

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

Inflation Report
for the Third 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

The situation in the consumer market in 2010 remains stable. At the same time, inflation rates in January-September 2010 somewhat exceed the inflation rates in the same period of 2009. The highest inflation run-up was in Q1 2010 with its contribution to the 9-month inflation exceeding 50%.

The inflation in Q3 2010 accounted for 0.8% (in Q3 2009 – 0.9%), annual inflation in September 2010 was at 6.7% (in December 2009 – 6.2%).

The inflation build up in July-September 2010 occurred, in the first instance, against the backdrop of rising prices for non-food items. It should be noted, however, that in 2010 the prices for non-food items have been growing evenly: the average monthly increase was 0.4%.

In Q3 2010 the prices for foodstuff increased insignificantly (by 0.3%), the growth rates in prices for paid services were moderate (0.9%).

After the turndown in many industries in the second half of 2009, positive trends in the macroeconomic development of Kazakhstan were noted in January-September 2010. The increase in output was observed in the majority of key economic activities (mining, manufacturing industry, trade, transport, communications). One of the main factors ensuring revival of the business activity in 2010 is the expansion of domestic demand, namely the growth in consumer demand and stable investment activity.

At the same time, the growth rates in money supply in the economy in January-September 2010 remained stable. Thus, during 9 months 2010 the reserve money expanded by 3.2% and the money supply increased by 12.3%.

In these circumstances the National Bank was implementing a balanced monetary policy aimed at ensuring the price stability, stability of the Tenge exchange rate and stability in the country's financial sector.

In Q3 2010 the National Bank retained its interest rate band at the existing level. From July 1, 2010 the official refinancing rate was retained at 7.0%. The rate on deposits attracted from banks was 0.5% for 7-day deposits and 1.0% – for 1-month deposits.

The National Bank continued providing refinancing loans to banks; however, the demand for such instruments remained low. At the same time, there was a growth in volumes of sterilization operations (short-term notes of the National Bank, deposits).

Evaluation of the Inflation Forecasts for the 3 Quarter 2010

The actual inflation rate (0.8%) in Q3 2010 was lower than the forecast (0.9-1.1%) which was published in the previous issue of the Inflation Report. The inflation in July and August was somewhat lower than the forecasted values whereas in September it appeared to be higher than expected.

The major increase in prices in Q3 2010 was in non-food items. In their structure the increase in prices for medications, clothes and footwear as well as books and the printed matter should be outlined. Based on the analysis of the dynamics in the previous years, the increase in prices for clothes, footwear and the printed matter is typical for the period since, apparently, it is related to the beginning of a new academic year and respective expansion in the consumer demand for such items. According to estimate, the inflation in Q3 2010, excluding the increase in prices for non-food items, amounted to 0.6% instead of actual 0.8%.

Despite the increase in certain types of paid services to the population (educational services, medical services, transportation services), the decreased tariffs for certain types of utilities or their insignificant growth contributed to a moderate growth in prices for paid services in July-September 2010 as a whole.

The decrease in prices for certain food items was curbing the build up of inflationary processes. Such food items as fruits and vegetables, eggs, and sugar may be mentioned among those items. As a whole, the impact of food items on inflation was insignificant.

The actual annual inflation rate at end-September 2010 (6.7%) was also lower than the projected level which was published in the previous issue of the Inflation Report (6.8-7.0%).

Inflation Forecast for the Fourth Quarter 2010

In Q4 2010 the inflation is expected to be within 2.5-2.7% (in Q4 2009 the actual inflation was 1.4%), which corresponds to the annual inflation of 7.8-8.0% at end-December 2010 (figure 1).

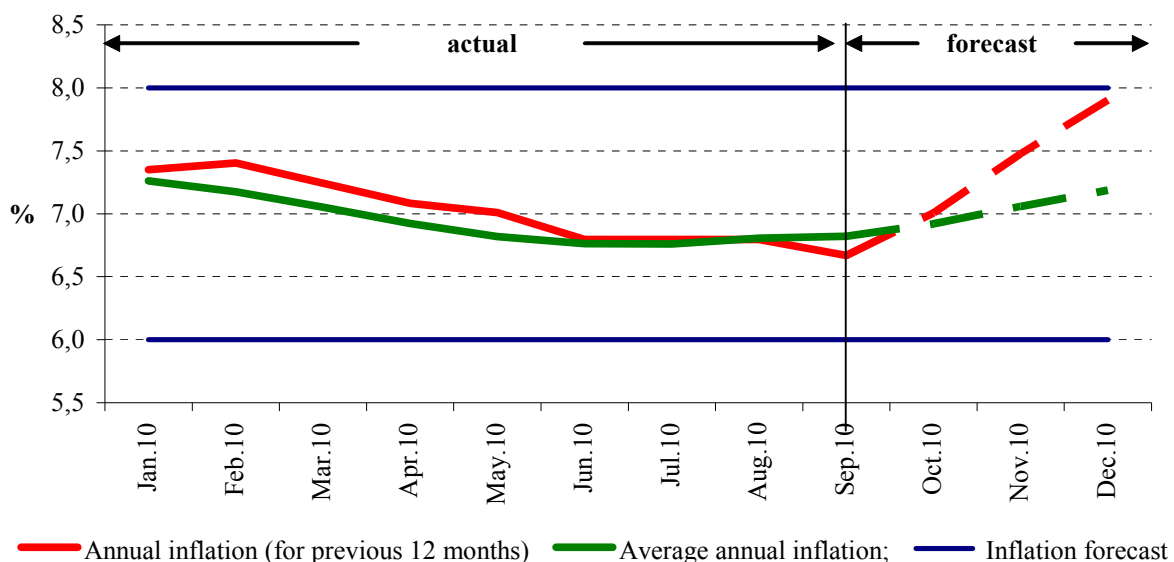
As a rule, the situation in the consumer market during the most recent months is characterized by the increase in prices. This is related to the seasonality factor and expansion of the consumer demand during holidays. As a result, prices in this period demonstrate the highest level of the year.

In October-December 2010 the prices for foodstuff are expected to increase in a way. Based on the analysis of the situation in the previous years, one may expect that after a seasonal decrease in prices for fruits and vegetables in Q3 of this year, they are expected to grow in Q4. In addition, prices for such food items as eggs, dairy and meat products are expected to grow. It should be also mentioned that unfavorable weather conditions in 2010 observed in many countries including Kazakhstan, Russia, Ukraine, and some Eastern European countries caused the decreased production of grain and oil seeds. This may have a negative impact on the pricing of relevant commodities in Kazakhstan.

At the year-end the situation in the market of fuel and lubricants is most likely to be stable. At the same time, one should not exclude a possibility of the growth in tariffs and prices for certain utilities such as hot water supply, gas supply and electric energy supply, in view of the beginning of the heating season.

figure 1

Actual and forecasted inflation in 2010



Source: National Bank of the Republic of Kazakhstan

Inflation Forecast for 2011

In 2011 the National Bank will continue taking measures to ensure the price stability in the country. The National Bank will regulate short-term liquidity in the banking sector by performing refinancing operations, issuing short-term notes and attracting deposits from banks.

The official refinancing rate will be set based on the situation in the money market and the inflation rate so that its level is kept positive in real terms.

The National Bank will take actions to ensure the stability of the Tenge exchange rate.

In doing so the National Bank anticipates that in 2011 the situation in the consumer market will remain stable. At the same time, improved macroeconomic situation in Kazakhstan amidst the output growth in the real economy, stable growth of earnings of the population, and decreased unemployment will be accompanied by the respective expansion of aggregate demand in the economy. By estimate, inflation indicators in 2011 will be comparable with those in 2010.

Inflation forecast for Q1 2011 is 2.7-2.9% (in Q1 2010 actual inflation accounted for 2.9%). As a whole, this level is in line with the inflationary trends of Q1 that were typical of the previous years. These expectations are associated with the fact that, in the first instance, the inflation build up in the near future will be affected by the seasonality factor.

At end-March 2011 the annual inflation is expected to be at 7.9-8.1%.

1. Inflationary Processes

1.1. Consumer Prices

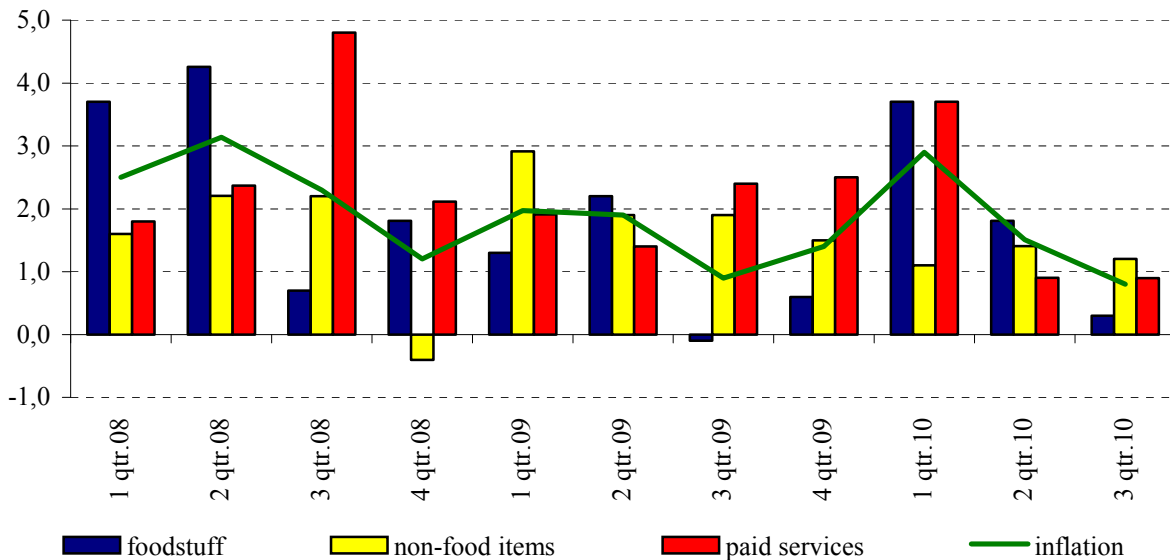
In Q3 2010 the inflation rates continued to slow down. During this period the inflation was growing at a slower rate as compared to the previous quarter and remained at the level of Q3 2009. In July-September 2010 the inflation was at 0.8% (in Q2 2010 – 1.5%).

The slowdown in the inflation rate in Q3 2010 was caused by the slowdown in the growth of prices for foodstuff and non-food items. Process for paid services to the population remained at the level of Q2 2010.

The price of food items increased by 0.3%, of non-food items – by 1.2% and of paid services – by 0.9% (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

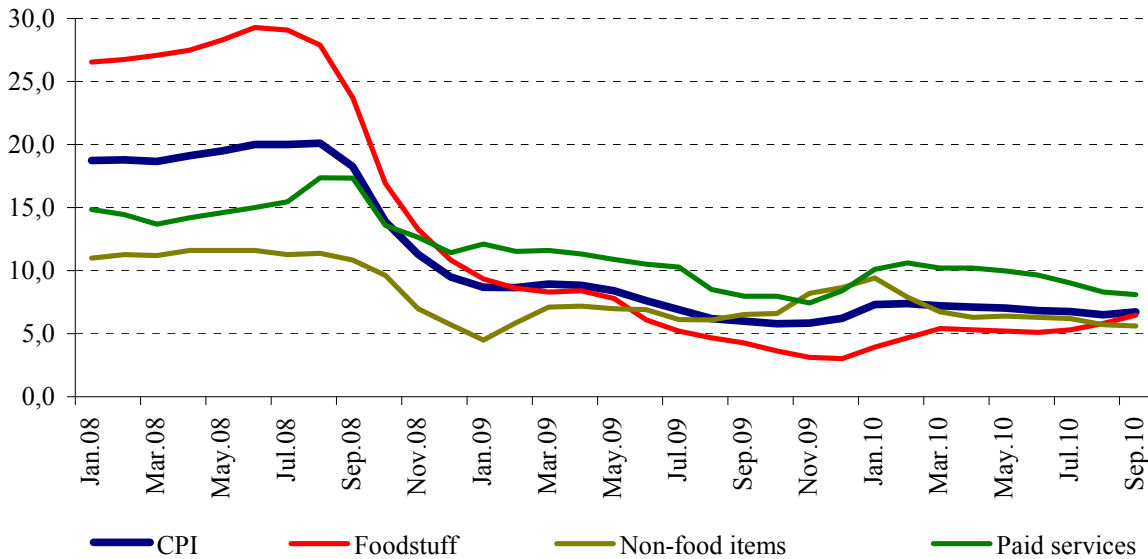
In Q3 2010 there was a slowdown in the growth rates of prices for certain goods and services. So, growth rates of prices for meat products slowed down from 3.6% in Q2 2010 to 2.1% in Q3 2010, for confectionery products – from 2.3% to 1.0%, for soft drinks – from 2.4% to 0.7%. There was a decrease in prices for fruits and vegetables – by 7.5%, for eggs – by 6.1%. Among non-food items there was a slowdown in prices for gasoline – from 4.7% in April-June 2010 to 0.9%, for diesel fuel – from 3.3% to 0.4%, detergents and cleaners – from 1.9% to 0.8%, respectively.

In the group of paid services to the population the highest increase occurred in the fee for educational services – by 6.7% (including for university education – by 12.0%), transportation services – by 2.9%.

In September 2010 the annual inflation accounted for 6.7% (in December 2009 – 6.2%). Prices for foodstuff grew by 6.5% (by 3.0%), non-food items – by 5.6% (by 8.6%), paid services – by 8.1% (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

Acceleration in the annual inflation rates in September 2010 was caused by a significant increase in prices for foodstuff and certain services to the population, including regulated services (electric energy, cold water supply, telecom). So, in annual terms the highest increase in prices was for sugar, tobacco products, meta products, oils and fats, soft drinks, diesel fuel, medications, gasoline and detergents and cleaners, for electric energy, cold and hot water, sewage, educational services, outpatient and legal services.

1.2. Core Inflation

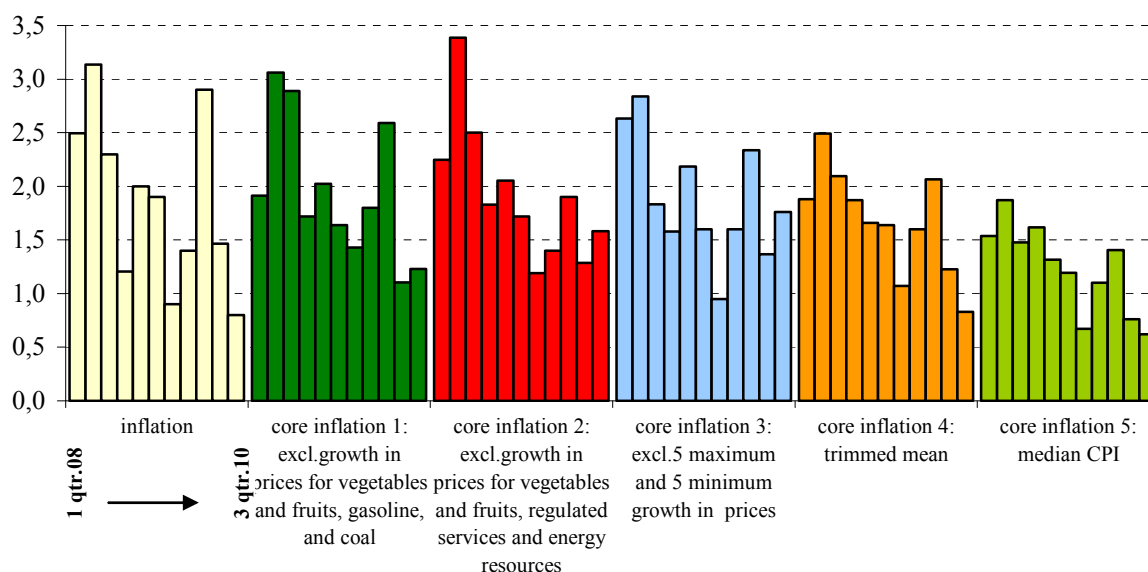
In Q3 2010 the core inflation indicators had multi-directional dynamics. So, in July-September 2010 the core inflation indicators, except for core inflation-2, demonstrated lower growth rates as compared to the indicators in Q3 2009, whereas core inflation-1 and core inflation-2 demonstrated higher growth rates as compared to Q2 2010 (figure 4).

Such dynamics was caused by the decrease in prices for fruits and vegetables and in certain types of regulated services (cold water supply, electric energy, communications services) which are excluded from the calculation of core inflation-1 and core inflation-2.

In July-September 2010 the indicators of annual core inflation also demonstrated multi-directional dynamics. Core inflation-1 was slowing down in July-August whereas in September it showed some acceleration. Rates of core inflation-2 were increasing throughout the period and the rest of the core inflation indicators demonstrated some slowdown. Only core inflation-1 was at a higher level as compared to the headline inflation.

figure 4

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

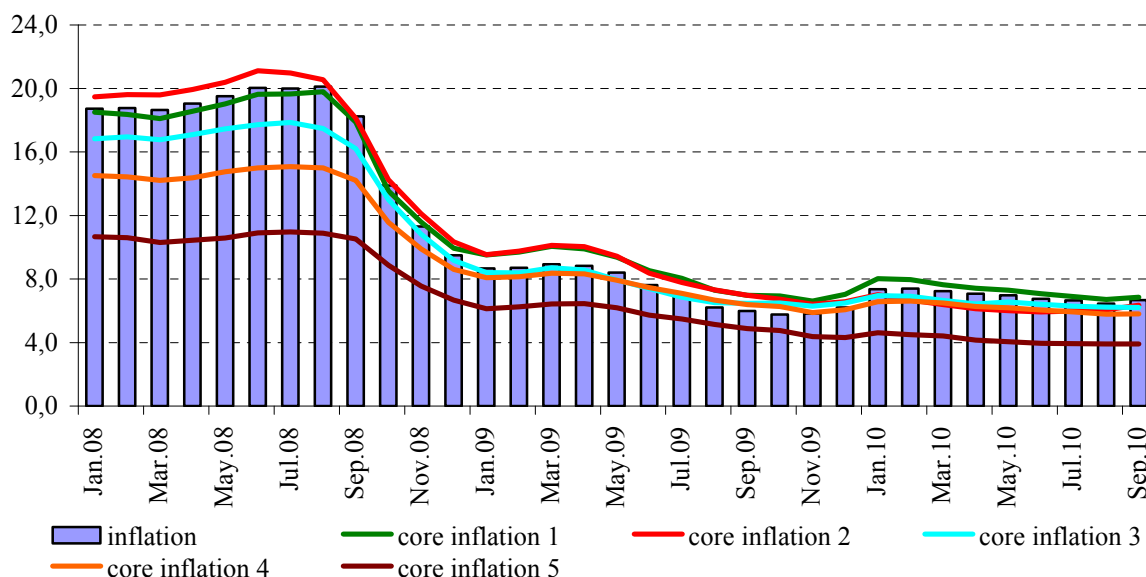


Source: Agency of Statistics of the Republic of Kazakhstan

In September 2010 indicators of the core inflation in annual terms were at a lower level as compared to December 2009. This fact is an indicator of the overall slowdown in inflationary processes despite disturbances (rise or fall) in the price dynamics for certain goods and services which “fall beyond” the overall trend (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 Q3 2010 the producer prices have increased by 0.9% (in Q3 2009 – by 11.7%). The cost of output appreciated by 0.9%, %, at the same time the price of production means within its composition decreased by 4.0%, the price of consumer goods increased by 2.1%, interim consumption products increased in price by 0.9%. The prices for production services increased by 0.8%.

In July-September 2010 the growth rate of producer prices in the mining industry decreased. After their growth in Q2 2010 by 2.3%, in Q3 prices decreased by 0.2% (in Q3 2009 – growth by 14.2%).

The cost of energy resources in Q 3 2010 increased by 1.5% (in Q3 2009 – growth by 15.5%). In the composition of energy resources the cost of oil production increased by 2.2% (in Q2 2010 – decrease by 2.3%), the cost of gas condensate decreased by 2.5% (growth by 6.5%).

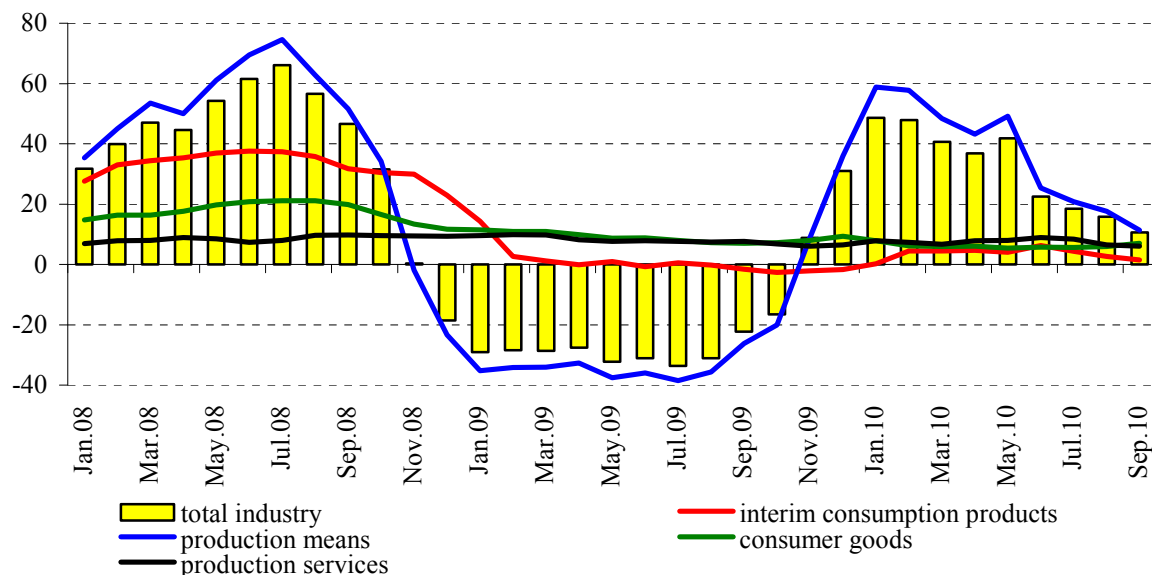
The growth rate of prices in the manufacturing industry in Q3 2010 accelerated to some extent amounting to 3.0% (in Q3 2009 – growth by 8.3%). Prices in the metallurgical industry increased by 2.9%, prices in the foodstuff production including drinks and tobacco increased by 8.1%, refined products increased in price by 1.3%.

There was a slowdown in the production and distribution of electric energy, gas and water in Q3 2010 amounting to 0.7%, after its growth by 0.9% in the previous quarter.

In September 2010 the growth in prices in the industry in annual terms (September 2010 versus September 2009) was 10.6% (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 10.8% in annual terms, including the interim consumption products – by 11.4%, consumer goods – by 7.0%, production means – by 1.5%. The cost of production services increased by 6.0%.

1.3.2. Prices in Agriculture

In Q3 2010 prices for agricultural production sold across all channels increased by 4.6% (in Q3 2009 – decrease by 0.4%). 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.

In July-September the cost of plant production increased by 7.5%, which was mainly caused by the growth in prices for grain cultures – by 7.9%.

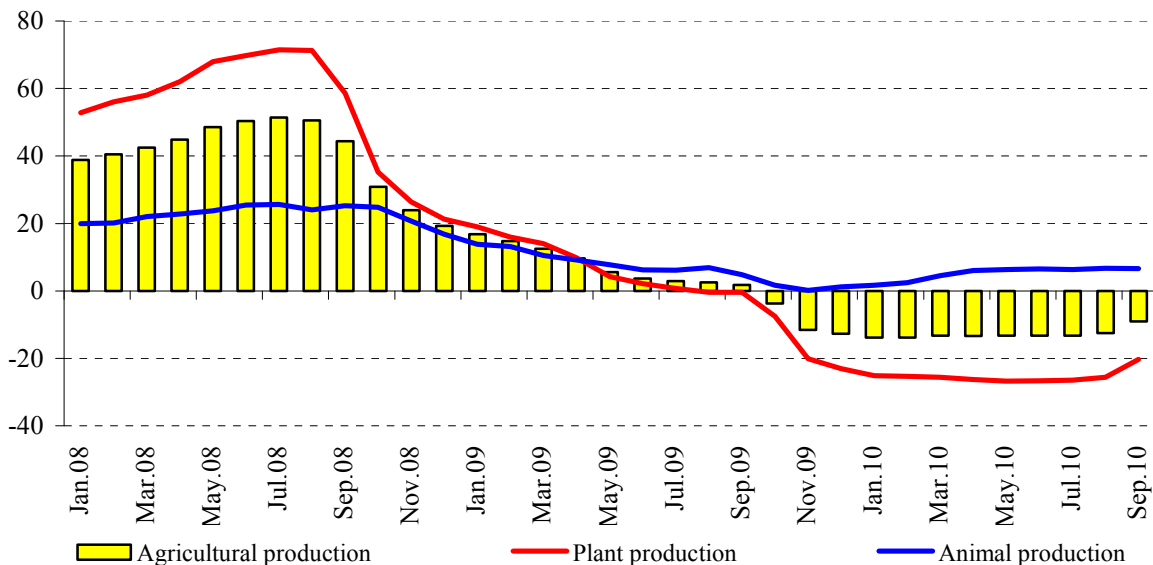
The year of 2010 was lean because of unfavorable weather and climatic conditions, both in Kazakhstan and in the CIS-countries – wheat exporters and resulted in a lower grain yield that started to influence the growth of prices for the plant production.

The cost of animal products appreciated by 1.3% in Q3 2010, whereas in Q2 2010 there was a decrease in price by 1.4% under the influence of the seasonality factor. At the same time, prices for meat and poultry increased by 2.0%, the cost of unpasteurized milk increased by 1.7%, while eggs became cheaper by 4.6%.

In September 2010 prices for agricultural products decreased by 9.0% in annual terms. The plant production became cheaper by 20.3%, animal products increased in price by 6.6% (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 Q3 2010 a growth in demand for final products of enterprises as compared to the previous quarter continued. This is evidenced by the increase in a generalized indicator – diffusion index of the change in the demand for final products – to 55.2 from 54.7 in Q2 2010 (figure 8). The decrease in the indicator was noted by 16.9% (in Q2 2010 – 18.8%) of interviewed enterprises, and the increase of the indicator – by 27.3% (in Q2 2010 – 28.1%),

The growth in the demand occurred in all sectors of the economy, moreover, the highest increase of the indicator was observed in industries such as “agriculture, hunting and forestry”, “production and distribution of electric energy, gas and water” and “transport and communications”. At the same time the slowdown in growth rates was observed in such

industries as “mining industry”, “construction”, “manufacturing industry” and “real estate operations”.

In Q4 2010 as compared to Q3 2010 a slowdown in the growth of demand for final products is expected in the economy as a whole: the diffusion index in the change of demand went down to 52.5. However, 20.9% of interviewed enterprises anticipate the increased demand for final products, and 15.9% - the decreased demand. The highest slowdown in the indicator is expected in such industries as “transport and communications”, “agriculture, hunting and forestry”, and “manufacturing industry”. In the construction sector enterprises anticipate the decreased demand for their products.

The situation with prices for final products of enterprises in Q3 2010 was characterized by notable 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 59.8 (in Q2 2010 – 54.9). The percentage of enterprises with increased prices for their products as compared to the previous quarter increased amounting to 24.0% (in Q2 2010 – 17.3%).

The maximum growth in prices occurred in such industries of the economy as «agriculture, hunting and forestry”, “trade”, “manufacturing industry”, “mining industry” and “hotels and restaurants”.

In Q4 2010 the diffusion index of the change in the prices for final products went down to 59.4 as compared to the previous quarter, which means low slowdown in the price growth.

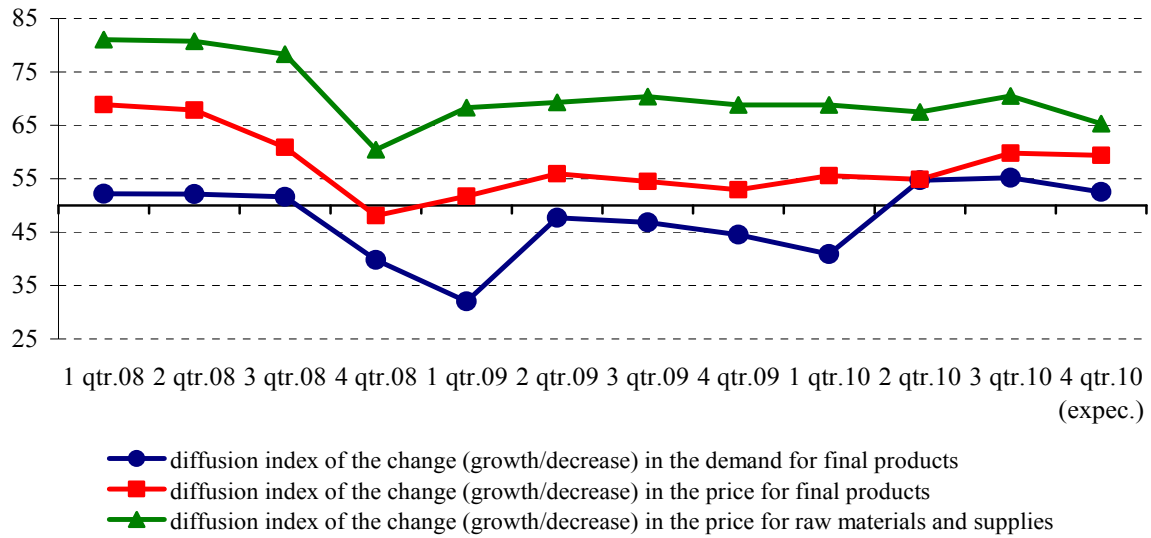
In Q3 2010 the growth rates of prices for raw materials and supplies increased significantly as compared to the previous quarter while remaining at a high level in the economy as a whole: the value of the diffusion index of the change in the price for raw materials and supplies was 70.5. The increase in the growth rates of the indicator occurred in all industries except for industries such as “mining industry” and “construction”. In the sample as a whole a number of enterprises that noted the increase in prices for raw and supplies increased as compared to the previous quarter amounting to 49.4% (in Q2 2010 – 44.6%). The percentage of enterprises that noted the decrease in prices for raw materials and supplies accounted for 1.0% only (in Q2 2010 – 2.2%). The number of respondents that noted invariance of the indicator decreased to 42.2% (in Q2 2010 – 45.8%).

For Q4 2010 the diffusion index of the change in the price for raw materials and supplies fell down to 65.3, which means a notable slowdown in the price growth. At the same time, the number of respondents anticipating the price growth reduced significantly – to 39.2%, and the percentage of enterprises that noted invariance and the decrease of the indicator increased to 52.3% and 1.2%, respectively (figure 8).

Thus, judging from the dynamics of the relevant diffusion indices, anticipations of the enterprises about Q4 2010 are associated, in the first instance, with a notable slowdown in the growth rates of prices for raw materials and supplies and the demand for final products, with a more stable behavior of prices for final products of enterprises.

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

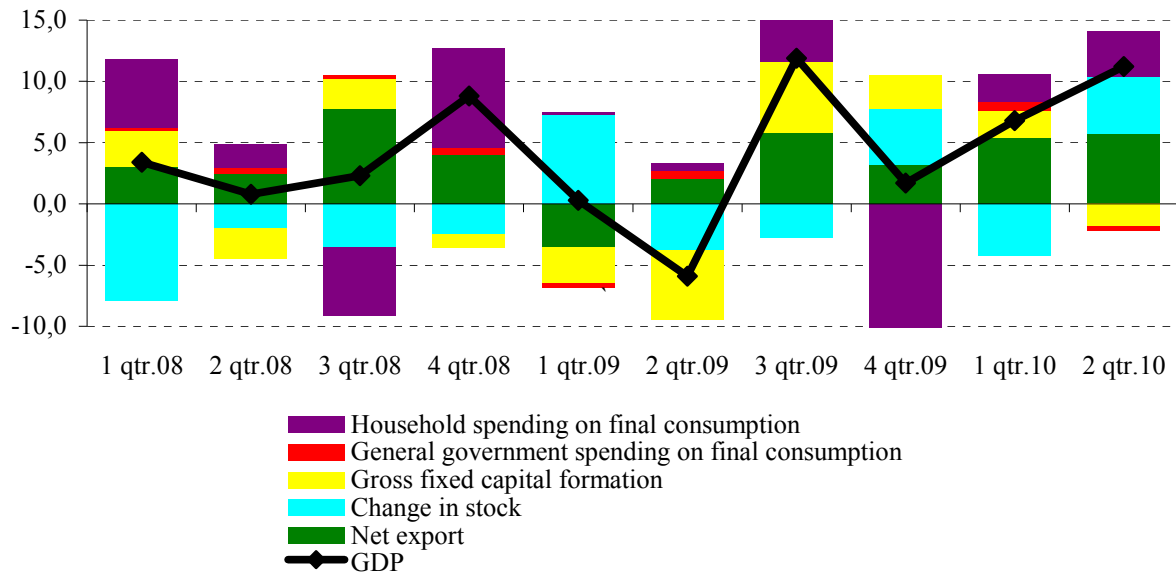
In Q2 2010 the GDP based on the final consumption method as compared to the respective period of 2009 increased in real terms by 11.2% (in the previous quarter – by 6.8%).

Despite the fall in one of the key GDP components (gross fixed capital formation), a significant growth in net exports, increase in spending on final consumption and change in stock were the reason for accelerated GDP growth. Spending on final consumption grew up by 3.6%, gross formation increased by 17.2% on the whole, net exports increased by 64.4%.

Net exports' contribution to the GDP growth accounted for 5.7%, gross fixed capital formation – (-) 1.8%, households consumption – 3.7%, change in stock – 4.7% (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 the National Bank of the Republic of Kazakhstan

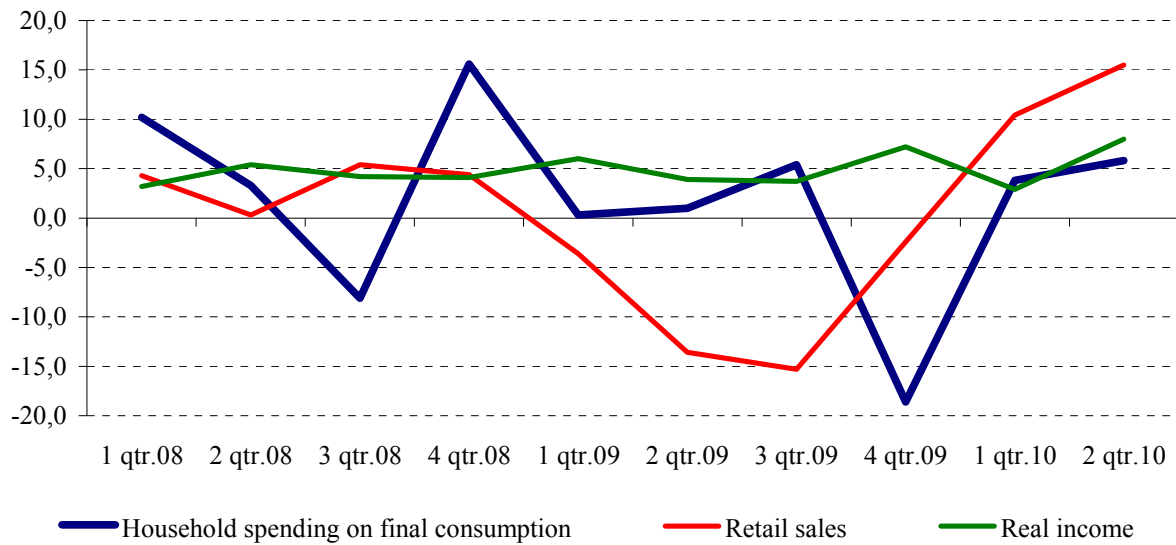
2.1.1. Individual Consumption and Investment Demand

Household spending on final consumption in Q2 2010 increased versus the respective period of 2009 by 5.8% (in Q1 2010 – growth by 3.8%).

Acceleration in the growth rate of per capita income in real terms to 8.0% (in Q1 2010 – growth by 2.9%) also affected retail sales, which increased by 15.5% (in Q1 2010 – growth by 10.4%). This trend while generally demonstrating the restoration of consumer demand in the first half of this year had significant impact on the improvement of one of the key GDP components, 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

Recovery of the Kazakh economy, stabilization of the situation in the financial sector, overall overcoming of negative consequences of the global crisis 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, their volume in the overall volume of retail sales being significant and accounting for about 55%.

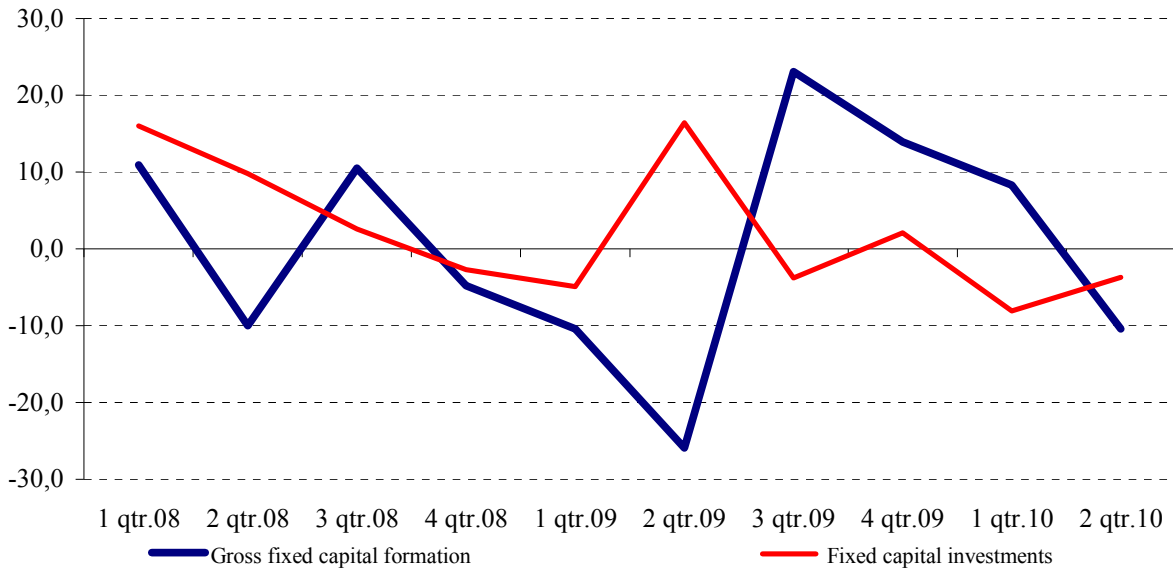
In Q2 2010 as compared to the respective period of 2009, a total volume of spending on gross savings in the GDP structure increased by 17.2%, making positive contribution to the GDP growth of 2.9%.

In its structure gross fixed capital formation decreased by 10.4%, mainly caused by reduced investment activity of enterprises and decrease in fixed capital investments by 3.7% (figure 11), which resulted in a negative contribution to the GDP growth of (-)1.8%.

However, significant growth in the change in stock, by more than three times in nominal terms, had a positive contribution to the GDP growth of 4.7%, thus fully neutralizing a negative effect achieved by the first component and resulting in the overall increase of the gross formation.

figure 11

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



Source: Information of 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 Q2 2010, as compared to the respective period of 2009, decreased by 4.6% (in Q1 2010 – growth by 11.2%).

In general, during Q2 2010 the state budget spending was financed in the amount of KZT 1 156.8 bln. or 12.7% of GDP. As compared to Q2 2009, the increase accounted for 20.3%.

Current state budget expenditures totaled to KZT 854.1 bln., being greater by 17.1% than in Q2 2009. Within the current expenditures costs on interest payments on domestic loans, on current transfers to natural persons and legal entities as well as for service purchases and current transfers abroad increased the most. Capital expenditures of the state budget in Q2 2010 increased by 1.3% as compared to the respective period of 2009, mainly because of the growth in expenditures for capital transfers abroad and within the country, for acquisition of fixed capital and purchase of land and intangible assets. Expenditures for acquisition of financial assets increased by 29.5%.

In April-June 2010 state budget revenues amounted to KZT 1 292.0 bln. or 14.1% of GDP, which is by 42.7% higher than in April-June 2009. Two items still prevail in the structure of the state budget revenues: tax revenues – 63.2% (in Q2 2009 – 57.7%), official transfers – 33.7% (38.7%). High percentage of official transfers was secured by the receipt of the guaranteed transfer of KZT 355.0 bln. from the National Fund of the Republic of Kazakhstan to the republican budget.

As a whole, in Q2 2010 tax revenues increased by 27.6% as compared to Q2 2009, the increase was due to the increased revenues from corporate income tax and personal income tax.

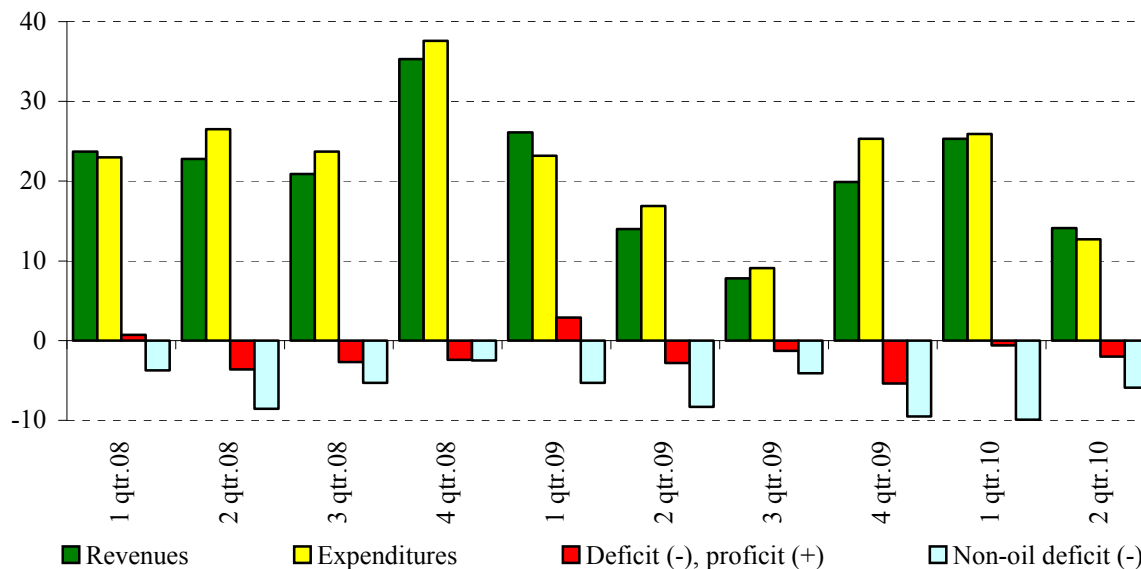
In Q2 2010 as compared to Q2 2009, the volume of non-tax revenues decreased by 3.2%, revenues from the fixed capital sales increased by 25.0%.

As the expenditures were in excess of revenues to the state budget, in Q2 2010 the deficit of KZT 181.8 bln. (2.0% of GDP) showed up whereas in Q2 2009 the deficit was KZT

182.4 bln. (figure 12). It should be noted that without transfers from the National Fund, Q2 2010 would have ended with the non-oil deficit of KZT 536.8 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 Q2 2010 the Ministry of Finance borrowed KZT 198.8 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 54.8 bln. As a result, account balances of the Government of the Republic of Kazakhstan with the National Bank decreased by KZT 37.8 bln.

Government domestic debt for Q2 2010 increased to KZT 1 499.1 bln. (7.7% of GDP), i.e. by 56.1% as compared to Q2 2009 (6.2% of GDP) and was secured by the issue of government medium-term obligations (MEOKAM), government long-term saving treasury obligations (MEUZHKAM), and government long-term treasury bills.

The Government’s external debt in Q2 2010 increased by 47.6% as compared to the indicator in Q2 2009 (1.3% of GDP) and amounted to US\$ 2.3 bln. (1.8% of GDP).

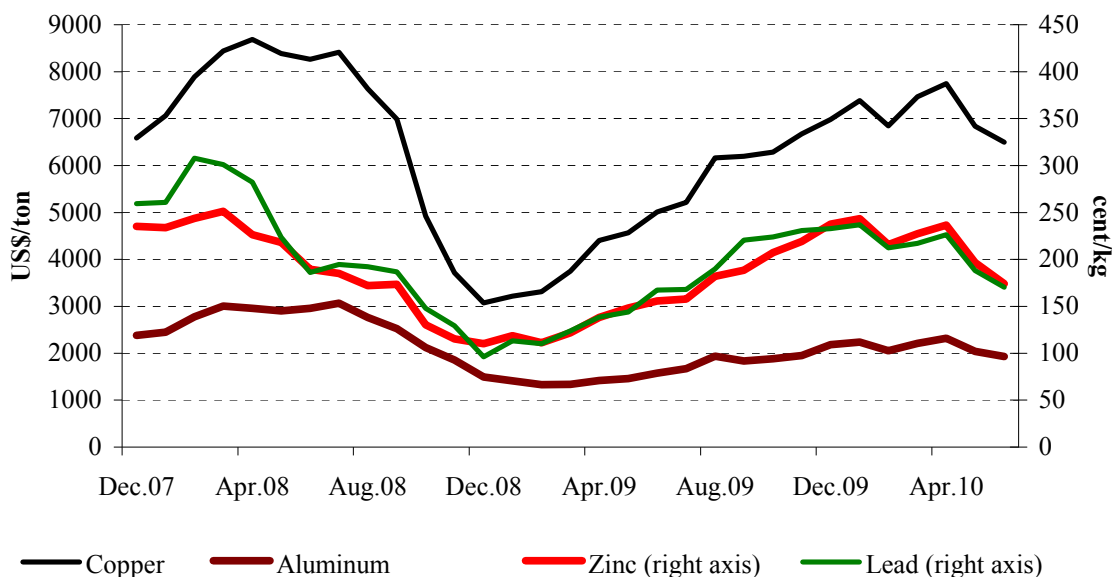
2.1.3. External Sector

– World Prices

In Q2 2010 prices for certain commodities in the global commodity markets remain volatile. Thus, world prices for metals in April 2010 increased to some extent; however, in May-June 2010 they started gradually decreasing. In Q2 2010 as a whole prices for copper decreased by 12.9% and were about US\$ 7027.3 per ton on average during the period, for aluminum – by 12.5% and US\$ 2096.3 per ton, respectively. World prices for lead decreased on average by 21.5% during the period amounting to 195.1 cents per kg, for zinc – by 23.4% and 202.6 cents per kg, respectively (figure 13).

figure 13

Dynamics of world prices for metals



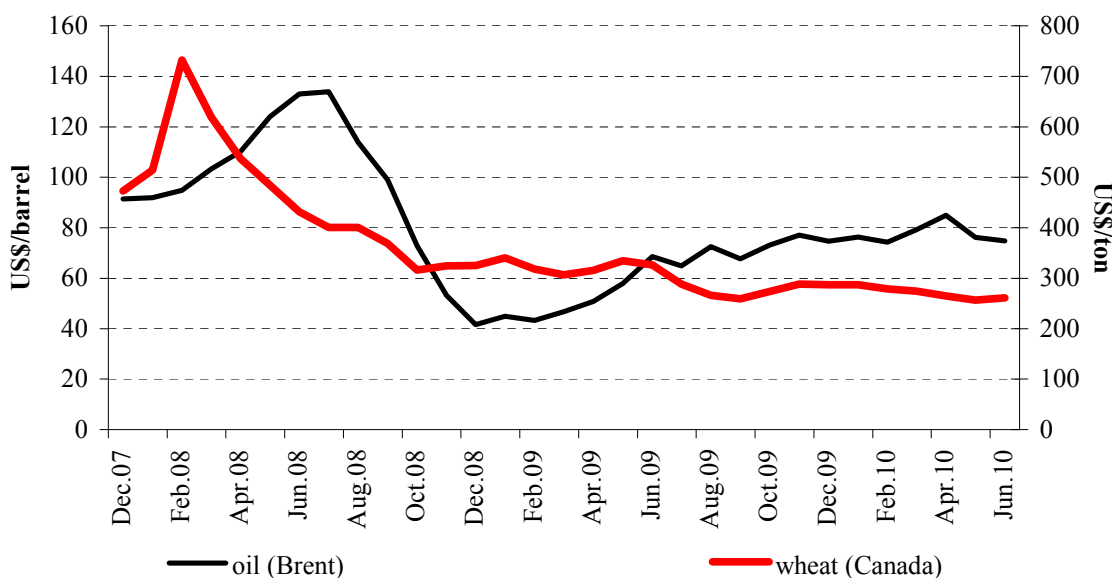
Source: World Bank

In Q2 2010 world oil prices had a downward trend. Thus, after some price growth in April 2010, in May-June the downward trend appeared. On the overall basis, in April-June 2010 oil prices (Brent) decreased by 5.6% and on average for the period were at US\$78.69 per barrel (figure 14).

World prices for wheat were also unstable. In April-May prices decreased whereas in June they increased to some extent. Generally, in Q3 2010 the world price for wheat (Canada) decreased by 4.7% and was on average at US\$ 260.9 per ton (figure 14).

figure 14

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



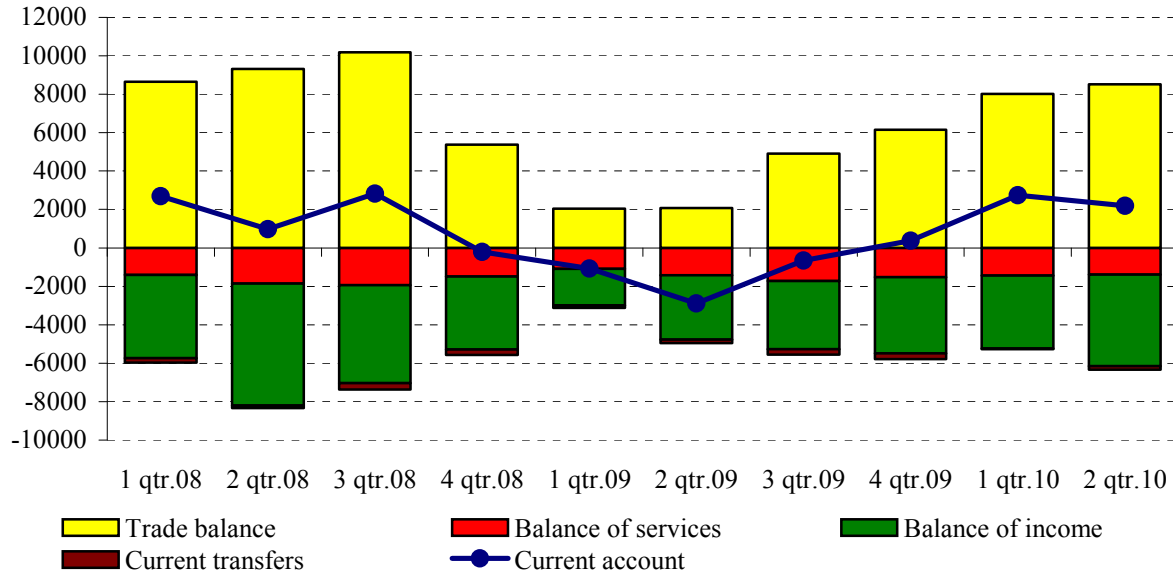
Source: World Bank

– **Balance of Payments**

In Q2 2010 the current account balance deficit was in surplus at US\$ 2.2 bln. (figure 15).

figure 15

Current account balance, US\$ mln.



Source: National Bank of the Republic of Kazakhstan

The main contribution to the current account profit was from export proceeds from commodities associated with a favorable pricing environment in the global energy prices. Proceeds from the exports of goods in Q2 2010 increased by over 1.7 times, and expenditures on commodity imports – by 7% as compared to Q2 2009. A positive trade balance increased by 4.1 times as compared to Q1 2009 and amounted to US\$ 8.5 bln., thus fully compensating a net outflow of resources on other components of the current account. The deficit in the balance of services as compared to Q2 2009 decreased by 2.6% to US\$ 1.4 bln., and the deficit in the income balance increased by 42.9% and amounted to US\$ 4.8 bln. Payments to non-residents on current transfers amounted to US\$ 180.2 mln., having decreased by 6.3% versus the level of Q2 2009.

The net inflow of resources on financial account operations was US\$ 983.9 mln. in Q2 2010 (in Q2 2009 – a net inflow of US\$ 884.9 mln.). Foreign assets of residents (except for reserve assets) increased by US\$ 1.4 bln., which is higher than in the respective period of 2009 by 1.8 times. Foreign liabilities of residents decreased by US\$ 426.3 mln. (by 16.2% less than in Q2 2009).

As a result, the positive balance of payments for Q2 2010 amounted to US\$ 70.2 mln. (in Q2 2009 – the deficit of US\$ 945.0 mln.).

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

In Q2 2010 the aggregate terms of trade index was by 42.7% higher than the respective indicator for Q2 2009. Alongside with that, the terms of trade with the Euro zone countries improved by 25.2%, and with Russia – by 11.0% (table 1).

table 1

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

	Q1. 09	Q2. 09	Q3. 09	Q4. 09	Q1. 10	Q2. 10
Export prices	-47.0	-52.5	-44.9	-16.6	48.2	60.1
Import prices	-1.2	-15.8	-18.2	-3.4	9.4	12.9
Terms of trade	-45.8	-42.4	-34.4	-11.3	22.6	42.7
including:						
the Euro zone countries						
Export prices	-54.2	-56.5	-49.9	-18.0	66.0	59.9
Import prices	17.7	0.1	12.8	32.5	22.4	31.0
Terms of trade	-57.8	-57.9	-59.2	-29.0	16.6	25.2
Russia						
Export prices	-28.3	-36.2	-35.8	-14.7	23.4	33.6
Import prices	-28.6	-25.5	-23.2	-2.6	28.5	19.1
Terms of trade	0.4	-15.0	-16.4	-12.6	-3.7	11.0

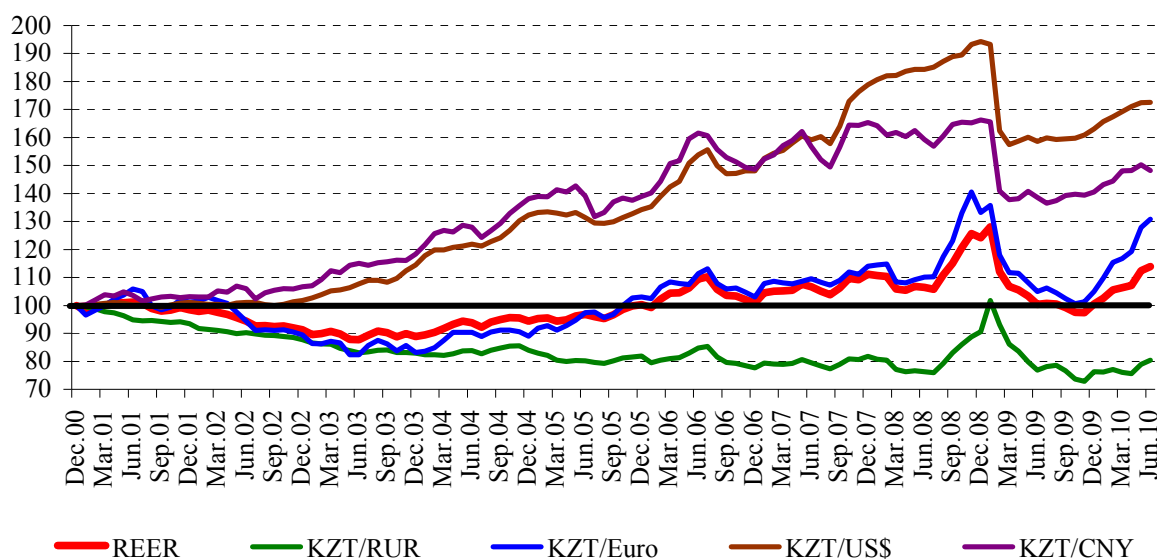
Source: National Bank of the Republic of Kazakhstan

In the first half of 2010 depreciation of the common European currency coupled with relatively high oil prices had a significant pressure on the Tenge exchange rate. Nonetheless, actions taken by the National Bank to keep the exchange rate allowed preventing its significant appreciation. Despite a relatively stable nominal exchange rate, significant depreciation of the Euro affected the growth rates of the Tenge appreciation in real terms. In Q2 2010 as compared to the previous period, the index of the real effective exchange rate of the Tenge appreciated by 6.0%. The Tenge has appreciated versus the CIS currencies basket by 2.4%, versus the basket of other currencies – by 7.4%.

In Q2 2010 the Tenge has appreciated in real terms against the US Dollar by 2.8% as compared to the previous period, by 10.5% against the Euro and by 2.5% - against the Russian ruble (figure 16).

figure 16

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



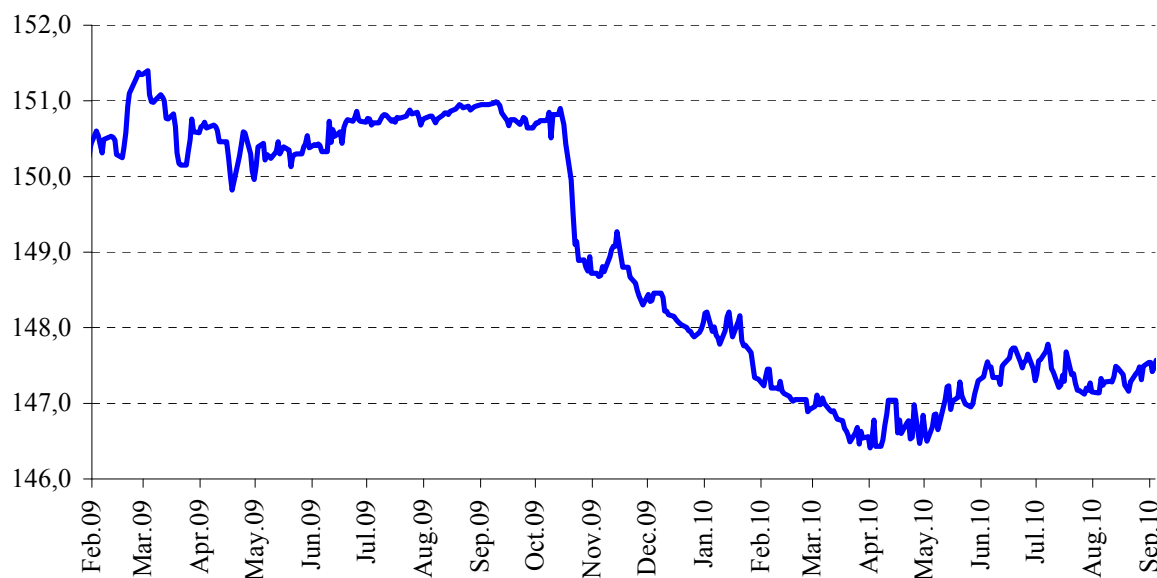
Source: National Bank of the Republic of Kazakhstan

– Nominal Exchange Rate of the Tenge

The average weighted exchange rate of the Tenge for Q3 2010 at the stock exchange was KZT 147.40/1\$. The stock exchange rate at end-period was KZT 147.57/1\$. 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

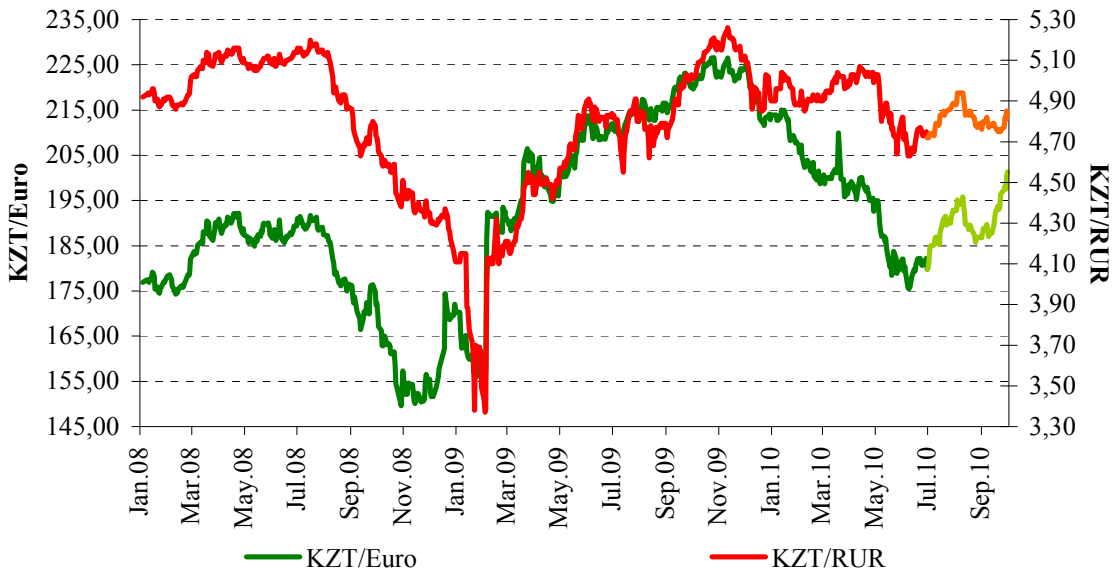
The dynamics of the exchange rate of the Tenge versus the Euro and the Russian ruble was driven by the dynamics of the exchange rate of the Tenge versus the US Dollar, the status

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 Q3 2010 the official exchange rate of the Tenge versus the Euro has depreciated by 11.4%, and versus the Russian ruble – by 2.7%. (figure 18).

figure 18

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



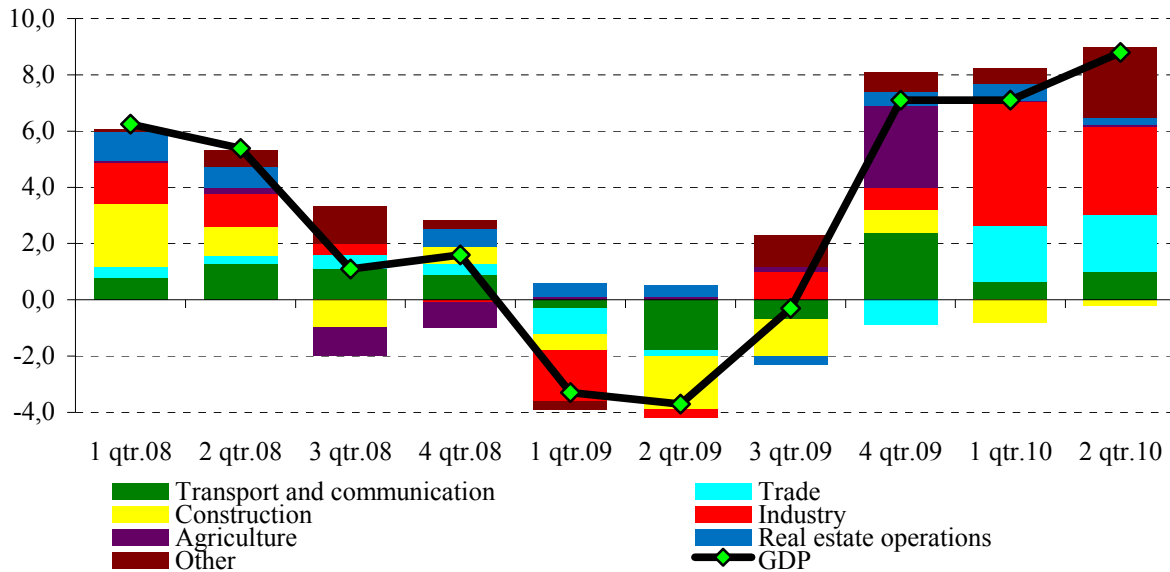
Source: National Bank of the Republic of Kazakhstan

2.2. Production

The volume of GDP output in Q2 2010 amounted to KZT 4360.1 bln. in current prices. Being positively influenced by the growth in production in virtually all industries of the economy, except construction as well as financial and insurance activities, the GDP in real terms increased, according to estimates by 8.8% versus Q2 2009 (in Q1 2010 the growth accounted for 7.1%) (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 by the improved situation, both in the production of commodities and in the production of services, where the growth in the indices of physical volume was 5.9% and 7.0%, respectively.

In the production of commodities, agriculture and industry showed growth while construction demonstrated decline. The index of physical volume in agriculture was 103.5%, in industry – 109.4%, in construction – 98.8%, which in the aggregate made a positive contribution of 3.1% to the GDP formation.

In the production of services the decline in the index of physical volume in financial and insurance activities by 1.5% and general government by 0.1% was fully neutralized by high growth in all other components, which resulted in a positive contribution to the GDP formation at the level of 3.4%.

The decrease in Q2 2010 in the volume of financial intermediation services indirectly measured which are used with a negative sign in the total volume of GDP contributed to the GDP formation in the amount of 2.0%, and the growth of net taxes on products and imports increased GDP by 0.3% in addition.

2.3. Labor Market

2.3.1. Employment and Unemployment

In Q3 2010 the number of people employed in the economy, according to tentative estimates, was 8.2 mln., having increased by 0.7% versus the previous period. At the same time, the number of employees reached 5.4 mln. (growth by 1.2%), the number of self-employed – 2.7 mln. people (decline by 0.3%).

In the structure of employees, 4.4 mln. individuals (81.3% of all employees) were working in public and non-public institutions, for natural persons – 0.7 mln. individuals (12.7%), at farms – 0.3 mln. individuals (6.0%).

In Q3 2010 the number of unemployed was 481.7 thous. individuals, having decreased by 4.4% as compared to the previous period, and by 10.1% - versus Q3 2009 (figure 20).

figure 20

The structure of economically active population, mln. individuals



Source: Agency of Statistics of the Republic of Kazakhstan

In July and August 2010 the structural changes in the composition of employees continued.

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

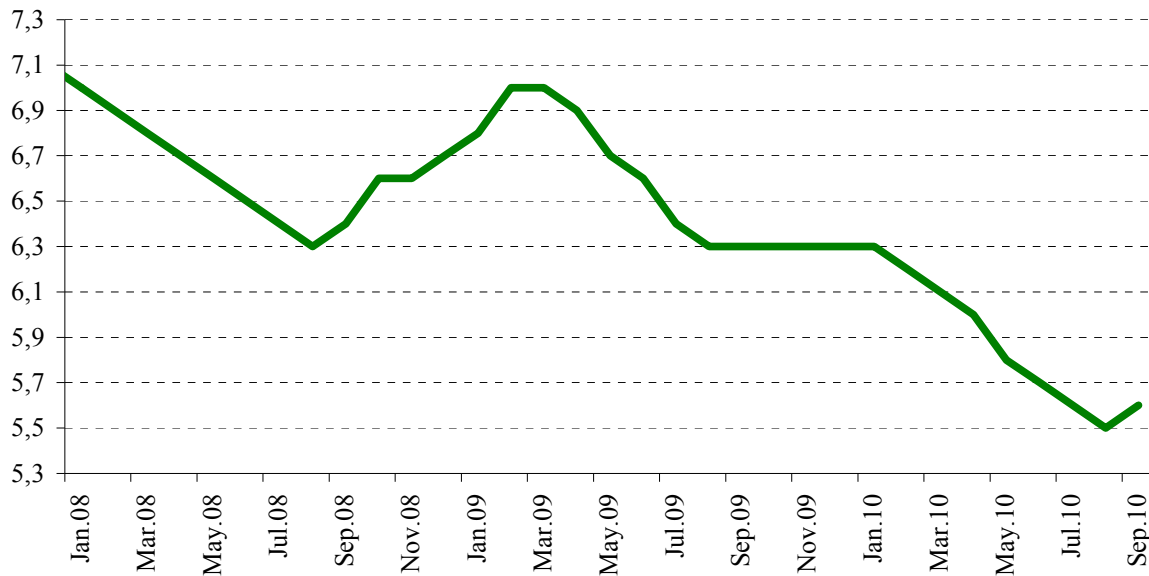
The largest percentage of outflow of the employed was in the construction, agriculture, financial and insurance activities, information and communications.

The decrease in the number of employed in some sectors was largely compensated by their growth in other sectors, whereby the unemployment rate in Q3 2010, according to preliminary information, decreased by 0.2 percentage points and accounted for 5.6% (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 a higher nominal and real growth in wages, as compared to the respective quarter of 2009.

After the slowdown in the growth rate of nominal wages in Q1 2010, the rate accelerated in Q2 2010. The average monthly wages grew by 17.0% in nominal terms as compared to the respective period of 2009 (in Q2 2009 – by 10.2 %), the real wage index increased by 9.4% (in Q2 2009 – by 1.8%).

The highest increase in wages was observed in the last month of Q2 2010. In June 2010 as compared to June 2009 wages in nominal terms increased by 17.9%, and in real terms – by 10.4%.

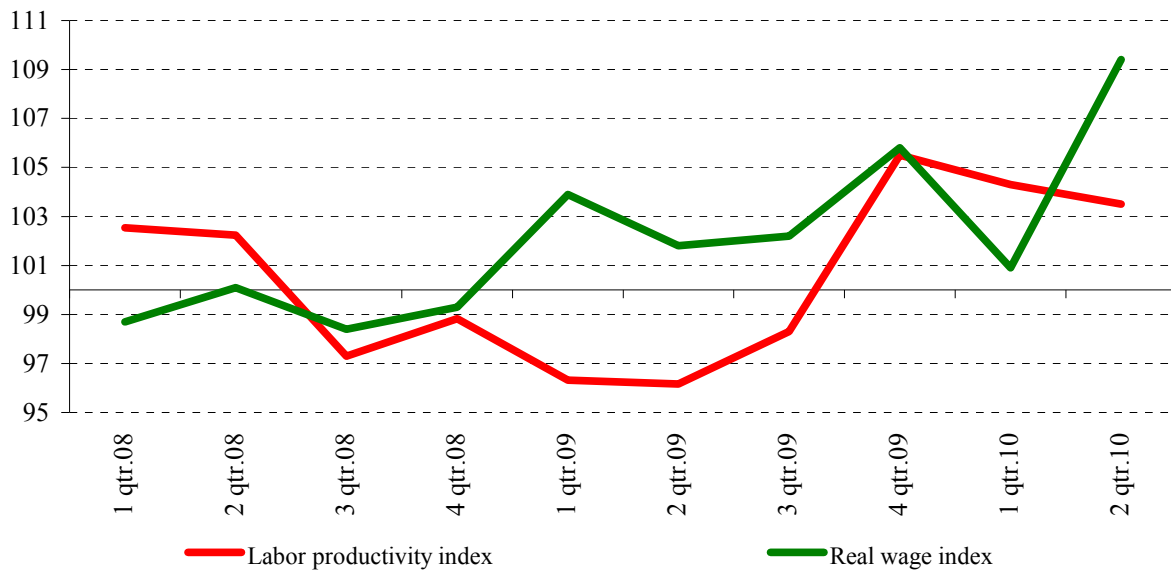
In Q2 2010 the real wage index accounted for 109.4% as compared to the respective quarter of the previous year, and 112.3% - versus Q1 2010. The wage growth was observed in virtually all sectors of the economy. The highest growth in wages was in such types of economic activity as: “ancillary educational services” (by 2.8 times); “veterinary activity” (by 49.6%); “passenger air transport” (by 32.4%). The maximum amount of average monthly wage of one employee was in such sector as “employment assistance” – KZT 532.0 thous., and minimum – in the sector of “repair of computers, items of personal consumption and household goods” (KZT 34.3 thous.).

In August 2010 the real wage index was 110.5% as compared to the respective month of the last year. The highest increase was noted in the activity of extra-territorial organizations and authorities (by 27.5%) and mining industry (by 20.6%), and the decrease – in information and communications (by 5.2%).

The increase in wages to the public sector employees from Q2 2010 impacted labor productivity where the growth index slowed down amounting to 3.5% in Q2 2010, according to the National Bank’s estimate (Q1 2010 – 4.3%) (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

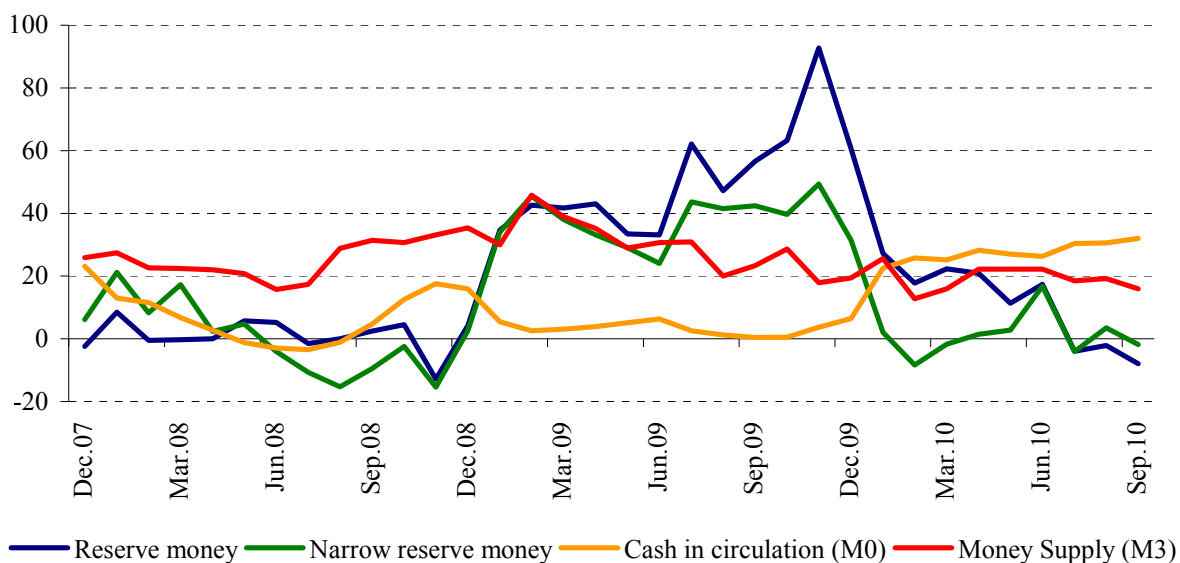
3. Money Supply

3.1. Monetary Aggregates

In Q3 2010 annual dynamics of money supply and cash in circulation demonstrated quite remarkable growth rates, whereas increases in reserve money and narrow reserve money were negative (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 Q3 2010 contracted by 7.6% and amounted to KZT 2529.9 bln. at end-September 2010. Narrow reserve money contracted by 2.5% to KZT 2162.2 bln.

In September 2010 as compared to September 2009 reserve money contracted by 7.9%.

Net international reserves of the National Bank increased by 36.1% to US\$ 27.3 bln. in September 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 with 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 with the National Bank. Assets denominated in gold also increased.

In September 2010 as compared to September 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)**

	Q4. 09	Q1. 10	Q2. 10	Q3. 10
Net international reserves	13.5	41.1	40.8	36.1
Net domestic assets	167.0	-634.7	-341.1	-364.5
Net claims on the Government	-902.7	-12.6	-67.9	-83.5
Claims on the economy	482.1	-197.0	-169.2	-154.3
Other net domestic assets	-204.9	-7.9	2.2	-18.8
Reserve money	60.7	22.3	17.3	-7.9
Narrow reserve money	31.5	-1.7	16.8	-1.8

Source: National Bank of the Republic of Kazakhstan

3.1.2. Money Supply

In Q3 2010 money supply grew by 1.5% to KZT 8411.1 bln.

In September 2010 as compared to September 2009 its growth accounted for 15.9% 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)**

	Q4. 09	Q1. 10	Q2. 10	Q3. 10
Net foreign assets	180.0	121.3	132.6	138.3
Domestic assets	2.2	-10.3	-12.3	-27.4
Claims on the Government	-58.0	506.1	425.6	166.2
Claims on the economy	10.4	5.3	5.1	3.6
Other net domestic assets	-42.6	-30.9	-26.0	-42.1
Money supply	19.5	16.0	22.1	15.9
Cash in circulation	6,5	25,1	26.3	34.2
Deposits of residents	21.5	14.9	21.6	13.6

Source: National Bank of the Republic of Kazakhstan

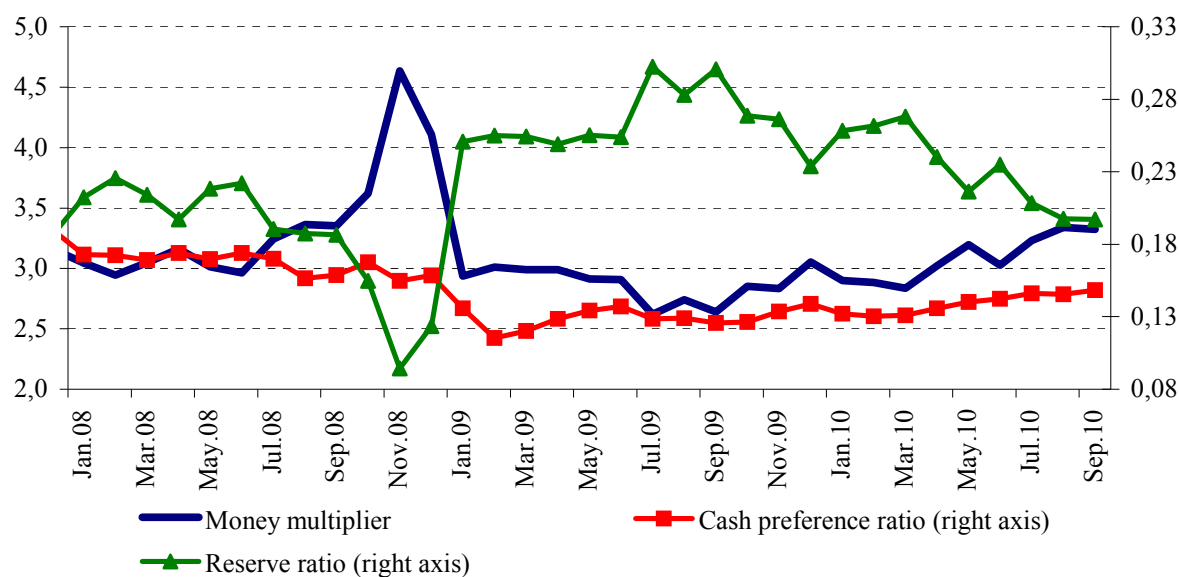
In the structure of net foreign assets of the banking system in September 2010 as compared to September 2009 net foreign assets increased, both of banks and the National Bank. The growth in net foreign assets of banks was mainly stipulated by the decreased claims of non-residents on banks.

In September 2010 as compared to September 2009, despite the growth in the volumes of credits to the economy and net claims on the Government, domestic assets of the banking system decreased on the basis of decreased other net domestic assets of the banking system.

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 88.8% in September 2009 to 87.7% at end-September 2010.

The money multiplier grew from 2.64 in September 2009 to 3.32 in September 2010 as a result of growth in the money supply against the contraction of the reserve money. The reason for that was the increased 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 Q3 2010 increased by 5.1% to KZT 1086.5 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 foreign exchange proceeds, and net proceeds from loans to individuals and legal entities.

In September 2010 as compared to September 2009, cash in circulation increased by 34.2%. This shows that the impact of factors contributing to the growth in cash (payout and 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 Q3 2010 as compared to Q3 2009 payouts of cash from bank cashier departments increased by 15.9% to KZT 2978.2 bln., cash receipts to bank cashier departments – by 9.5% to KZT 2725.4 bln. As a result, net payouts from bank cashier departments amounted to KZT 252.8 bln.

3.2. Financial Market**3.2.1. Deposits of Residents**

At end-September 2010 deposits of residents amounted to KZT 7324.7 bln., having increased by 1.0% during Q3 2010. Deposits of legal entities decreased by 0.4%, deposits of individuals increased by 4.7%. Deposits in the domestic currency increased by 7.3% to KZT 4695.8 bln., deposits in foreign currency – decreased by 8.6% amounting to KZT 2628.8 bln.

Since the beginning of the year the growth in deposits of residents amounted to 11.4% and was secured by the growth in the domestic currency deposits by 26.9% whereas deposits in foreign currency decreased by 8.5% (table 4).

table 4

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

	Sep.07	Sep.08	Sep.09	Sep.10
Deposits of residents	20.5	30.6	19.2	11.4
<i>of the population</i>	<i>36.6</i>	<i>6.3</i>	<i>24.7</i>	<i>9.9</i>
<i>of non-bank legal entities</i>	<i>12.5</i>	<i>44.7</i>	<i>17.1</i>	<i>12.0</i>
Deposits in the Tenge	28.8	21.5	-7.5	26.9
Deposits in foreign currency	5.3	49.9	67.7	-8.5

Source: National Bank of the Republic of Kazakhstan

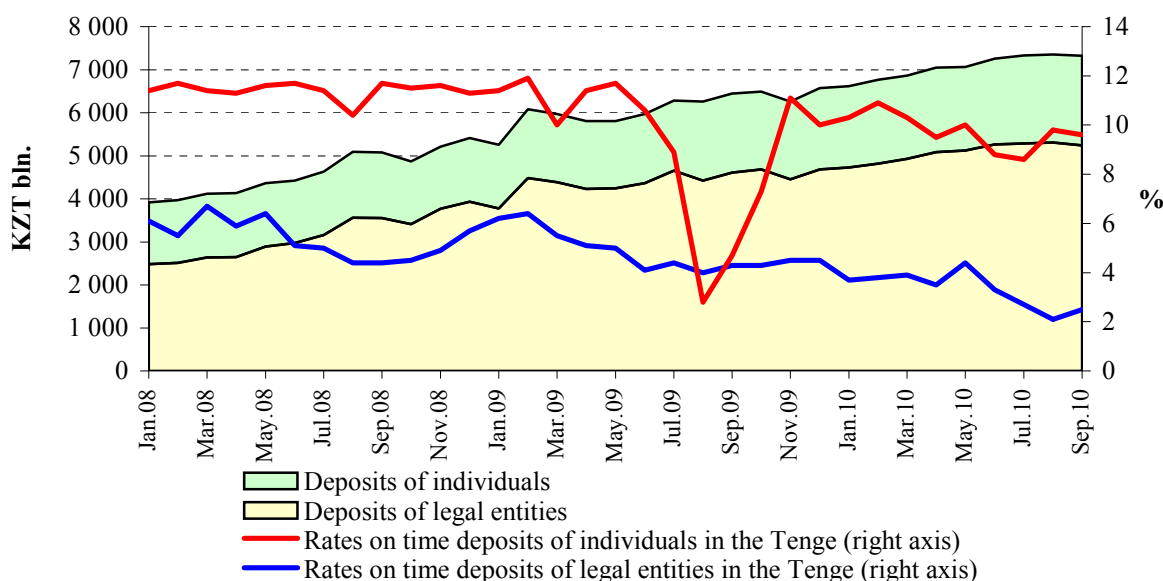
As compared to the respective month of 2009, total volume of deposits of residents with depository institutions grew up by 13.6% in September 2010. The dynamics in deposits of residents during this year were characterized by the higher growth rates of deposits in the second quarter and by lower rates – in the first and third quarters. These changes were caused by the transformation of foreign currency deposits of legal entities.

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

The average weighted interest rate on the Tenge time deposits of non-bank legal entities was 2.5% in September 2010 (in September 2009 – 4.3%), and on deposits of individuals – 9.6% (4.7%) (figure 25).

figure 25

Dynamics of deposits and their interest rates



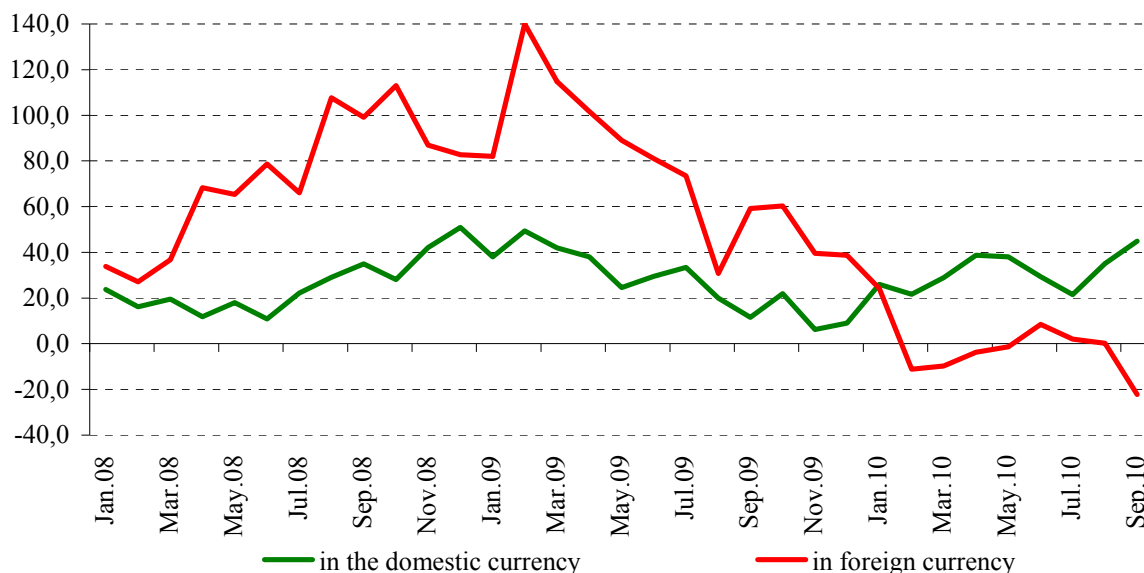
Source: National Bank of the Republic of Kazakhstan

Measures taken by the government to ensure financial stability, continue maintaining 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, the stabilization 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 0.4% in Q1 2010.

The volume of deposits of legal entities increased by 13.8% in September 2010 as compared to the respective period of 2009. Deposits of legal entities in the domestic currency increased in annual terms by 44.9%, and in foreign currency – by 22.2% (figure 26).

figure 26

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

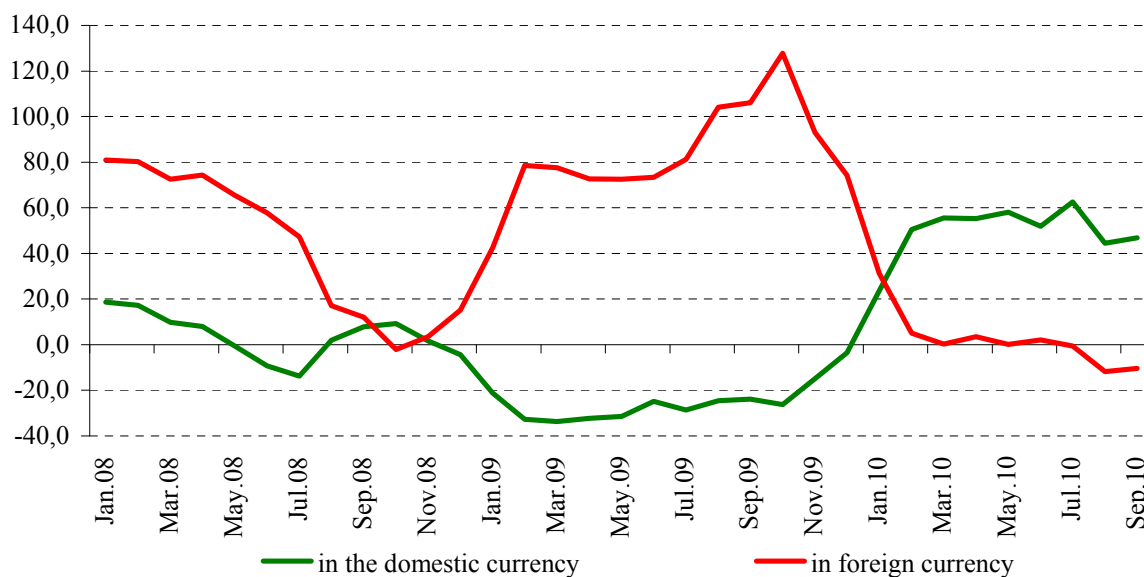


Source: National Bank of the Republic of Kazakhstan

The volume of deposits of individuals in September 2010 as compared to the respective period of 2009 increased by 13.3%. Deposits of individuals in the domestic currency increased in annual terms by 46.9%, in foreign currency – decreased by 10.4% (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

In Q3 2010 bank credits to the economy increased by 0.2% to KZT 7 493.3 bln. Credits to the population increased by 0.1%, to legal entities – by 0.3%.

The lending volume decreased by 6.6% versus September 2009, including the decrease in credits to legal entities by 6.1%, and to individuals – by 8.1%.

The average weighted rate on credits to legal entities decreased from 13.8% to 12.5% in September 2010 as compared to September 2009. This was caused by the decrease in the cost of long-term borrowing for legal entities, both in the domestic currency and foreign currency, with the more significant decrease in the rates on credits in foreign currency.

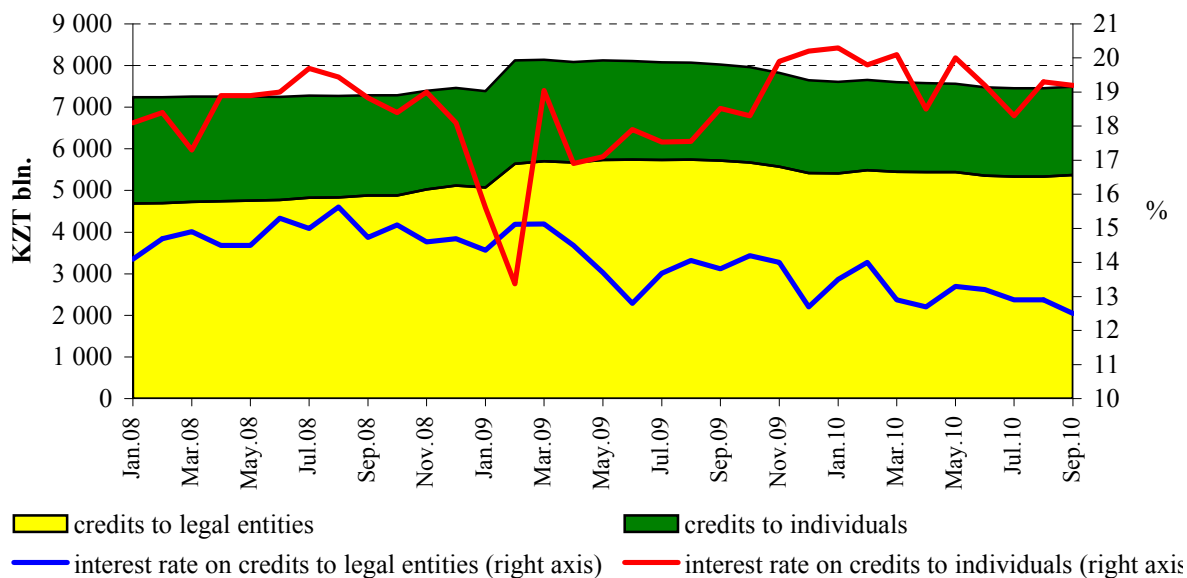
The average weighted rate on credits to individuals increased from 18.9% to 19.2% in September 2010, which was caused by the growth of rates on long-term loans in the domestic currency (figure 28).

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 (40.4%), trade (23.6%), construction (18.8%), and industry (10.0%).

figure 28

Dynamics of credits to the economy and their interest rates

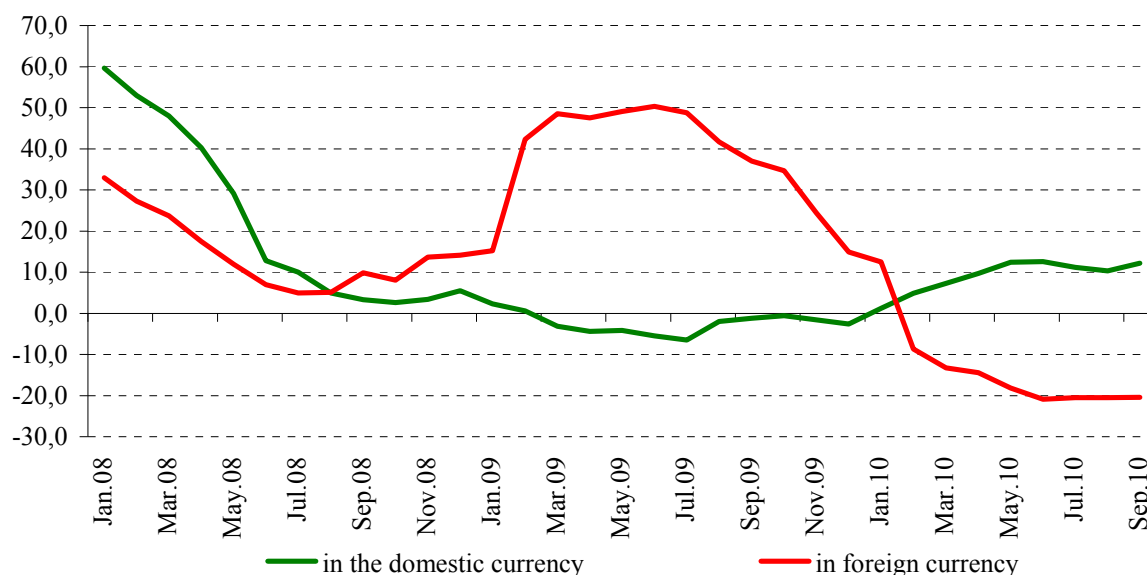


Source: National Bank of the Republic of Kazakhstan

The volume of credits to legal entities decreased in September 2010 as compared to the respective period of 2009 decreased by 6.1%. Credits to legal entities in the domestic currency increased by 12.2% in annual terms, and credits in foreign currency decreased by 20.4% (figure 29).

figure 29

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



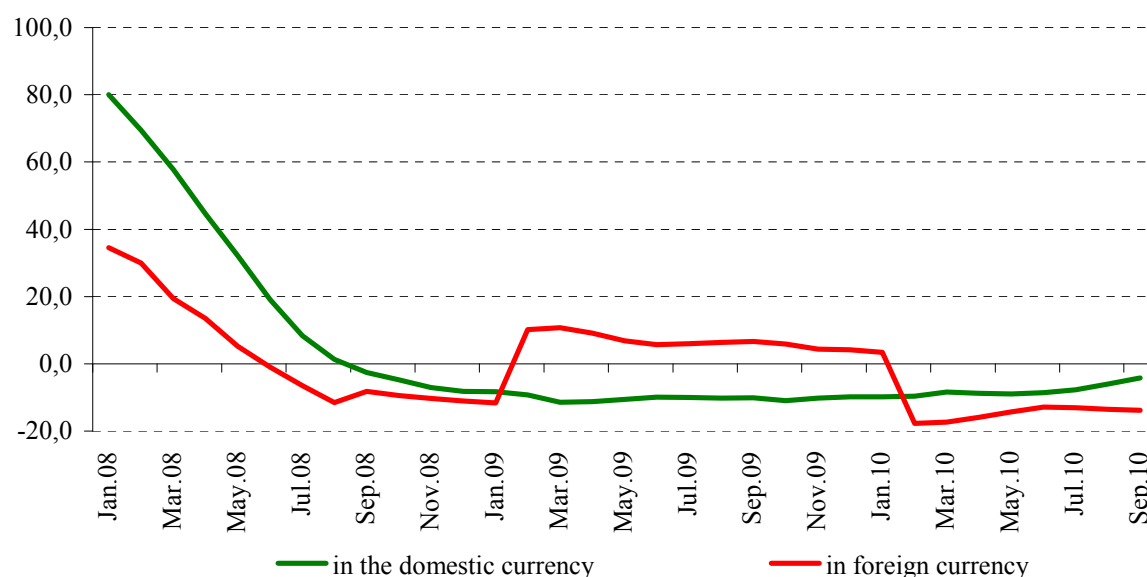
Source: National Bank of the Republic of Kazakhstan

The share of medium- and long-term credits at end-September 2010 amounted to 79.6% in the total volume of credits to legal entities (in September 2009 – 78.5%).

The volume of credits to individuals decreased by 8.1% in September 2010, as compared to the same period of 2009. In the structure of credits to the population, credits in the domestic currency have demonstrated the decrease by 4.2% and in foreign currency – by 13.8% (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

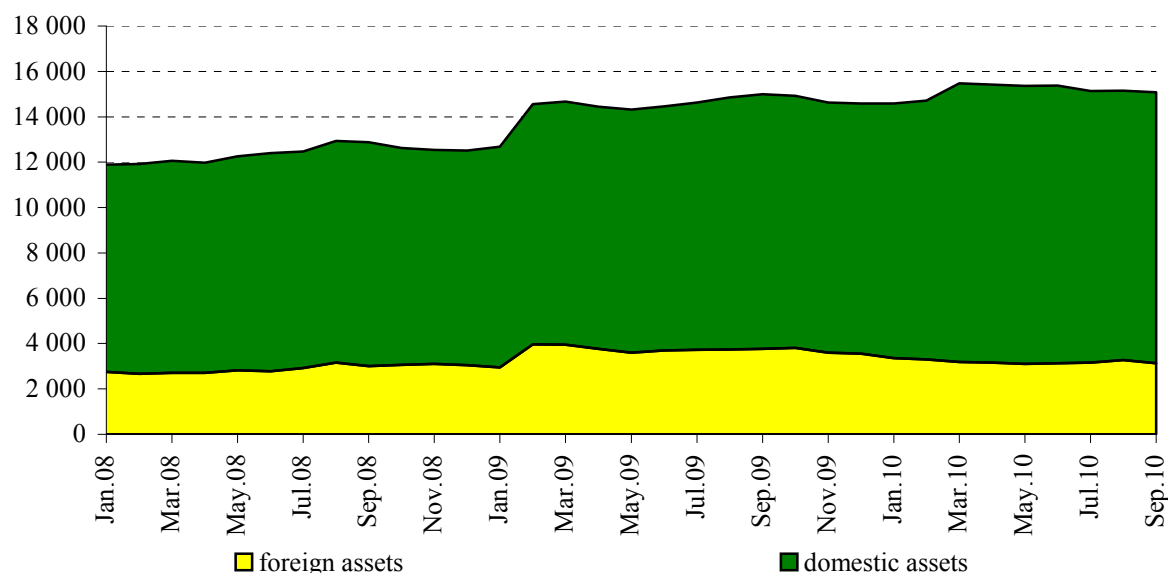
3.2.3. Bank Assets and Liabilities

– Assets

In Q3 2010 the amount of bank assets calculated under the Monetary Survey decreased by 1.9% to KZT 15.1 trln. Bank assets increased by 0.6% in annual terms (in September 2010 as compared to September 2009) (figure 31).

figure 31

Dynamics of bank assets, KZT bln.



Source: National Bank of the Republic of Kazakhstan

Foreign assets of banks in September 2010 accounted for 20.8% of the total volume of assets or US\$ 21.3 bln. They have decreased by 11.6% as compared to December 2009, by 16.9% - as compared to September 2009, and as compared to June 2010 – they increased by 2.0%.

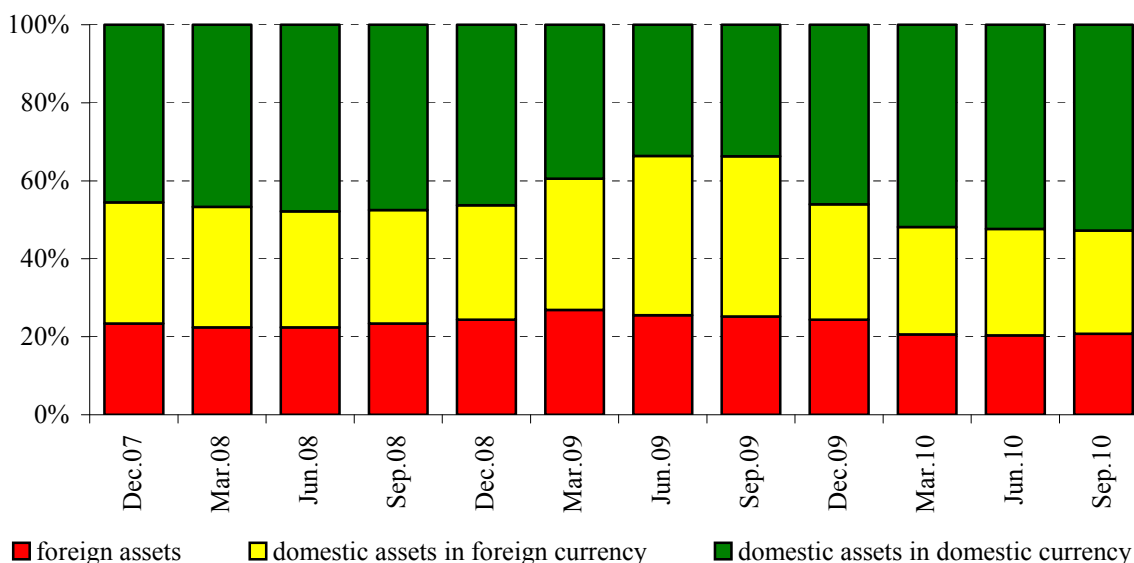
In the structure of foreign assets in September 2010, credits to non-residents accounted for 55.2% (in June 2010 – 52.9%), deposits placed with non-residents – 20.3% (in June 2010 – 23.3%), securities of non-residents – 5.6 % (in June 2010 - 5.9%), other accounts receivable – 18.9% (in March 2010 – 17.9%).

Domestic assets in September 2010 accounted for 79.2% or KZT 11.9 trln., where assets in the domestic currency amounted to 66.6% or KZT 8.0 trln. and assets in foreign currency – 33.4% or KZT 4.1 trln..

In June-September 2010 domestic assets in the domestic currency decreased by 1.0%, and assets in foreign currency – by 5.0%. As compared to September 2009, domestic assets increased by 6.5% as a whole, of which domestic assets in the domestic currency increased by 29.0%, and assets in foreign currency decreased by 21.0% (figure 32).

figure 32

Structure of bank assets, %



Source: National Bank of the Republic of Kazakhstan

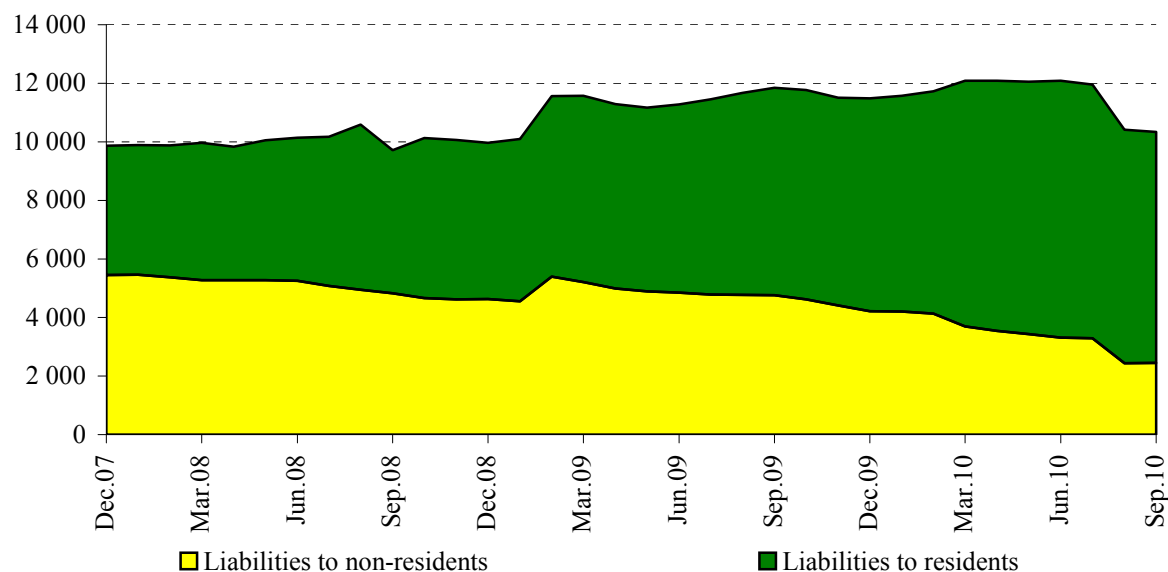
During June-September 2010 the quality of bank assets slightly improved. The share of bad assets decreased from 19.3% to 17.7%. However, the share of standard assets slightly decreased (from 51.3% to 47.6%), while the share of doubtful assets increased (from 29.4% to 34.7%). Moreover, there is a migration of assets in the structure of doubtful assets towards the lower quality assets: there was an increase in the share of the 2nd category (from 3.9% to 4.2%), 4th category (from 3.5% to 3.8%) and 5th category (from 5.2% to 7.8%). This is an evidence of the remaining threat of a further reduction in the quality of bank assets.

As a whole, under the Monetary Survey for Q3 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 adhere to their extremely 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 27.7% to 23.3%, the share of standard credits also decreased from 26.6% to 26.0%). 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 Q3 2010 total bank liabilities calculated in line with the Monetary Survey decreased by 14.5% and amounted to KZT 10.3 trln. at end-September 2010. In September 2010 as compared to September 2009, bank liabilities decreased by 12.7% (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

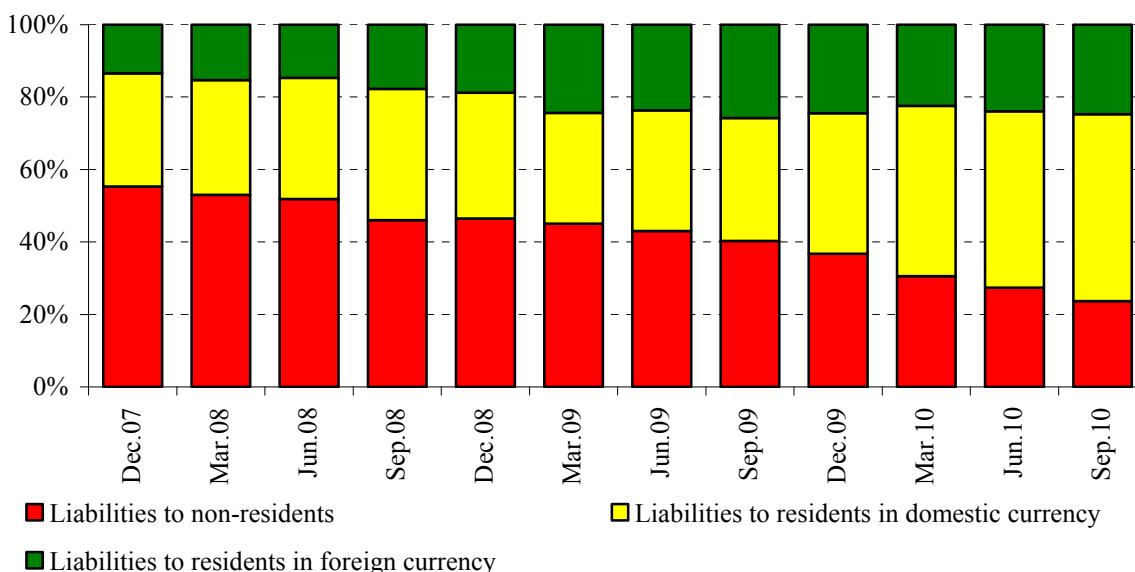
In September 2010 in the structure of bank liabilities to non-residents, liabilities on deposits of non-residents decreased to 6.6% from 7.1% in June 2010, liabilities on securities increased from 31.3% to 67.2%. Credits from non-residents, on the contrary, decreased to 23.8% from 59.7% in June 2010.

During June-September 2010 liabilities to residents also decreased by 10.1% to KZT 7.9 trln., of which liabilities in the domestic currency decreased by 9.4% to KZT 5.3 trln.. liabilities in foreign currency – by 11.5% to KZT 2.6 trln. The growth in these indicators accounted for 11.6%, 32.8% and -16.3%, respectively versus the respective month of 2009 (figure 34).

Thus, in Q3 2010 there was decrease in liabilities both to non-residents and residents. The process of liability restructuring in BTA Bank, Alliance Bank and Temirbank (BTA Bank's subsidiary) was successfully completed. As the result of foreign debt restructuring in these banks, their debt was reduced, repayment schedules were adjusted, both in terms of maturities and the amounts to be repaid. The decreased foreign debt of banks also resulted in reduced foreign debt servicing (i.e. of interest payable to the creditors).

figure 34

Structure of bank liabilities, %



Source: National Bank of the Republic of Kazakhstan

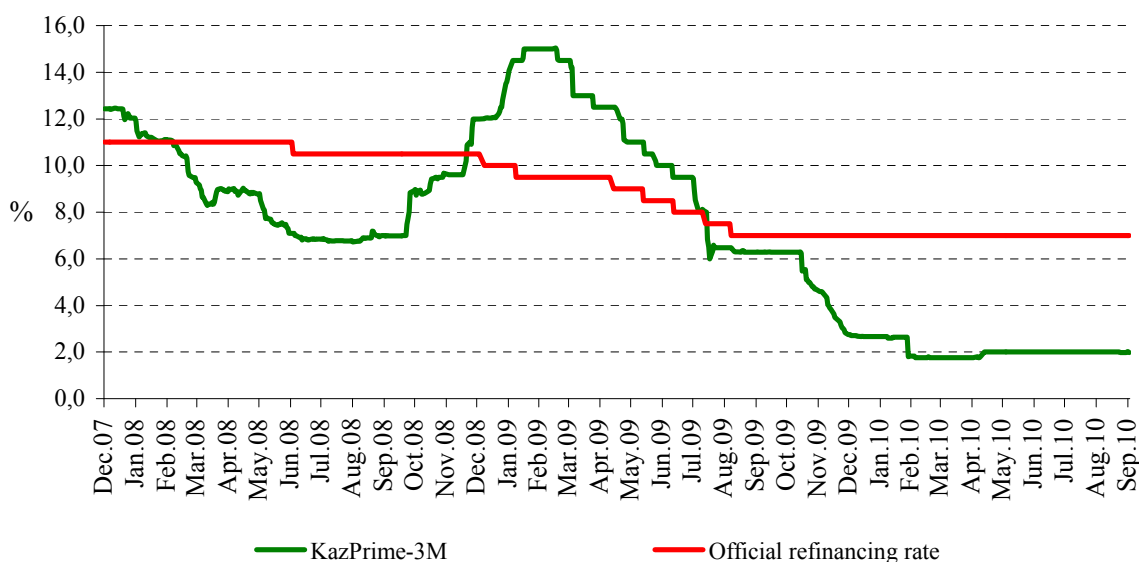
3.2.4. Financial Market Rates

In Q3 2010 there was slight growth in interbank market rates.

The KazPrime index increased from 1.90% on average in Q2 2010 to 2.00% on average in the third quarter. This indicator was 2.00% at end-June 2010, and 1.98% - at end-September. (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

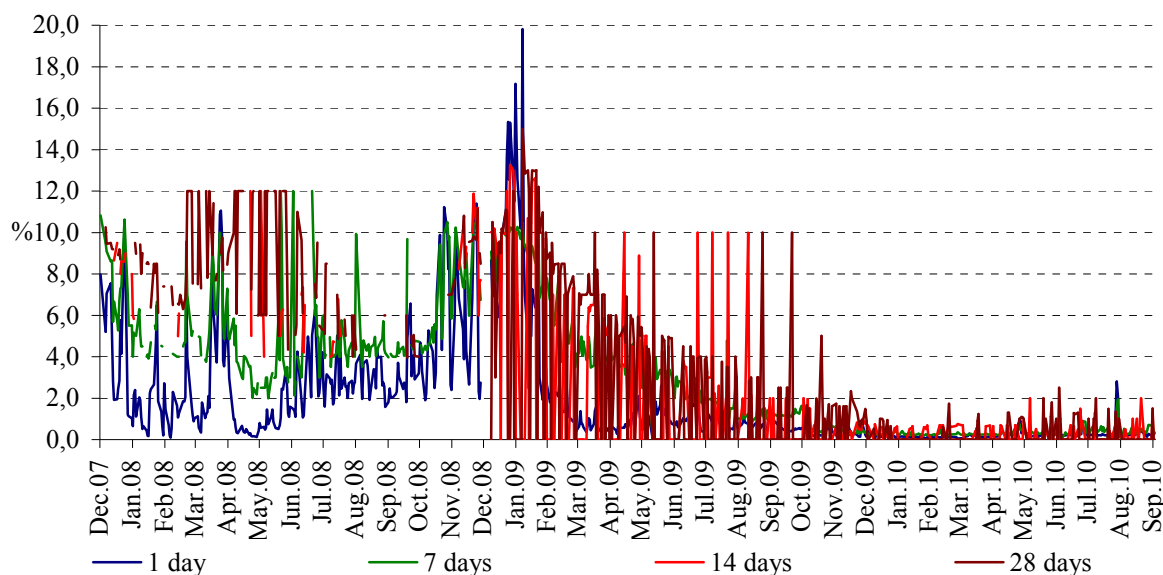
Rates on REPO operations are growing.

The average weighted rate on 1-day operations in the sector of the automatic REPO in Q3 2010 increased and was 0.36% (in Q2 2010 – 0.25%). Its maximum level was 2.81% and minimum – 0.09%.

Rate fluctuations on 7-day REPO operations in Q3 2010 were within the range of 0.19% to 1.95% (the average weighted rate was 0.41%), on 14-day REPO operations – from 0.20% to 2.00% (the average weighted rate was 0.67%), and on 28- day REPO operations – from 1.00% to 2.50% (the average weighted rate was 1.23%) (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 Q3 2010 the transaction volumes in the sector of the automatic REPO decreased by 9.4% as compared to the previous quarter. At the same time, the volumes on 2-day and 14-day REPO operations increased as compared to Q2 2010.

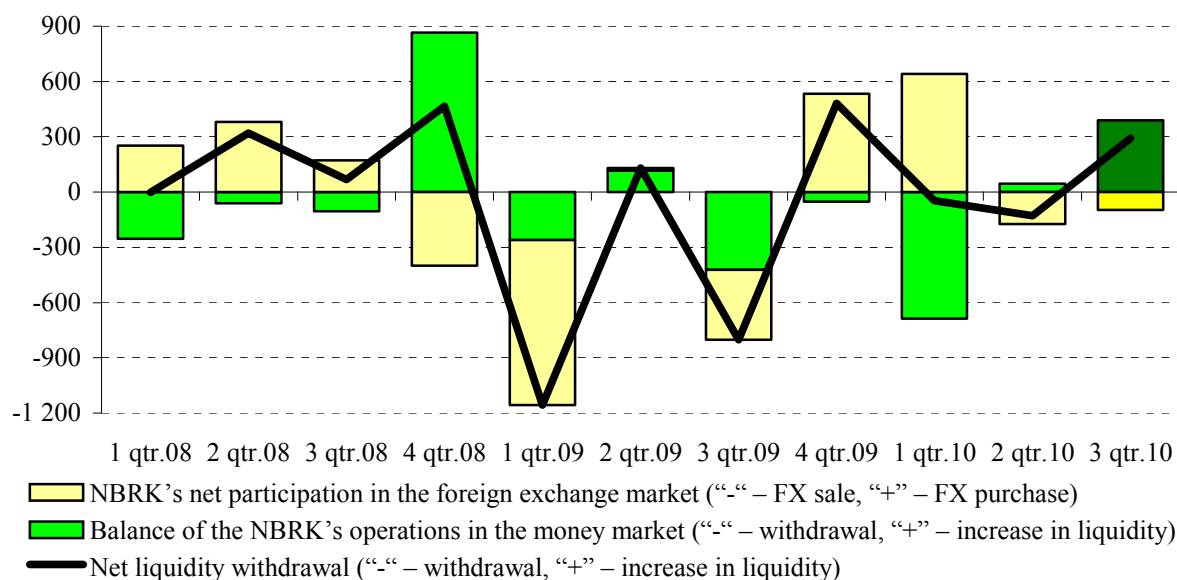
4. Monetary Policy Instruments and Operations

In Q3 2010 the situation in the financial market was stable, banks had sufficient Tenge liquidity.

In Q3 2010 the National Bank's operations in the financial market resulted in the supply of the Tenge liquidity mainly because of the decreased volumes of operations on the issue of short-term notes and attraction of deposits from banks. (figure 37).

figure 37

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



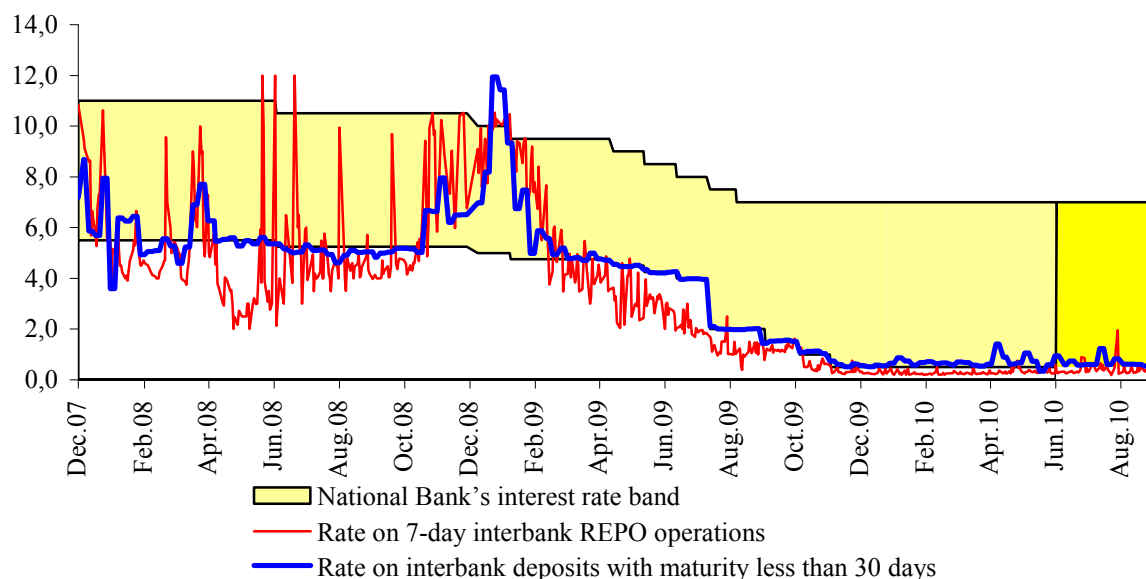
Source: National Bank of the Republic of Kazakhstan

In Q3 2010 the National Bank's rate band remained unchanged. From July 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 July-September 2010 the situation in the money market was characterized by some increase in the interest rate volatility as compared to Q2 2010. On average, in Q3 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 0.70% in Q3 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, %

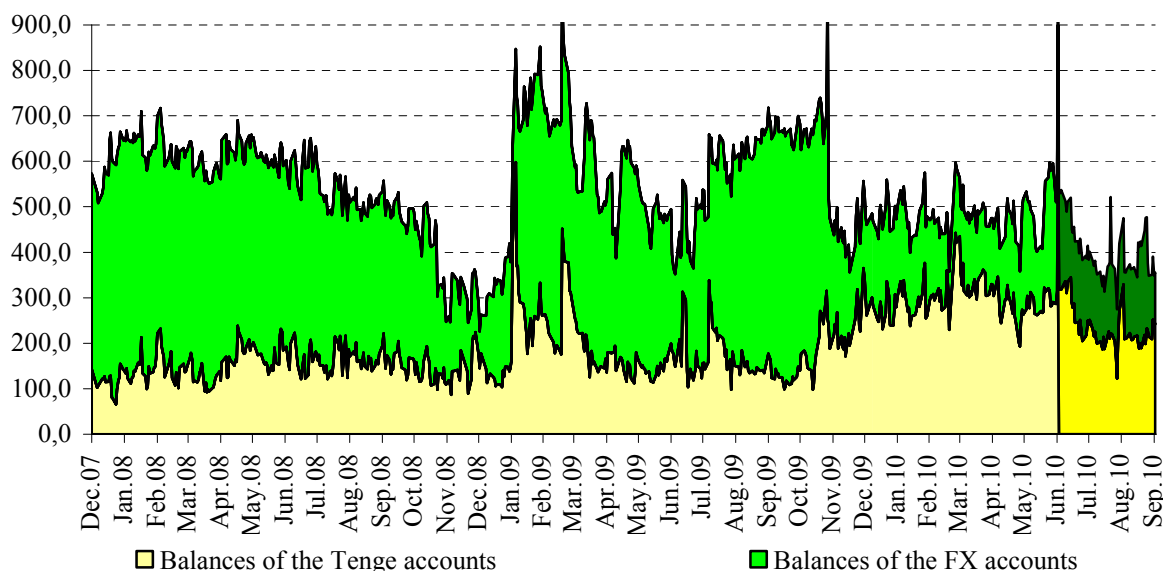


Source: National Bank of the Republic of Kazakhstan

In Q3 2010 there was some decrease in the volumes of correspondent account balances of banks with the National Bank. In July-August correspondent account balances of banks in foreign currency were decreasing, in mid-October they increased, however, they decreased virtually by half in the subsequent days. Correspondent account balances of banks in the domestic currency were also decreasing in July-August, and their volume remained virtually unchanged in September. (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

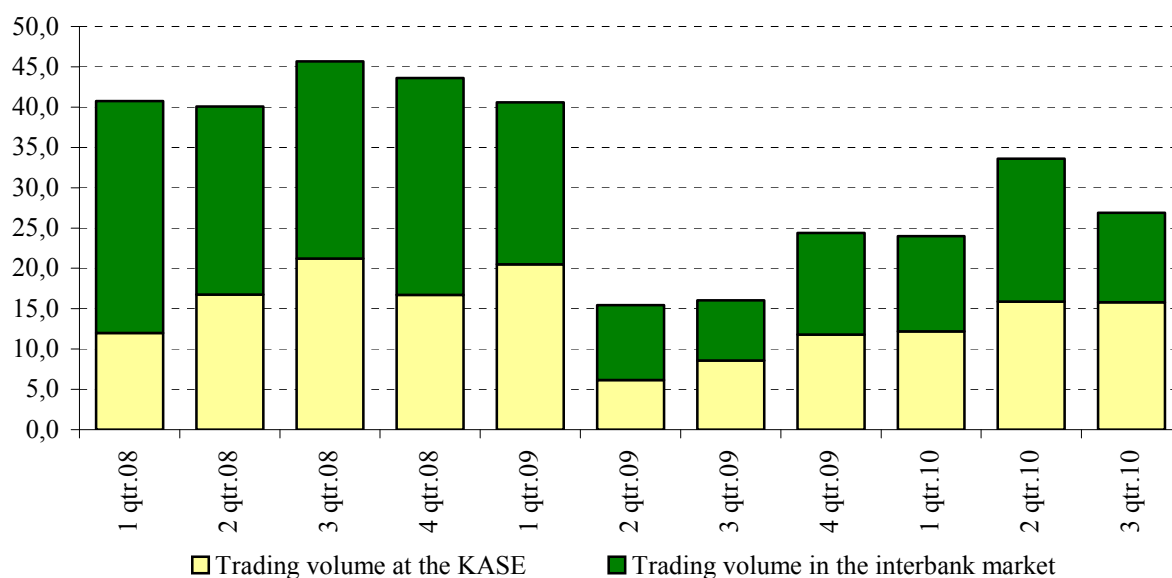
The situation in the domestic foreign exchange market was characterized by relative stability.

In Q3 2010 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank foreign exchange market amounted to US\$ 26.9 bln. having decreased by 19.8% as compared to Q2 2010.

The volume of trades in the Dollar position at the Kazakhstan Stock Exchange decreased by 0.3% as compared to Q2 2010 and amounted to US\$ 15.8 bln. (net trades at the Kazakhstan Stock Exchange made up 81% of gross trades). In the off-exchange foreign currency market the volume of transactions in the third quarter of 2010 decreased by 50.0% as compared to the previous quarter and amounted to US\$ 11.1 bln. (figure 40).

figure 40

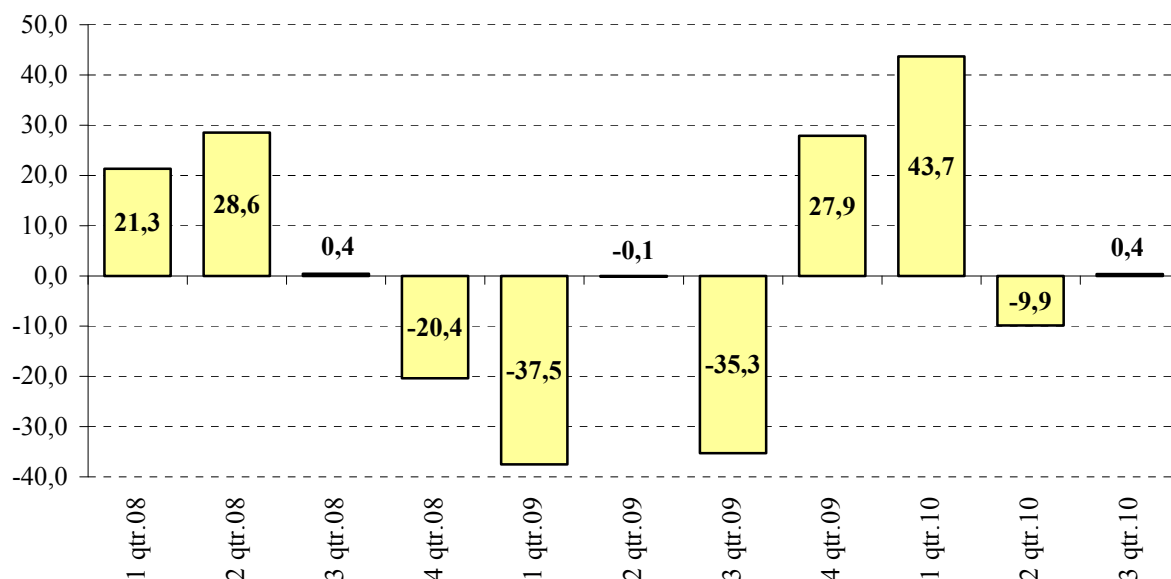
Volume of trading in the domestic exchange market, US\$ bln.



Source: National Bank of the Republic of Kazakhstan

Based on Q3 2010, 2010 the National Bank's participation coefficient in the Kazakhstan Stock Exchange was 0.4% (in Q2 2010 it was negative, (-)9.9%) (figure 41). Thus, in Q3 2010 the National Bank was primarily the buyer of foreign exchange in the domestic foreign exchange market.

figure 41

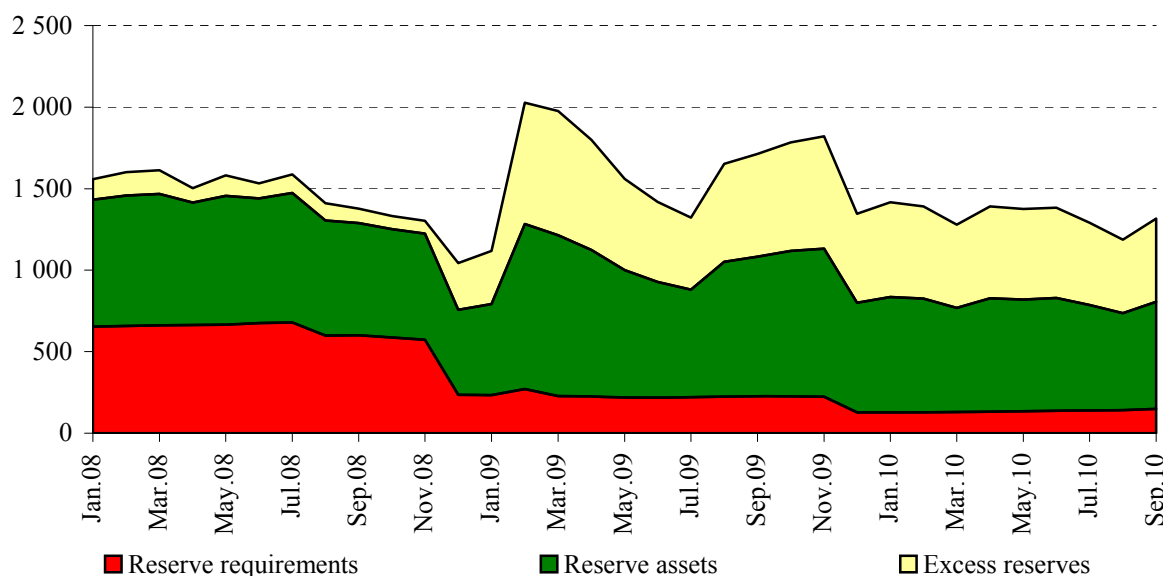
Coefficient of the National Bank's participation at the Kazakhstan Stock Exchange, %


Source: National Bank of the Republic of Kazakhstan

4.2. Minimum Reserve Requirements

On average, in July-September 2010 reserve assets exceeded the required reserving volume by 4.7 times (in Q2 2010 – by 5.14 times, in Q3 2009 – by 3.4 times) (figure 42).

figure 42

Compliance with minimum reserve requirements, KZT bln.


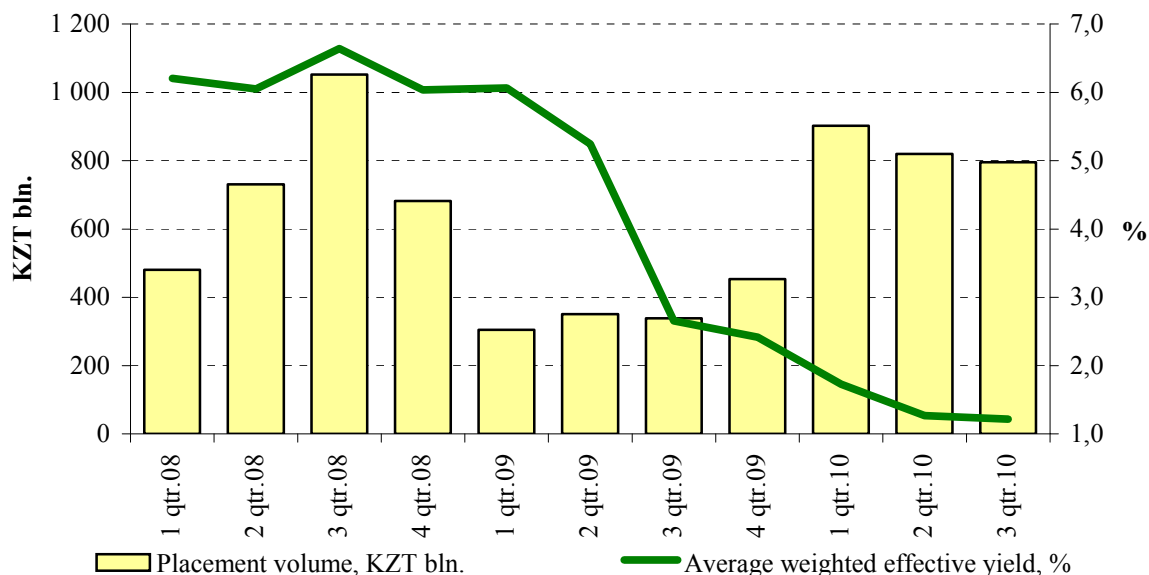
Source: National Bank of the Republic of Kazakhstan

4.3. Open Market Operations

In Q3 2010 the demand of banks for short-term notes of the National Bank was high. In July-September 2010 short-term notes with maturities of 3 and 6 months were issued.

Volume of short-term notes issued in Q3 2010 decreased by 3.0% as compared to Q2 2010 and amounted to KZT 795.5 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 decreased from 1.27% in Q2 2010 to 1.22% in Q2 2010. (figure 43).

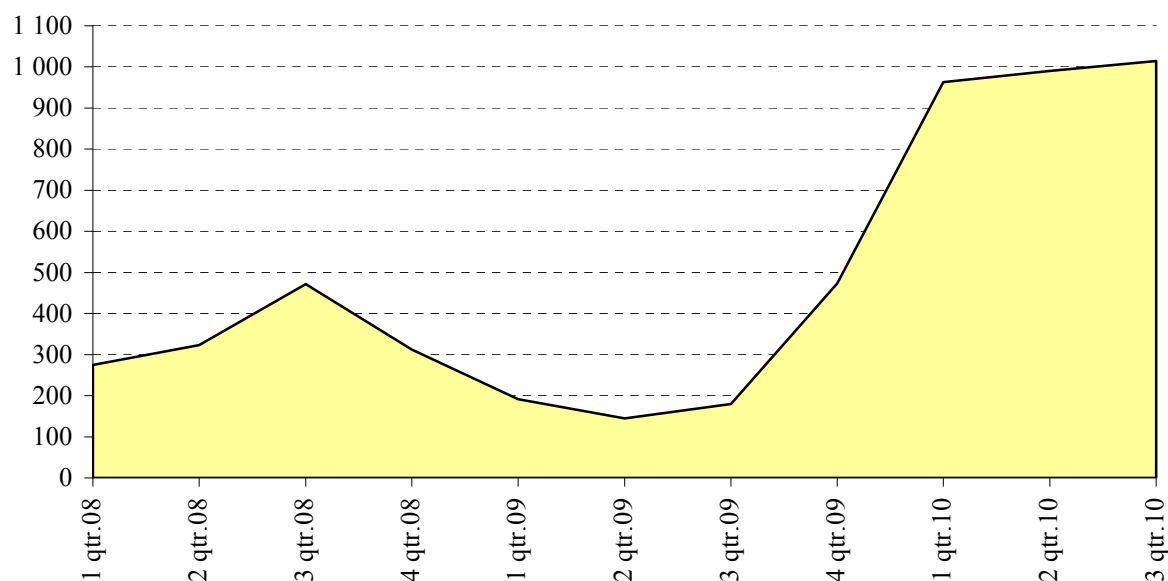
figure 43

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


Source: National Bank of the Republic of Kazakhstan

At end-September 2010 the volume of short-term notes in circulation amounted to KZT 1014.4 bln., which is by 2.1 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

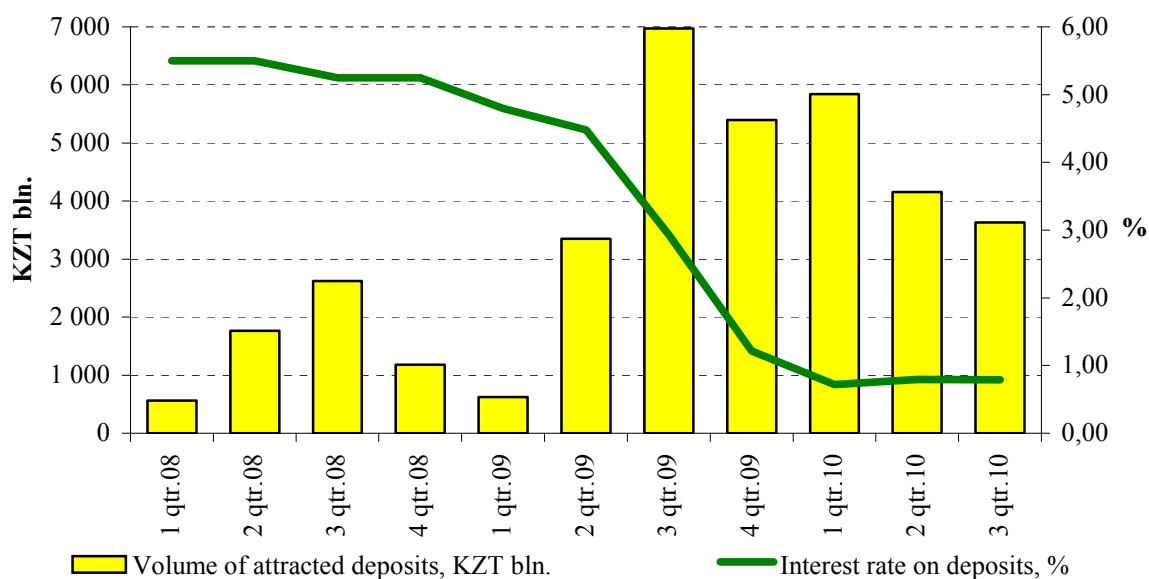
4.4. Standing Facilities

In July-September 2010 the volume of bank deposits with the National Bank decreased as compared to the previous quarter. Nonetheless, the volumes of attraction remained high: the peak of attraction occurred in July-August, in September the volumes somewhat decreased. In total, during July-September, 2010 KZT 3631.4 bln. of deposits was attracted, which is by 12.6% below the volume of Q2 2010 and by 1.9 times less than the volume in Q3 2009.

The average interest rate on deposits didn't change in Q3 2010 as compared to the previous quarter and was 0.79%. (figure 45).

figure 45

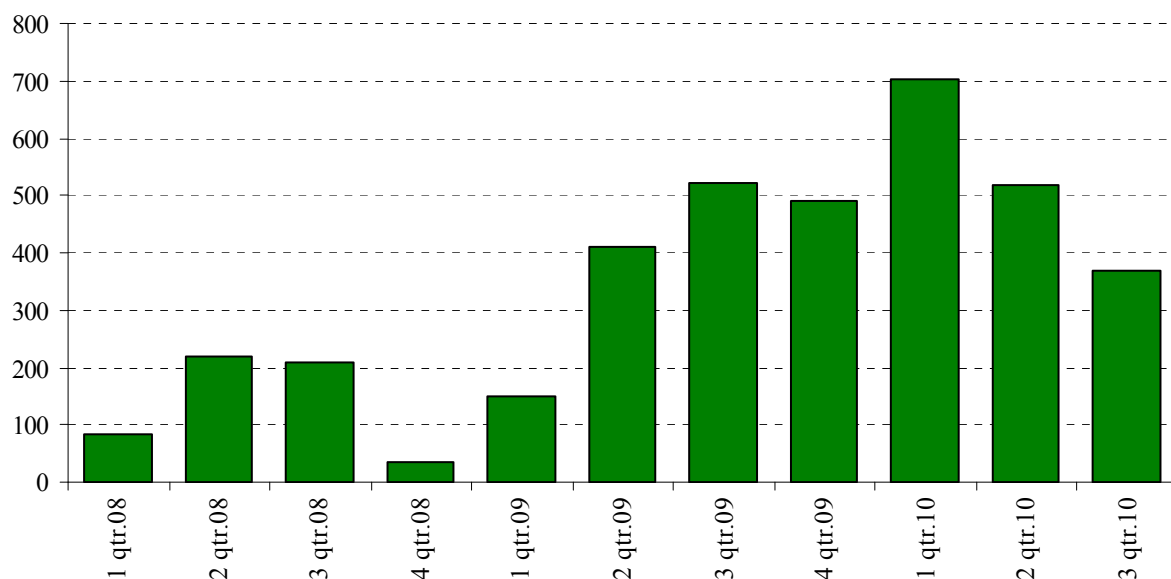
Volume and interest rates on deposits attracted by the National Bank (for the period)



Source: National Bank of the Republic of Kazakhstan

Decreased volumes of attracted deposits were accompanied by the decrease in the volume of the National Bank's outstanding liabilities on such deposits by 29.3% to KZT 367.5 bln. in September 2010 as compared to June 2010. (figure 46).

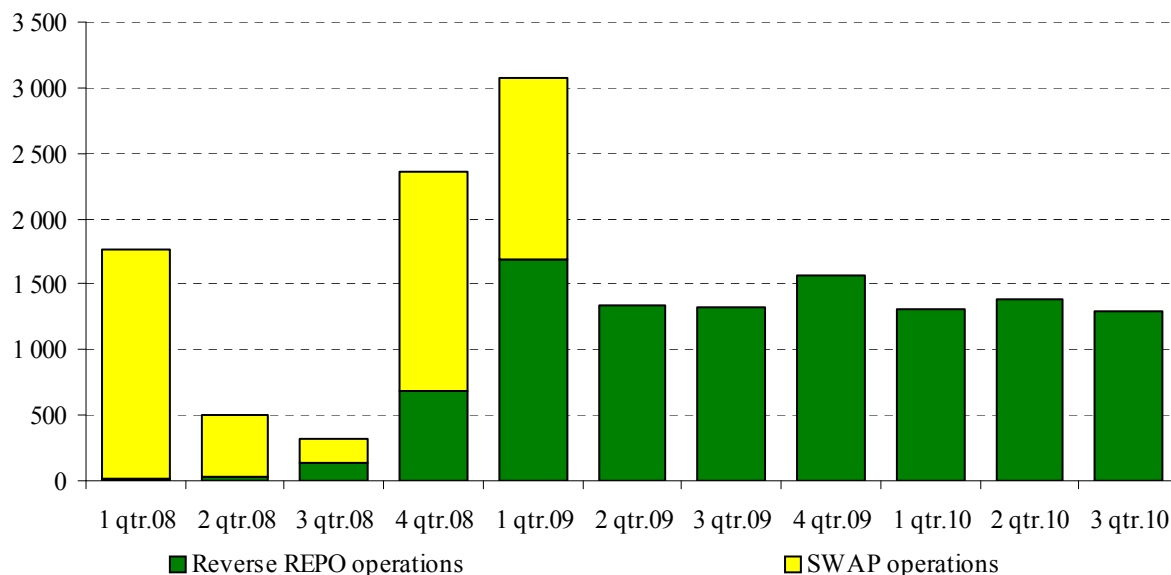
figure 46

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 Q3 2010 the National Bank continued to provide refinancing loans to the banking sector through reverse REPO operations. Total volume of reverse REPO operations in July-September 2010 amounted to KZT 1294.8 bln. (figure 47).

figure 47

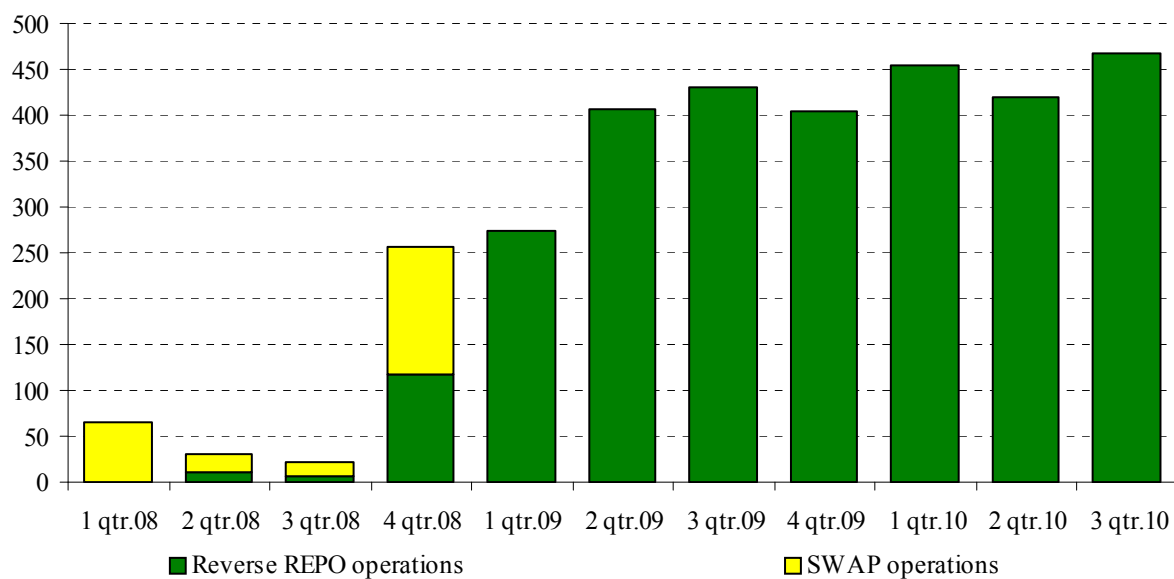
Volume of the National Bank's refinancing operations, KZT billion (for the period)


Source: National Bank of the Republic of Kazakhstan

At end-September 2010 the outstanding debt on reverse REPO operations amounted to KZT 466.5 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