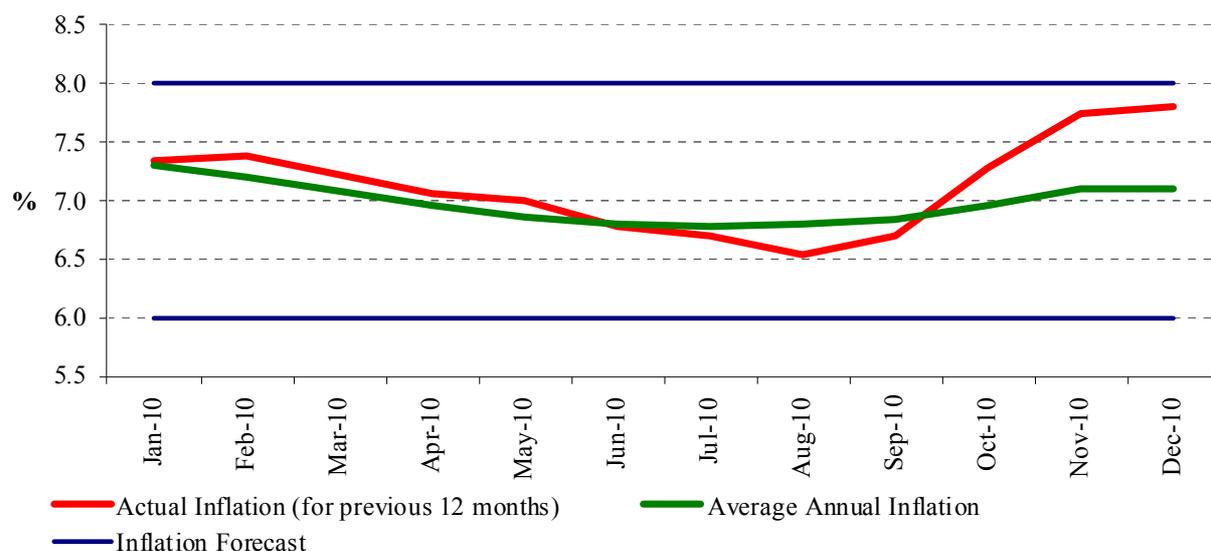
The impact on the inflation by non-food items and paid services, due to their moderate growth, except for increased prices for gasoline, gas supply services and medical services, remained insignificant in October-December 2010.

As a whole, based on the performance in 2010 it may be pointed out that inflationary processes in Kazakhstan were building up against a steady trend of reduced impact of the paid services and increased impact of the food stuff. The impact by non-food items was moderate in 2010.

The actual inflation rate in annual terms at end-2010 (7.8%) was within the target band of 6-8% established by the National Bank (Figure 1).

Figure 1

Actual and Forecasted Inflation in 2010



Source: National Bank of the Republic of Kazakhstan

Inflation Forecast for 2011

According to the Monetary Policy Guidelines of the Republic of Kazakhstan for 2011, the main goal of the National Bank was to keep the inflation within 6-8%.

The buildup of the inflationary processes in 2011, just like in 2010, will occur amidst the unbalanced aggregate demand and supply. Certain increase in the inflationary pressure is anticipated because of the increase in wages, retirement benefits, social benefits and other welfare payments from the budget scheduled for January and July 2011. In addition, in 2011 the situation in the global commodity markets will most likely remain volatile, which will have some increasing pressure on the inflation in Kazakhstan.

In 2011 the National Bank will continue to improve and enhance the efficiency of monetary policy instruments and to further enhance the impact of taken measures on the condition of the money market.

When the established regime of the Tenge exchange rate band fluctuations will cease to be in effect, the National Bank will move to the managed floating exchange rate regime. This is stipulated by the domestic currency stability promoted to by a favorable pricing environment for the major items of the Kazakhstani exports in the global markets and the status of the balance of payments.

The interest rate policy of the National Bank will be aimed at keeping the market interest rates in the money market of short-term instruments within the interest rate band of the National Bank. The official refinancing rate will be established based on the situation in the money market and the inflation rate in such a way that its level remains positive in real terms.

Short-term notes and deposits of banks at the National Bank will remain as the main instruments for the regulation of interest rates in the financial market as well as for the sterilization of excessive liquidity of banks.

As necessary, the National Bank will provide refinancing loans to support the short-term liquidity of banks. The maturities of such operations will remain short.

The monetary policy will be adequate to the forming macroeconomic conditions. Money supply in the economy will remain at the level consistent with the growth of the economy.

The Inflation Forecast for the First Quarter 2011 is 2.5-2.7% (in Q1 2010 the actual inflation was 2.9%). Generally, this inflation level corresponds to the inflation trends of January-March, which were common for the prior years. Such expectations are associated with the fact that the inflation buildup in the near term will be mainly influenced by the seasonality factor. The decrease in prices for certain goods and services (meat, dairy products, fuel and lubricants, certain utilities, and transportation services) is anticipated. Moreover, the increase in inflationary expectations is possible due to scheduled increase in payments from the budget in January 2011.

At end-March 2011 the annual inflation is expected to be at 7.2-7.4%.

The Inflation Forecast for the Second Quarter 2011 is 1.6-1.8% (in Q2 2010 the actual inflation was at 1.4%), which corresponds to the annual inflation of 7.4-7.6% at end-June 2011.

In April-June 2011 the decrease in prices for individual food items such as eggs, dairy products, fruits and vegetables, meat products, and for services of education is anticipated.

1. Inflationary Processes

1.1. Consumer Prices

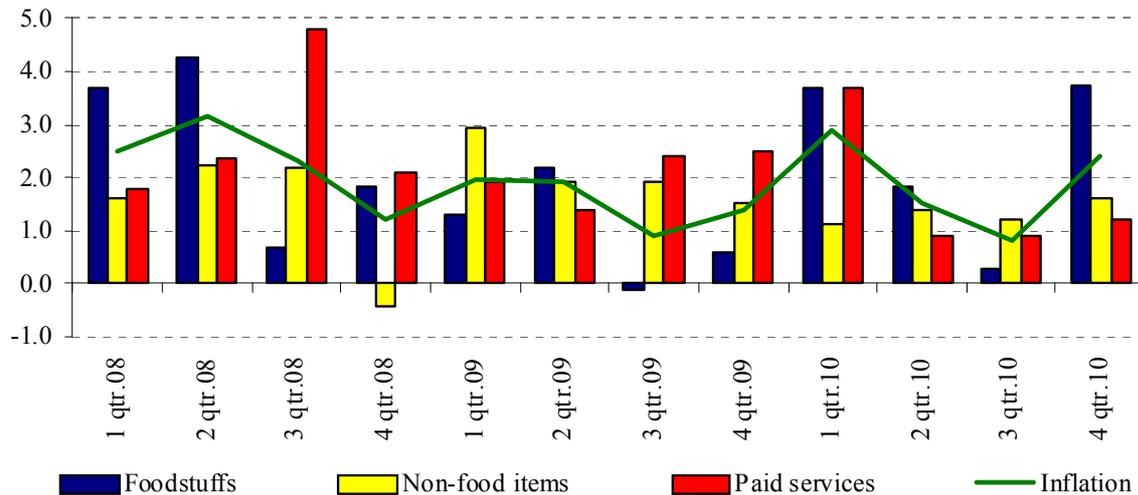
In Q4 2010 the tendency of increased inflationary pressure in the economy remained. The inflation during this period was growing at high rates as compared to Q4 2009. In October-December 2010 the inflation was at 2.4% (in Q3 2010 – 0.8%).

Acceleration of the inflation rates in Q4 2010 was caused by the seasonality factor because of the increase in prices for some foodstuffs and non-food items and for certain services provided to the population including regulated services (hot water supply, central heating).

Foodstuffs increased in price by 3.8%, non-food items - by 1.6% and paid services – by 1.2% (Figure 2).

Figure 2

Dynamics of quarterly inflation and its components (as % of the previous year)



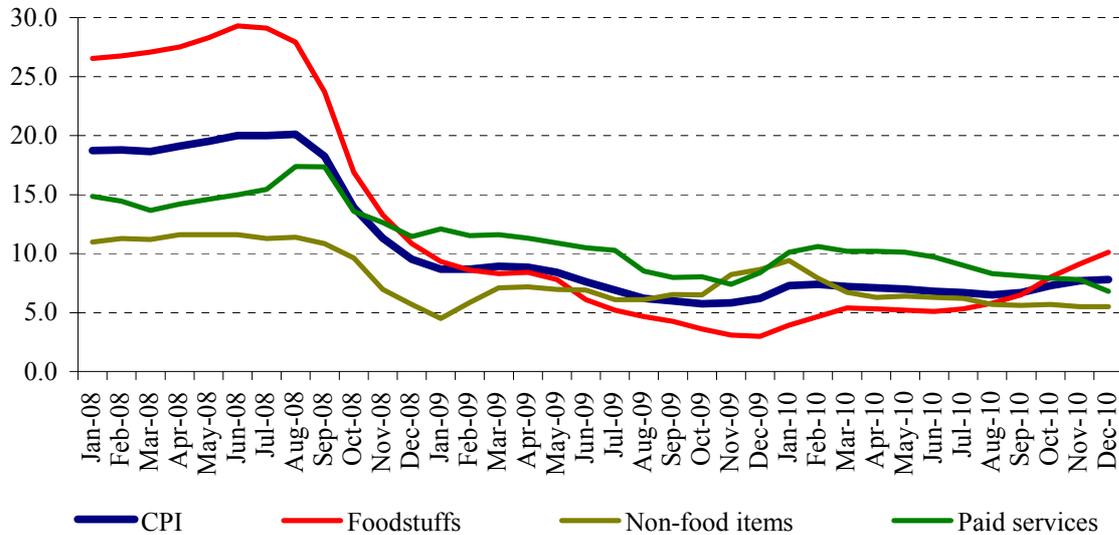
Source: Agency of Statistics of the Republic of Kazakhstan

The main growth in prices in Q4 2010 fell on the following goods and services: cereals– by 28.9%, eggs – by 15.5%, oils and fats – by 10.2%, fruits and vegetables – by 7.2%, flour – by 5.7%, sugar – by 5.2%, dairy products – by 5.1%, diesel fuel – by 8.5%, solid fuel – by 6.6%, liquidized gas – by 4.7%, gasoline – by 2.5%, cold water fees – by 1.7%, central heating fees – by 1.6%. Also the fees for out patient services also increased – by 2.5%.

At end-December 2010 the annual inflation was 7.8% (in December 2009 – 6.2%). Prices for foodstuff increased by 10.1% (by 3.0%), non-food items – by 5.5% (by 8.6%), paid services – by 6.8% (by 8.4%) (Figure 3).

Figure 3

**Dynamics of annual inflation and its components
(as % of the respective month of the previous year)**



Source: Agency of Statistics of the Republic of Kazakhstan

In annual terms the highest price growth was in tobacco products, sugar, meat and dairy products, oils and fats, soft beverages, liquidized gas, medications, diesel fuel and gasoline, detergents and cleaners, electricity, cold and hot water, sewage, education services, outpatient services, transportation and legal services.

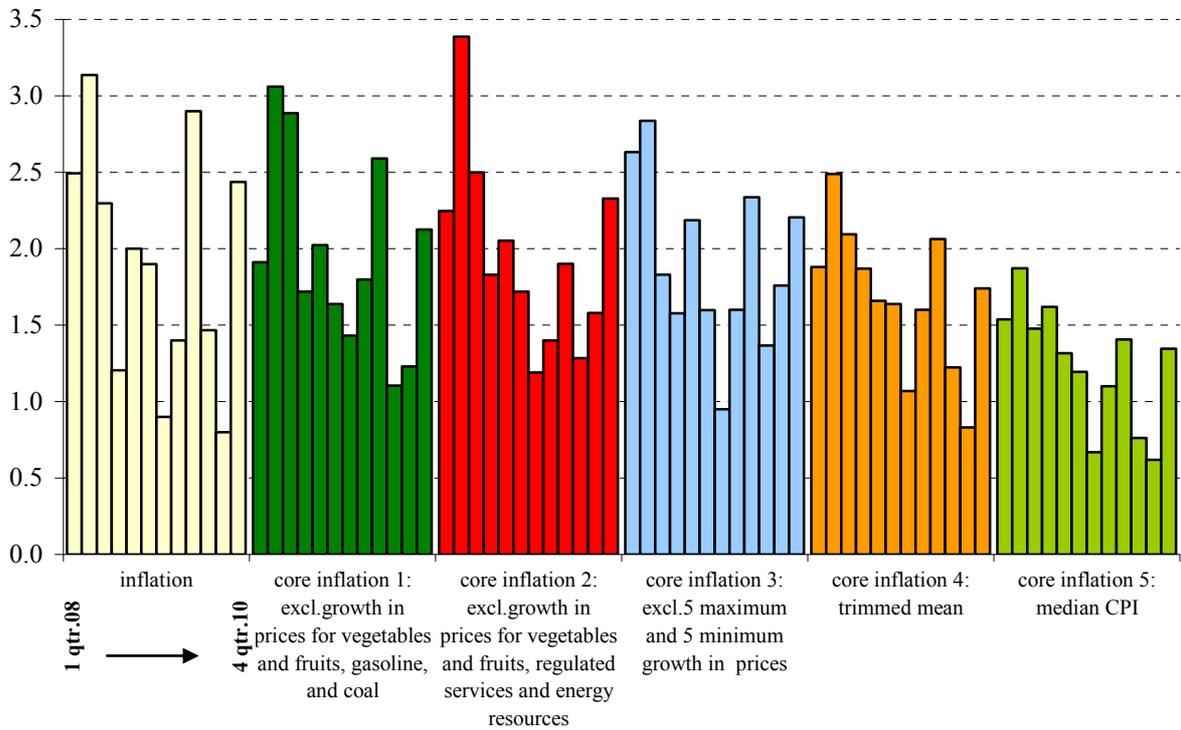
1.2. Core Inflation

In Q4 2010 the core inflation indicators as well as the headline inflation demonstrated higher growth rates both as compared to the previous quarter and versus Q4 2009 (Figure 4). Such dynamics was caused primarily by higher growth rates of prices virtually for all food items that are included in the calculation of the consumer price index.

In October-December 2010 the core inflation indicators demonstrated multi-directional dynamics. Core inflation-2 was accelerating in Q4 2010 whereas all other core inflation indicators, after some acceleration in October-November, started to gradually slowdown in December 2010. All core inflation indicators at end-December 2010 were at a lower level as compared to the headline inflation.

Figure 4

**Dynamics of quarterly inflation and core inflation
(as % of the previous period)**

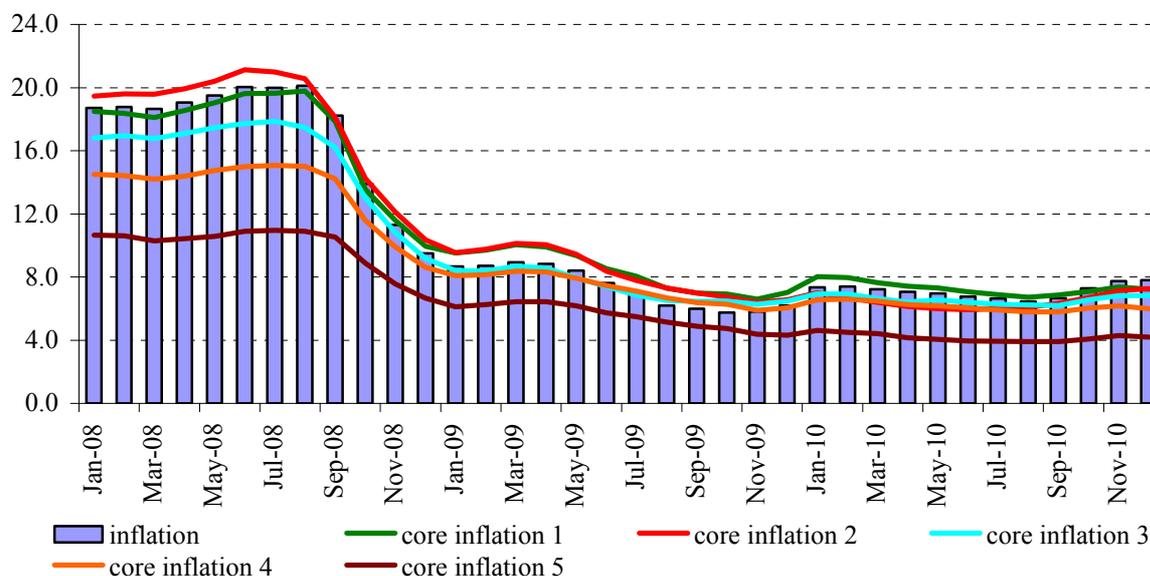


Source: Agency of Statistics of the Republic of Kazakhstan

In December 2010 indicators of the core inflation-1, 2 and 3 in annual terms were at a higher level as compared to December 2009. This indicates that the inflation background in the economy remains, at the same time the impact of monetary factors on the inflation is minor (Figure 5).

Figure 5

Dynamics of annual inflation and core inflation (as % of the respective quarter of the previous year)



Source: Agency of Statistics of the Republic of Kazakhstan

1.3. Prices in the Real Sector of the Economy

1.3.1. Prices in the Industry

In Q4 2010 the producer prices have increased by 9.3% (in Q4 2009 – by 7.0%). The cost of output appreciated by 9.8%, at the same time the price of production means within its composition increased by 3.0%, the price of consumer goods – by 4.6%, and interim consumption products – by 10.3%. The price for production services increased by 0.6%.

In October-December 2010 the growth rate of producer prices in the mining industry increased significantly. After their decrease in Q3 2010 by 0.2%, in Q4 prices increased by 11.1% (in Q4 2009 – growth by 9.5%).

The cost of energy resources in Q4 2010 increased by 10.2% (in Q4 2009 – growth by 9.9%). In the composition of energy resources the cost of oil production increased by 13.0% (in Q3 2010 – growth by 2.2%), the cost of gas condensate decreased by 4.9% (decrease by 2.5%).

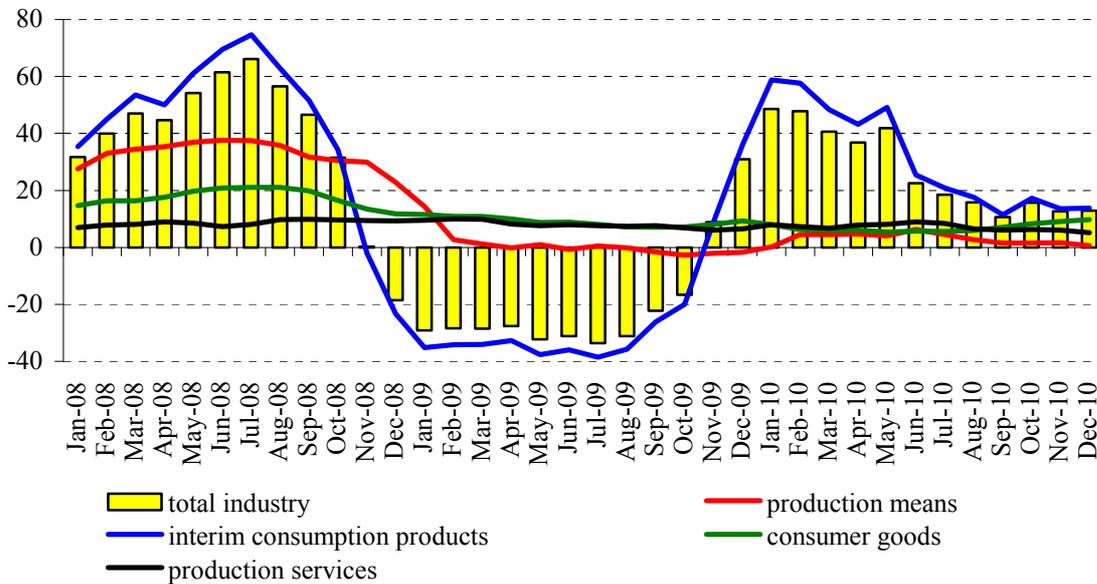
The growth rate of prices in the manufacturing industry in Q4 2010 accelerated significantly amounting to 7.2% (in Q4 2009 – growth by 3.6%). Prices in the metallurgical industry increased by 9.8%, prices in the foodstuff production including drinks and tobacco increased by 7.5%, refined products increased in price by 10.9%.

There was a decrease in prices in the production and distribution of electric energy, gas and water in Q4 2010, which amounted to 0.4% (in Q3 2010 – growth by 0.7%).

In December 2010 the growth of prices in the industrial production in annual terms (December 2010 to December 2009) was 12.9% (Figure 6).

Figure 6

**Dynamics of the producer price index
(as % of the respective month of the previous year)**



Source: Agency of Statistics of the Republic of Kazakhstan

The cost of output increased by 13.4% in annual terms, including the interim consumption products – by 13.8%, consumer goods – by 9.7%, production means – by 0.6%. The cost of production services increased by 5.1%.

1.3.2. Prices in Agriculture

In Q4 2010 prices for agricultural production realized across all channels increased by 21.2% (in Q4 2009 – decrease by 10.7%). The dynamics of prices in agriculture was impacted by appreciation of output in the plant production to a greater extent and in stock-breeding – to a smaller extent.

During October-December the cost of plant production increased by 30.7%, which was mainly caused by the growth in prices for grain cultures – by 30.9%.

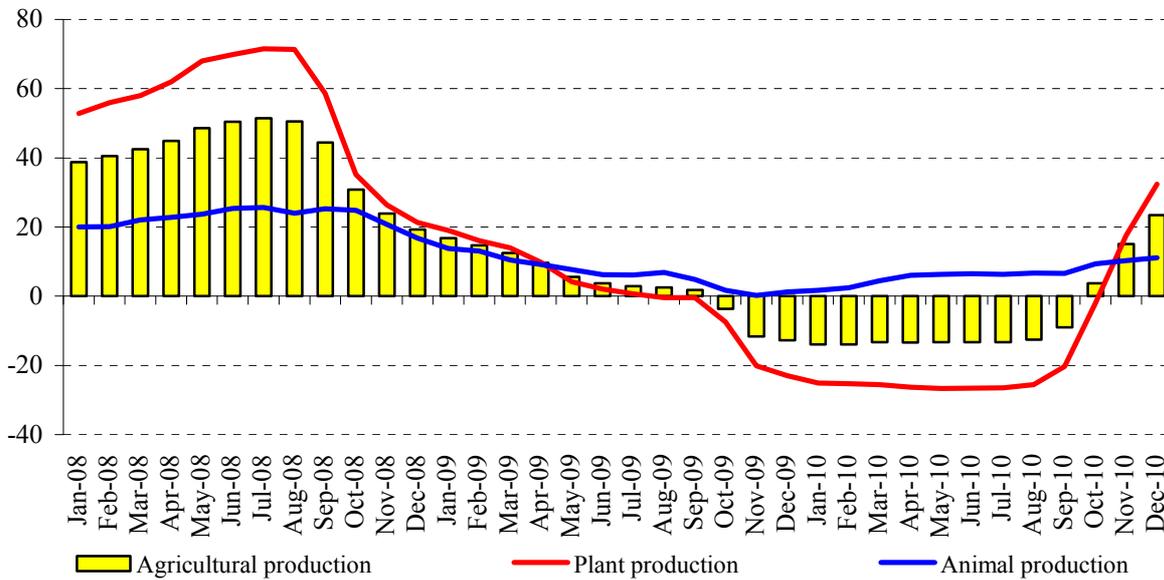
Adverse weather and climatic conditions in 2010 resulted in a lower grain yield that influenced the growth in prices for the plant production.

The cost of animal products appreciated by 8.0% in Q4 2010, whereas in Q2 2010 there was a decrease in price under the influence of the seasonality factor, and in Q3 the price growth was insignificant and made 1.3%. At the same time, prices for meat and poultry increased by 1.9%, the cost of unpasteurized milk increased by 20.8%, and the price of eggs increased by 23.6%.

At end-December 2010, prices for agricultural products increased by 23.4% in annual terms. The cost of plant production increased by 32.4%, and animal products increased in price by 11.1% (Figure 7).

Figure 7

**Dynamics of the agricultural price index
(as % of the respective month of the previous year)**



Source: Agency of Statistics of the Republic of Kazakhstan

1.3.3. Enterprise Monitoring

In Q4 2010 there was a notable slowdown in the growth rates of demand for final products of enterprises as compared to the previous quarter. This is evidenced by the decrease in a generalized indicator – diffusion index of the change in the demand for final products – to 50.9 from 55.2 in Q3 2010 (Figure 8). The decrease in the indicator was noted by 21.9% (in Q3 2010 – 17.0%) of interviewed enterprises and the increase in the indicator – by 23.7% (in Q3 2010 – 27.3%).

The slowdown in the growth rates of demand is, in the first instance, related to the decrease of the indicator in such industries as “construction”, “real estate operations”, “rent and services to enterprises” and “manufacturing industry”, and secondly, with the slowdown in the growth rates of demand in such industries as “agriculture, hunting and forestry”, “transport and communications”, “trade” and “hotels and restaurants”.

In Q1 2011 a minor growth in the demand for final products is expected in the economy as a whole: the diffusion index of the change in the demand went up to 51.1. Alongside with that, 17.0% of interviewed enterprises anticipate that the demand for final products will rise, and 14.9% anticipate that it will fall. The highest growth in the demand is expected in such sectors as “agriculture, hunting and forestry”, and enterprises in such sectors as “construction” and “manufacturing industry” anticipate that the indicator will decrease.

The situation with prices for final products of enterprises in Q4 2010 was characterized by insignificant increase in the growth rates of the indicator as compared to the previous quarter: the diffusion index of the change in the prices for final products went up to 60.7 (in Q3 2010 – 59.8). The percentage of enterprises with increased prices for their products as compared to the previous quarter increased amounting to 25.9% (in Q3 2010 – 24.0%).

The maximum growth in prices occurred in such industries of the economy as “mining industry”, “production and distribution of electric energy, gas and water”, “manufacturing

industry” and “transport and communications”. The slowdown in the growth rates of the indicator was observed in the “construction” industry influenced by the seasonality factor.

In Q1 2011 some increase in the growth rates of prices is anticipated, evidenced by the diffusion index of the change in prices for final products which was 62.4 (in Q4 2010 – 60.7). The maximum rates of growth in prices is anticipated in such industries as “production and distribution of electric energy, gas and water”, “transport and communications”, “real estate operations”, “rent and services to enterprises”. At the same time, in such industries as “agriculture, hunting and forestry”, “mining industry” and “trade” a slowdown in the growth in prices for final products is anticipated.

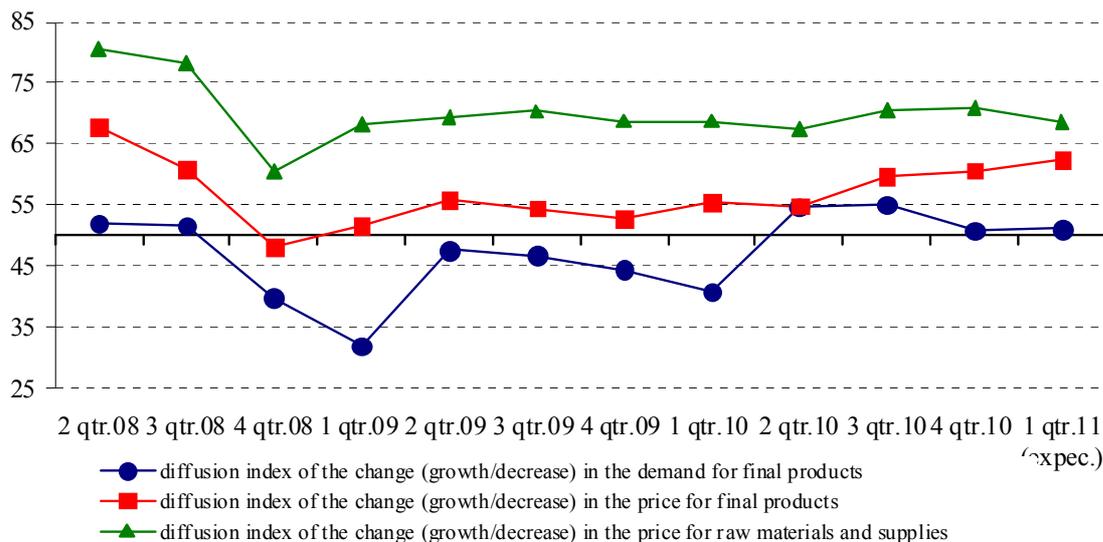
In Q4 2010 there was an insignificant increase in the growth rates of prices for raw materials and supplies as compared to the previous quarter that still remain at a high level in the economy as a whole: the value of the diffusion index of the change in the price for raw materials and supplies was 71.0. The increase in the growth rates occurred in all industries except for industries such as “agriculture, hunting and forestry” and “construction”. In the sample as a whole a number of enterprises that noted the increase in prices for raw materials and supplies increased as compared to the previous quarter amounting to 50.1% (in Q3 2010 – 49.5%). The percentage of enterprises that noted the decrease in prices for raw materials and supplies accounted for 0.9% only (in Q3 2010 – 1.0%). The number of respondents that noted invariance of the indicator decreased to 41.7% (in Q3 2010 – 42.1%).

For Q1 2011 the diffusion index of the change in the price for raw materials and supplies fell down to 68.6, which means a notable slowdown in the price growth. At the same time, the number of respondents anticipating the price growth decreased significantly – to 44.9%, and the percentage of enterprises that noted invariance of the indicator increased to 47.5%, and that the indicator will fall – decreased to 0.3% (Figure 8).

Thus, judging from the dynamics of the relevant diffusion indices, anticipations of the enterprises about Q1 2011 are associated with a slowdown in the growth rates of prices for raw materials and supplies and a minor growth in the demand for final products.

Figure 8

Diffusion indices of the change in demand and prices



Source: National Bank of the Republic of Kazakhstan

2. Inflation Factors

2.1. Aggregate Demand

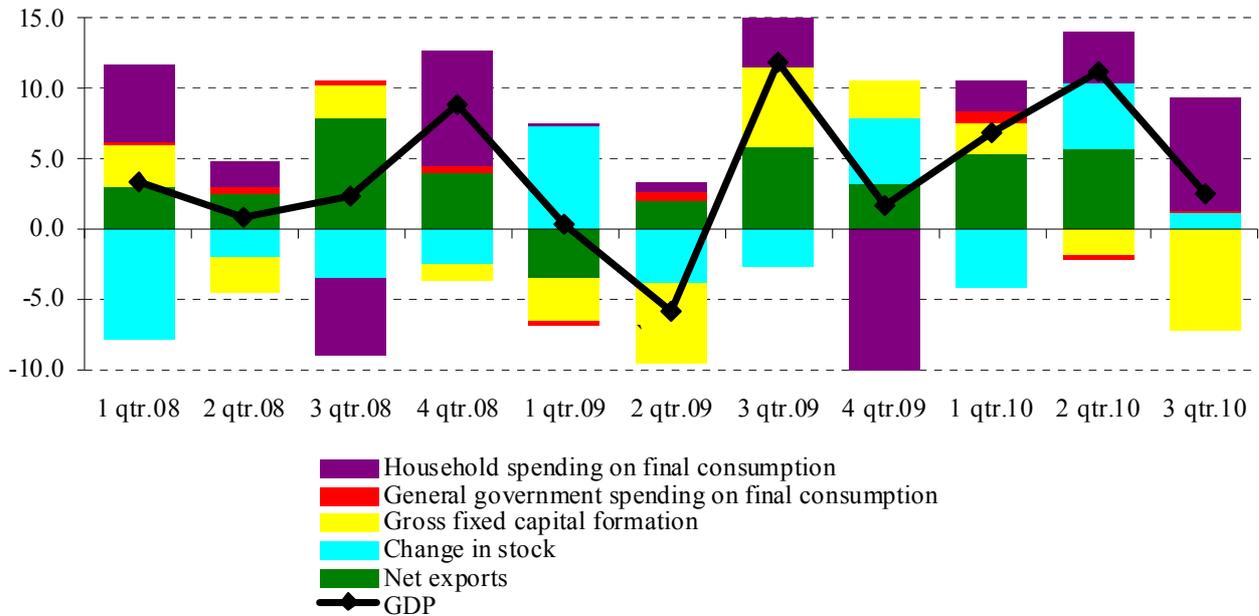
In Q3 2010 the GDP based on the final consumption method as compared to the respective period of 2009 increased in real terms, according to the estimate, by 2.5% (in the previous quarter – by 11.2%).

Despite the significant fall in one of the key GDP components (gross fixed capital formation), increase in spending on final consumption, growth in net exports, and change in stock were the reason for the GDP growth, although its rate slowed down significantly. Spending on final consumption grew up by 11.1%, net exports increased by 10.7%, gross formation decreased by 25.0% on the whole.

Net exports' contribution to the GDP growth accounted for 1.1%, gross fixed capital formation – (-) 17.2%, households consumption – 8.0%, change in stock – 1.2% (Figure 9).

Figure 9

Contribution of components of aggregate demand to the growth in GDP, %



Source: Information of the Agency of Statistics of the Republic of Kazakhstan, estimates by National Bank of the Republic of Kazakhstan

2.1.1. Individual Consumption and Investment Demand

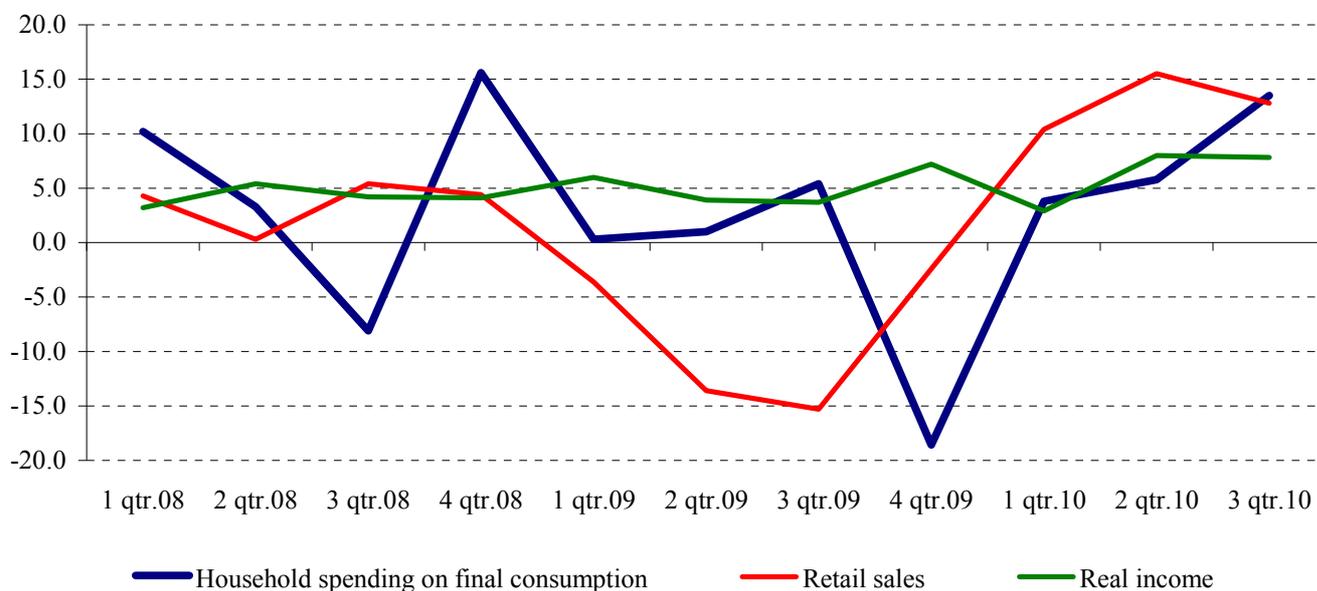
Household spending on final consumption in Q3 2010 increased versus the respective period of 2009 by 13.6% (in Q2 2010 – growth by 5.8%).

The slowdown of in the growth rate of per capita income in real terms to 7.8% (in Q2 2010 – growth by 8.0%) also affected retail sales, whose rate slowed down to 12.8% (in Q2 2010 – growth by 15.5%). The growth in retail sales, while generally demonstrating the restoration of consumer demand this year, had a significant impact on the improvement of

one of the key GDP components by the aggregate demand method, namely the growth in household spending on final consumption (Figure 10).

Figure 10

**Dynamics of personal spending and income
(as % of the respective period of the previous year)**



Source: Information of the Agency of Statistics of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

A high rate of the economic recovery in Kazakhstan, stabilization of the situation in the banking sector, overcoming of negative consequences of the global crisis on the whole as well as the increase in the amounts of social benefits and retirement benefits from the beginning of 2010 and 25% increase of scholarships and salaries of the public sector employees from the 2nd quarter were the basis for the change in the consuming behavior pattern of the population.

As a result, after their fall during the entire 2009, the volumes of realization of goods in retailers (shops, shopping centers) began to grow since the beginning of this year, their volume in the overall volume of retail sales being significant and accounting for about 55%.

The total volume of spending on gross capital formation demonstrated a significant decline in Q3 2010, as compared to the respective period of 2009, decreasing by 25.0% and thus making negative contribution to the GDP growth of (-)5.9%.

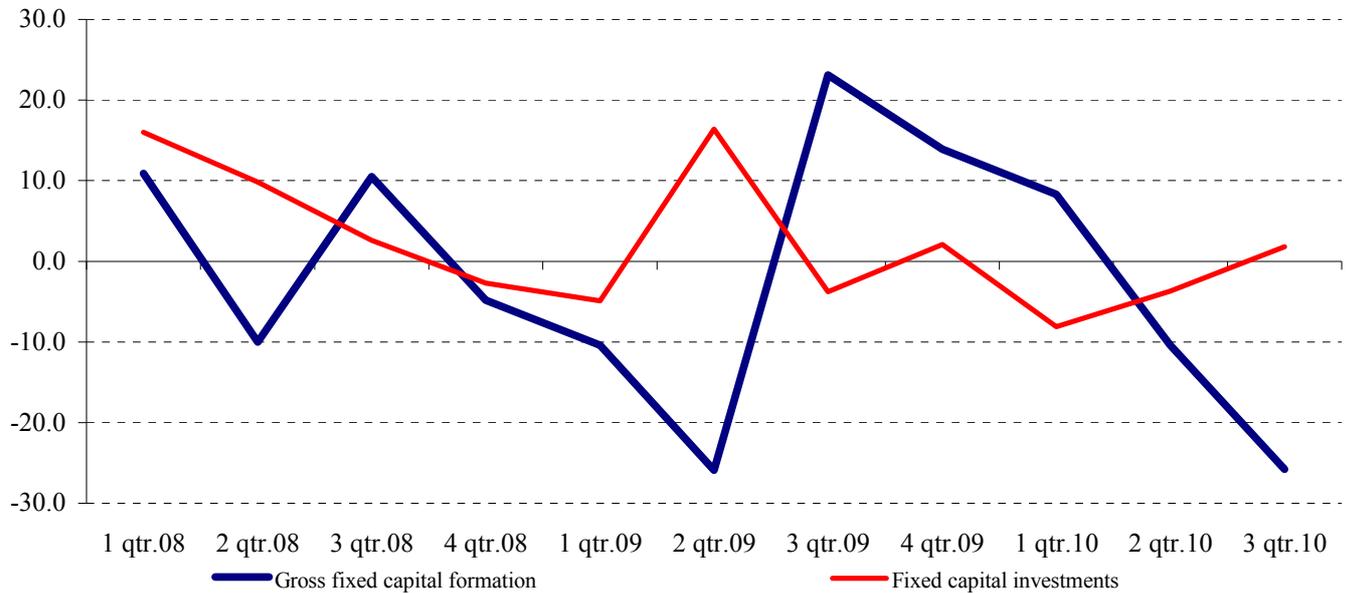
In its structure, despite the fact that the investment activity of enterprises somewhat increased in Q3 2010 and the volume of fixed capital investments increased by 1.8% (Figure 11), gross fixed capital formation decreased by 25.8%, which made negative contribution to the GDP growth of (-)7.2%.

In its turn, the indicator of the change in stock showed nearly a three-fold increase in nominal terms, thus making positive contribution to the GDP growth of 1.2%.

However, such insignificant positive contribution could not neutralize negative effect of the first component, thus resulting in the decline of gross formation as a whole.

Figure 11

**Dynamics of spending on investments in fixed capital
(as % of the respective period of the previous year)**



Source: Information of the Agency of Statistics of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

2.1.2. Government Consumption

Spending on final consumption by the general government in Q3 2010, as compared to the respective period of 2009, increased by 2.7% (in Q2 2010 – decrease by 4.6%).

In general, during Q3 2010 the state budget spending was financed in the amount of KZT 1 128.7 bln. or 7.7% of GDP. As compared to Q3 2009, the increase accounted for 23.7%.

Current state budget expenditures totaled to KZT 821.5 bln., being greater by 19.2% than in Q3 2009. Within the current expenditures costs on interest payments on domestic and foreign loans, on current transfers to natural persons and legal entities as well as for employer contributions, wages and service purchases increased the most. Capital expenditures of the state budget in Q3 2010 increased by 8.0% as compared to the respective period of 2009, mainly because of the growth in expenditures for acquisition and buildup of fixed capital. Expenditures for acquisition of land and intangible assets and capital transfers abroad decreased by 62.8% and 46.7%, respectively, as compared to the respective quarter of the previous year.

During July-September 2010 state budget revenues amounted to KZT 1 292.65 bln. or 8.8% of GDP, which is by 89.0% greater than in July-September 2009. Two items still prevail in the structure of the state budget revenues: tax revenues – 55.1% (in Q3 2009 – 60.3%), and the official transfer – 41.3% (35.9%). High percentage of official transfers was secured by the receipt of the guaranteed transfer of KZT 445.0 bln. from the National Fund of the Republic of Kazakhstan to the republican budget.

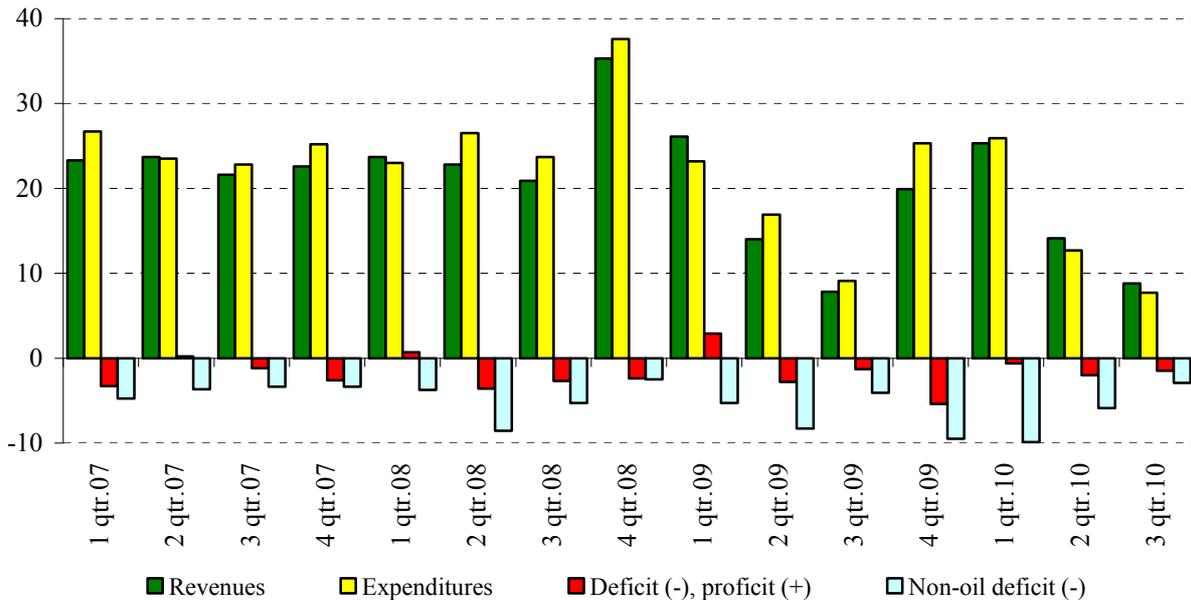
As a whole, in Q3 2010 tax revenues increased by 12.5% as compared to Q3 2009, the increase was due to the increased revenues from corporate income tax and value added tax by 46.3% and 10.7%.

In Q3 2010 as compared to Q3 2009 revenues from the fixed capital sales increased by 30.7%, the volume of non-tax revenues increased by 7.4%.

Since the expenditures were in excess of revenues to the state budget, in Q3 2010 the deficit of KZT 217.8 bln. (1.5% of GDP) showed up whereas in Q3 2009 the deficit was KZT 144.9 bln. (Figure 12). It should be noted that without the guaranteed transfer of KZT 445.0 bln. to the republican budget from the National Fund, Q3 2010 would have ended with the non-oil deficit of KZT 662.8 bln.

Figure 12

Execution of the state budget, % of GDP



Source: Ministry of Finance of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

During Q3 2010, the Ministry of Finance borrowed KZT 372.3 bln. (mainly by issuing government issue-grade securities). During the same period debentures were also extinguished on securities issued earlier for the amount of KZT 90.8 bln. As a result, account balances of the Government of the Republic of Kazakhstan with the National Bank increased by KZT 38.6 bln.

Government domestic debt for Q3 2010 increased to KZT 1 634.9 bln. (7.2% of GDP), i.e. by 46.0% as compared to Q3 2009 (7.2% of GDP). The growth was secured by the issue of government short-term treasury obligations (MEKKAM), government long-term treasury bonds (MEUKAM), and government long-term saving treasury obligations (MEUZHKAM).

The Government’s external debt in Q3 2010 increased by 2.1 times as compared to Q3 2009 (1.6% of GDP) and amounted to KZT 508.9 bln. (2.5% of GDP).

2.1.3. External Sector

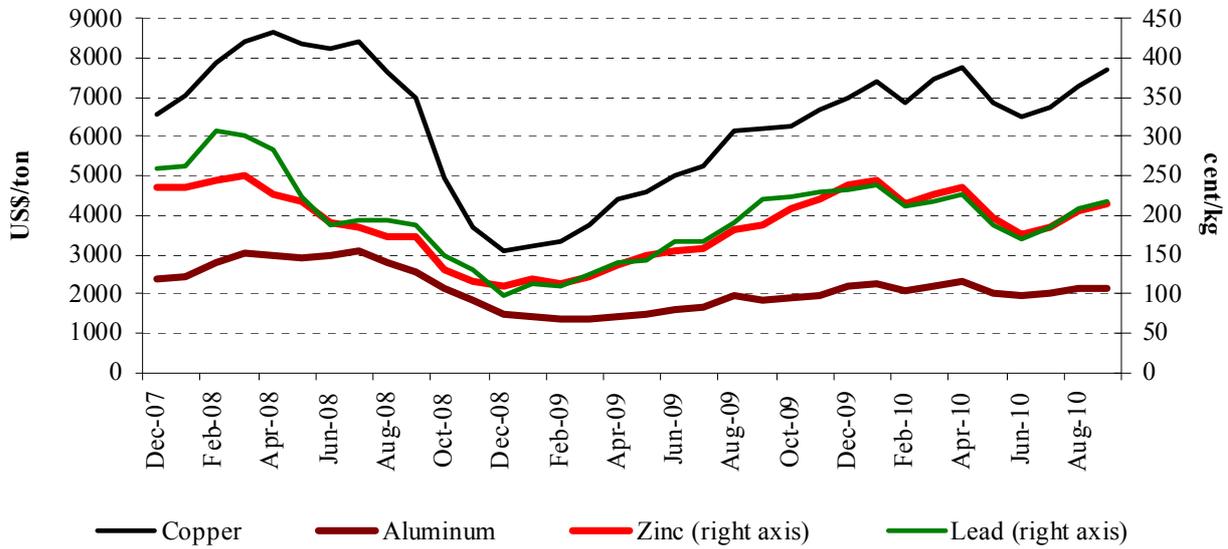
– World Prices

In Q3 2010 the situation in the global commodity markets remained unstable, which was accompanied by volatility of prices for certain commodities. World prices for metals in July-September 2010 demonstrated a steady upward trend. On the overall, in Q3 2010 prices for copper increased by 3.1% and were about US\$ 7242.7 per ton on average during the

period. World prices for lead increased by 4.2% amounting to 203.2 cents per kg on average during the period, prices for zinc decreased by 0.6% with the price of 201.3 cents per kg, on average for the period (Figure 13).

Figure 13

Dynamics of world prices for metals



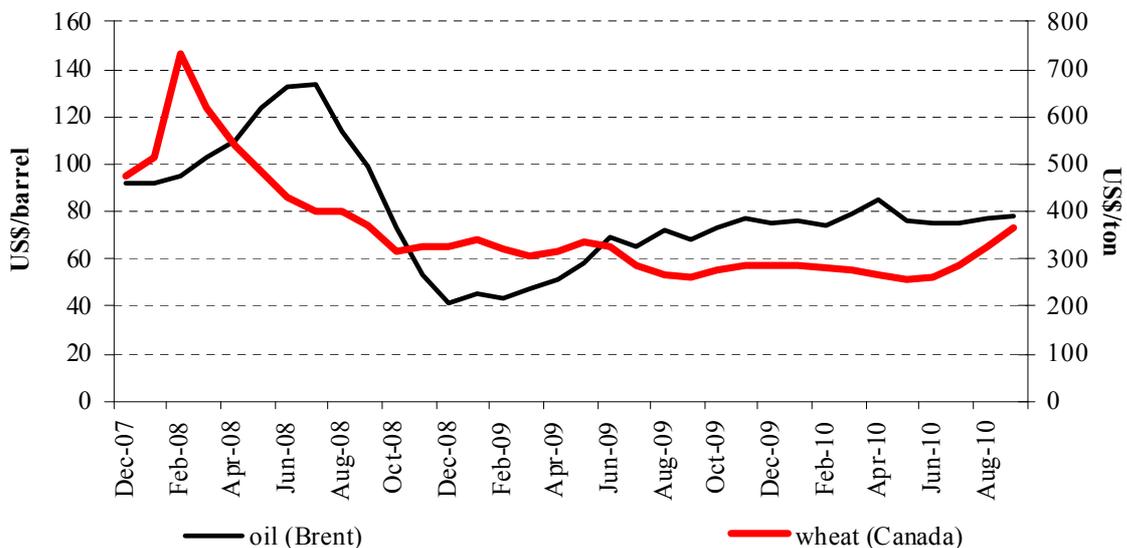
Source: World Bank

In Q3 2010 world oil prices had an upward trend. Thus, after some decline in prices in May 2010, an upward trend appeared in August-September 2010. On the overall basis, in Q3 2010, as compared to Q2 2010, oil prices (Brent) decreased by 2.9% and were at US\$76.41 per barrel on average for the period (Figure 14).

World prices for wheat also increased in July-September 2010. On the overall basis, in Q3 2010 the world price for wheat (Canada) increased by 25.0% and was at US\$326.2 per ton on average (Figure 14).

Figure 14

Dynamics of world prices for oil (Brent) and wheat (Canada)



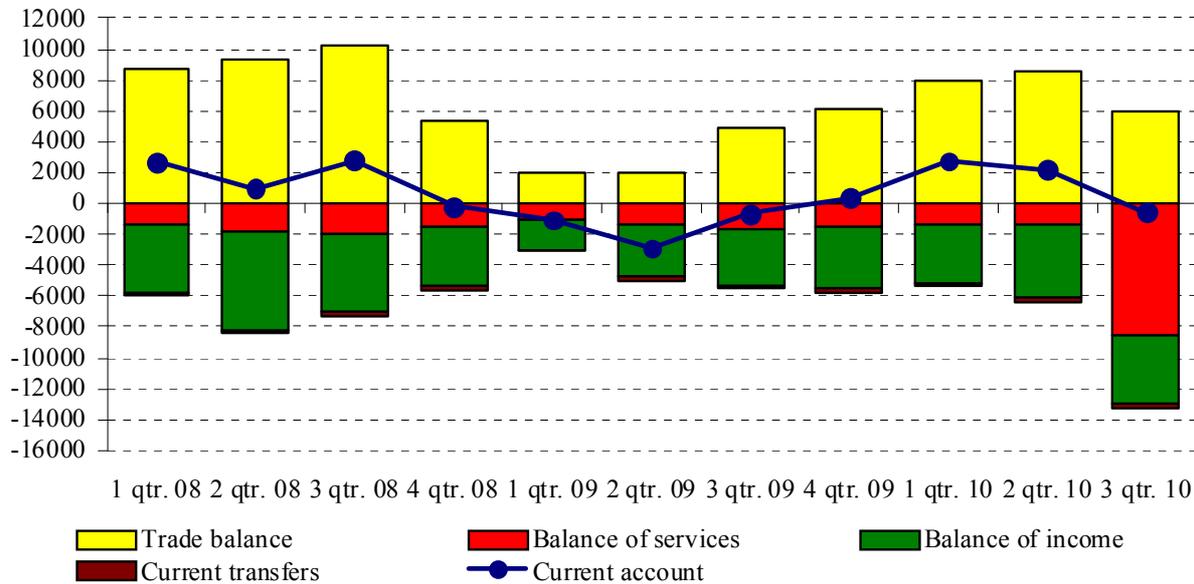
Source: World Bank

– **Balance of Payments**

In Q3 2010 the current account balance was in deficit at US\$ 0.6 bln. (Figure 15).

Figure 15

Current account balance, US\$ mln.



Source: National Bank of the Republic of Kazakhstan

Proceeds from the exports of goods in Q3 2010 increased by 17.1%, and expenditures on commodity imports – by 13.9% as compared to Q3 2009. A positive trade balance increased by 21.9% and amounted to US\$ 6.0 bln. At the same time, it didn't compensate a net outflow of resources on other components of the current account. The deficit in the balance of services as compared to Q3 2009 increased by 5.8% to US\$ 1.8 bln., and the deficit in the income balance increased by 22.7% and was over US\$ 4.3 bln. Payments to non-residents on current transfers amounted to US\$ 395.9 mln., having increased by 36.3% versus the level of Q3 2009.

The net outflow of resources on financial account operations was US\$ 5.7 bln. in Q3 2010 (in Q3 2009 there was a net inflow of US\$ 2.5 bln.). Foreign assets of residents (except for reserve assets) increased by US\$ 3.3 bln., which is by 1.7 higher than in the respective period of 2009. Foreign liabilities of residents decreased by US\$ 2.4 bln. (growth by US\$ 4.5 bln. in Q3 2009).

As a result, the positive balance of payments for Q3 2010 amounted to US\$ 22.8 mln. (in Q3 2009 – US\$ 1.8 bln.).

– **Terms of Trade and the Real Effective Exchange Rate**

In Q3 2010 the aggregate terms of trade index was by 14.7% higher than the respective indicator for Q3 2009. Alongside with that, the terms of trade with the Euro zone countries improved by 3.7%, and with Russia – deteriorated by 33.3% (Table 1).

Table 1

**Change in price indices and terms of trade
(as % of the respective period of the previous year)**

1 qtr. 09	2 qtr. 09	3 qtr. 09	4 qtr. 09	1 qtr. 10	2 qtr. 10	3 qtr. 10
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Inflation Factors

Export prices	-47.0	-52.5	-44.9	-16.6	48.2	60.1	17.4
Import prices	-1.2	-15.8	-18.2	-3.4	9.4	12.9	5.1
Terms of trade	-45.8	-42.4	-34.4	-11.3	22.6	42.7	14.7
including:							
the Euro zone countries							
Export prices	-54.2	-56.5	-49.9	-18.0	66.0	59.9	17.9
Import prices	17.7	0.1	12.8	32.5	22.4	31.0	14.1
Terms of trade	-57.8	-57.9	-59.2	-29.0	16.6	25.2	3.7
Russia							
Export prices	-28.3	-36.2	-35.8	-14.7	23.4	3.6	-24.4
Import prices	-28,6	-25,5	-23,2	-2,6	28.5	19.1	10.9
Terms of trade	0.4	-15.0	-16.4	-12.6	-3.7	11.0	-33.3

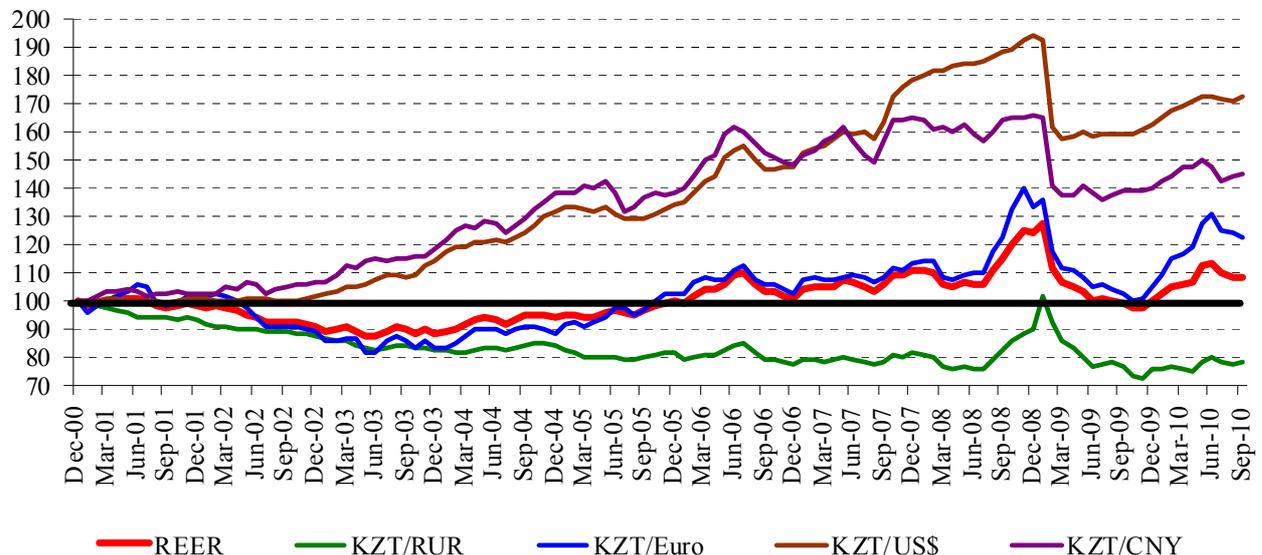
Source: National Bank of the Republic of Kazakhstan

Despite a relatively stable nominal exchange rate, the index of the real effective exchange rate of the Tenge depreciated by 1.9% in Q3 2010 as compared to the prior period. At the same time, Tenge has depreciated versus the CIS currencies basket by 0.2%, versus the basket of other currencies – by 2.5%.

During Q3 2010 the Tenge has depreciated in real terms against the US Dollar by 0.1% as compared to the previous period, by 1.4% against the Euro and remained unchanged against the Russian ruble (Figure 16).

Figure 16

Indices of real exchange rates of the Tenge (December 2000 = 100%)

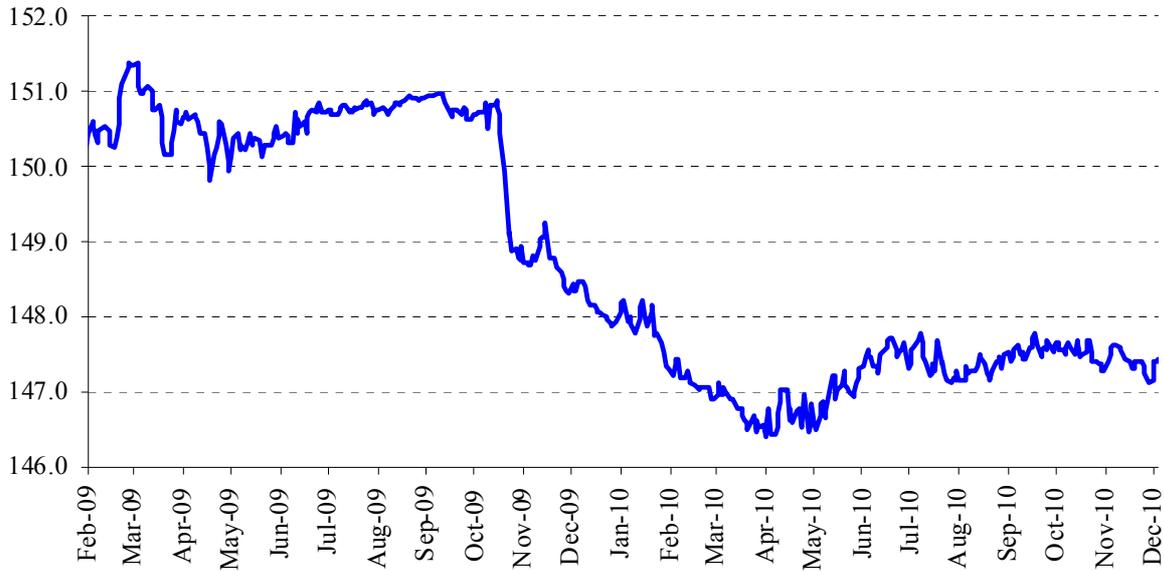


Source: National Bank of the Republic of Kazakhstan

– Nominal exchange Rate of the Tenge

The average weighted exchange rate of the Tenge for Q4 2010 at the stock exchange was KZT 147.46/1\$. The stock exchange rate at end-period was KZT 147.50/1\$. Since the beginning of the year the Tenge has appreciated against the US Dollar in nominal terms by 0.6% (Figure 17).

Figure 17

Dynamics of the nominal exchange rate of the Tenge against the U.S. Dollar

Source: National Bank of the Republic of Kazakhstan

In October and November the exchange rate of the Tenge versus the US Dollar virtually didn't change and in December it appreciated by 0.1%.

Since the transaction volumes in the Euro and the Russian ruble remain insignificant in the stock exchange segment of the domestic foreign exchange market, the exchange rate of the Tenge versus those currencies is calculated based on the cross-rate to US Dollar. So, the dynamics of the exchange rate of the Tenge versus the Euro and the Russian ruble were driven by the dynamics of the exchange rate of the Tenge versus the US Dollar, the status of the common European currency in the international financial market and the policy implemented by the Central Bank of Russia in respect of the exchange rate of the Russian ruble against the currency basket.

On the whole, during Q4 2010 the official exchange rate of the Tenge versus the Euro has appreciated by 2.6%, and versus the Russian ruble – by 0.2% (Figure 18).

Figure 18

Dynamics of the official exchange rate of the Tenge against the Euro and the Russian ruble



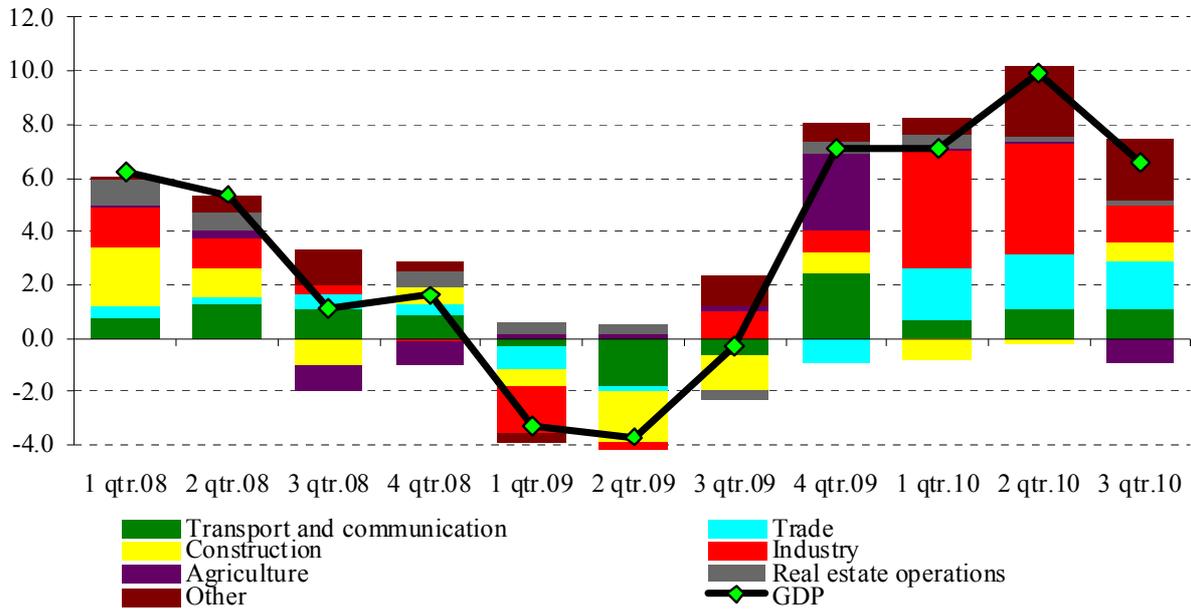
Source: National Bank of the Republic of Kazakhstan

2.2. Production

The volume of GDP output in Q3 2010 amounted to KZT 5505.7 bln. in current prices. Being positively influenced by the growth in production in virtually all sectors of the economy, except construction as well as financial and insurance activities, the GDP in real terms increased, according to estimates, by 6.5% versus Q3 2009 (in Q2 2010 the growth accounted for 10.0%) (Figure 19).

Figure 19

**Contribution of key sectors of the economy to growth in real GDP
(as % of the respective period of the previous year)**



Source: Information of the Agency of Statistics of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

The GDP growth was caused to a greater extent by the improved situation in the production of services, where the growth rate increased from 7.3% (Q2 2010) to 8.7%, whereas in the production of commodities the growth slowed down from 7.7% to 2.2%.

In the in construction – 104.6%, in agriculture – 93.6% that in the aggregate made a positive contribution of 1.2 % to the GDP formation.

In the production of services the decline in the index of physical volume in financial and insurance activities by 4.1% was fully neutralized by high growth in all other components, which resulted in positive contribution to the GDP formation at the level of 3.6%.

The decrease in Q3 2010 in the volume of financial intermediation services indirectly measured which are used with a negative sign in the total volume of GDP, contributed positively to the GDP growth in the amount of 0.4 %, and the growth of net taxes on products and imports increased the GDP by 1.3% in addition

2.3. Labor Market

2.3.1. Employment and Unemployment

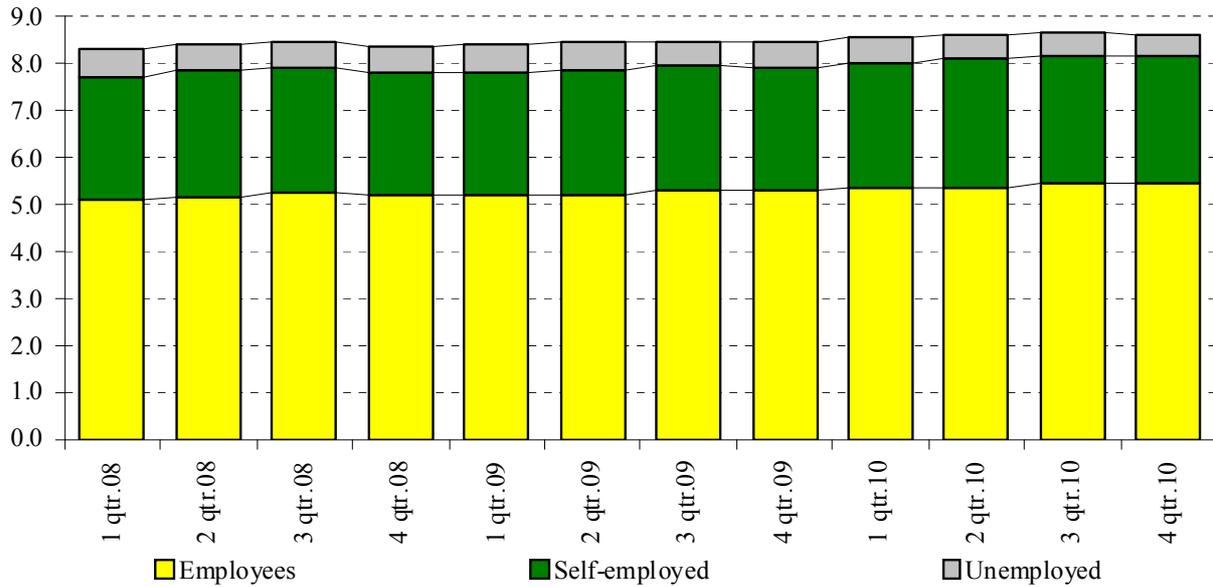
In Q4 2010 the number of people employed in the economy, according to tentative estimates, was 8.1 mln., having decreased by 0.4% versus the previous period. At the same time, the number of employees reached 5.5 mln. (growth by 0.2%), the number of self-employed – 2.7 mln. people (decline by 1.6%).

In the structure of employees, 4.5 mln. individuals (81.5% of all employees) were working in public and non-public institutions, for natural persons – 0.7 mln. individuals (12.6%), at farms – 0.3 mln. individuals (5.9%).

In Q4 2010 the number of unemployed amounted to 474.7 thous. individuals, having decreased by 1.4% as compared to the prior period and by 10.7% as compared to Q4 2009 (Figure 20).

Figure 20

The structure of economically active population, mln. individuals



Source: Agency of Statistics of the Republic of Kazakhstan

In October and November 2010 the following structural changes in the composition of employees were observed.

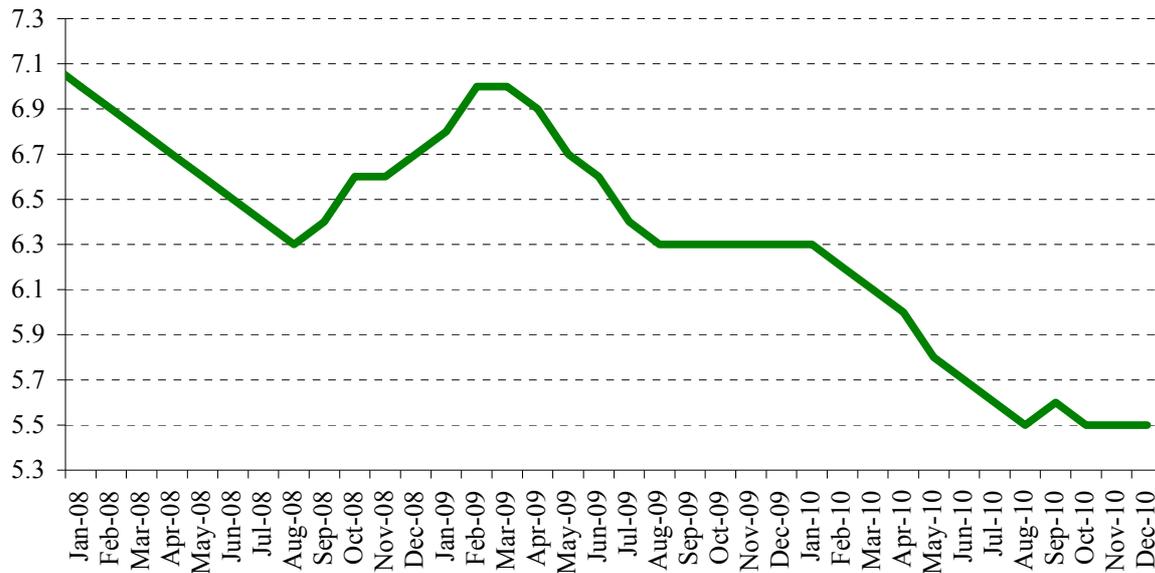
The main sectors that contributed to the growth in the employment rates, as compared to the respective period of 2009, were the industry; real estate operations; trade; transport and warehousing; education; public healthcare and social services; general government; accommodation and catering services.

The largest percentage of outflow of the employed was in the construction sector and agriculture.

The decrease in the number of employed in some sectors was largely compensated by their growth in other sectors, whereby the unemployment rate in Q4 2010, according to preliminary information, decreased by 0.1 percentage point and accounted for 5.5% (Figure 21).

Arrangements implemented as part of the Regional Employment and Staff Retraining Strategy (the Road Map) continue to have significant influence on decreasing the unemployment level and increasing employment.

Figure 21

Actual unemployment rate, %

Source: Agency of Statistics of the Republic of Kazakhstan

2.3.2. Wages and Productivity

The twenty five percent increase in scholarships and wages to the public sector employees from Q2 2010 resulted in accelerated nominal and real growth in wages, as compared to 2009.

After the slowdown in the growth rate of nominal wages in Q1 2010, the growth rate accelerated significantly in the two subsequent quarters. In Q3 2010 as compared to the respective period of 2009, the average monthly wages grew by 17.6% in nominal terms (in Q3 2009 – by 8.7 %), the real wage increased by 10.3% (in Q3 2009 – by 2.2%).

The highest increase in wages was observed in the first month of Q3 2010. In July 2010 as compared to July 2009, wages in nominal terms increased by 18.0%, and in real terms – by 10.6%.

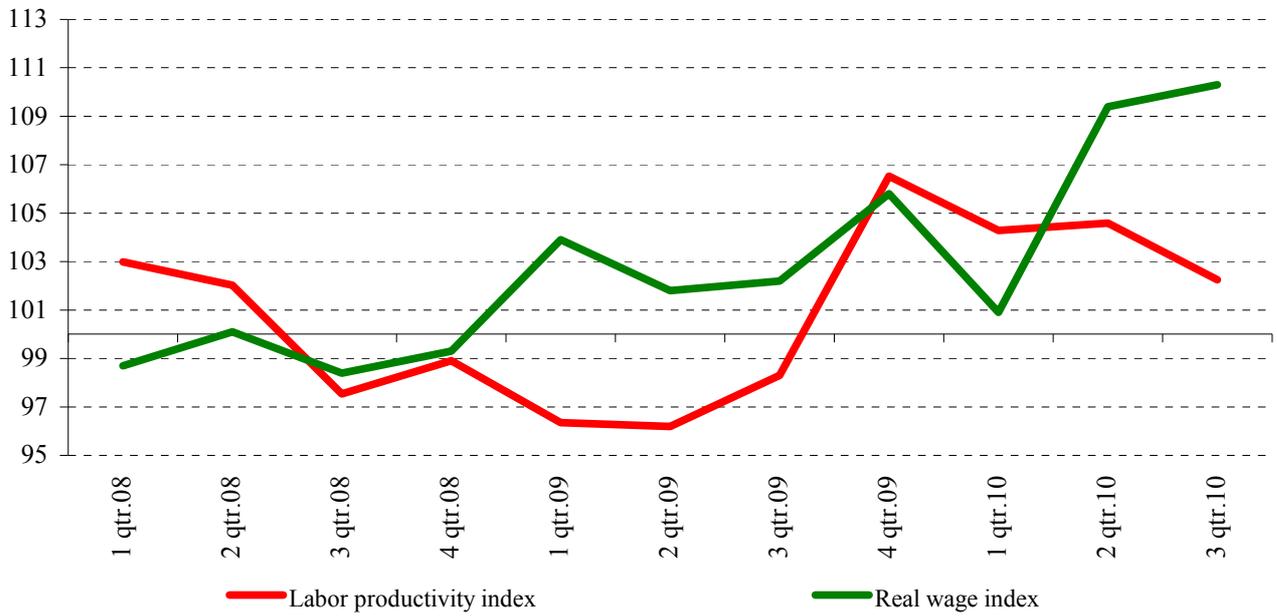
In Q3 2010 the real wage index accounted for 110.3% as compared to the respective quarter of the previous year, which represents the maximum growth rate since 2007. The wage growth was observed in virtually all sectors of the economy. The highest growth in wages was in such types of economic activity as: “ancillary educational services” (two-fold growth); “repair of computers, items of personal consumption and household goods” (by 54.6%); “veterinary business” (by 36.9%). The maximum amount of average monthly wage of one employee was in such sector as “employment assistance” – KZT 545.5 thous., minimum – in “fishery and aquaculture” (KZT 29.3 thous.).

In November 2010 the real wage index was 106.1% as compared to the respective month of the last year. The highest increase was noted in such sectors as “ancillary educational services” (by 3.3 times) and “air freight service and space transportation system” (by 49.1%), and the decline – in “production of motion-picture and video films, television programs, soundtracks and recorded music” (by 31.8%).

The increase in wages to the public sector employees from Q2 2010 impacted labor productivity where the growth index slowed down amounting to 2.3% in Q3 2010, according to the National Bank’s estimate (Q2 2010 – 4.6%) (Figure 22).

Figure 22

**Dynamics of labor productivity and real wages
(as % of the respective period of the previous year)**



Source: Agency of Statistics of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

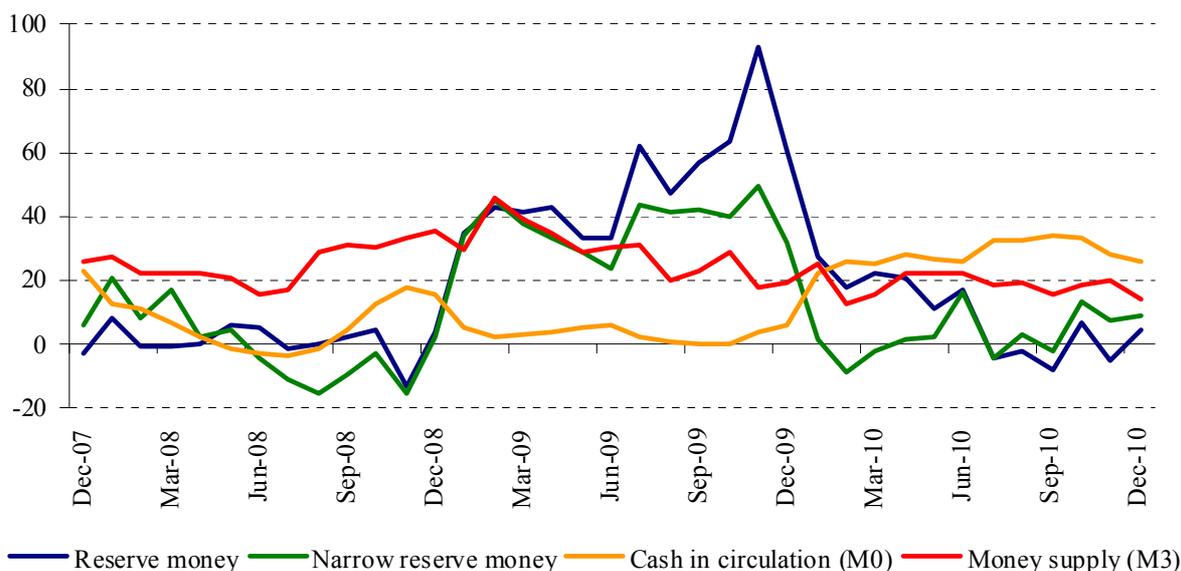
3. Money Supply

3.1. Monetary Aggregates

In Q3 2010 annual dynamics of cash in circulation demonstrated quite remarkable growth rates, whereas increases in money supply, reserve money and narrow reserve money were moderate (Figure 23).

Figure 23

Dynamics of monetary aggregates (as % of the respective month of the previous year)



Source: National Bank of the Republic of Kazakhstan

3.1.1. Reserve Money

Reserve money in Q4 2010 expanded by 1.7% and amounted to KZT 2572.9 bln. at end-December 2010. Narrow reserve money contracted by 0.9% to KZT 2143.7 bln.

In 2010 reserve money expanded by 5.0% as compared to December 2009.

Net international reserves of the National Bank increased by 23.0% to US\$ 27.7 bln. in December 2010 as compared to the respective period of 2009. Within their structure, despite operations on the servicing of the Government's external debt and decrease in foreign currency balances with the correspondent accounts of the second-tier banks at the National Bank, net currency reserves increased as a result of foreign exchange purchase in the domestic foreign exchange market and currency proceeds to the Government's accounts at the National Bank. Assets denominated in gold also increased.

In December 2010 as compared to December 2009 net domestic assets of the National Bank decreased (Table 2), mainly because of a significant increase in liabilities to banks on short-term notes.

Table 2

**Dynamics of changes in assets and liabilities of the National Bank
(as % of the respective period of the previous year)**

	1 qtr. 10	2 qtr. 10	3 qtr. 10	4 qtr. 10
Net international reserves	41.1	40.8	36.1	23.0
Net domestic assets	-634.7	-341.1	-364.5	-498.0
Net claims on the Government	-12.6	-67.9	-83.5	-64.4
Claims on the economy	-197.0	-169.2	-154.3	-222.4
Other net domestic assets	-7.9	2.2	-18.8	-20.3
Reserve money	22.3	17.3	-7.9	5.0
Narrow reserve money	-1.7	16.8	-1.8	9.3

Source: National Bank of the Republic of Kazakhstan

3.1.2. Money Supply

During Q4 2010 money supply increased by 1.6% to KZT 8546.4 bln.

In December 2010 as compared to December 2009 its growth accounted for 14.1% as a result of increase in net foreign assets of the banking system (Table 3).

Table 3

**Dynamics of changes in money supply
(as % of the respective period of the previous year)**

	1 qtr. 10	2 qtr. 10	3 qtr. 10	4 qtr. 10
Net foreign assets	121.3	132.6	138.3	63.3
Domestic assets	-10.3	-12.3	-27.4	-14.2
Claims on the Government	506.1	425.6	166.2	72.4
Claims on the economy	5.3	5.1	3.6	6.1
Other net domestic assets	-30.9	-26.0	-42.1	28.4
Money supply	16.0	22.1	15.9	14.1
Cash in circulation	25.1	26.3	34.2	25.7
Deposits of residents	14.9	21.6	13.6	12.5

Source: National Bank of the Republic of Kazakhstan

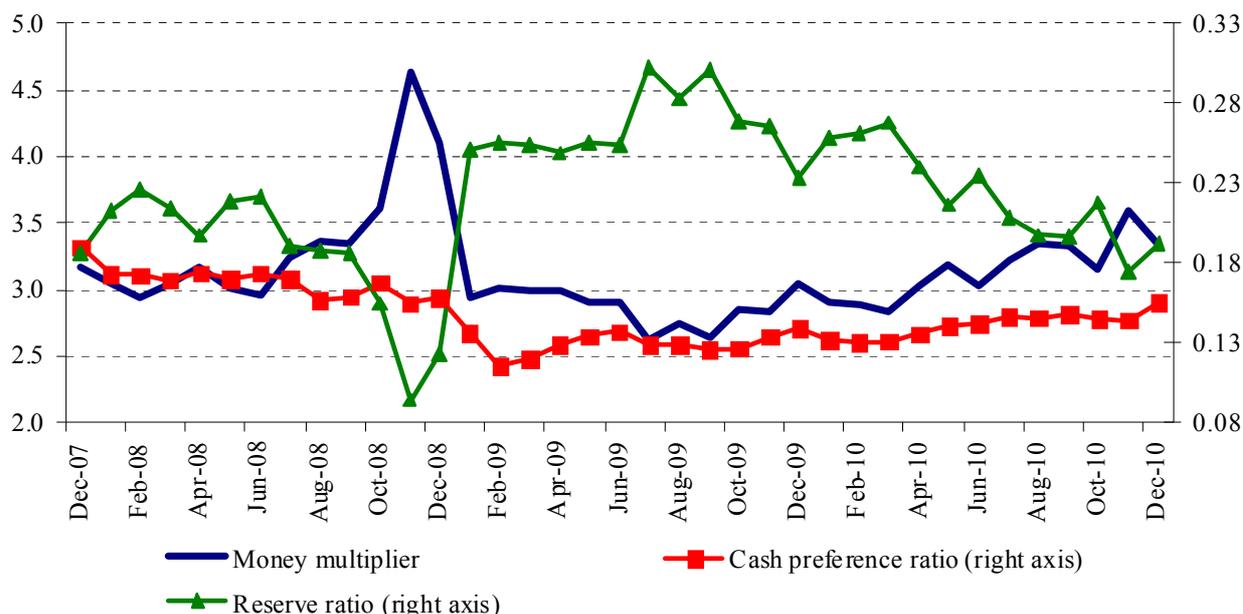
In the structure of net foreign assets of the banking system in December 2010 as compared to December 2009 net foreign assets increased, both of banks and of the National Bank. The growth in net foreign assets of banks was mainly stipulated by the decreased claims of non-residents on banks.

In the structure of the main components of money supply the outstripping growth rates of cash in circulation were noted as compared to the growth rates of residents' deposits in the banking system. As a result, the share of deposits of residents in the structure of the money supply decreased from 87.8% in December 2009 to 86.6% at end-December 2010.

The money multiplier grew from 3.06 in December 2009 to 3.32 in December 2010 as a result of outstripping growth in the money supply against the rates of expansion of the reserve money. The reason for that was the decreased reserve ratio alongside with an increase in cash preference ratio (Figure 24).

Figure 24

Dynamics of money multiplier and its components



Source: National Bank of the Republic of Kazakhstan

3.1.3. Cash in Circulation

The volume of cash in circulation in Q4 2010 increased by 5.7% to KZT 1148.5 bln. The main reasons for the increase in the cash in circulation were the growth in net payouts on wages, net payoffs on individuals’ time deposits and payouts for retirement benefits and allowances. At the same time, the impact of these factors was not neutralized by the growth in net proceeds from the sale of goods, services and performed works, net proceeds from the foreign exchange sales, and net proceeds from loans to individuals and legal entities recorded in Q4 2010.

In December 2010 as compared to December 2009 cash in circulation increased by 25.7%. This shows that the impact of factors contributing to the growth in cash (the increase in wages, retirement benefits and allowances) was dominating over the impact of factors which contributed to its decrease (increased volumes of foreign cash sold by the exchange offices, increased deposit balances, proceeds from sales of goods, works and services, etc.).

In Q4 2010 as compared to Q4 2009 payouts of cash from bank cashier departments increased by 14.1% to KZT 3284.4 bln., cash receipts to bank cashier departments – by 14.9% to KZT 3003.4 bln. As a result, net payouts from bank cashier departments amounted to KZT 281.0 bln.

3.2. Financial Market

3.2.1. Deposits of Residents

At end-December 2010 deposits of residents amounted to KZT 7397.9 bln., having increased by 1.0% during Q4 2010. Deposits of legal entities decreased by 0.8%, deposits of individuals – increased by 5.4%. Deposits in the domestic currency increased by 2.4% to KZT 4807.9 bln., deposits in foreign currency – decreased by 1.5% amounting to KZT 2590.0 bln.

Since the beginning of 2010 the growth in deposits of residents amounted to 12.5% and was secured by the growth in the domestic currency deposits by 30.0% whereas deposits in foreign currency decreased by 9.9% (Table 4).

Table 4

**Dynamics of changes in residents' deposits
(as % to December of the previous year)**

	Dec.07	Dec.08	Dec.09	Dec.10
Deposits of residents	26.4	39.1	21.5	12.5
<i>of the population</i>	<i>40.5</i>	<i>2.8</i>	<i>28.5</i>	<i>15.9</i>
<i>of non-bank legal entities</i>	<i>19.5</i>	<i>60.2</i>	<i>18.9</i>	<i>11.2</i>
Deposits in the Tenge	32.7	32.0	5.9	30.0
Deposits in foreign currency	14.9	54.0	50.0	-9.9

Source: National Bank of the Republic of Kazakhstan

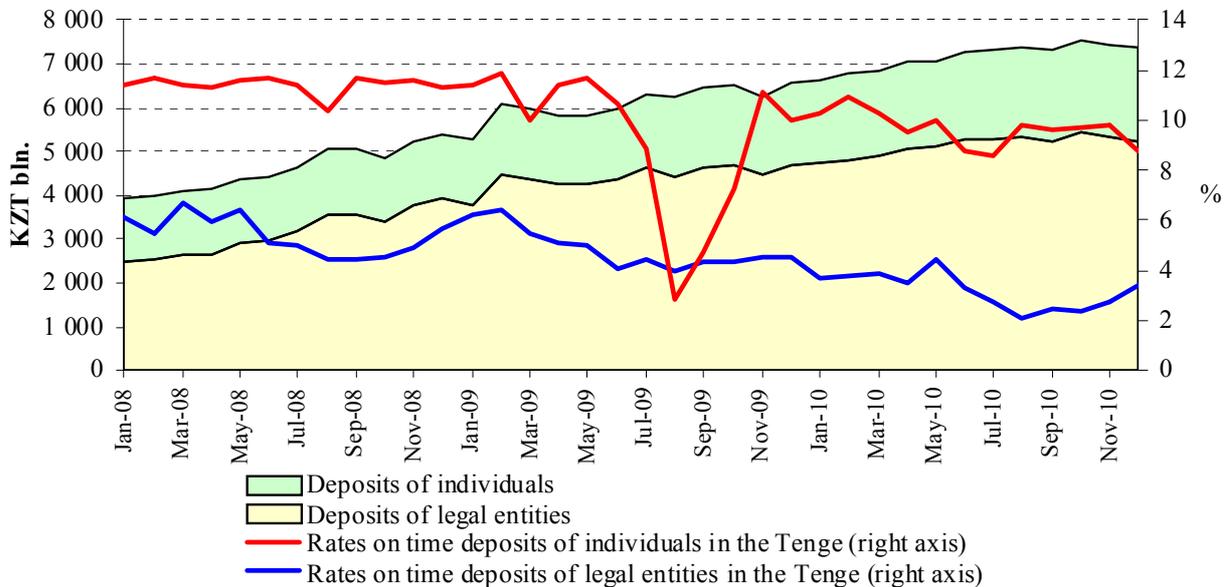
In 2010 the dynamics in deposits of residents were characterized by the highest growth rates of deposits in the second quarter, with a gradual slowdown in the third and fourth quarters. These changes were caused by the transformation of foreign currency deposits of legal entities and individuals.

The interest rates on deposits – both in the domestic currency and in foreign currency – have been generally lower during 2010 than in 2009.

The average weighted interest rate on the Tenge time deposits of non-bank legal entities was 3.4% in December 2010 (in December 2009 – 4.5%), and on deposits of individuals – 8.8% (10.0%) (Figure 25).

Figure 25

Dynamics of deposits and their interest rates



Source: National Bank of the Republic of Kazakhstan

Measures taken by the government to ensure financial stability continue to maintain the high level of confidence of the population in the banking system, which serves as the basis for stable growth of the deposit base of individuals. In its turn, a strong recovery in the growth

rate of the Kazakh economy stipulated the decrease in the volume of funds coming as part of the anti-crisis actions influencing the deposit base of legal entities, which decreased by 0.8% in Q4 2010.

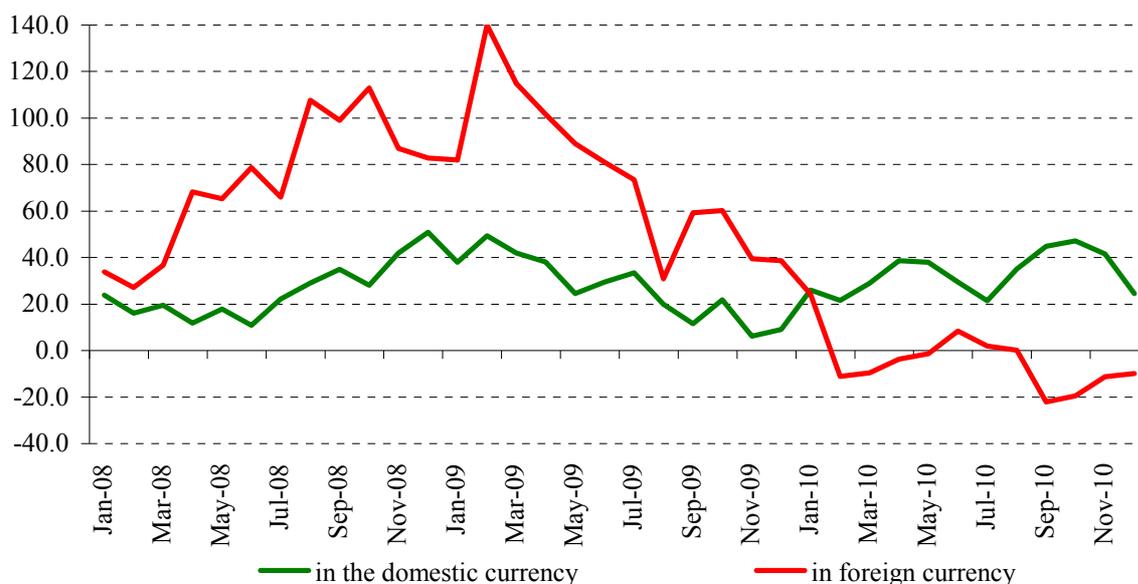
The volume of deposits of legal entities increased by 13.8% in December 2010, as compared to December 2009. Deposits of legal entities in the domestic currency increased in annual terms by 24.5%, and in foreign currency – decreased by 9.9% (Figure 26).

The main trend in the deposit market of 2010 was the decrease of the degree of dollarization of deposits ensured by a decreased volume of foreign currency deposits and the growth of the domestic currency savings. The percentage of foreign currency deposits in December 2010 decreased to 35% versus 43.7% in December 2009.

Since the exchange rate of the Tenge versus the US Dollar has been stable in 2010, devaluation expectations reduced significantly and the return on deposits started to be the major factor in attraction of savings. As a result, a higher interest rate on the Tenge deposits appeared to be the main incentive which dominated in the preferences of legal entities and the population.

Figure 26

**Dynamics of the change in deposits of legal entities
(as % of the respective period of the previous year)**

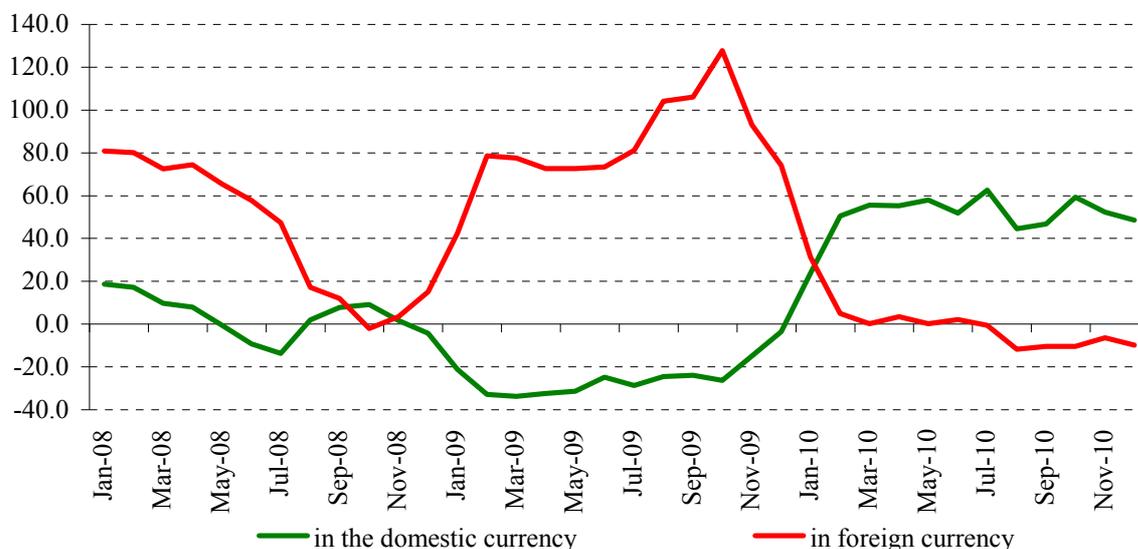


Source: National Bank of the Republic of Kazakhstan

The volume of deposits of individuals in December 2010 as compared to December 2009 increased by 15.9%. Deposits of individuals in the domestic currency increased in annual terms by 48.7%, in foreign currency – decreased by 9.9% (Figure 27).

Figure 27

**Dynamics of the change in deposits of individuals
(as % of the respective period of the previous year)**



Source: National Bank of the Republic of Kazakhstan

3.2.2. Credits to the Economy

During Q4 2010 bank credits to the economy increased by 1.4% to KZT 7596.5 bln. Credits to legal entities increased by 2.1%, credits to the population decreased by 0.4%.

As compared to December 2009, the lending volume decreased by 0.6%, including the increase in credits to legal entities by 1.2%, and the decrease in credits to individuals by 4.9%.

The average weighted rate on credits to legal entities decreased from 12.7% to 11.9% in December 2010 as compared to December 2009. This was caused by the decrease in the cost of borrowing for legal entities, both in the domestic currency and foreign currency, with a more significant decrease in the rates on credits in the domestic currency.

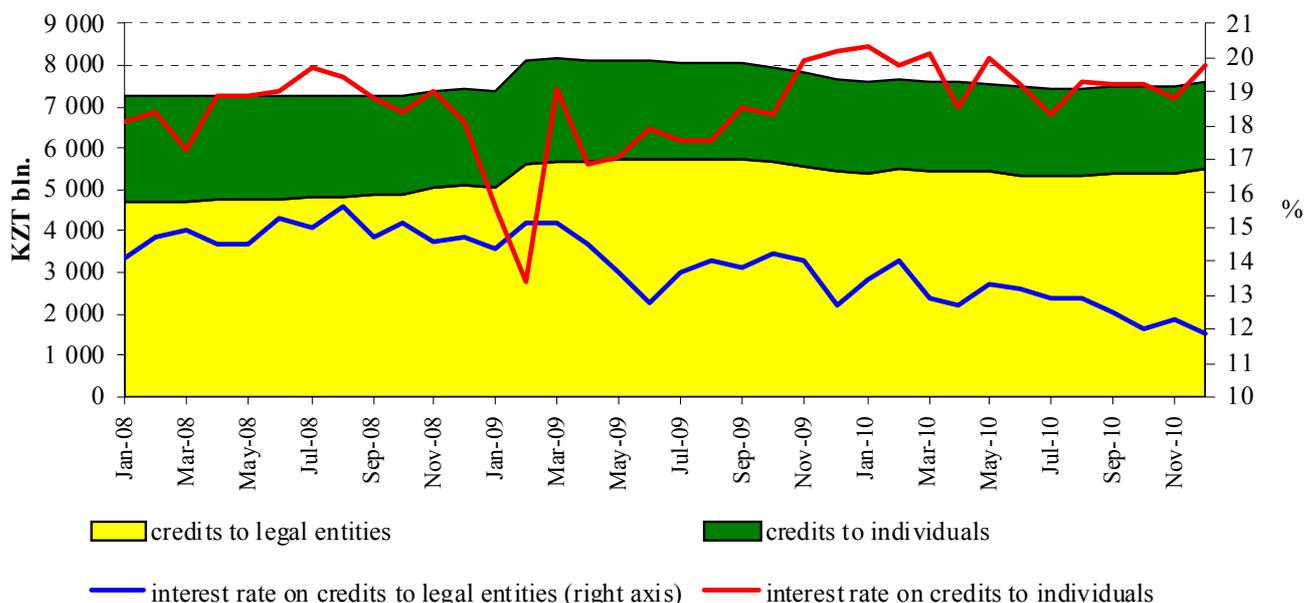
The average weighted rate on credits to individuals decreased from 20.2% to 19.8% in December 2010, which was caused by the growth of rates on loans in the domestic currency (Figure 28).

In the structure of credits by objects of financing the major volume of debt falls on credits provided for the purchase of fixed assets, for new construction and reconstruction as well as for other purposes, mainly for refinancing of earlier loans.

In a sectoral breakdown, the highest debt on bank credits falls on non-production sphere and individual entrepreneurship (40.6%), trade (24.0%), construction (18.1%), and industry (9.4%).

Figure 28

Dynamics of credits to the economy and their interest rates

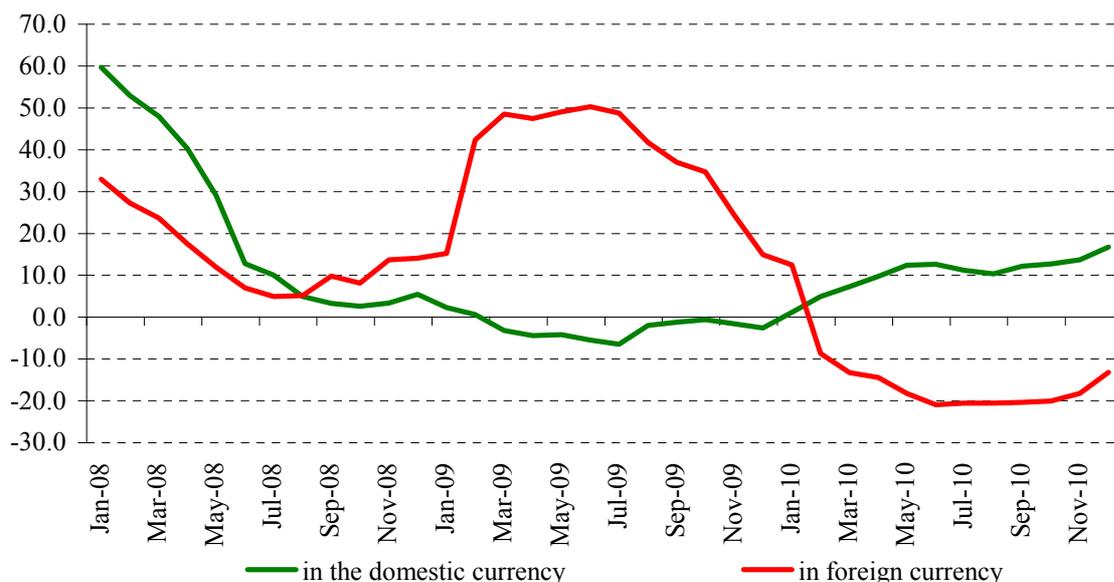


Source: National Bank of the Republic of Kazakhstan

The volume of credits to legal entities decreased in December 2010 as compared to December 2009 increased by 1.2%. Credits to legal entities in the domestic currency increased by 16.8% in annual terms, and credits in foreign currency decreased by 13.1% (Figure 29).

Figure 29

Dynamics of credits to legal entities (as % of the respective period of the previous year)



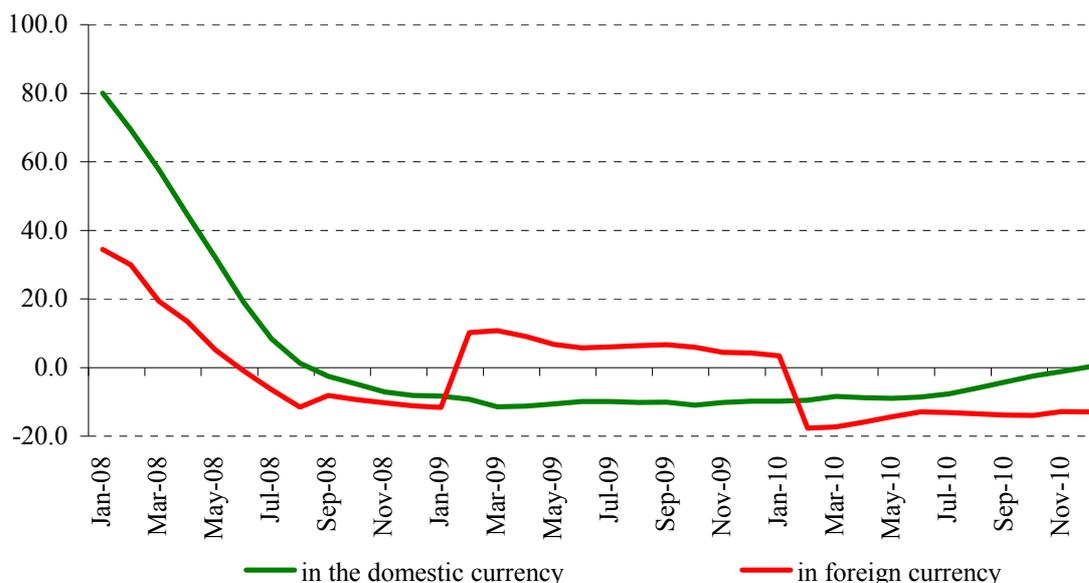
Source: National Bank of the Republic of Kazakhstan

The share of medium- and long-term credits at end-December 2010 amounted to 78.7% in the total volume of credits to legal entities (in December 2009 – 78.7%).

The volume of credits to individuals decreased by 4.9% in December 2010, as compared to the respective period of 2009. In the structure of credits to the population, credits in the domestic currency have demonstrated the increase by 0.2% and in foreign currency – the decrease by 12.9% (Figure 30).

Figure 30

**Dynamics of credits to the population
(as % of the respective period of the previous year)**



Source: National Bank of the Republic of Kazakhstan

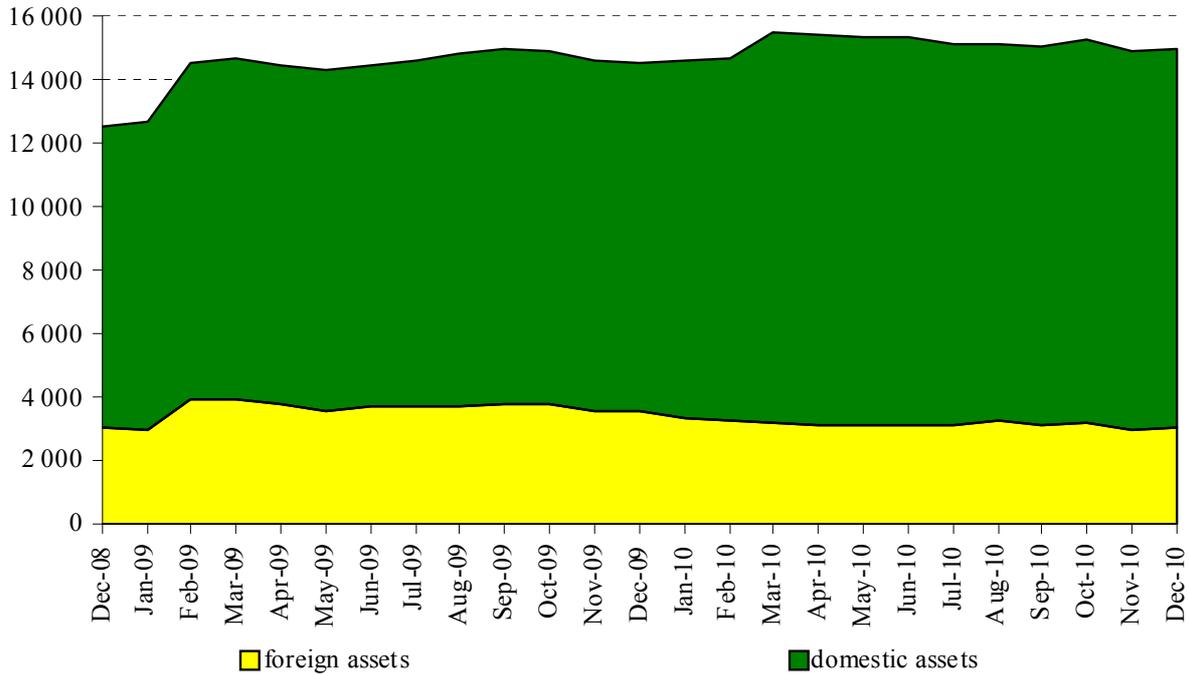
3.2.3. Bank Assets and Liabilities

– **Assets**

In Q4 2010 the amount of bank assets calculated under the Monetary Survey decreased by 0.5% to KZT 15.0 trln. Bank assets increased by 3.0% in annual terms (in December 2010 as compared to December 2009). (Figure 31).

Figure 31

Dynamics of bank assets, KZT bln.



Source: National Bank of the Republic of Kazakhstan

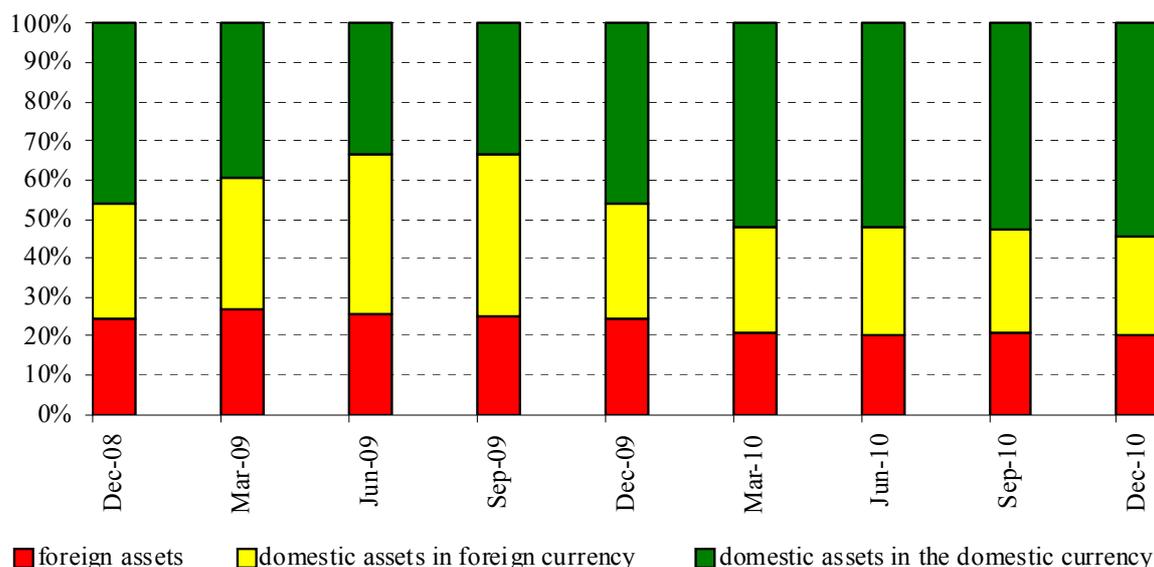
Foreign assets of banks in December 2010 accounted for 20.2% of the total volume of assets or US\$ 20.6 bln. They have decreased by 14.6% as compared to December 2009, by 3.3% - as compared to September 2010.

In the structure of foreign assets in December 2010, credits to non-residents accounted for 49.6% (in September 2010 – 55.2%), deposits placed with non-residents – 28.5% (in September 2010 – 20.3%), securities of non-residents – 4.8 % (in September 2010 - 5.6%), other accounts receivable – 17.2% (in September 2010 – 18.9%).

Domestic assets in December 2010 accounted for 79.8% or KZT 12.0 trln., where assets in the domestic currency amounted to 68.1% or KZT 8.2 trln. and assets in foreign currency – 31.9% or KZT 3.8 trln. In September-December 2010 domestic assets increased by 0.3%, including the increase in the domestic currency assets by 2.6% and the decrease in foreign currency assets by 4.3%. As compared to December 2009, the growth in these indicators reached 8.6%, 21.6% and -11.7%, respectively (Figure 32).

Figure 32

Structure of bank assets, %



Source: National Bank of the Republic of Kazakhstan

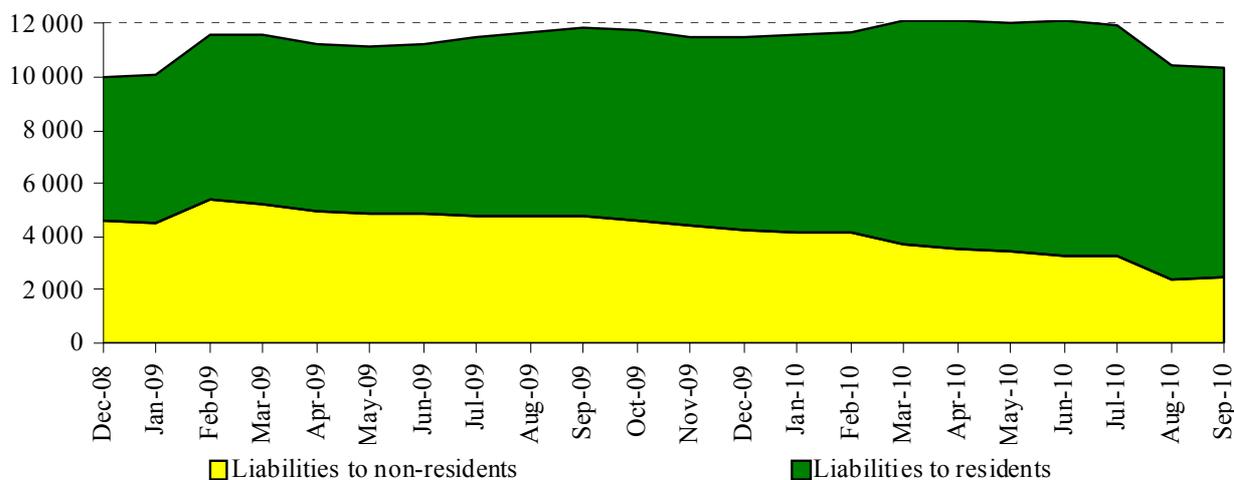
In September-December 2010 the quality of bank assets somewhat improved. The share of bad assets decreased from 17.7% to 15.3%, and the share of standard assets increased from 47.6% to 48.3%, at the same time the share of doubtful assets increased from 34.7% to 36.4%. Besides, there is a multi-directional asset migration in the structure of doubtful assets. The share of the 5th category of assets increased from 7.8% to 9.2%, of the 3rd category increased from 6.0% to 7.1%. The share of assets of the 4th category decreased from 3.8% to 3.6% and of the 1st category – from 12.8% to 12.3%. The share of the 2nd category of assets remained unchanged (4.2%). This is an evidence of the remaining threat of the deterioration in the quality of bank assets.

As a whole, under the Monetary Survey for Q4 2010, bank assets showed some decrease. A high level of credit risk and low asset quality still represent weak aspects of the Kazakh banking system. As before, banks maintain their conservative investment policy and avoid crediting the economy. At the same time, the quality of credit portfolio of Kazakh banks slightly improved (the share of bad credits decreased from 23.3% to 20.0%, and the share of standard credits increased from 26.0% to 26.4%). Generally, the situation with troubled debt, as broadly defined, including restructured credits has been gradually stabilizing. The policy of banks and authorized body focused on accumulation of significant reserves will help leveling down future problem debt write offs.

– Liabilities

In Q4 2010 total bank liabilities calculated in line with the Monetary Survey increased by 1.1% and amounted to KZT 10.5 trln. at end-December 2010. In December 2010 as compared to December 2009 bank liabilities decreased by 9.0% (Figure 33).

Figure 33

Dynamics of bank liabilities, KZT bln.

Source: National Bank of the Republic of Kazakhstan

Bank liabilities to non-residents decreased by 10.0% to US\$ 16.6 bln. in September 2010 as compared to December 2009. Bank liabilities decreased by 48.7% versus the respective month of 2009. At end-September 2010 they accounted for 23.7% of the volume of bank liabilities.

Bank liabilities to non-residents increased by 5.5% to US\$ 17.5 bln. in December 2010 as compared to September 2010. Bank liabilities decreased by 37.3% versus the respective month of 2009. At end-December 2010 they accounted for 24.7% of the volume of bank liabilities.

In December 2010 in the structure of bank liabilities to non-residents, liabilities on deposits of non-residents increased from 6.6% to 9.6% in September 2010, liabilities on securities decreased from 67.2% to 65.0%. Credits from non-residents also decreased to 23.2% from 23.8% in September 2010.

In September-December 2010 liabilities to non-residents also decreased by 0.3% to KZT 7.86 trln., including the decrease in liabilities in the domestic currency by 0.6% to KZT 5.3 trln., and the increase in foreign currency liabilities by 0.4% to KZT 2.6 trln. the change in these indicators versus the respective month of 2009 amounted to -9.0%, - 37.3% and 6.8%, respectively (Figure 34).

Thus, in Q4 2010 there was a decrease in liabilities to residents and an increase in liabilities to non-residents. The restructuring process in three Kazakh banks (BTA Bank, Alliance Bank and Temir Bank) has been accomplished successfully, with the risk-sharing with the creditors. As a result, total foreign debt of these banks decreased by over US\$ 11.0 bln. The outcomes of these efforts contributed to creating conditions for the improvement of the situation in the banking sector and pre-requisites for its development in the post-crisis period. Moreover, the restructuring helped meeting one more challenge for the banking sector in early 2010 – reducing the external debt of the banking sector within total liabilities to the level not exceeding 30%. Particularly, the share of foreign liabilities of banks in their total liabilities decreased to 23.9%¹ at end-2010 versus 33.6%¹ at end-2009.

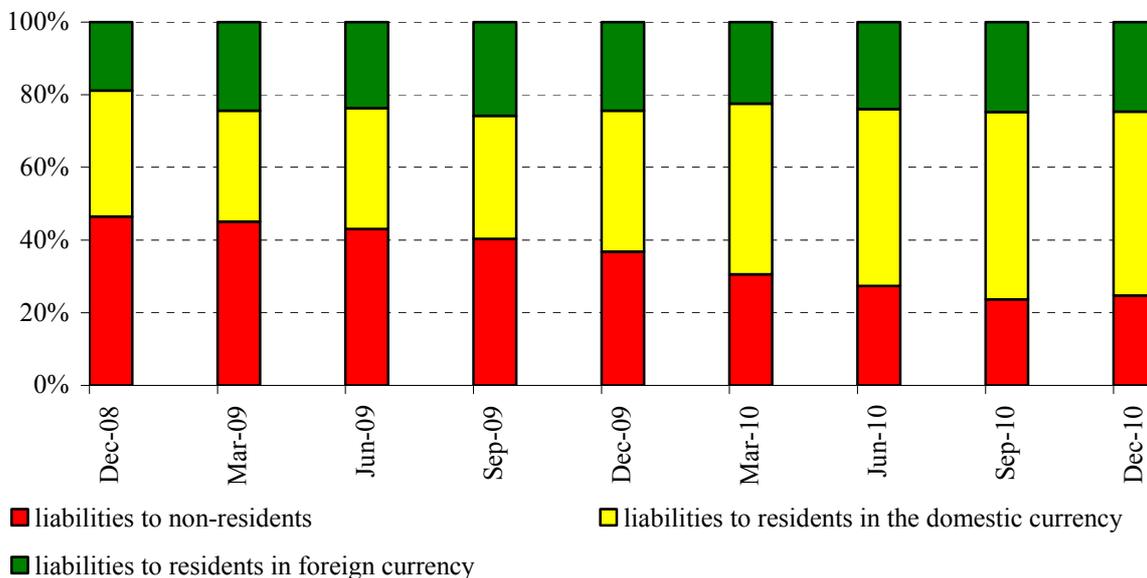
As a whole, in 2010 the trend of replacing the external funding by the domestic funding sources such as domestic deposits was continuing. Under the Concept of the

¹ According to the FSA's data

Financial Sector Development in the Post-crisis Period, deposits of the population and legal entities with banks should remain the main funding source for the financial sector.

Figure 34

Structure of bank liabilities, %



Source: National Bank of the Republic of Kazakhstan

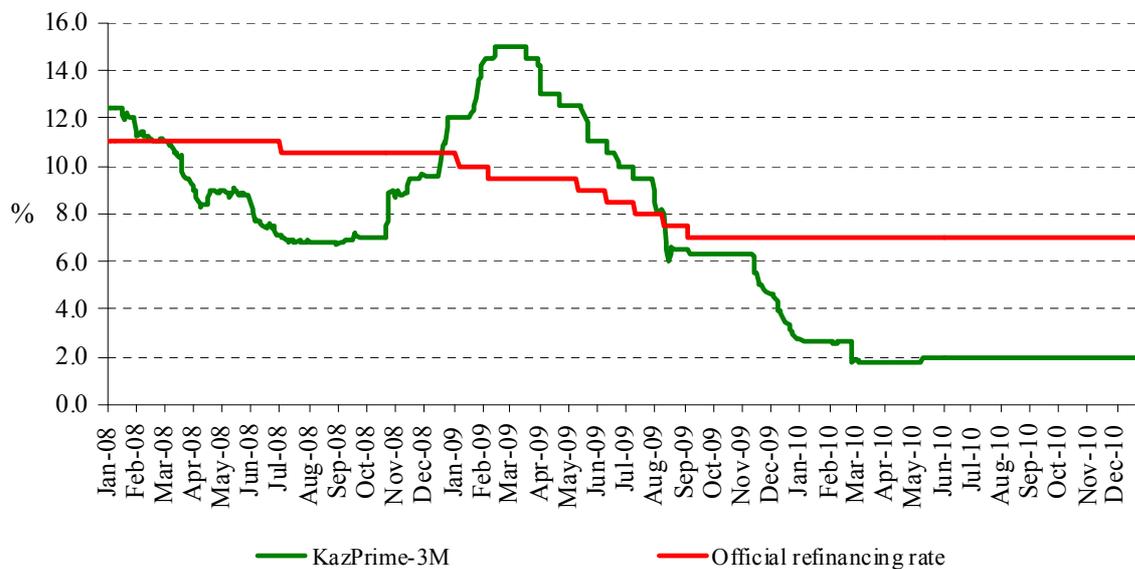
3.2.4. Financial Market Rates

In Q4 2010 there was some decrease in the interbank market rates.

The KazPrime index decreased from 2.00% on average in Q3 2010 to 1.98% on average in Q4 2010. At end-September 2010 this indicator was 1.98%, and at end-December – 2.00% (Figure 35).

Figure 35

Dynamics of the KazPrime index and the official refinancing rate, %



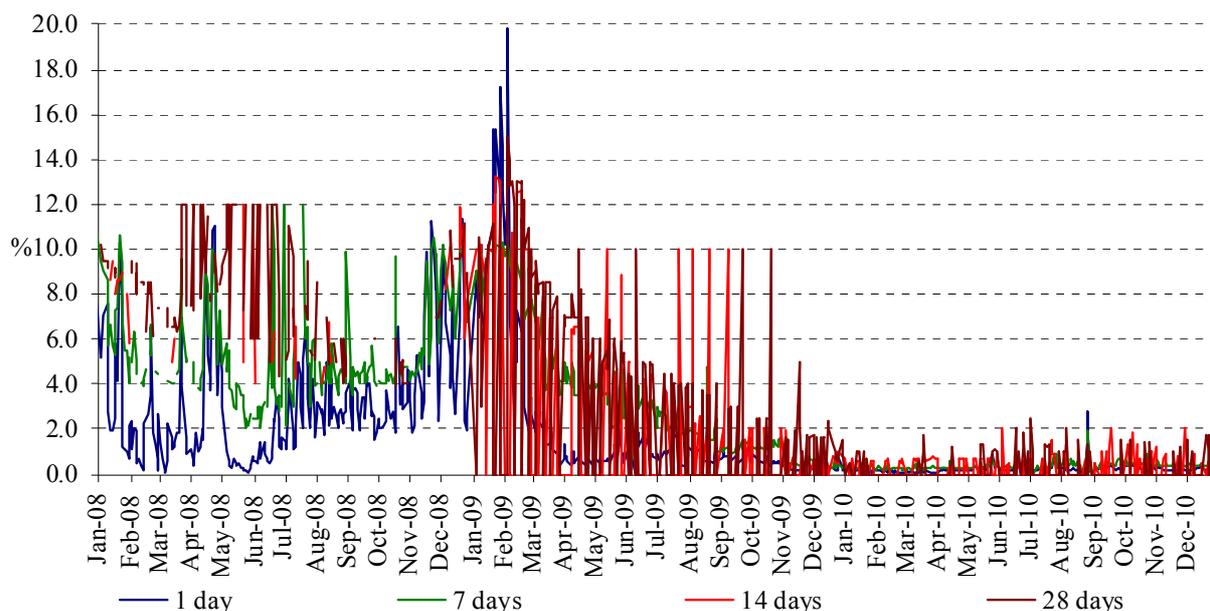
Source: Kazakhstan Stock Exchange, National Bank of the Republic of Kazakhstan

The average weighted rate on 1-day operations in the sector of the automatic REPO in Q4 2010 decreased and was 0.28% (in Q3 2010 – 0.36%). Its maximum level was 0.57% and minimum – 0.11%.

Rate fluctuations on 7-day REPO operations in Q4 2010 were within the range of 0.30% to 0.90% (the average weighted rate was 0.41%), on 14-day REPO operations – from 0.50% to 2.00% (the average weighted rate was 0.76%), and on 28-day REPO operations – from 1.00% to 1.70% (the average weighted rate was 1.24%) (Figure 36).

Figure 36

Dynamics of rates on REPO operations, %



Source: Kazakhstan Stock Exchange

The rate volatility in the money market remains high because of small market capacity, its insignificant depth, the lack of sufficient number of instruments of pledge, and low activity of the market players.

In Q4 2010 the transaction volumes in the sector of the automatic REPO increased by 4.7% as compared to the previous quarter. At the same time, the volumes on 1-day, 2-day and 28-day REPO operations decreased as compared to Q3 2010.

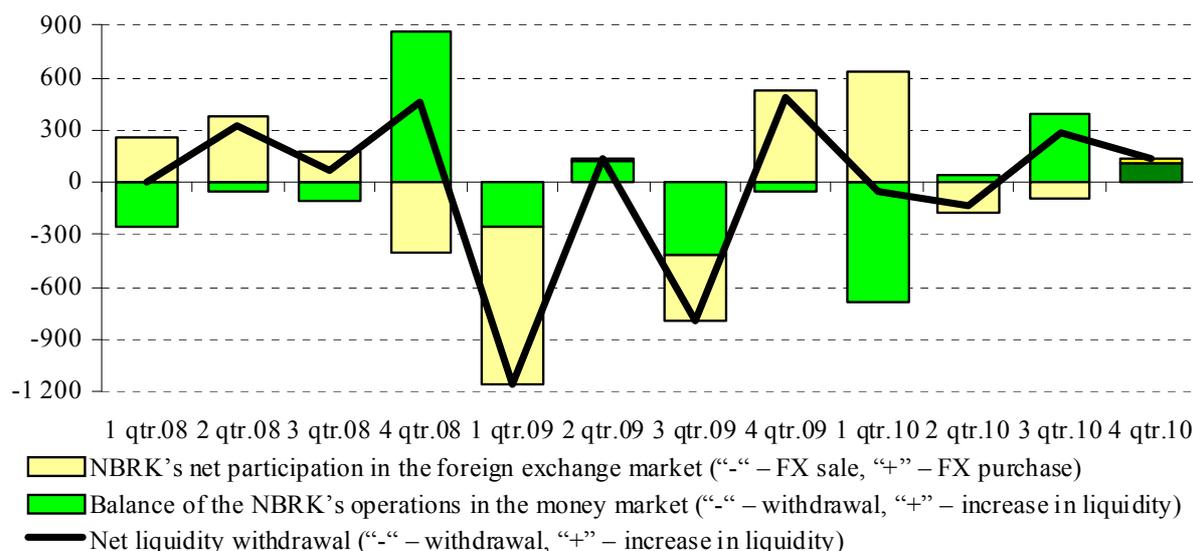
4. Monetary Policy Instruments and Operations

In Q4 2010 the situation in the financial market was stable, banks had sufficient Tenge liquidity.

In Q4 2010 the National Bank's operations in the financial market resulted in the supply of the Tenge liquidity mainly because of the decrease in balances with correspondent accounts of banks at the National Bank (Figure 37).

Figure 37

Balance of the National Bank's operations in the domestic market, KZT bln.



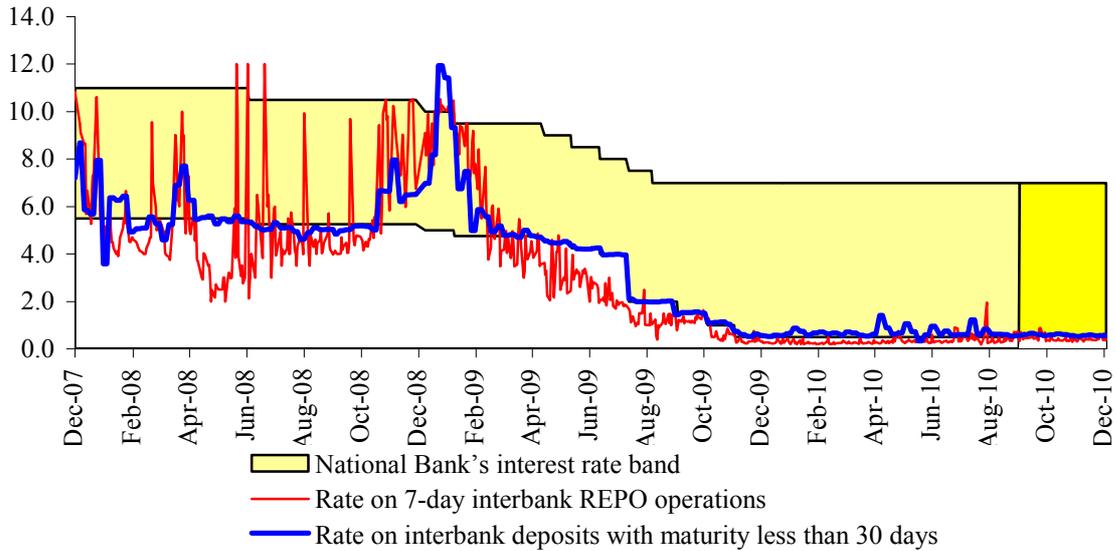
Source: National Bank of the Republic of Kazakhstan

In Q4 2010 the National Bank's rate band remained unchanged. From October 1, 2010 based on the Resolution of the National Bank's Board, the official refinancing rate stayed at the same level – 7.0%. The rates on deposits attracted from banks also didn't change: the rate on 7-day deposits is 0.5%, on 1-month deposits – 1.0%.

In Q4 2010 the situation in the money market was characterized by lower interest rate volatility as compared to Q3 2010. On average, in Q4 2010 the level of rates was closer to the lower boundary of the National Bank's rate band. The average weighted rate on interbank deposits with maturity less than 30 days was 0.59% in Q4 2010. The average weighted rate on interbank 7-day REPO operations was 0.41% (Figure 38).

Figure 38

Boundaries of the National Bank's interest rates band, %

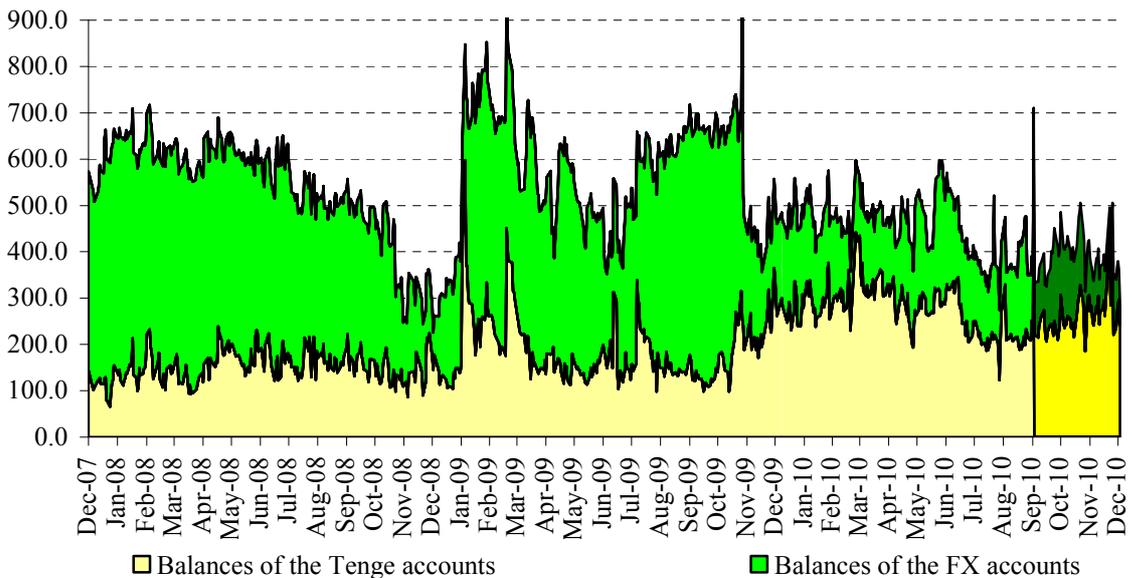


Source: National Bank of the Republic of Kazakhstan

In October-December 2010 the dynamic in correspondent account balances of banks with the National Bank was multi-directional. In October correspondent account balances of banks in foreign currency were increasing, from the second half of November a downward trend appeared which increased by the end of December. As a result, at end-December 2010 their volume decreased by more than twice as compared to September. Correspondent account balances of banks in the domestic currency in Q4 2010 were volatile and there was an overall trend for their growth (Figure 39).

Figure 39

Balances of correspondent accounts with the National Bank, KZT bln.



Source: National Bank of the Republic of Kazakhstan

4.1. Interventions in the Domestic Foreign Exchange Market

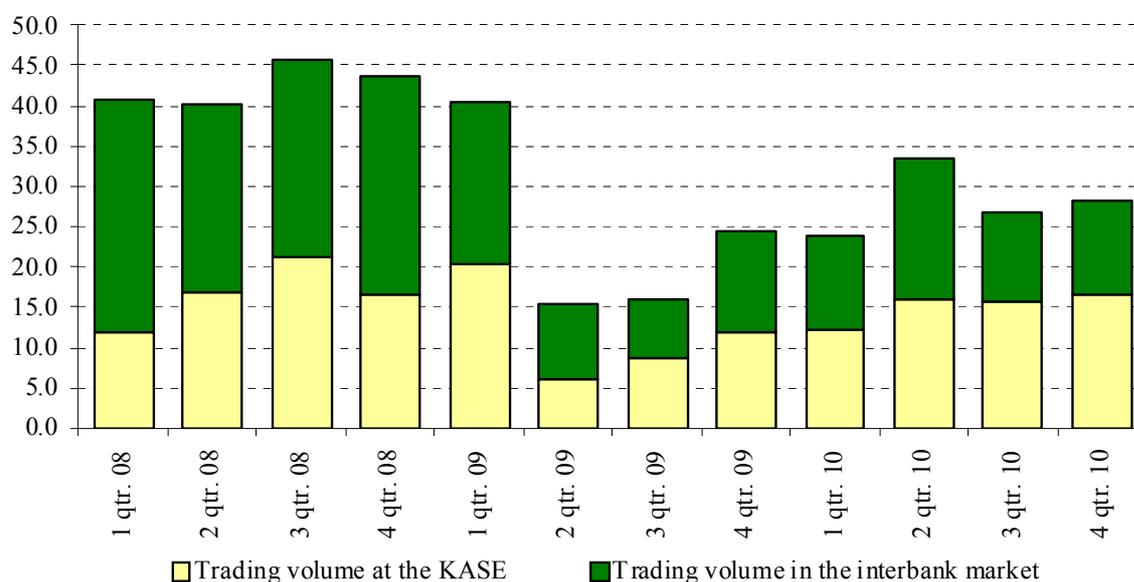
The situation in the domestic foreign exchange market was characterized by relative stability.

In Q4 2010 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank foreign exchange market amounted to US\$ 28.3 bln., having increased (by 5.2%) as compared to Q3 2010.

The volume of trades in the Dollar position at the Kazakhstan Stock Exchange increased by 5.9% as compared to Q3 2010 and amounted to US\$ 16.7 bln. (net trades at the Kazakhstan Stock Exchange made up 84% of gross trades). In the off-exchange foreign currency market the volume of transactions in Q4 2010 increased by 4.2% as compared to the previous quarter and amounted to US\$ 11.6 bln. (Figure 40).

Figure 40

Volume of trading in the domestic exchange market, US\$ bln.

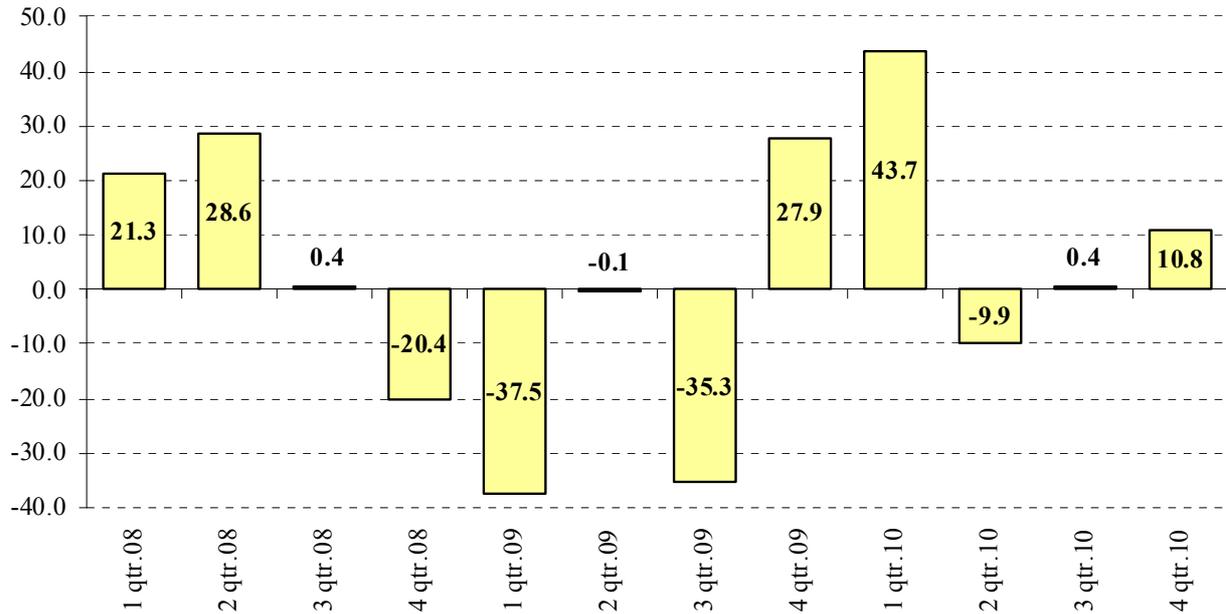


Source: National Bank of the Republic of Kazakhstan

In Q4 2010 the National Bank's participation coefficient in the Kazakhstan Stock Exchange was 10.8% (in Q3 2010 it was 0.4%) (Figure 41). Thus, in Q4 2010 the National Bank was primarily the buyer of foreign exchange in the domestic foreign exchange market.

Figure 41

Coefficient of the National Bank’s participation at the Kazakhstan Stock Exchange, %



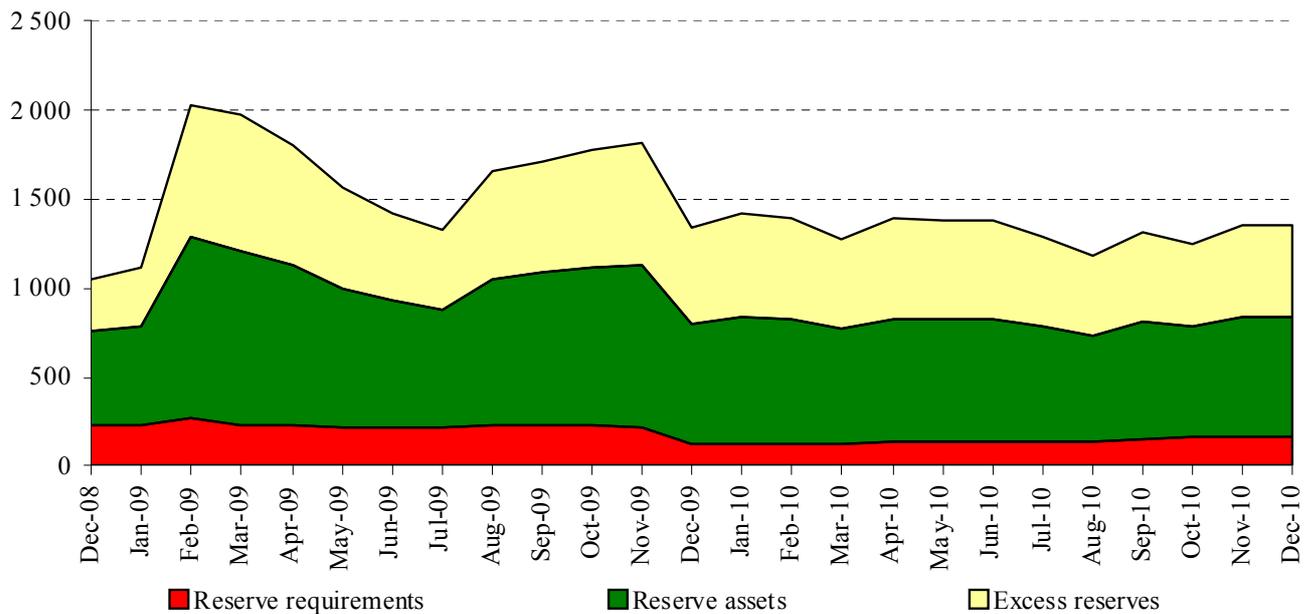
Source: National Bank of the Republic of Kazakhstan

4.2. Minimum Reserve Requirements

On average, in September-December 2010 reserve assets exceeded the required reserving volume by 4.0 times (in Q3 2010 – by 4.7 times, and in Q4 2009 – by 4.5 times) (Figure 42).

Figure 42

Compliance with minimum reserve requirements, KZT bln.



Source: National Bank of the Republic of Kazakhstan

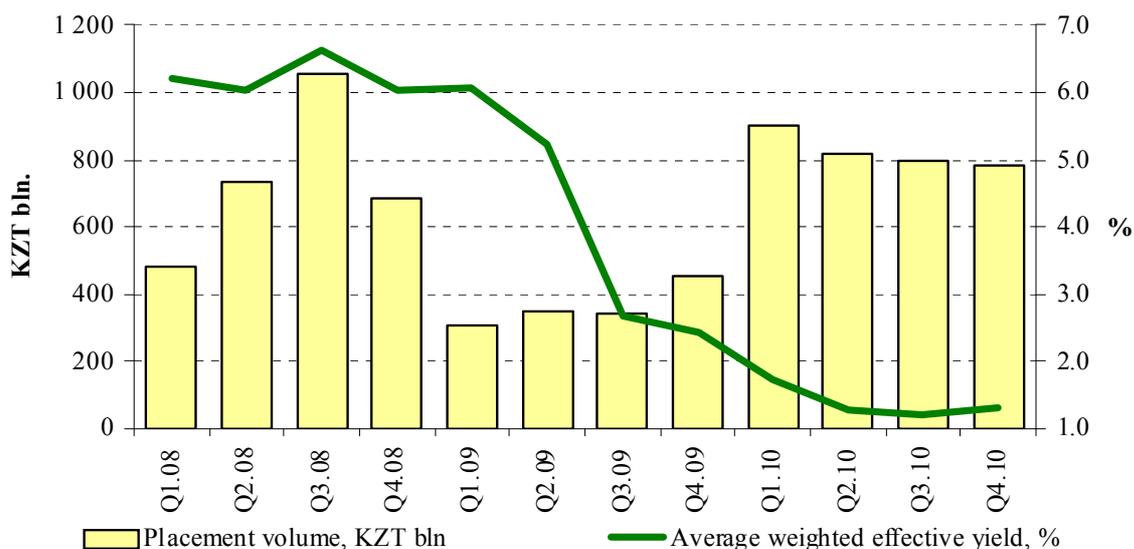
4.3. Open Market Operations

In Q4 2010 the demand of banks for short-term notes of the National Bank remained high. In October-December 2010 short-term notes with maturities of 3 and 6 months were issued.

The volume of short-term notes issued in Q4 2010 decreased by 1.8% as compared to Q3 2010 and amounted to KZT 781.4 bln. This was fully in line with the aggregate demand of the market participants for these types of government securities. The average weighted yield on issued notes increased from 1.22% in Q3 2010 to 1.31% in Q4 2010 (Figure 43).

Figure 43

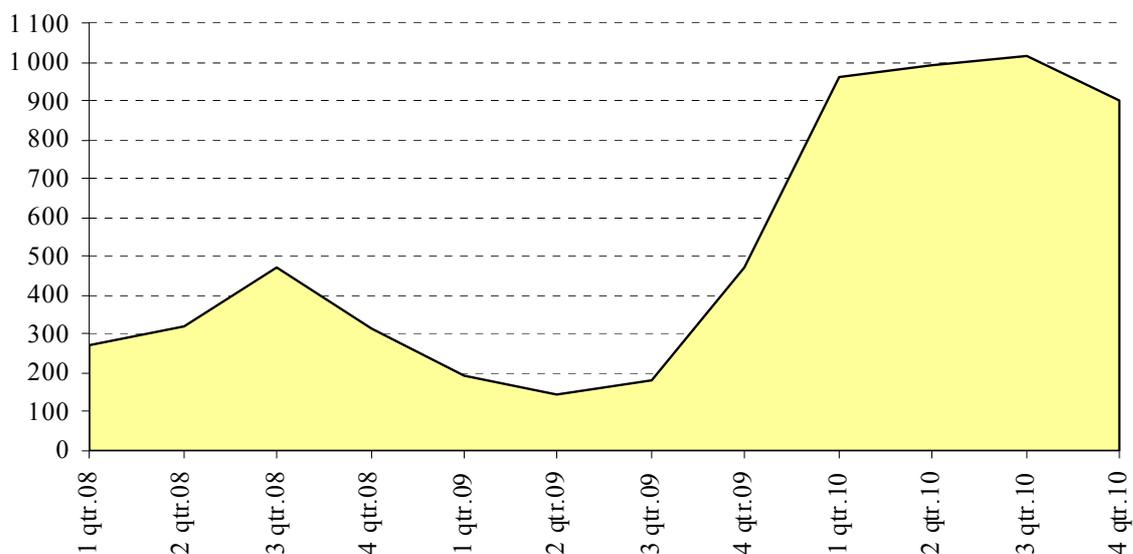
Volume of placed short-term notes and their yield (for the period)



Source: National Bank of the Republic of Kazakhstan

At end-December 2010 the volume of short-term notes in circulation amounted to KZT 899.5 bln., which is by 1.9 times greater than the volume at end-December 2009 (Figure 44).

Figure 44

Short-term notes in circulation, KZT bln. (at the end of the period)

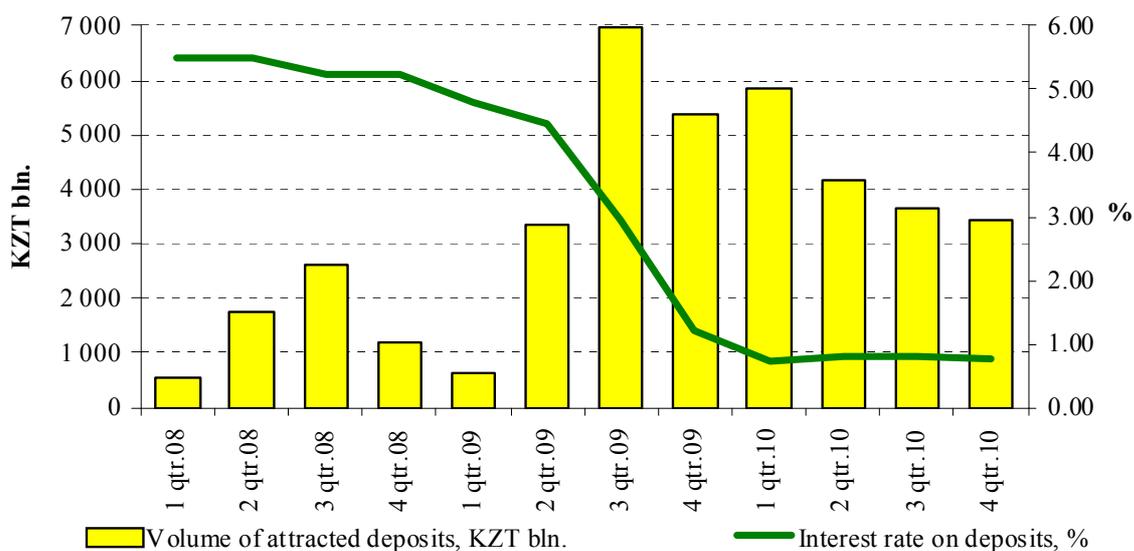
Source: National Bank of the Republic of Kazakhstan

4.4. Standing Facilities

In Q4 2010 the volume of deposits attracted from banks slightly decreased as compared to the previous quarter. Nonetheless, the volumes of attraction remained high: the peak of attraction occurred in December. In total, during October-December 2010, KZT 3443.1 bln. of deposits was attracted, which is by 5.2% less than the volume of Q3 2010 and by 36.2% less than the volume of Q4 2009.

The average interest rate on deposits in Q4 2010 as compared to the previous quarter decreased from 0.79% to 0.77% (Figure 45).

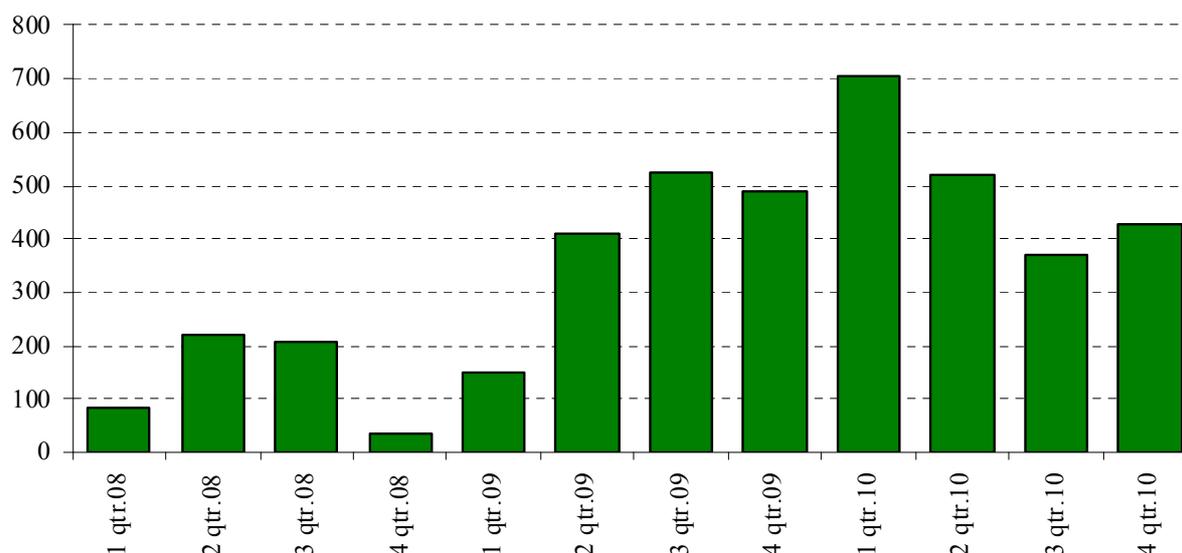
Figure 45

Volume and interest rates on deposits attracted by the National Bank (for the period)


Source: National Bank of the Republic of Kazakhstan

The decrease in the volumes of attracted deposits was not accompanied by the decrease in the volume of the National Bank's outstanding liabilities on such deposits. In December 2010 the volume of outstanding balances on deposits of banks with the National Bank amounted to KZT 429.1 bln., which is by 16.7% greater as compared to the volume in September 2010 and by 12.2% less as compared to December 2009 (Figure 46).

Figure 46

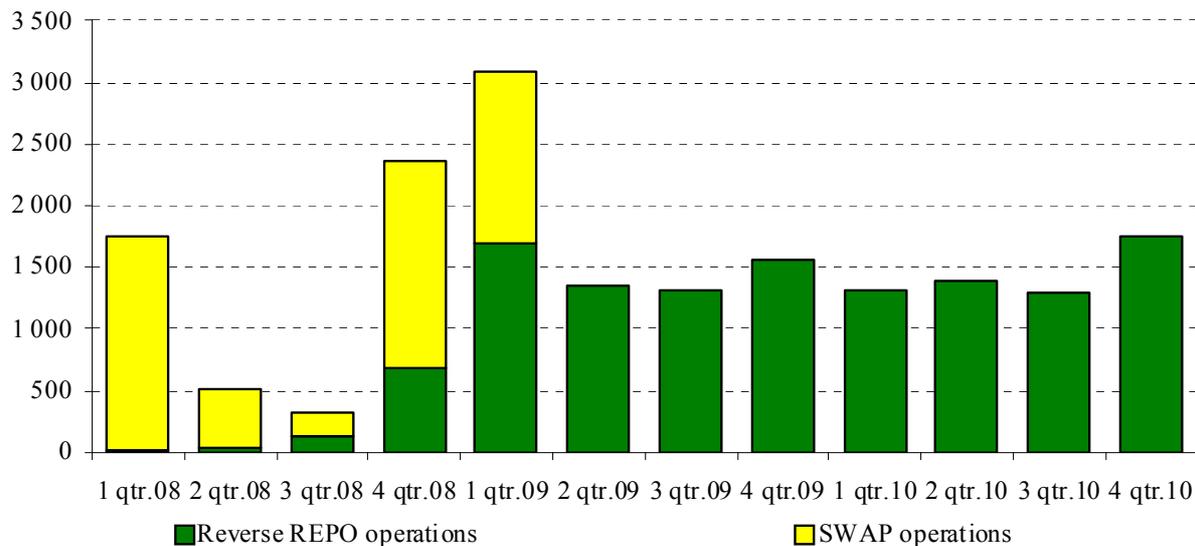
Volume of outstanding liabilities of the National Bank on deposits attracted from banks, KZT bln. (at the end of the period)


Source: National Bank of the Republic of Kazakhstan

In addition to sterilization operations, in Q4 2010 the National Bank continued to provide refinancing loans to the banking sector through reverse REPO operations. The total volume of reverse REPO operations in October-December 2010 amounted to KZT 1747.4 bln. (Figure 47).

Figure 47

Volume of the National Bank’s refinancing operations, KZT billion (for the period)

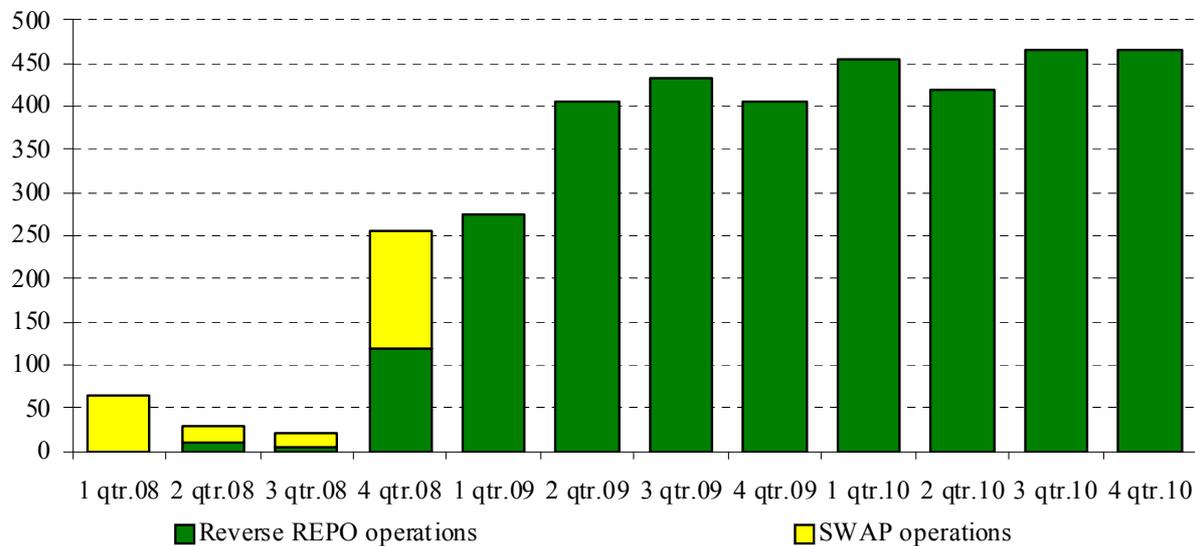


Source: National Bank of the Republic of Kazakhstan

At end-December 2010 the outstanding debt on reverse REPO operations amounted to KZT 464.9 bln. (Figure 48).

Figure 48

Volume of outstanding liabilities on refinancing operations of the National Bank, KZT bln. (at the end of the period)



Source: National Bank of the Republic of Kazakhstan