

National Bank
National Bank
of the Republic of Kazakhstan

Inflation Report
for the Second Quarter 2010

Table of Contents

Table of Contents	2
Basic Terms and Definitions	3
List of Figures and Tables	5
Summary	7
Evaluation of the Inflation Forecasts for the Second Quarter 2010	7
Inflation Forecast for 2010	8
1. Inflationary Processes	10
1.1. Consumer Prices	10
1.2. Core Inflation	11
1.3. Prices in the Real Sector of the Economy	13
1.3.1. <i>Prices in the Industry</i>	13
1.3.2. <i>Prices in Agriculture</i>	14
1.3.3. <i>Enterprise Monitoring</i>	14
2. Inflation Factors	17
2.1. Aggregate Demand	17
2.1.1. <i>Individual Consumption and Investment Demand</i>	17
2.1.2. <i>Government Consumption</i>	19
2.1.3. <i>External Sector</i>	20
2.2. Production	25
2.3. Labor Market	26
2.3.1. <i>Employment and Unemployment</i>	26
2.3.2. <i>Wages and Productivity</i>	28
3. Money Supply	30
3.1. Monetary Aggregates	30
3.1.1. <i>Reserve Money</i>	30
3.1.2. <i>Money Supply</i>	31
3.1.3. <i>Cash in Circulation</i>	32
3.2. Financial Market	32
3.2.1. <i>Deposits of Residents</i>	32
3.2.2. <i>Credits to the Economy</i>	35
3.2.3. <i>Bank Assets and Liabilities</i>	37
3.2.4. <i>Financial Market Rates</i>	40
4. Monetary Policy Instruments and Operations	43
4.1. Interventions in the Domestic Foreign Exchange Market	45
4.2. Minimum Reserve Requirements	46
4.3. Open Market Operations	47
4.4. Standing Facilities	48

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.

List of Figures and Tables

Figures

- figure 1. Actual and forecasted inflation in 2010
- figure 2. Dynamics of quarterly inflation and its components
- figure 3. Dynamics of annual inflation and its components
- figure 4. Dynamics of quarterly inflation and core inflation
- figure 5. Dynamics of annual inflation and core inflation
- figure 6. Dynamics of the producer price index
- figure 7. Dynamics of the agricultural price index
- figure 8. Diffusion indices for changes in the demand and prices
- figure 9. Contribution of components of aggregate demand to growth in GDP
- figure 10. Dynamics of personal spending and income
- figure 11. Dynamics of spending on investments in fixed capital
- figure 12. Execution of the state budget
- figure 13. Dynamics of world prices for metals
- figure 14. Dynamics of world prices for oil (Brent), and wheat (Canada)
- figure 15. Current account balance
- figure 16. Indices of real exchange rates of the Tenge
- figure 17. Dynamics of the nominal exchange rate of the Tenge against the U.S. dollar
- figure 18. Dynamics of the official exchange rate of the Tenge against the Euro and the Russian ruble
- figure 19. Contribution of key sectors of the economy to growth in real GDP
- figure 20. Structure of the economically active population
- figure 21. Actual unemployment rate
- figure 22. Dynamics of labor productivity and real wages
- figure 23. Dynamics of monetary aggregates
- figure 24. Dynamics of money multiplier and its components
- figure 25. Dynamics of deposits and interest rates
- figure 26. Dynamics of the change in deposits of legal entities
- figure 27. Dynamics of the change in deposits of individuals
- figure 28. Dynamics of credits to the economy and interest rates
- figure 29. Dynamics of credits to legal entities
- figure 30. Dynamics of credits to the population
- figure 31. Dynamics of bank assets
- figure 32. Structure of bank assets
- figure 33. Dynamics of bank liabilities
- figure 34. Structure of bank liabilities
- figure 35. Dynamics of the KazPrime index
- figure 36. Dynamics of rates on REPO operations
- figure 37. Balance of the National Bank's operations in the domestic market
- figure 38. Boundaries of the National Bank's interest rates band
- figure 39. Balances of correspondent accounts with the National Bank
- figure 40. Volume of trading in the domestic exchange market
- figure 41. Coefficient of the National Bank's participation in the Kazakhstan Stock Exchange
- figure 42. Compliance with minimum reserve requirements
- figure 43. Volume of placed short-term notes and their yield
- figure 44. Short-term notes in circulation
- figure 45. Volume of deposits and interest rates on deposits attracted by the National Bank

figure 46. Volume of outstanding liabilities of the National Bank on deposits attracted from banks

figure 47. Volume of the National Bank's refinancing operations

figure 48. Volume of outstanding liabilities on the National Bank's refinancing operations

Tables

table 1. Change in price indices and terms of trade

table 2. Dynamics of changes in the National Bank's assets and liabilities

table 3. Dynamics of changes in the money supply

table 4. Dynamics of changes in deposits of residents

Summary

After some boosting in inflationary processes at the beginning of 2010, the annual inflation started to slowdown by the end of the second half-year. Based on Q2 2010, the inflation was at 1.5% (in Q2 2009 – 2.2%), annual inflation in June 2010 amounted to 6.8% (in December 2009 – 6.2%).

The increased inflation in January-June 2010 was, in the first instance, caused by the increase in prices for food items and paid services to the population. The major increase in prices and tariffs for paid services to the population occurred in January-February of this year, whereas prices for foodstuff were growing evenly virtually throughout the first half a year of 2010 except for June. It should be noted that the main role in the buildup of inflationary processes was played by non-monetary factors as well as by the seasonality factor.

In 2010 the economy of Kazakhstan started to gradually recover. This was accompanied by the growing output in many sectors of the economy (mining industry, manufacturing industry, trade, transport, and communications). A stable investment activity appeared to be one of the factors conducive to the business recovery. At the same time, given that bank lending was virtually non-existent, about 45% of investments in the first half of 2010 were made from own resources of the enterprises, and 28% – from foreign investments.

Favorable pricing environment for major items of Kazakhstan's exports contributed to the improved trading conditions and significant increase in exports. This factor played an important role in supporting the mining industry and the economy as a whole.

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 Q2 2010 the National Bank retained its interest rate band at the existing level. From April 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 Second Quarter 2010

The actual inflation rate (1.5%) in Q2 2010 was completely in line with the forecast (1.3-1.5%), which was published in the previous issue of the Inflation Report. The inflation in April and May was somewhat higher than the projected numbers whereas in June it was lower than expected.

The main increase in prices occurring in Q2 2010 was in the foodstuff. In their structure, the increased prices for fruit and vegetables, meat products as well as alcohol beverages should be pointed out. Based on the analysis of the dynamics in the prior years, the increase in prices for fruit and vegetables and meat products is typical for the period since, in the first instance, it was caused by the seasonality factor. The decreased prices for such items as eggs, dairy products and bakery restrained the buildup of inflationary processes.

The impact of non-food items on the inflation rate in April-June 2010 was insignificant.

The actual annual inflation rate in June 2010 (6.8%) was also within the projected level which was published in the previous issue of the Inflation Report (6.8-7.0%).

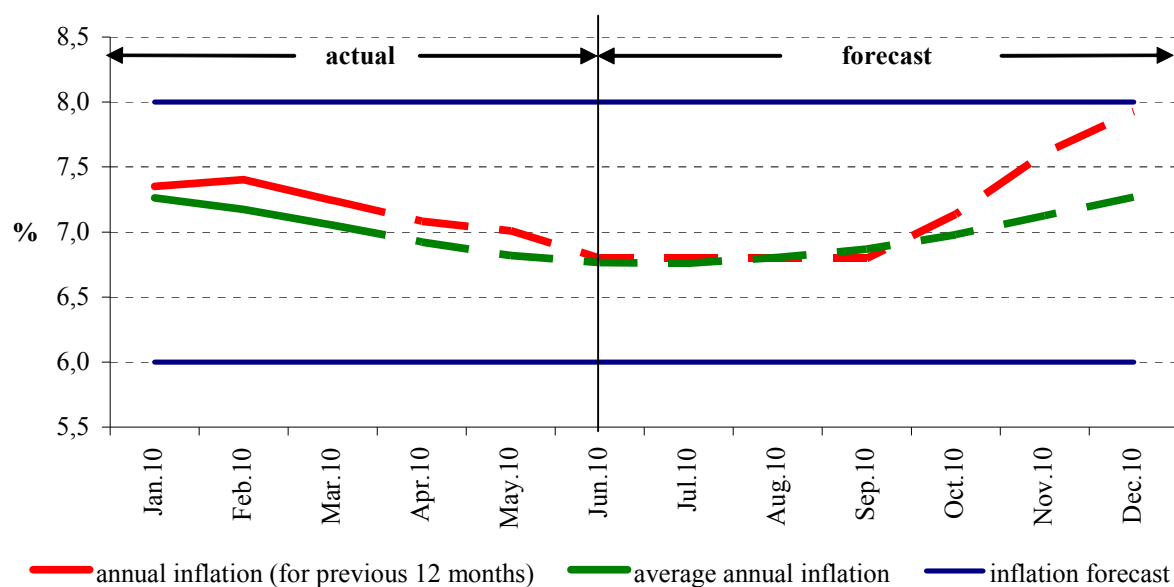
Inflation Forecast for 2010

Recovery of business activity, favorable pricing environment in the global commodity markets, stable growth rates of the real income of the population represent positive trends in the macro-economic development of Kazakhstan. At the same time, these factors bear the upside risks of inflation.

To ensure the price stability, the National Bank takes measures in line with the Monetary Policy Guidelines for 2010. The primary monetary policy objective for 2010 is to ensure the price stability and maintenance of inflation within 6-8% based on 2010. (figure 1).

figure 1

Actual and forecasted inflation in 2010



Source: National Bank of the Republic of Kazakhstan

In addition, at present one of the top-priority guidelines in monetary policy is to seek for the optimal mechanisms to channel available resources of banks to the real sector of the economy. The National Bank will continue to monitor the level of the bank liquidity and related risks including foreign exchange risks.

The exchange rate policy will be implemented to avoid significant fluctuations in the real exchange rate of the domestic currency that may have negative impact on the domestic production competitiveness in the ever-changing global environment. The National Bank will maintain the Tenge exchange rate within the announced band: KZT 150/1US\$ (+)10% or KZT 15, (-)15% or KZT 22.5.

The inflation forecast for the 3rd Quarter 2010 is 0.9-1.1% (in Q3 2009 the actual inflation was 0.9%). On the whole the inflation level is in line with the inflationary trends of the third quarter that were typical for the past years.

The situation in the consumer market in this period develops mainly under the impact of the seasonality factor, which, in its turn, leads to the decrease in prices for certain food items (eggs, dairy products, fruit and vegetables, and meat products). At the same time, the beginning of a school year, as a rule, is accompanied by the growing prices for educational services, printed matter, clothes and footwear.

In September 2010, the annual inflation is expected to be at 6.8-7.0%.

The Inflation Forecast for the 4th Quarter 2010 is 2.5-2.7% (in Q4 2009 the actual inflation was 1.4%), which corresponds to the annual inflation forecast of 7.8-8.0% at end-December 2010.

As a rule, the situation in the consumer market in the last months of a year is characterized by the increase in prices. This is related to the seasonality factor and revived consumer demand because of holidays. Prices for such goods and services as fruit and vegetables, eggs, dairy and meat products, clothes and footwear, and certain types of utilities are expected to grow in October-December 2010.

1. Inflationary Processes

1.1. Consumer Prices

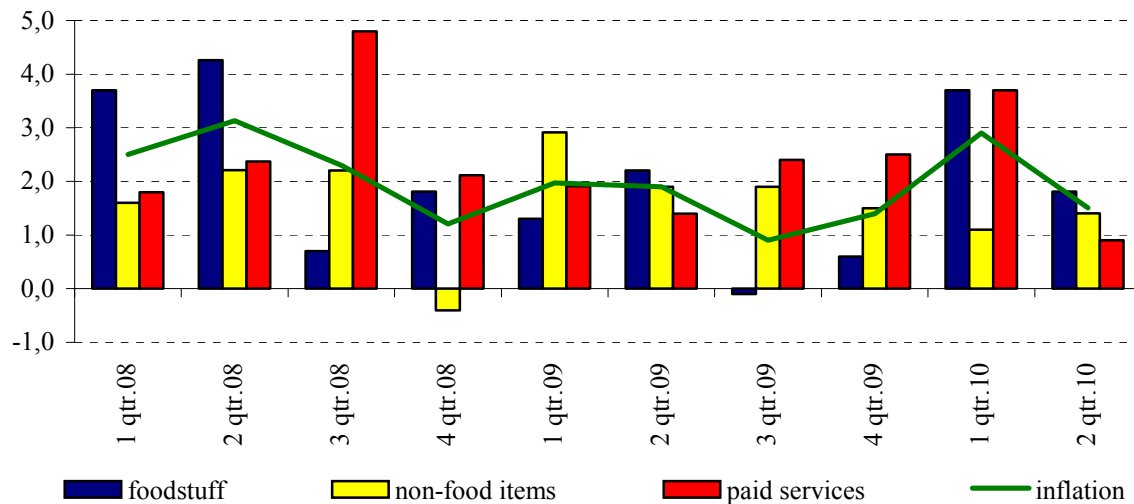
In Q2 2010 the inflation was lower as compared to inflation in Q2 2009 and in the previous quarter. In April-June 2010 the inflation was 1.5% (in January-March 2010 – 2.9%).

The slowdown in the inflation rates in Q2 2010 was caused by the slowdown in the growth of prices for foodstuff and paid services to the population.

The price of foodstuff increased by 1.8%, non-food items – by 1.4% and 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

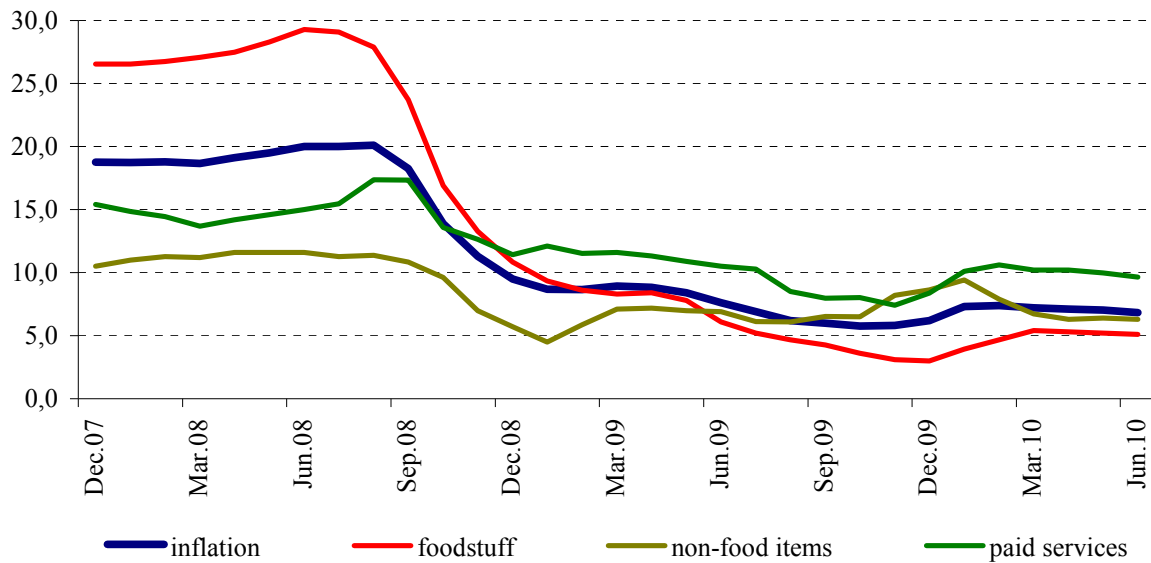
The slowdown in the price growth in Q2 2010 occurred in such goods as fruit and vegetables – from 12.6% in Q1 2010 to 6.7%, tobacco – from 8.1% to 6.3%, sugar – from 8.1% to the decrease in prices by 1.0%. In the group of paid services to the population the slowdown in the price growth occurred in the communication services – from 8.4% in January-March 2010 to 0.1% in April-June 2010, for legal services – from 7.3% to 0.2%, for utilities – from 4.4% to 0.4% (including for electricity – from 12.4% to 0.7%, for cold water – from 10.6% to 1.0%, for sewage – from 6.8% to 1.2%).

The accelerated growth in prices in the group of non-food items is also worth mentioning. Mainly, the prices for gasoline and diesel fuel increased – from the decrease in prices by 2.2% and 0.4% in Q1 2010 to the price growth by 4.7% and 3.3%, respectively, in Q2 2010.

In June 2010, the annual inflation was 6.8% (in December 2009 – 6.2%). The acceleration of the annual inflation rates in June 2010 was caused by the rise in prices for paid services to the population by 9.7% (by 8.4%), including electricity, cold and hot water supply, sewage, communication services, outpatient services and legal services. Prices of foodstuff increased by 5.1% (by 3.0%), non-food items – by 6.3% (by 8.6%) (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

1.2. Core Inflation

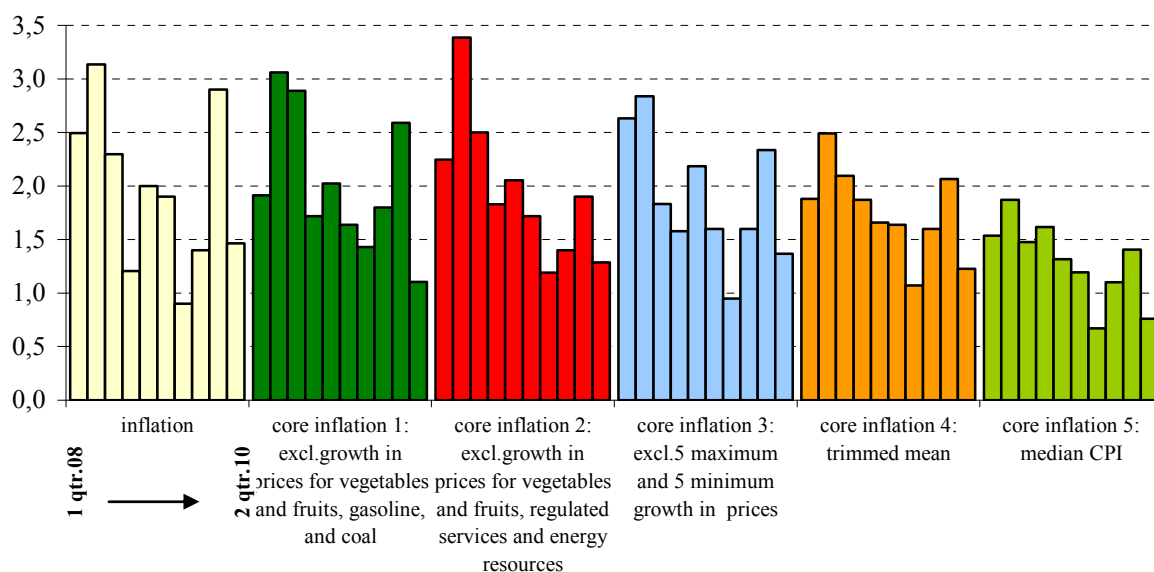
The dynamics of core inflation is also indicative of the slowdown in inflationary processes. So, indicators of core inflation in Q2 2010 alike the headline inflation demonstrated lower growth rates, both as compared to Q2 2009 and as compared to Q1 2010 (figure 4).

In Q2 2010 the headline inflation was at a higher level as compared to all core inflation indicators. This was caused, to a greater extent, by increased prices for fruit and vegetables, meat products and fuel and lubricants because of their large share in the structure of the consumer basket.

In April-June 2010 there was a slowdown in all core inflation indicators in annual terms. The core inflation appeared to be at a lower level as compared to the headline inflation.

figure 4

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

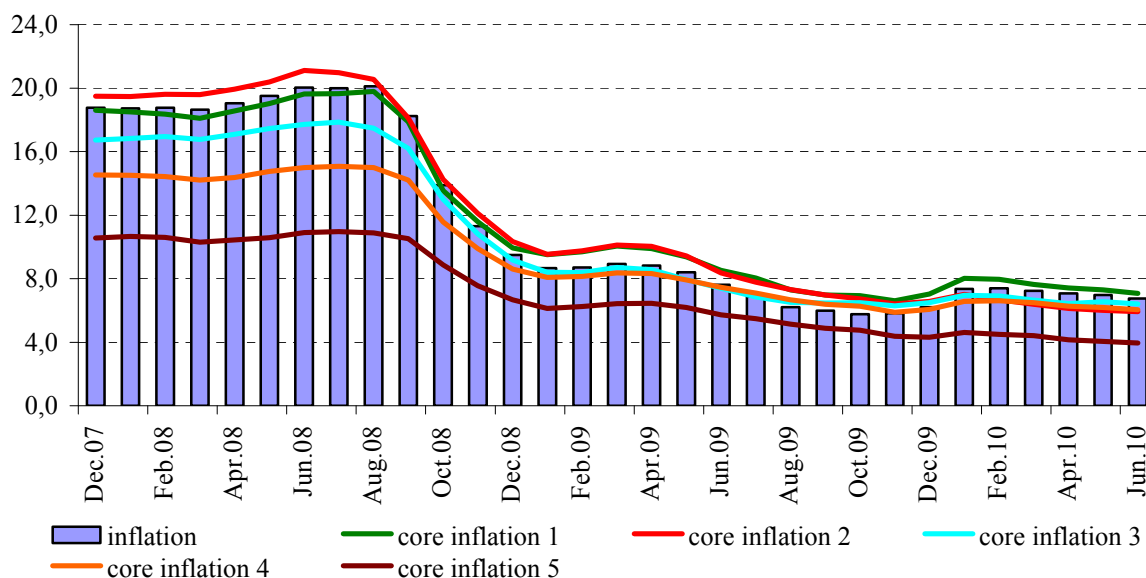


Source: Agency of Statistics of the Republic of Kazakhstan

In June 2010 all indicators of the core inflation in annual terms except core inflation-1 and core inflation-4, 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 Q2 2010 the producer prices have increased by 2.5% (in Q2 2009 – by 17.5%). The cost of output appreciated by 2.4%, at the same time the price of production means within its composition increased by 2.3%, consumer goods – by 2.1%, interim consumption products – by 2.5%. The prices for production services increased by 1.7%.

In April-June 2010 the growth rate of producer prices in the mining industry accelerated. After decline in prices in Q1 2010 by 1.5%, in Q2 prices increased by 2.3% (in Q2 2009 – by 32.4%).

The cost of energy resources in Q2 2010 decreased by 1.5% (in Q2 2009 – growth by 33.3%). In the composition of energy resources the cost of oil production decreased by 2.3% (in Q1 2010 – decrease by 3.1%), the cost of gas condensate – increased by 6.5% (the decrease by 4.9%).

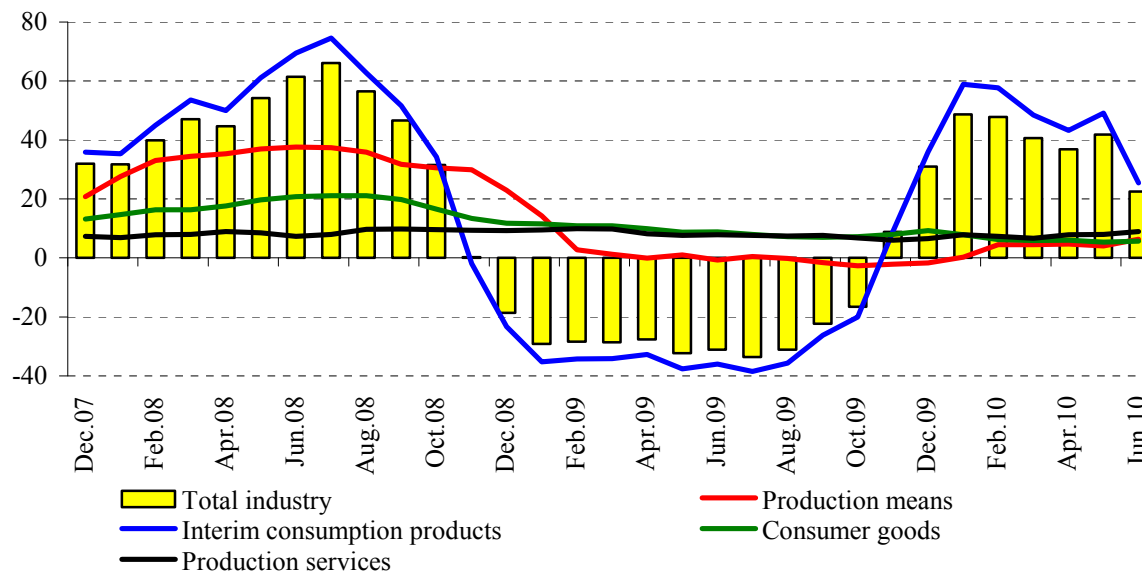
Under the impact of pricing environment in the mining industry, the growth rate of prices in the manufacturing industry in Q2 2010 also accelerated amounting to 2.9% (in Q2 2009 – by 2.1%). Prices in the metallurgical industry increased by 5.2%, cost of food production including drinks and tobacco increased by 1.1%, oil refined products decreased in price by 3.1%.

There was a slowdown in the production and distribution of electric energy, gas and water in Q2 2010 amounting to 0.9%, after its growth by 13.4% in the previous quarter, which has been caused by the increase in tariffs for electric energy and water.

In June 2010 the growth in prices in the industry in annual terms (June 2010 versus June 2009) was 22.5% (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 23.2% in annual terms, including the interim consumption products – by 25.4%, consumer goods – by 5.7%, production means – by 6.3%. The cost of production services increased by 8.9%.

1.3.2. Prices in Agriculture

In Q2 2010 prices for agricultural production realized across all channels decreased by 2.0% (in Q2 2009 – by 2.1%). The dynamics of prices in agriculture was impacted by depreciation of output, both in the plant production and in stock-breeding.

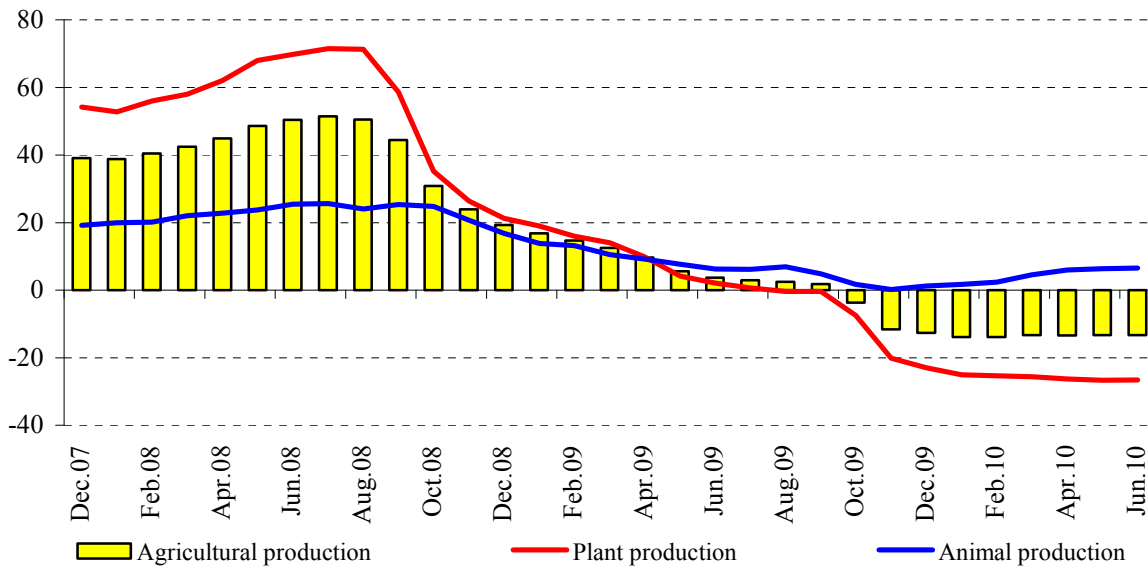
In April-June the cost of plant production depreciated by 2.5%, being mainly caused by the decreased prices for grain cultures – by 3.1%. Heavy grain yield in Kazakhstan and the countries importing wheat from Kazakhstan still causes problems with selling grains which results in the drop of prices for wheat and becomes a determining factor for the decrease in prices in agriculture.

Influenced by the seasonality factor, the cost of animal products in Q2 2010 depreciated by 1.4%, at the same time prices for meat and poultry increased by 3.3%, while the price for unpasteurized milk decreased by 7.7%, and eggs became cheaper by 14.9%.

In June 2010, prices for agricultural products in annual terms decreased by 13.3%. At that, the plant production became cheaper by 26.6%, animal products appreciated in price by 6.5% (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 Q2 2010, there was a growth in demand for final products of enterprises as compared to the previous quarter, for the first time since Q4 2008. This is evidenced by the increase in a generalized indicator – diffusion index of the change in the demand for final products – to 54.6 from 40.9 in Q1 2010 (figure 8). The increase in the indicator was noted by 28.0% (in Q1 2010 – 15.0%) of interviewed enterprises, and the decrease – by 18.9% (in Q1 2010 – 33.2%).

The growth in the demand was observed virtually in all sectors of the economy except for such industry as “production and distribution of electric energy, gas and water”.

In Q3 2010 as compared to Q2 2010, a further growth in the demand for final products in the economy as a whole is anticipated: diffusion index of the change in the demand grew up to 57.0. The increase in the demand for final products is anticipated by 23.0% of enterprises participating in the survey, and the decrease – by 8.9%. The highest growth of the indicator is anticipated in such sectors as “agriculture, hunting and forestry”, “manufacturing industry” and “construction”.

The situation with prices for final products of enterprises in Q2 2010 was characterized by some decrease in the growth rates of the indicator as compared to the previous quarter: diffusion index of the change in the prices for final products went down to 54.9 (in Q1 2010 – 55.6). The percentage of enterprises with increased prices for their products as compared to the previous quarter decreased amounting to 17.3% (in Q1 2010 – 21.1%).

The maximum decline in the growth rates of prices occurred in such industries of the economy as “hotels and restaurants”, “production and distribution of electric energy, gas and water” and “mining industry”. In agriculture the slowdown in the decline in prices for final products continued as compared to the previous quarter.

In Q3 2010 the diffusion index of the change in the prices for final products grew up to 56.1 as compared to the previous quarter. This is primarily associated with a notable decrease in a percentage of enterprises anticipating the decrease in prices – to 2.9% (in Q2 2010 – 7.5%). The percentage of enterprises anticipating the growth in prices for final products was 15.2% (in Q2 2010 – 17.3%).

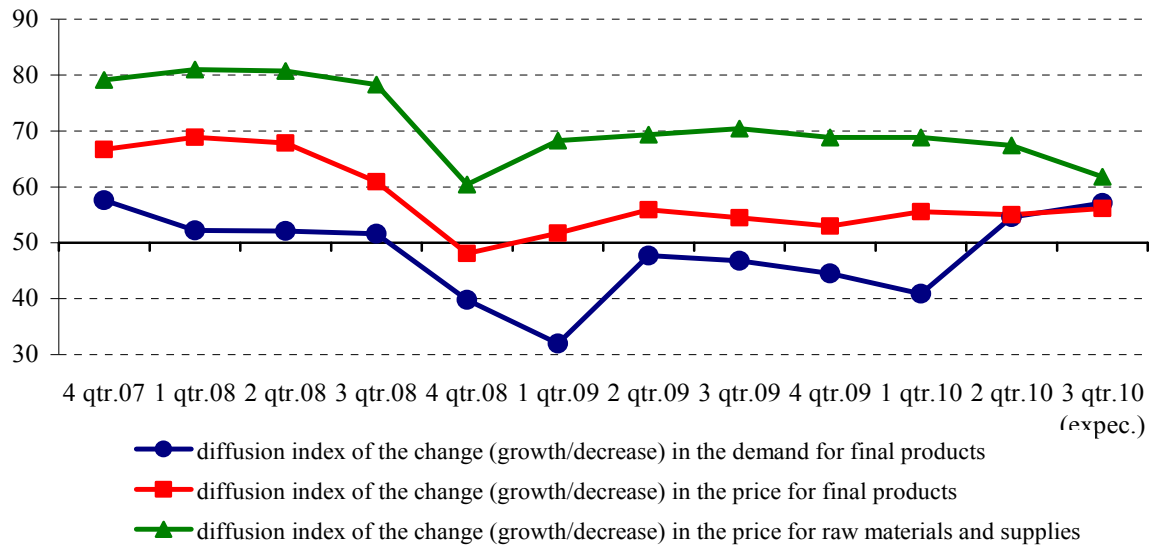
In Q2 2010 the growth rates of prices for raw materials and supplies decreased insignificantly as compared to the previous quarter while remaining at a high level in the economy as a whole: the value of the diffusion index of the change in the price for raw materials and supplies was 67.5. The slowdown in the growth rates of the indicator occurred in all industries except such industries as “manufacturing industry” and “construction”. Generally, the growth in prices was observed in the majority of industries except “hotels and restaurants” industry where a further decrease in the indicator occurred. In the sample as a whole the number of enterprises that noted the growth in prices for raw materials and supplies decreased as compared to the previous quarter amounting to 44.6% (in Q1 2010 – 48.0%). The percentage of enterprises that noted the growth in prices for raw materials and supplies was 2.2% (in Q1 2010 – 2.9%). The number of respondents that noted invariance of the indicator increased to 45.8% (in Q1 2010 – 41.6%).

For Q3 2010 the diffusion index of the change in the price for raw materials and supplies fell down to 61.7, which means that the enterprises anticipate a further price growth but at notably low rates. At the same time the number of respondents anticipating the price growth reduced significantly – to 32.3%, and the percentage of enterprises that noted the decrease of the indicator was 1.5% (figure 8).

Thus, judging from the dynamics of the relevant diffusion indices, anticipations of the enterprises about Q3 2010 are associated, in the first instance, with the increase in the demand and prices for final products and a notable slowdown in the growth of prices for raw materials and supplies.

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

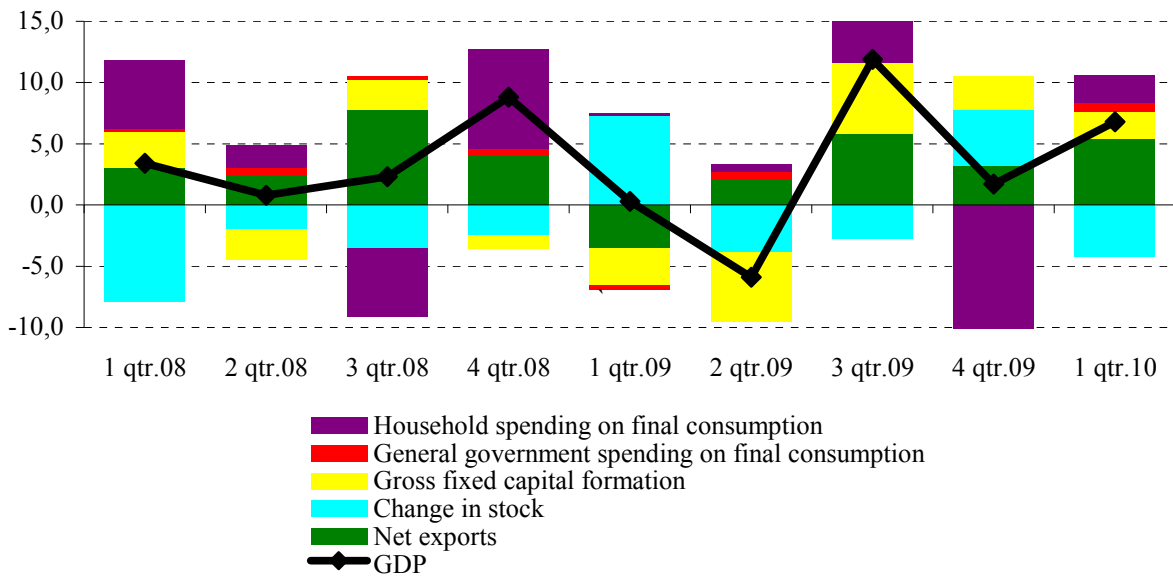
In Q1 2010 the GDP based on the final consumption method as compared to the respective period of 2009 increased in real terms by 6.8% (in the previous quarter – by 1.7%).

Despite the fall in one of the key GDP components (change in stock), a significant growth in net exports and increase in spending on final consumption were the reason for accelerated GDP growth. Spending on final consumption grew up by 5.2%, gross formation decreased by 8.1%, net exports increased by 57.1%.

Net exports' contribution to the GDP growth accounted for 5.4%, gross fixed capital formation – 2.2%, households consumption – 2.2%, change in stock – (-) 4.2% (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 the National Bank of the Republic of Kazakhstan

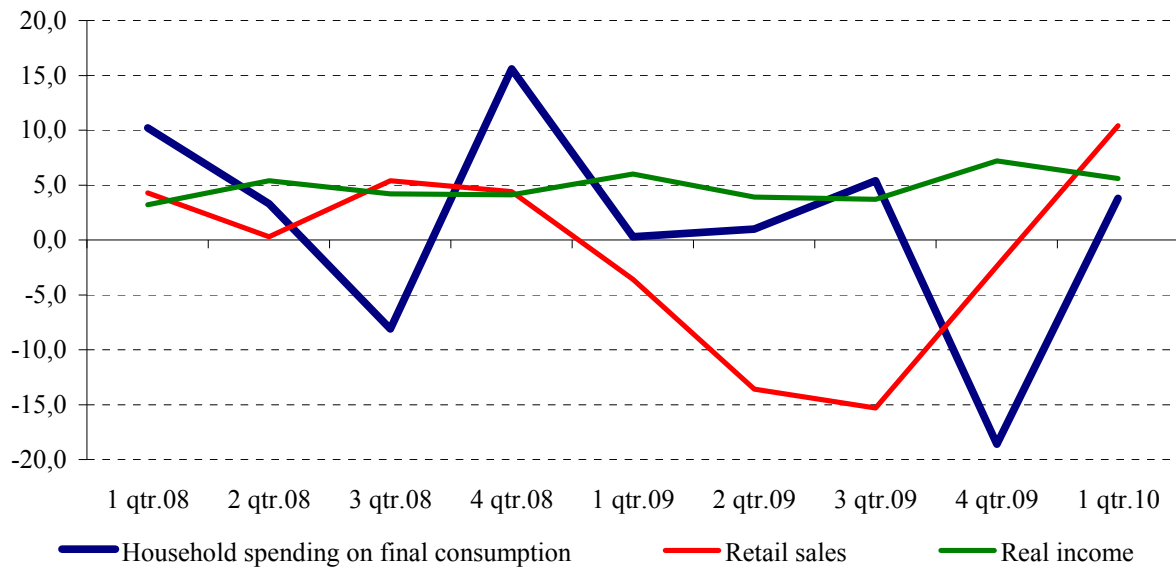
2.1.1. Individual Consumption and Investment Demand

Household spending on final consumption in Q1 2010 increased versus the respective period of 2009 by 3.8% (in Q4 2009 – decrease by 18.6%).

At the same time, despite the slowdown in the growth rate of per capita income in real terms to 5.6% (in Q4 2009 – by 7.2%), retail sales increased by 10.4% (in Q4 2009 – decrease by 2.4%) (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

Stabilization of the situation in the economy and financial sector of Kazakhstan, overall overcoming 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 were the basis for the change in the consuming behavior patterns 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 56%.

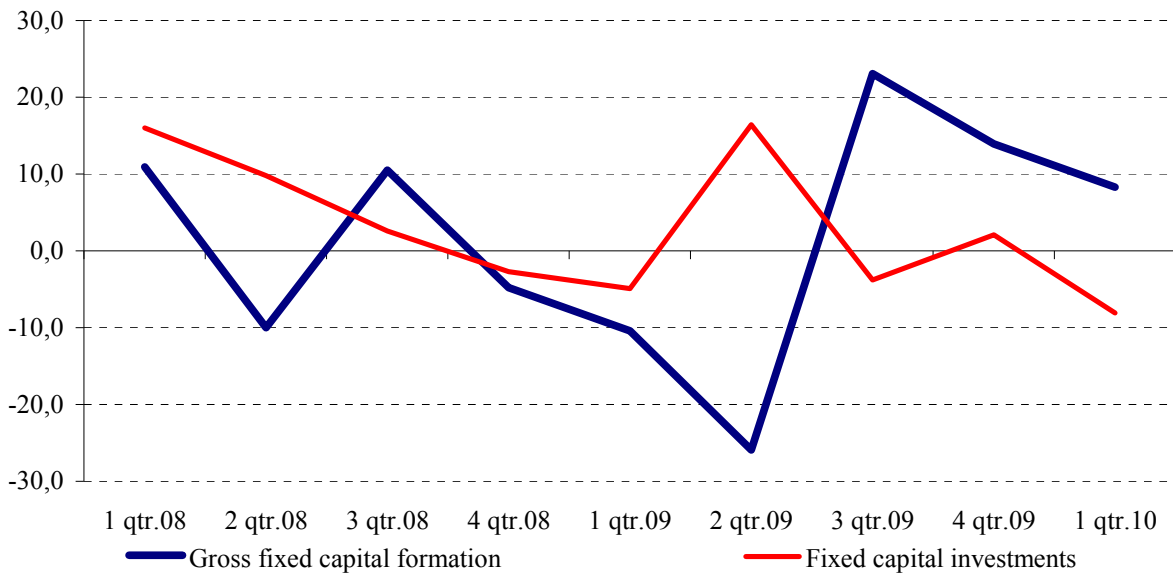
In Q1 2010 as compared to the respective period of 2009, a total volume of spending on gross savings in the GDP structure decreased by 8.1%, making negative contribution to the GDP growth of (-)2.0%.

In its structure gross fixed capital formation increased by 8.3%, and, despite the reduced investment activity of enterprises and decrease in fixed capital investments by 8.1% (figure 11), had a positive contribution to the GDP growth of 2.2%.

However, significant drop in the change in stock, by more than two times in nominal terms, had a negative contribution to the GDP growth of (-)4.2%, thus fully neutralizing a positive effect achieved by the first component and resulting in the overall decrease of the gross formation indicator.

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 Q1 2010, as compared to the respective period of 2009, increased by 11.2% (in Q4 2009 – by 0.6%).

In general, during Q1 2010 the state budget spending (excluding loan repayments) was financed in the amount of KZT 1 004.1 bln. or 25.9% of GDP. As compared to the indicators for the respective quarter of 2009, it decreased by 41.5%.

Current state budget expenditures totaled to KZT 682.9 bln. (63.3% of overall expenditures), being greater by 17.1% than in Q1 2009. Within the current expenditures costs on service and works purchases as well as on current transfers to natural persons increased the most. Capital expenditures of the state budget in Q1 2010 increased by 85.1% (to 17.7% of the volume of the state budget spending) as compared to the respective period of 2009 because of the growth in expenditures for fixed capital formation. Expenditures for acquisition of financial assets increased by 2.1 times (4.6% of the total volume of expenditures). If in Q1 2009 budget credits were not provided, in Q1 2010 they amounted to KZT 80.7 bln. or 7.5% of the volume of the state budget spending.

Over January-March 2010 state budget revenues amounted to KZT 981.4 bln. or 25.3% of GDP, which is by 23.1% higher than in January-March 2009. The structure of the state budget revenues was as follows: tax revenues accounted for 60.7% (in Q1 2009 – 64.7%), official transfers – 36.7% (31.4%). High percentage of official transfers was secured by the receipt of the guaranteed transfer from the National Fund of the Republic of Kazakhstan to the republican budget.

As a whole, in Q1 2010 tax revenues increased by 15.4% as compared to Q1 2009, the increase was due to the increased revenues from value-added tax and personal income tax.

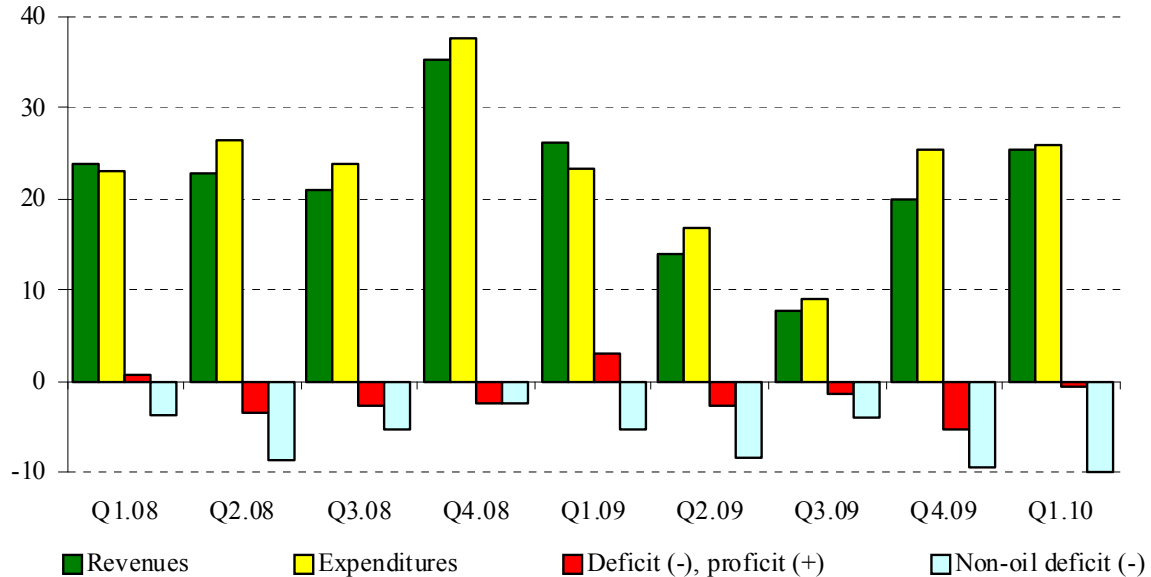
In Q1 2010 as compared to Q1 2009, the volume of non-tax revenues decreased by 24.8%, revenues from the fixed capital sales increased by 4.6%, transfers increased by 44.0%.

As the expenditures were in excess of revenues to the state budget, in Q1 2010 the deficit of KZT 22.7 bln. (0.6% of GDP) showed up whereas in Q1 2009 the deficit was KZT

87.3 bln. (figure 12). It should be noted that without transfers from the National Fund of KZT 360.0 bln., Q1 2010 would have ended with the non-oil deficit of KZT 382.7 bln. (figure 12).

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 Q1 2010 the Ministry of Finance borrowed KZT 166.6 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 74.5 bln. As a result, account balances of the Government of the Republic of Kazakhstan with the National Bank including the state budget deficit financing increased by KZT 69.5 bln.

Government domestic debt for Q1 2010 increased to KZT 1 373.4 bln. (8.6% of GDP), i.e. by 60.8% as compared to Q1 2009 (5.3% of GDP) and was secured by the issue of government long-term treasury bonds (MEUKAM), government long-term saving treasury obligations (MEUZHKAM), and government medium-term obligations (MEOKAM). The Government’s external debt in Q1 2010 increased by 44.0% as compared to the indicator in Q1 2009 (1.4% of GDP) and amounted to US\$ 2.2 bln. (2.1% of GDP).

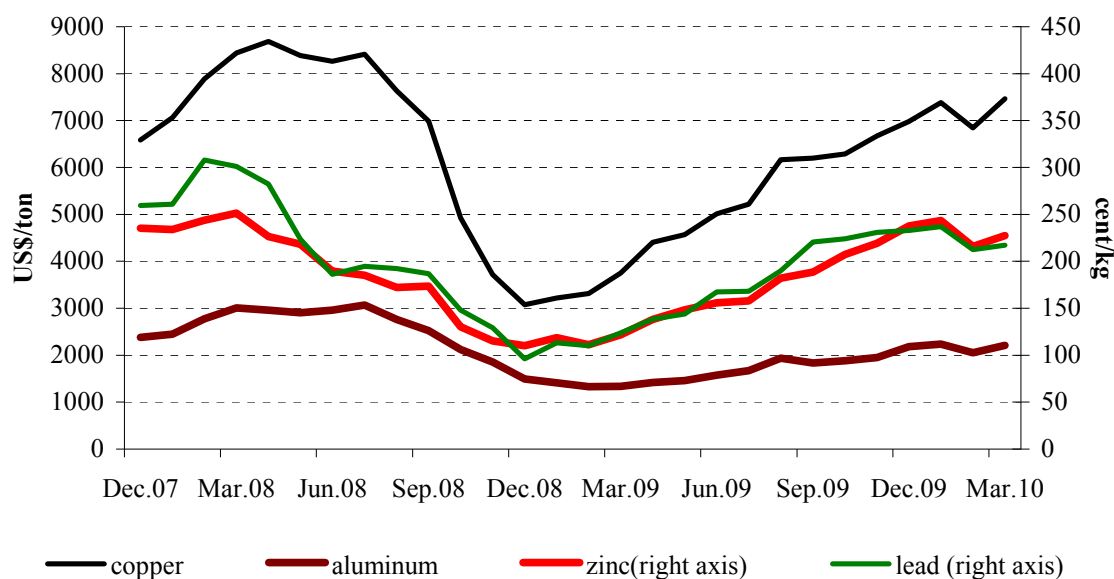
2.1.3. External Sector

– World Prices

In Q1 2010 the situation in the global commodities markets was characterized by the volatility of prices for certain commodities. So, world prices for metals after their growth at end-2009 somewhat decreased in February 2010, and started to grow again in March 2010. Generally, in January-March 2010 prices for copper increased by 6.9% and were about US\$ 7232 per ton during the period, for aluminum – by 1.2% and US\$ 2163 per ton, respectively. World prices for lead decreased by 6.7% amounting to 222.1 cents per kilo for the period on average, for zinc – by 4.3% and 228.9 cents per kilo, respectively (figure 13).

figure 13

Dynamics of world prices for metals



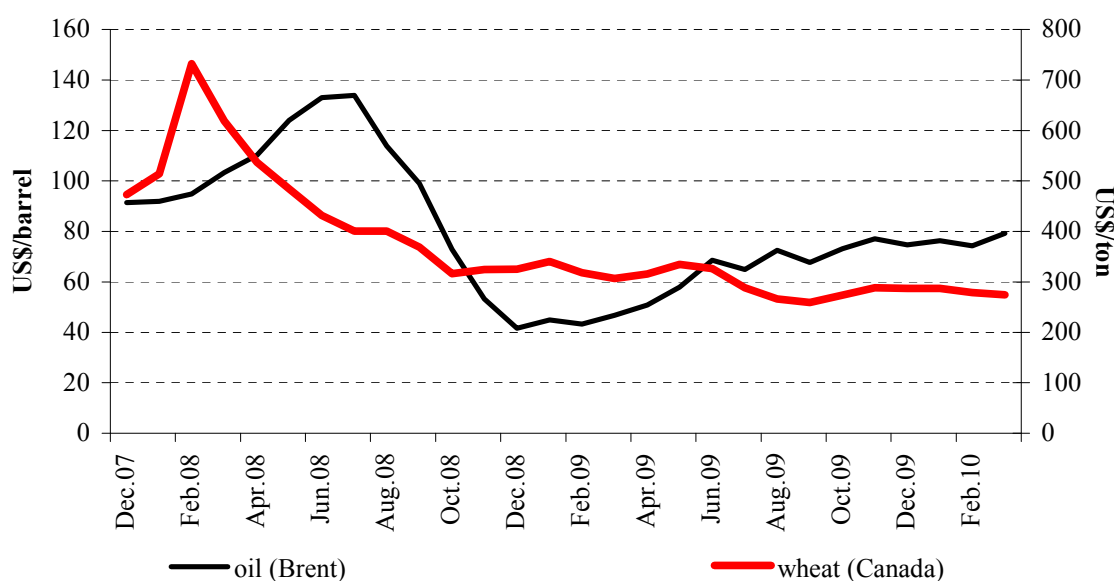
Source: World Bank

In Q1 2010 world oil prices remained volatile without a stable trend. Thus, the price growth in January turned to their decline in February and in March the upward trend reappeared. On the overall basis, in January-March 2010 oil prices (Brent) increased by 6.2% and on average for the period were at US\$76.65 per barrel (figure 14).

World prices for wheat were also unstable. In January prices remained unchanged whereas in February-March they were decreasing. Generally, the world price for wheat (Canada) decreased by 4.5% in January-March 2010 and was on average at US\$280.2 per ton. (figure 14).

figure 14

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



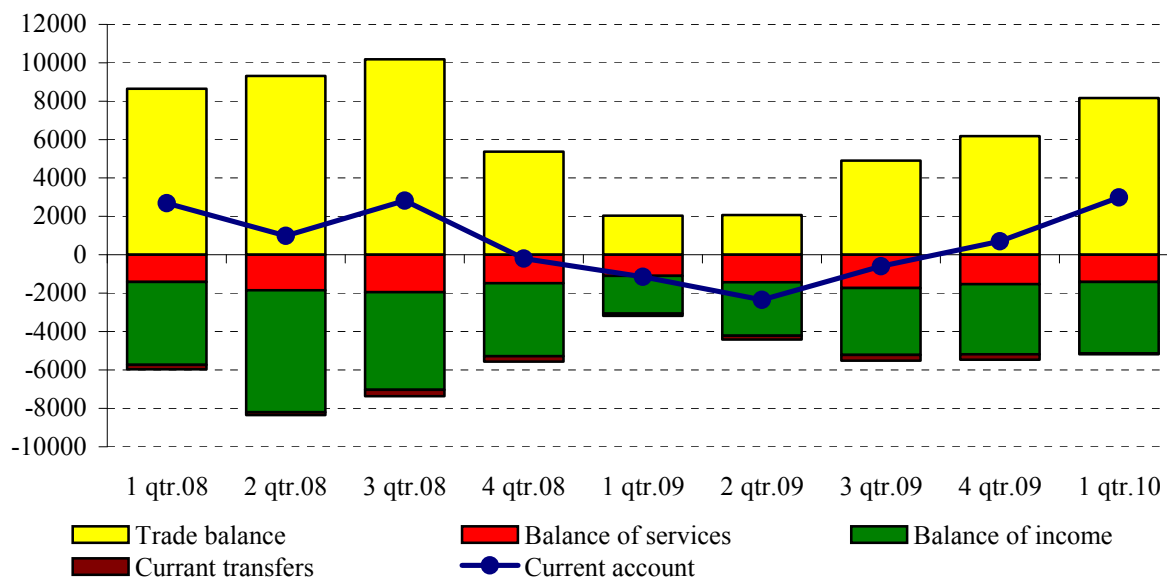
Source: World Bank

– **Balance of Payments**

Based on Q1 2010, the current account balance deficit was in surplus at the level of almost US\$ 3.0 bln. CIIIA (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 significant export proceeds from commodities amidst favorable pricing environment in the global energy market, which allowed offsetting the expenditures on commodity imports and net outflow of resources on other components of the current account. Thus, proceeds from the exports of goods in Q1 2010 increased by 66.9%, whereas expenditures on commodity imports reduced by 11.0% as compared to Q1 2009. Therefore, a positive trade balance increased by over US\$ 6.1 bln. as compared to Q1 2009 and amounted to US\$ 8.2 bln. The deficit in the balance of services as compared to Q1 2009 increased by 28.9% and amounted to US\$ 1.4 bln., and the deficit in the income balance increased more significantly – by 89.5% to US\$ 3.7 bln. Negative current transfers balance decreased by 63.4%, amounting to US\$ 47.8 mln.

The net inflow of resources on capital and financial account operations was US\$ 2.2 bln. in Q1 2010 (in Q1 2009 – US\$ 3.3 bln.). Foreign assets of residents (except for reserve assets) increased by US\$ 619.7 mln. as compared to the decrease by US\$ 3.3 bln. in Q1 2009. The decrease in foreign liabilities of residents was US\$ 309.4 mln. (US\$ 38.2 mln. in Q1 2009).

As a result, the positive balance of payments for Q1 2010 amounted to US\$ 4.3 bln. (in Q1 2009 – the deficit of US\$ 0.6 bln).

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

As compared to Q1 2009, in Q1 2010 the aggregate terms of trade index was by 22.6% higher. Alongside with that, the aggregate price index of Kazakhstan’s exports was by 48.2% higher, and the import price index – by 9.4% (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
Export prices	-47.0	-52.5	-44.9	-16.6	48.2
Import prices	-1.2	-15.8	-18.2	-3.4	9.4
Terms of trade	-45.8	-42.4	-34.4	-11.3	22.6
including:					
the Euro zone countries					
Export prices	-54.2	-56.5	-49.9	-18.0	66.0
Import prices	17.7	0.1	12.8	32.5	22.4
Terms of trade	-57.8	-57.9	-59.2	-29.0	16.6
Russia					
Export prices	-28.3	-36.2	-35.8	-14.7	23.4
Import prices	-28.6	-25.5	-23.2	-2.6	28.5
Terms of trade	0.4	-15.0	-16.4	-12.6	-3.7

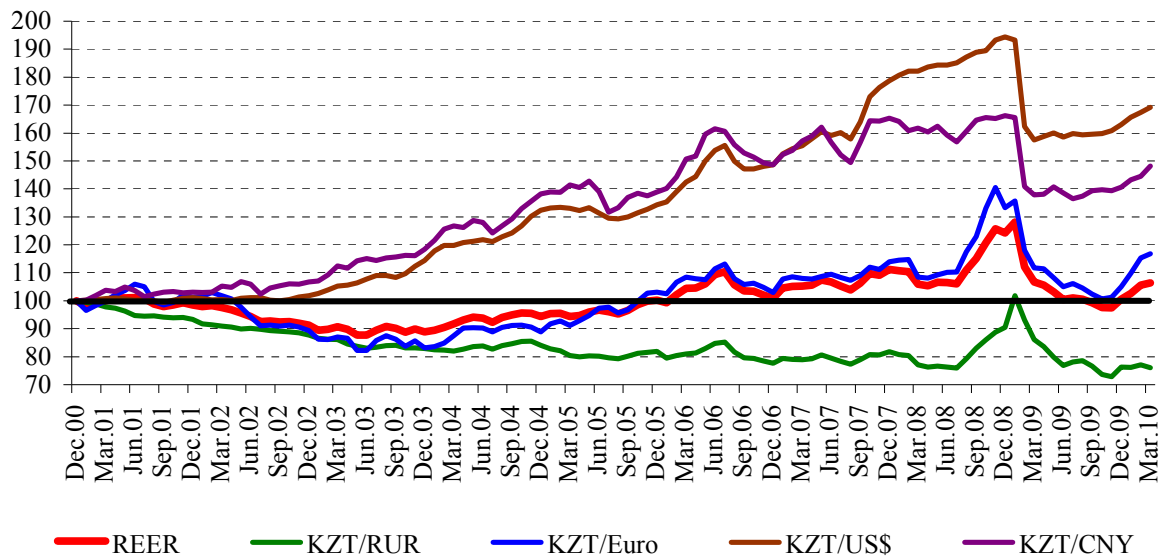
Source: National Bank of the Republic of Kazakhstan

Based on Q1 2010 as compared to the previous period, the index of the real effective exchange rate of the Tenge appreciated by 6.4%. The Tenge has appreciated versus the CIS currencies basket by 2.5%, versus the basket of other currencies – by 7.9%.

During Q1 2010 the Tenge has appreciated in real terms against the US Dollar by 3.8% as compared to the previous period, by 11.4% against the Euro and by 2.9% - 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

Average weighted exchange rate of the Tenge for Q2 2010 at the stock exchange was KZT 146.89/1\$. The stock exchange rate at end-period was KZT 147.77/1\$. Since the beginning of the year the Tenge has appreciated against the US Dollar in nominal terms by 0.6%. (figure 17).

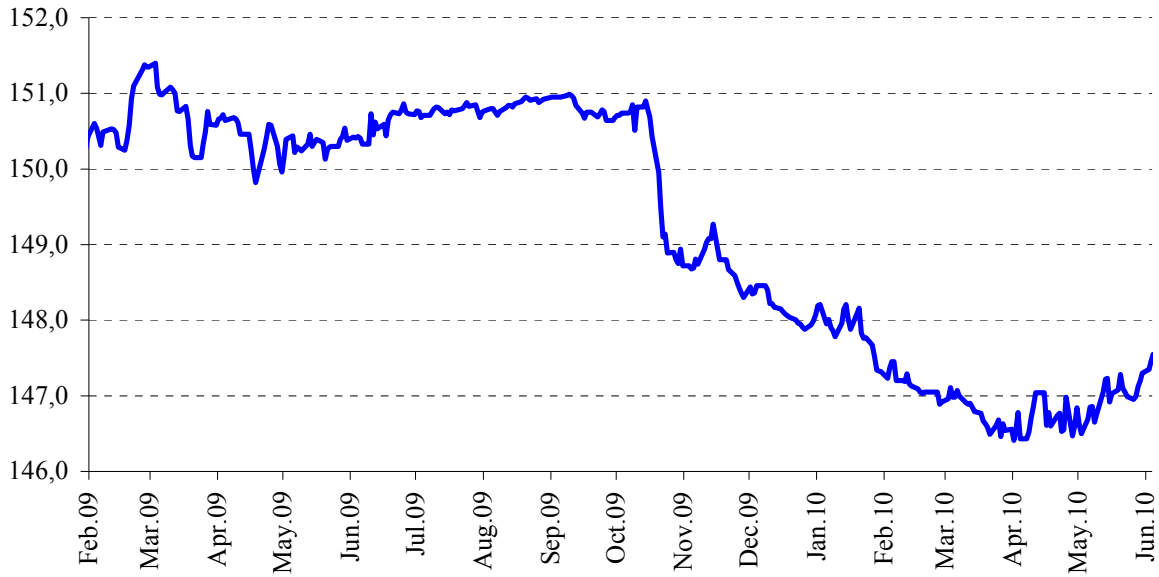
In April the Tenge appreciated against the US Dollar by 0.4%, and in May and June it depreciated by 0.2% and 0.6%, respectively.

Since the volumes of transactions in Euro and the Russian ruble in the stock exchange segment of the domestic foreign exchange market remain insignificant, the rate of the Tenge versus those currencies is calculated based on the cross-rate to the US Dollar. Accordingly, the dynamics of the exchange rate of the Tenge versus 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, over Q2 2010 the official exchange rate of the Tenge versus the Euro has appreciated by 6.7%, and it depreciated by 1.6% versus the Russian ruble (figure 18).

figure 17

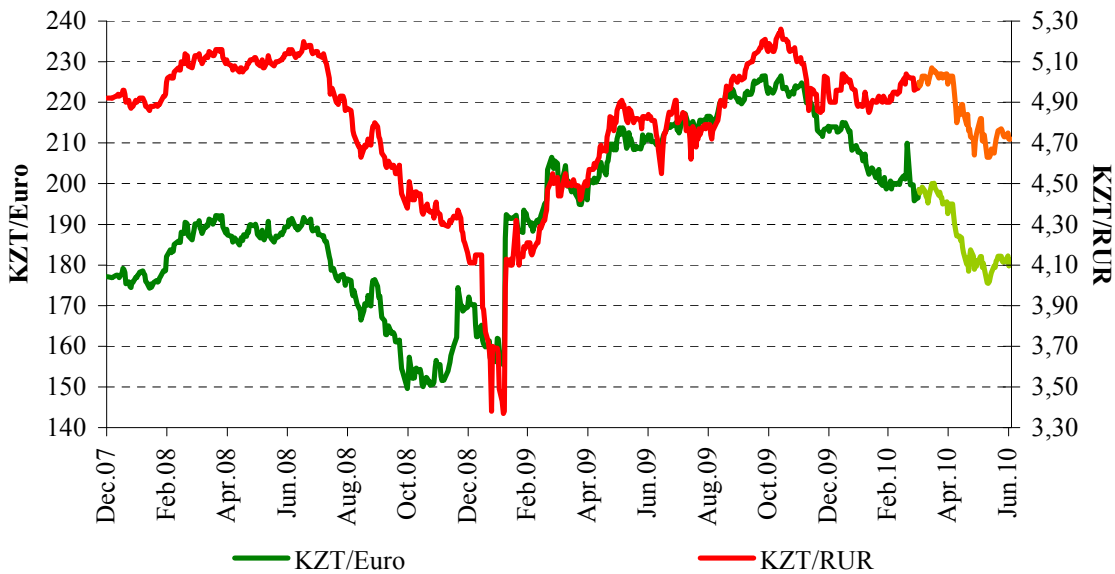
Dynamics of the nominal exchange rate of the Tenge against the U.S. Dollar



Source: National Bank of the Republic of Kazakhstan

figure 18

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



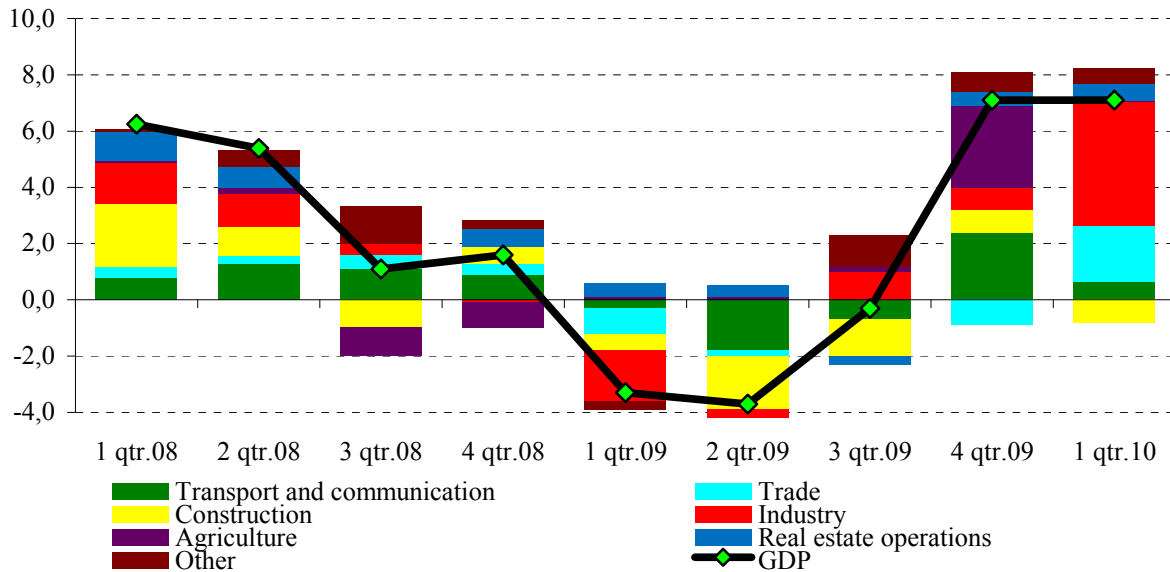
Source: National Bank of the Republic of Kazakhstan

2.2. Production

The volume of GDP output in Q1 2010 amounted to KZT 4372.9 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 by 7.1% versus Q1 2009 (in Q4 2009 the growth, according to estimates, also 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 production of commodities and in production of services, where the growth in the indices of physical volume was 7.6% and 1.8%, respectively.

In the production of commodities agriculture and industry showed growth while construction demonstrated decline. The index of physical volume in agriculture was 102.3%, in industry – 112.5%, in construction – 91.3%, which in the aggregate made a positive contribution of 3.6% to the GDP formation.

In the production of services the decline in the index of physical volume in financial and insurance activities by 15.5% was fully neutralized by the growth in all other components, which resulted in a positive contribution to the GDP formation at the level of 3.0%.

The decrease in Q1 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 0.2%, 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

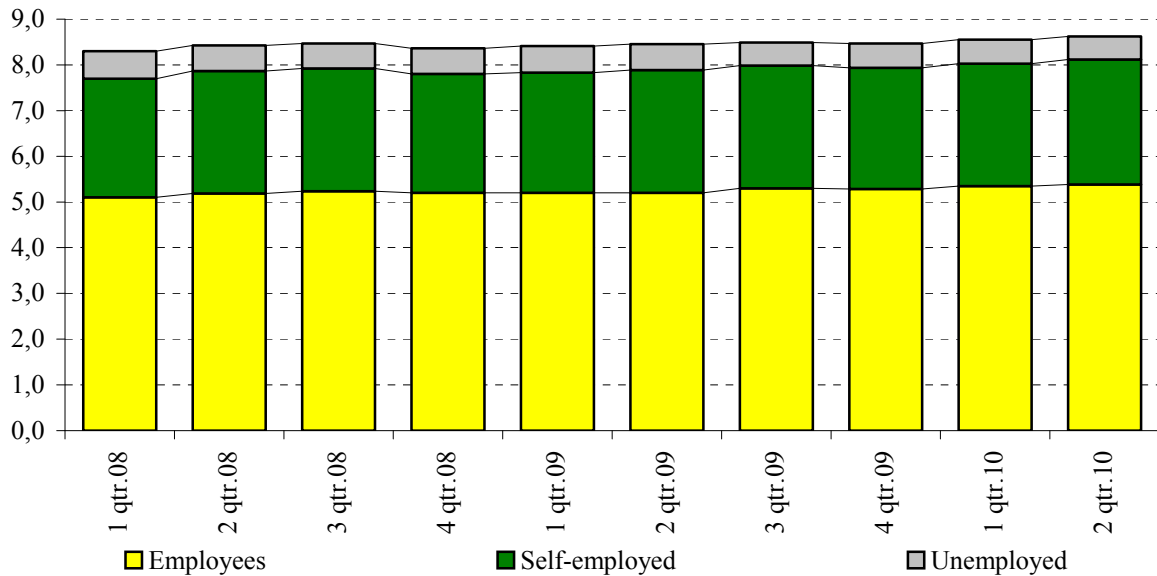
In Q2 2010 the number of people employed in the economy, according to tentative estimates, was 8.1 mln., having increased by 1.1% versus the previous period. At the same time, the number of employees reached 5.4 mln. (growth by 0.6%), the number of self-employed – 2.7 mln. people (growth by 2.0%).

In the structure of employees, 4.4 mln. individuals (81.2% 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 (6.1%).

In Q2 2010 the number of unemployed amounted to 503.9 thousand people having decreased by 4.2% as compared to the previous period and by 11.3% versus Q2 2009 (figure 20).

figure 20

The structure of economically active population, mln. individuals



Source: Agency of Statistics of the Republic of Kazakhstan

In April and May 2010 structural changes in the composition of employees continued.

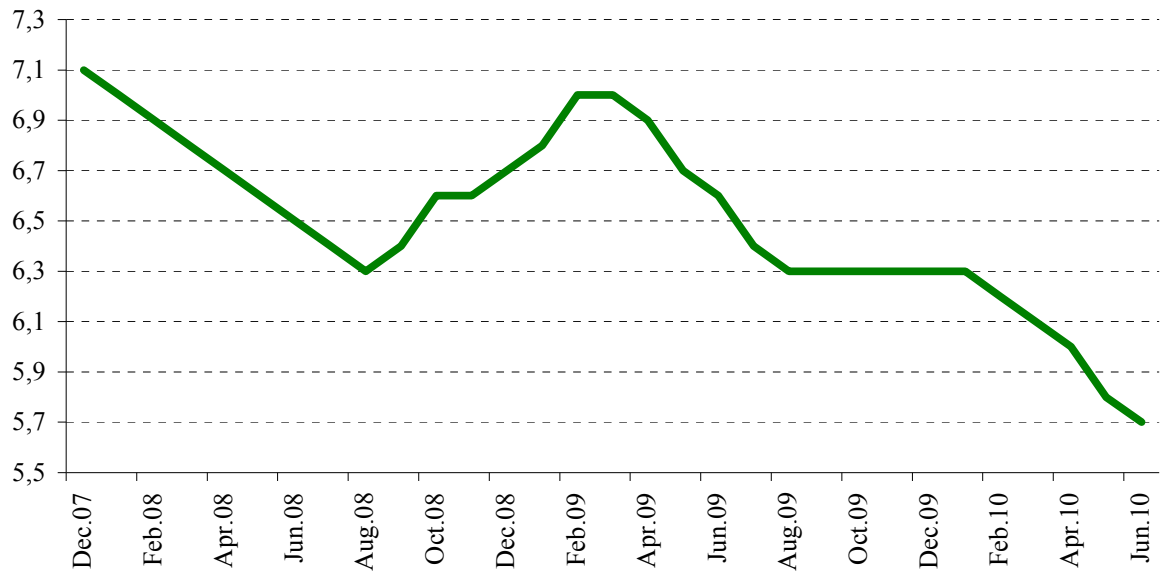
The main industries that contributed to the growth in the employment rates, as compared to the respective period of the previous year, were industry; real estate operations; trade; transport and warehousing; education; public healthcare and social services; professional scientific and technical activities; arts, recreation and leisure.

The largest percentage of outflow of the employed was in the construction, financial and insurance activities, public administration, 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 Q2 2010, according to preliminary information, decreased by 0.4 percentage points and accounted for 5.8% (figure 21).

Arrangements implemented as part of the Regional Employment and Staff retraining Strategy (the Road Map) 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 postponed date of the increase in wages of workers in the public sector this year resulted in lower nominal and real growth of wages as compared to the respective quarter of 2009.

After the acceleration in the growth of nominal wages in Q4 2009, in Q1 2010 the rate slowed down. As compared to the respective period of 2009 the average monthly wage in nominal terms increased by 8.2% (in Q1 2009 – by 13.1%), the real wage increased by 0.9% (in Q1 2009 – by 3.9%).

The highest increase in wages was observed in the last month of Q1 2010. In March 2010 as compared to March 2009 wages in nominal terms increased by 9.5%, and in real terms – by 2.2%.

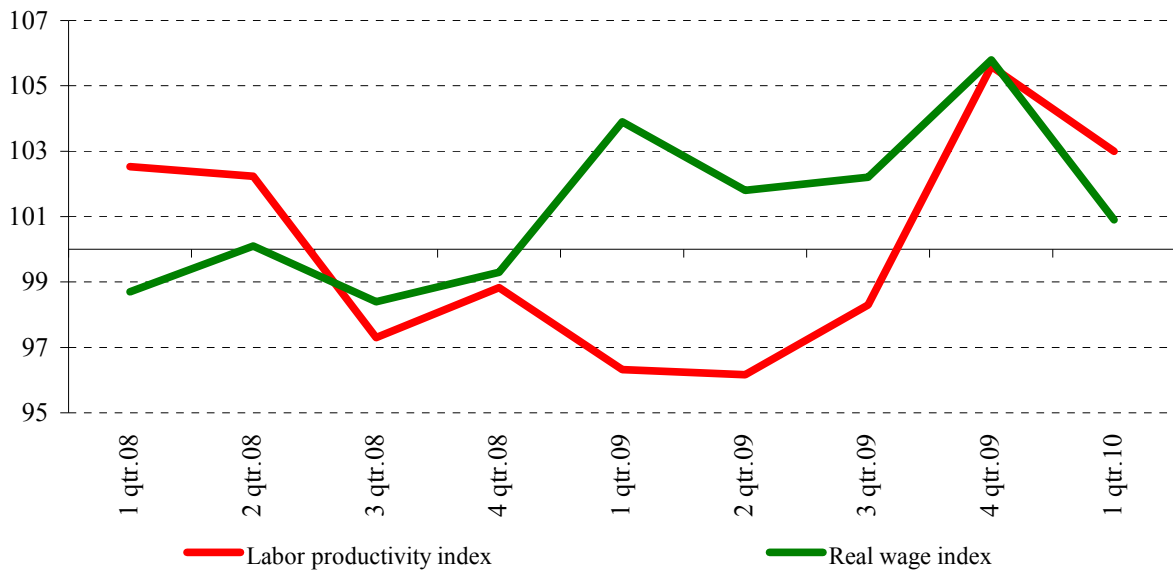
In Q1 2010 the growth in real terms was observed in virtually all sectors of the economy except for accommodation services, public administration, education and healthcare. Alongside with that the highest growth in wages was in the mining industry – by 15.4% and in the real estate operations – by 14.5%.

In March 2010 the largest wage was in the financial and insurance sector, in the mining industry, in professional, scientific and technical activities, and the smallest – in agriculture, forestry and fishery, education, water supply, arts, and recreation and leisure.

The slowdown as compared to the previous quarter in the growth rates of industries comprising the GDP, alongside with more active increase in the number of the employed and the decrease in the unemployment resulted, according to the National Bank's estimate, to the growth in the labor productivity index by 3.0% in Q1 2010 (figure 22).

figure 22

**Dynamics of labor productivity and real wages
(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

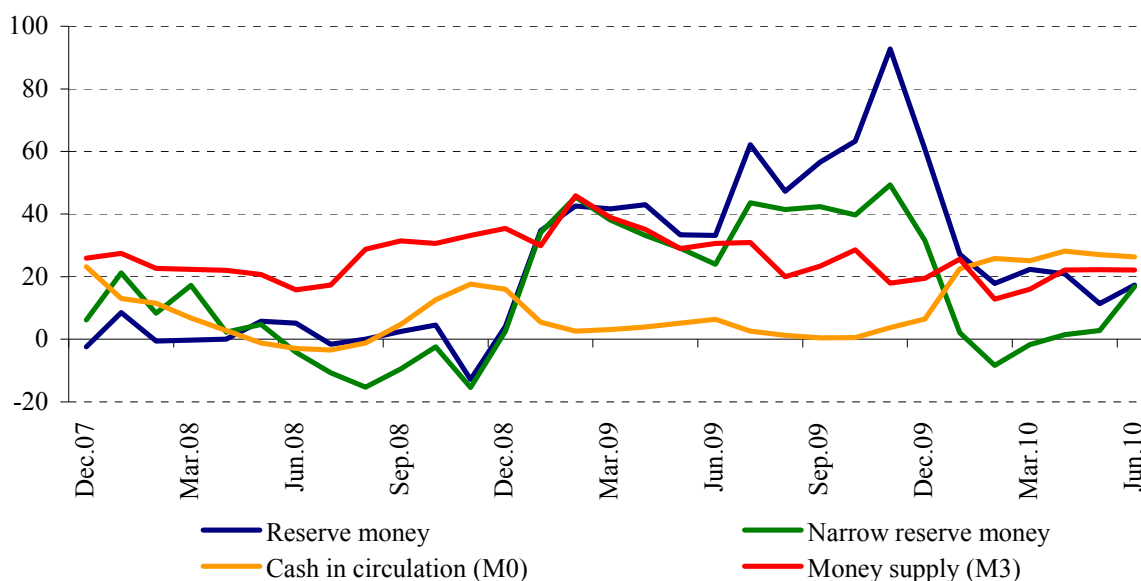
3. Money Supply

3.1. Monetary Aggregates

In Q2 2010 annual dynamics of monetary aggregates (excluding narrow reserve money) demonstrated quite remarkable growth rates (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 Q2 2010 expanded insignificantly, by 0.1%, and amounted to KZT 2738.4 bln. at end-June 2010. Narrow money expanded by 9.4% to KZT 2218.4 bln.

In June 2010 as compared to June 2009 reserve money expanded by 17.3%.

Net international reserves of the National Bank increased by 40.8% to US\$ 26.1 bln. in June 2010 as compared to the respective period of 2009. Within their structure, despite operations on the servicing of the Government's external debt, net currency reserves increased as a result of growth of foreign currency balances with the correspondent accounts of the second-tier banks with the National Bank, FX sales 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 June 2010 as compared to June 2009, net international assets of the National Bank decreased (table 2), mainly, because of the significant increase in claims from 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)**

	Q3. 09	Q4. 09	Q1. 10	Q2. 10
Net international reserves	-8.7	13.5	41.1	40.8
Net domestic assets	153.5	167.0	-634.7	-341.1
Net claims on the Government	-173.2	-902.7	-12.6	-67.9
Claims on financial institutions	231.8	482.1	-197.0	-169.2
Claims on the rest of the economy	-245.2	-204.9	-7.9	2.2
Other net domestic assets	56.6	60.7	22.3	17.3
Reserve money	42.4	31.5	-1.7	16.8

Source: National Bank of the Republic of Kazakhstan

3.1.2. Money Supply

Over Q2 2010 money supply increased by 6.8% to KZT 8287.9 bln.

In June 2010 as compared to June 2009 its growth was 22.1% as a result of the 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)**

	Q3. 09	Q4. 09	Q1. 10	Q2. 10
Net foreign assets	99.4	180.0	121.3	132.6
Domestic assets	10.7	2.2	-10.3	-12.3
Claims on the Government	-75.4	-58.0	506.1	425.6
Claims on the economy	16.7	10.4	5.3	5.1
Other net domestic assets	-40.5	-42.6	-30.9	-26.0
Money supply	23.3	19.5	16.0	22.1
Cash in circulation	0.4	6.5	25.1	26.3
Deposits of residents	26.9	21.5	14.9	21.6

Source: National Bank of the Republic of Kazakhstan

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

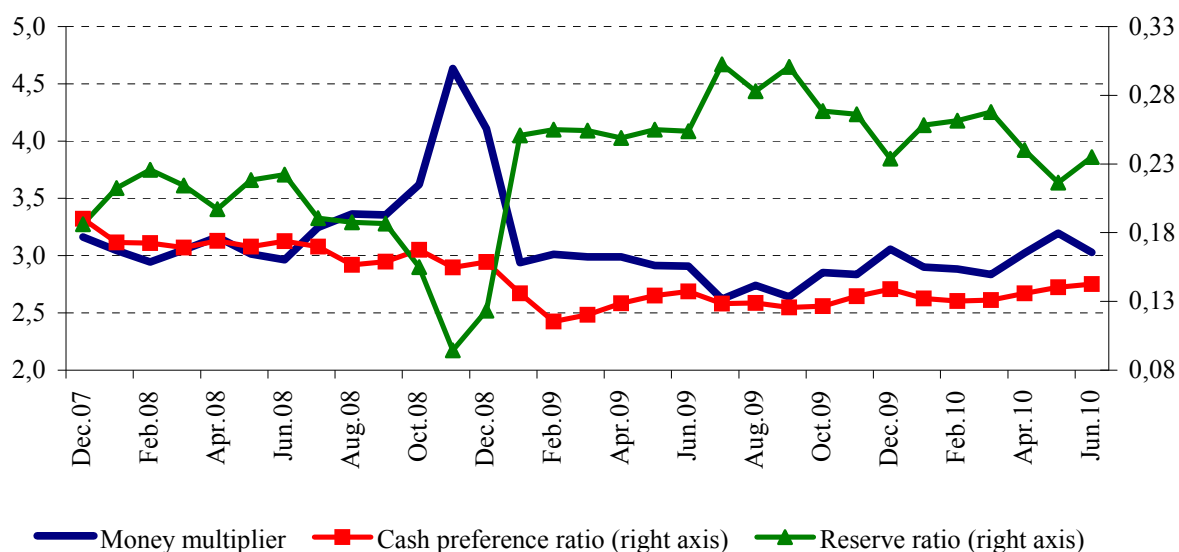
In June 2010 as compared to June 2009, despite the growth in the volumes of credits to the economy and net claims on the Government, domestic assets of the banking system decreased on the basis of decreased other net domestic assets of the banking system.

The analysis of the dynamics of the main components of money supply shows that outstripping growth rates of cash in circulation were fixed 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 87.9% in June 2009 to 87.5% based on June 2010.

The money multiplier grew from 2.91 in June 2009 to 3.03 in June 2010 as a result of outstripping rates of growth in the money supply versus the rates of expansion of the reserve money. The reason for that was the increased reserve ratio alongside with a slight 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 Q2 2010 increased by 15.1% to KZT 1034.0 bln. The main reason for the increase in the cash in circulation was the growth in net payouts on wages, net payoffs on individuals’ 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, which occurred in Q2 2010.

In June 2010 as compared to June 2009 cash in circulation increased by 26.3%. 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 Q2 2010 as compared to Q2 2009, payouts of cash from bank cashier departments increased by 11.8% to KZT 2721.6 bln., cash receipts to bank cashier departments – by 8.0% to KZT 2436.9 bln. As a result, net payouts from bank cashier departments amounted to KZT 284.6 bln.

3.2. Financial Market

3.2.1. Deposits of Residents

At end-June 2010 deposits of residents amounted to KZT 7254.0 bln., having increased by 5.7% during Q2 2010. Deposits of legal entities increased by 6.9%, deposits of individuals increased by 2.8%. Deposits in the domestic currency increased by 4.4% to KZT 4376.5 bln., deposits in foreign currency – by 7.9% amounting to KZT 2877.5 bln.

Since the beginning of the year the growth in deposits of residents amounted to 10.3% and was secured mainly by the growth in the domestic currency deposits. In addition, deposits of legal entities demonstrated higher growth indicators as compared to deposits of individuals (table 4).

table 4

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

	June 07	June 08	June 09	June 10
Deposits of residents	20.1	13.8	10.3	10.3
<i>of the population</i>	<i>32.8</i>	<i>1.4</i>	<i>9.1</i>	<i>5.0</i>
<i>of non-bank legal entities</i>	<i>13.8</i>	<i>21.0</i>	<i>10.8</i>	<i>12.5</i>
Deposits in the Tenge	40.8	9.9	-6.6	18.3
Deposits in foreign currency	-18.0	21.9	41.2	0.1

Source: National Bank of the Republic of Kazakhstan

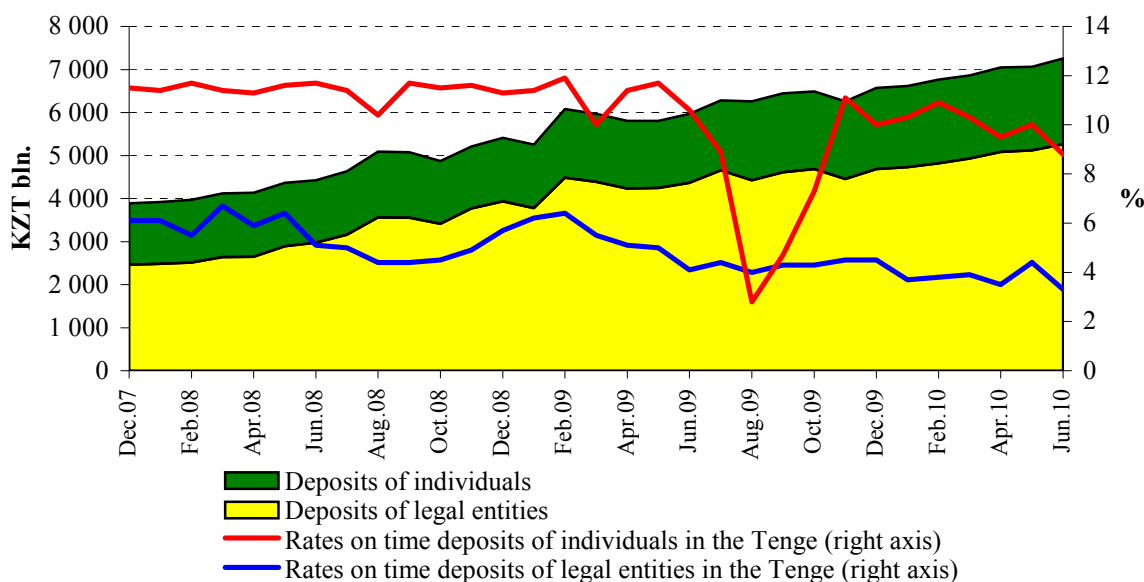
As compared to the respective month of 2009, total volume of deposits of residents with depository institutions grew up by 21.6% in June 2010. The dynamics in deposits of residents during this year were characterized by the slowdown in the growth rates in the first quarter and by their acceleration in the second quarter. The trend observed both in relation to deposits of individuals and deposits of legal entities was caused mainly by the change in the deposit base denominated in foreign currency.

The interest rates on deposits – both in the domestic currency and in foreign currency – are generally lower than in the respective periods of the previous year.

The average weighted interest rate on the Tenge time deposits of non-bank legal entities was 3.3% in June 2010 (in June 2009 – 4.1%), and on deposits of individuals – 8.8% (10.6%) (figure 25).

figure 25

Dynamics of deposits and their interest rates



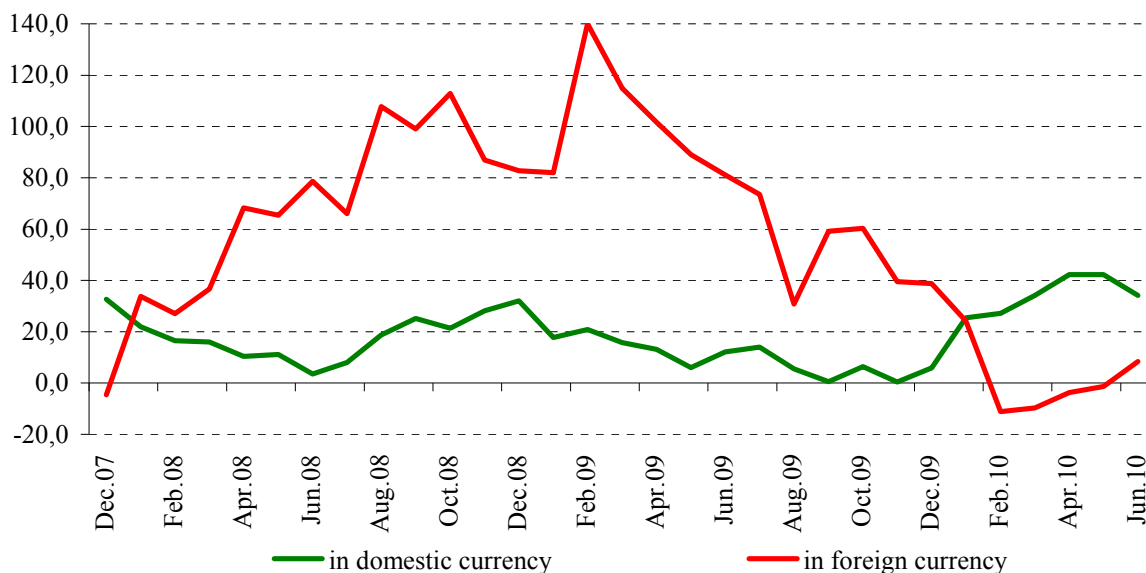
Source: National Bank of the Republic of Kazakhstan

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 natural persons. In its turn, the beginning of a new fiscal year and stabilization of the Kazakh economy stipulated the decrease in the volume of funds coming as part of the anti-crisis actions causing a slowdown effect on the growth of deposits of legal entities in Q1 2010, however, in Q2 the growth rate accelerated.

The volume of deposits of legal entities increased by 20.8% in June 2010 as compared to the respective period of 2009. Deposits of legal entities in the domestic currency increased in annual terms by 29.4%, and in foreign currency – by 8.5% (figure 26).

figure 26

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

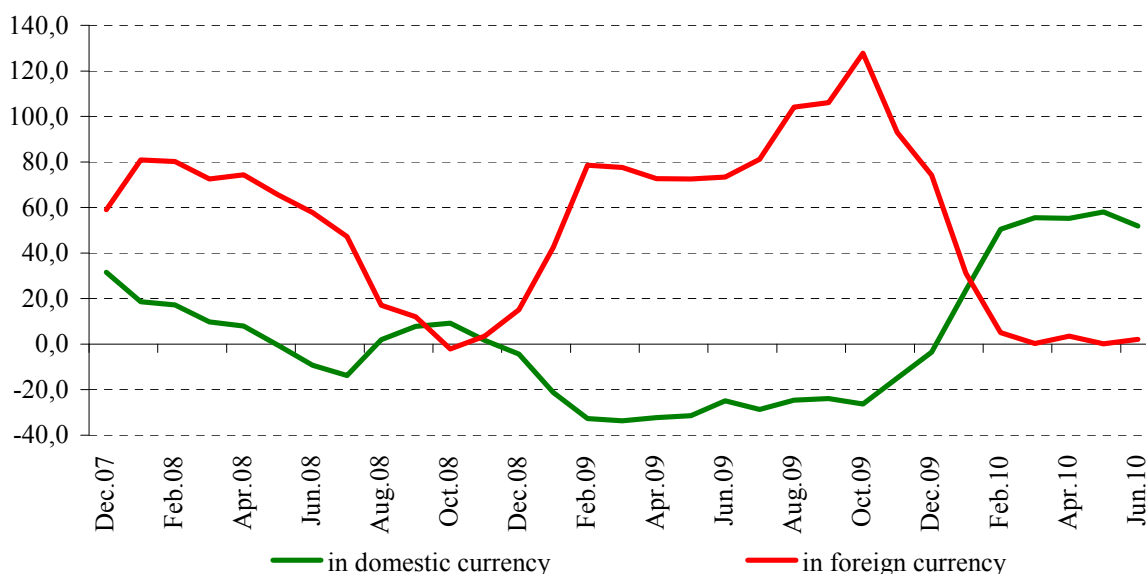


Source: National Bank of the Republic of Kazakhstan

The volume of deposits of individuals in June 2010 as compared to the respective period of 2009 increased by 23.8%. Deposits of individuals in the domestic currency increased in annual terms by 51.9%, in foreign currency – by 2.1% (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 Q2 2010, the total debt on bank credits to the economy decreased by 2.2% to 7 476.4 bln. Credits to the population decreased by 4.7% and credits to legal entities - by 1.2%.

The lending volume decreased by 7.8% versus June 2009, including the decrease in credits to legal entities by 6.8%, and to individuals – by 10.3%.

The average weighted rate on credits to legal entities increased from 12.8% to 13.2% in June 2010 as compared to June 2009, the increase of the cost of long-term lending for legal entities being the reason.

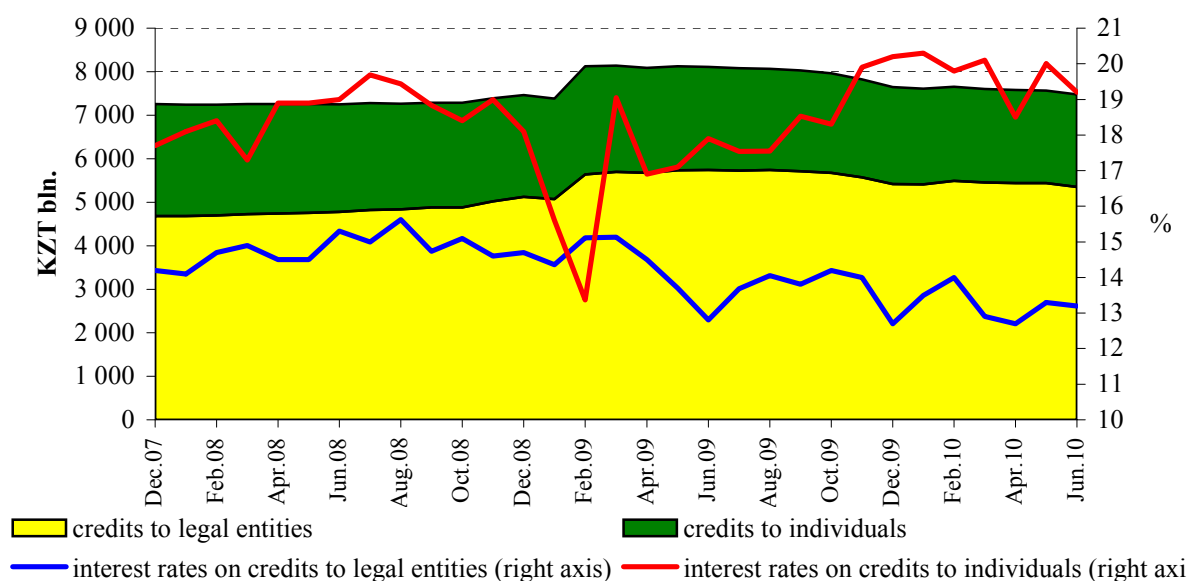
The average weighted rate on credits to natural persons increased from 17.9% to 19.2% in June 2010, which was caused by the growth of rates on short-term loans in foreign currency and long-term loans in the Tenge (figure 28).

In the structure of credits 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 (40.8%), trade (23.3%), construction (18.9%), and industry (9.7%).

figure 28

Dynamics of credits to the economy and their interest rates

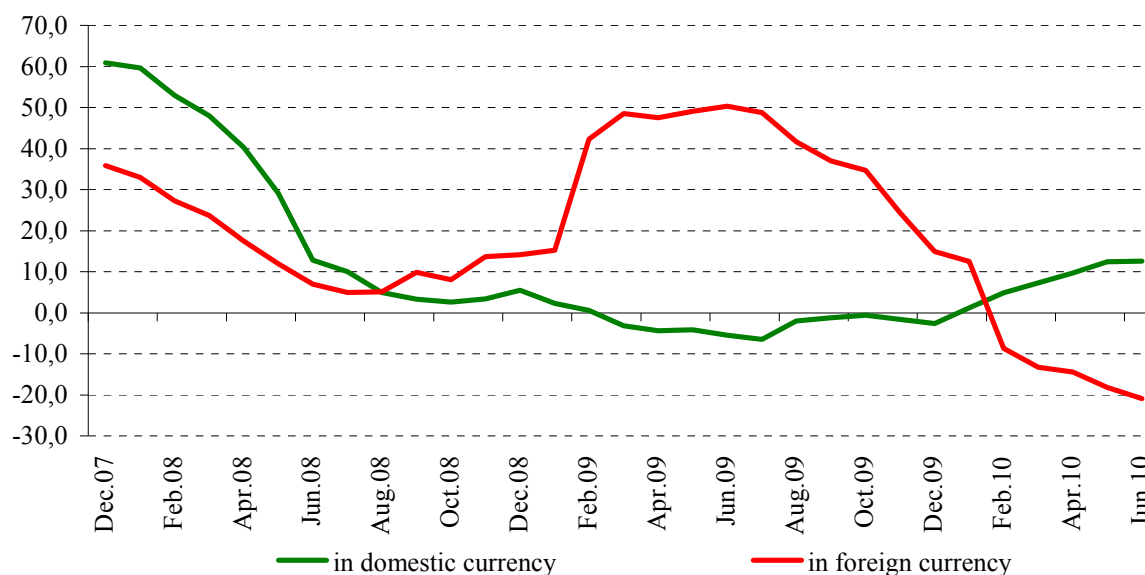


Source: National Bank of the Republic of Kazakhstan

The volume of credits to legal entities decreased in June 2010 as compared to the respective period of 2009 by 6.8%. Credits to legal entities in the domestic currency increased by 12.6% in annual terms, and credits in foreign currency decreased by 20.9% (figure 29).

figure 29

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



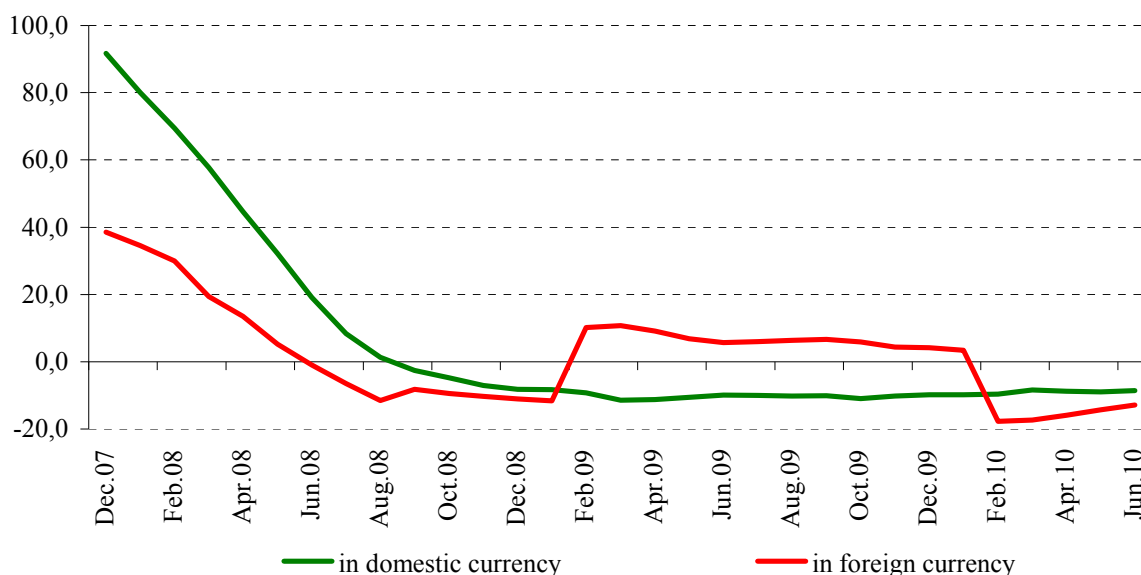
Source: National Bank of the Republic of Kazakhstan

The share of medium- and long-term credits at end-June 2010 amounted to 78.6% in the total volume of credits to legal entities (in June 2009 – 76.4%).

The volume of credits to natural persons decreased by 10.3% in June 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 8.6% and in foreign currency – 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 Q2 2010 the amount of bank assets calculated under the Monetary Survey decreased by 0.7% to KZT 15.4 trln. Bank assets increased by 6.3% in annual terms (in June 2010 as compared to June 2009). (figure 31).

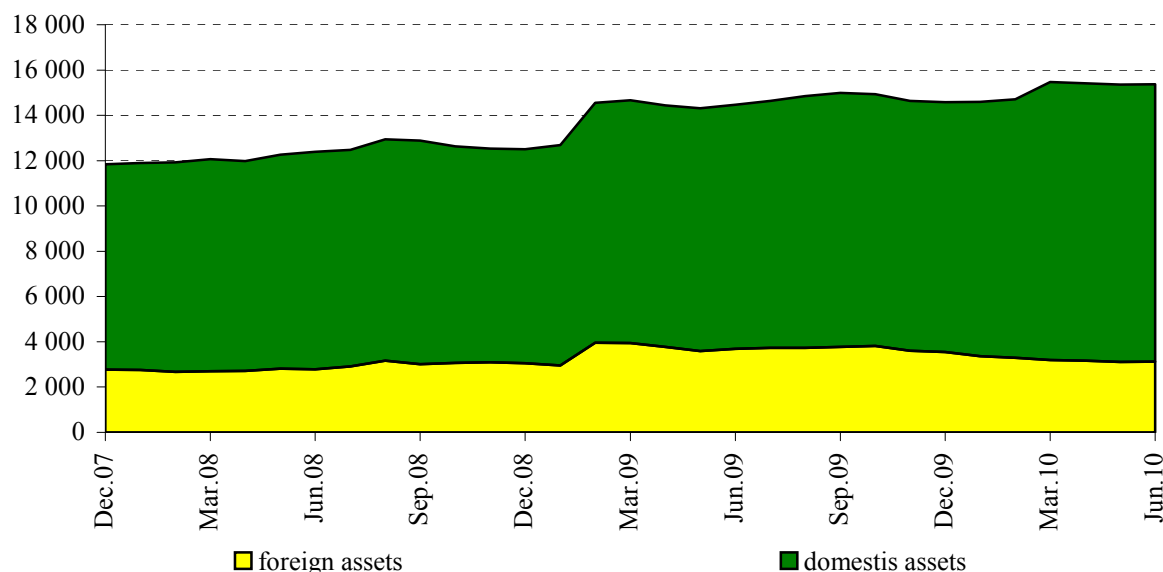
Foreign assets of banks in June 2010 accounted for 20.3% of the total volume of assets or US\$ 21.2 bln. They have decreased by 11.9% as compared to December 2009, by 15.3% - as compared to June 2009, and as compared to March 2010 – by 2.0%.

In the structure of foreign assets in June 2010, credits to non-residents accounted for 52.9% (in March 2010 – 57.6%), deposits placed with non-residents – 23.3% (in March 2010 – 21.1%), securities of non-residents – 5.9 % (in March 2010 - 3.6%), other accounts receivable – 17.9% (in March 2010 – 17.7%).

Domestic assets in June 2010 accounted for 79.7% or KZT 12.2 trln., where assets in the domestic currency amounted to 65.7% or KZT 8.0 trln. and assets in foreign currency – 34.3% or KZT 4.2 trln. (figure 32).

figure 31

Dynamics of bank assets, KZT bln.

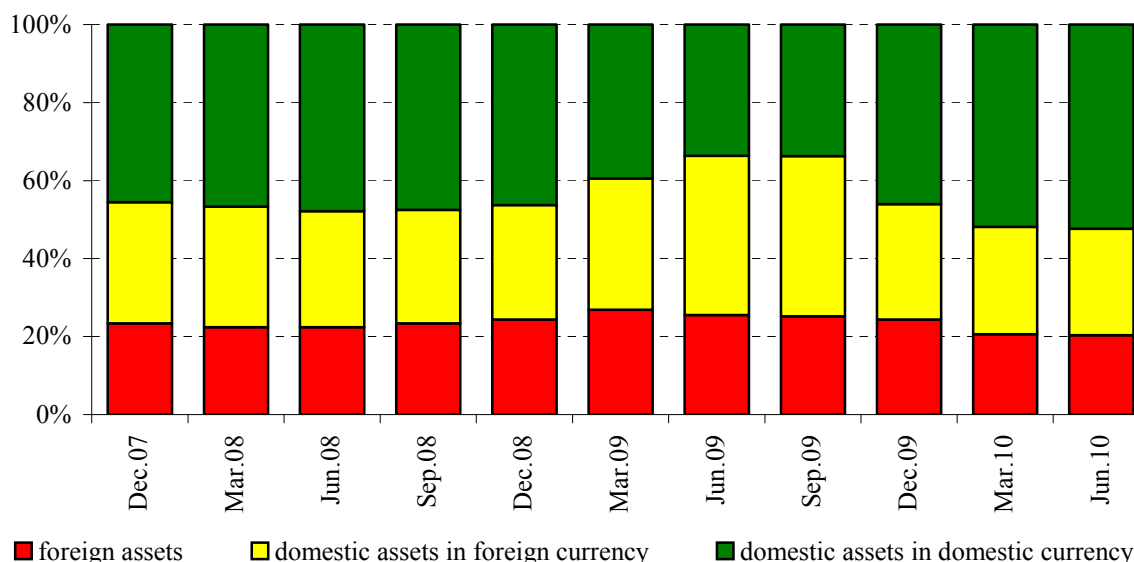


Source: National Bank of the Republic of Kazakhstan

In April-June 2010 domestic assets decreased by 0.4%, where assets in the domestic currency increased by 0.1%, and assets in foreign currency decreased by 1.3%. As compared to June 2009, the growth in these indicators reached 13.7%, 36.2% and 13.6%, respectively.

figure 32

Structure of bank assets, %



Source: National Bank of the Republic of Kazakhstan

In April-June 2010 the quality of bank assets slightly improved. The share of bad assets decreased from 21.0% to 19.3% while the share of standard assets increased (from 50.7% to 51.3%). However, the share of doubtful assets slightly increased (from 28.3% to 29.4%). 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 3.0% to

3.9%), 4th category (from 2.1% to 3.5%) and 5th category (from 4.6% to 5.2%). This is an evidence of the remaining threat of a further reduction in the quality of bank assets.

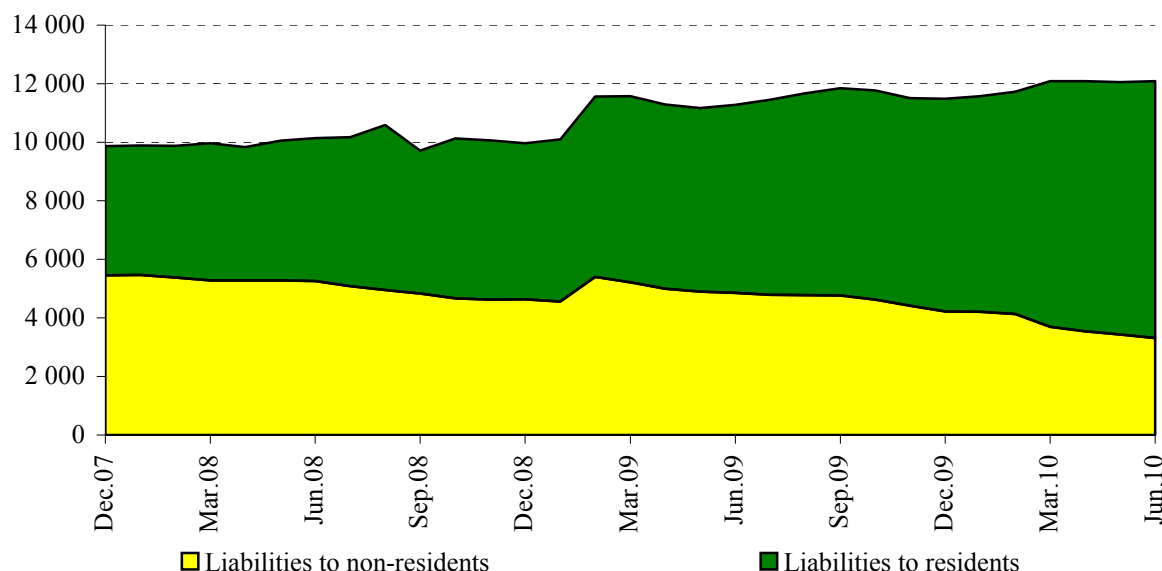
As a whole, under the Monetary Survey for Q2 2010, bank assets showed insignificant decrease. Nonetheless, the structure of assets hasn't changed dramatically over the most recent months. A high level of credit risk and low asset quality still represent weak aspects of the Kazakh banking system. As before, 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 somewhat improved (the share of bad credits decreased from 29.9% to 27.7%, the share of standard credits increased from 25.8% to 26.6%). This was brought about by the tightened credit policy implemented by banks; restructuring by banks of loans provided to the population, implementation of the employment support program, etc.

– **Liabilities**

In Q2 2010 total bank liabilities calculated in line with the Monetary Survey was virtually unchanged and amounted to KZT 12.1 trln. at end-June 2010. In June 2010 as compared to June 2009, bank liabilities increased by 7.2% (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 19.1% to US\$ 22.5 bln. in June 2010 as compared to December 2009. Bank liabilities decreased by 30.3% versus the respective month of 2009. At end-June 2010 they accounted for 27.4% of the volume of bank liabilities.

In June 2010 in the structure of bank liabilities to non-residents, liabilities on deposits of non-residents decreased to 6.7% from 15.3% in March 2010, liabilities on securities – from 29.4% to 31.3%. Credits from non-residents, on the contrary, increased to 59.7% from 52.6% in March 2010.

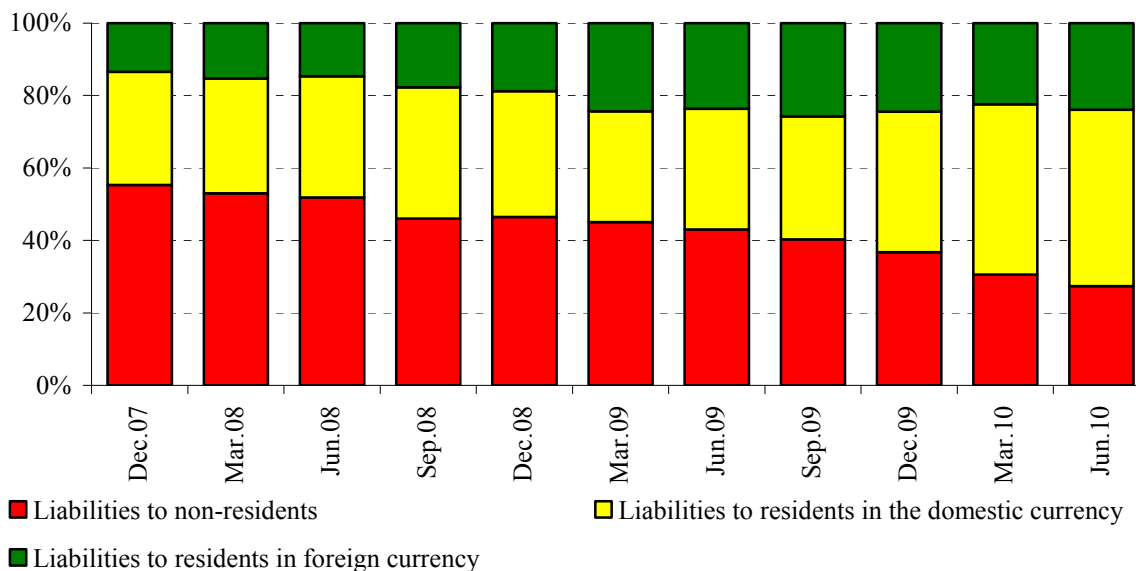
In April-June 2010 liabilities to residents increased by 4.6% to KZT 8.8 trln., where liabilities in the domestic currency increased by 3.5% to KZT 5.9 trln., liabilities in foreign currency – by 6.8% to KZT 2.9 trln. The growth in these indicators accounted for 36.6%, 56.6% and 8.4%, respectively versus the respective month of 2009 (figure 34).

At end-June 2010, the share of transferable and other deposits of non-government non-financial institutions in the structure of liabilities to residents decreased to 19.0% (in

March 2010 – 19.5%). The share of deposits of non-government non-financial institutions increased over the period from 25.8% to 28.6%, and of households – decreased from 23.3% to 22.6%.

figure 34

The structure of bank liabilities, %



Source: National Bank of the Republic of Kazakhstan

Thus, the consequences of the global financial and economic instability weakened its negative impact on the banking sector development in Q2 2010. The restructuring of liabilities of JSC “BTA Bank”, JSC “Alliance Bank” and JSC “Temirbank” – a subsidiary of JSC “BTA Bank” – is successfully being finalized. As a result of restructuring of foreign liabilities of these banks their debt will be reduced, maturities will be adjusted, both in terms of the repayment dates and the repayment amounts. The decrease in the banks’ foreign debt also entails the reduced external debt servicing (i.e. interest payable to creditors).

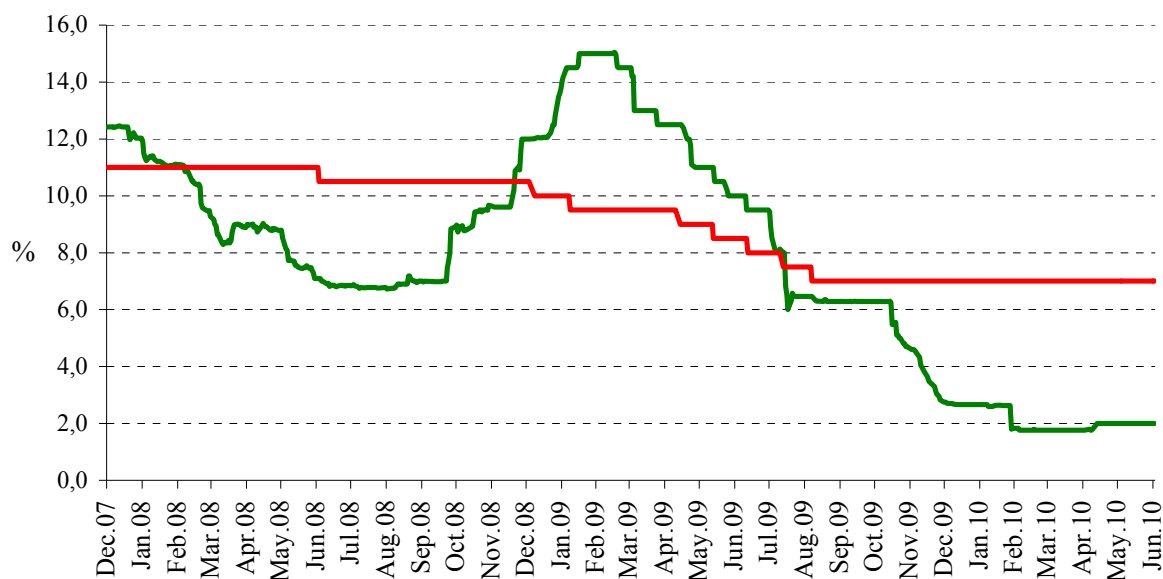
3.2.4. Financial Market Rates

In Q2 2010 there were multi-directional changes of interest rates in the interbank market.

The KazPrime indicator decreased from 2.33% on average in Q1 2010 to 1.90% on average in Q2 2010. This indicator was 1.76% - at end-March 2010 and 2.00% - at end-June 2010 (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

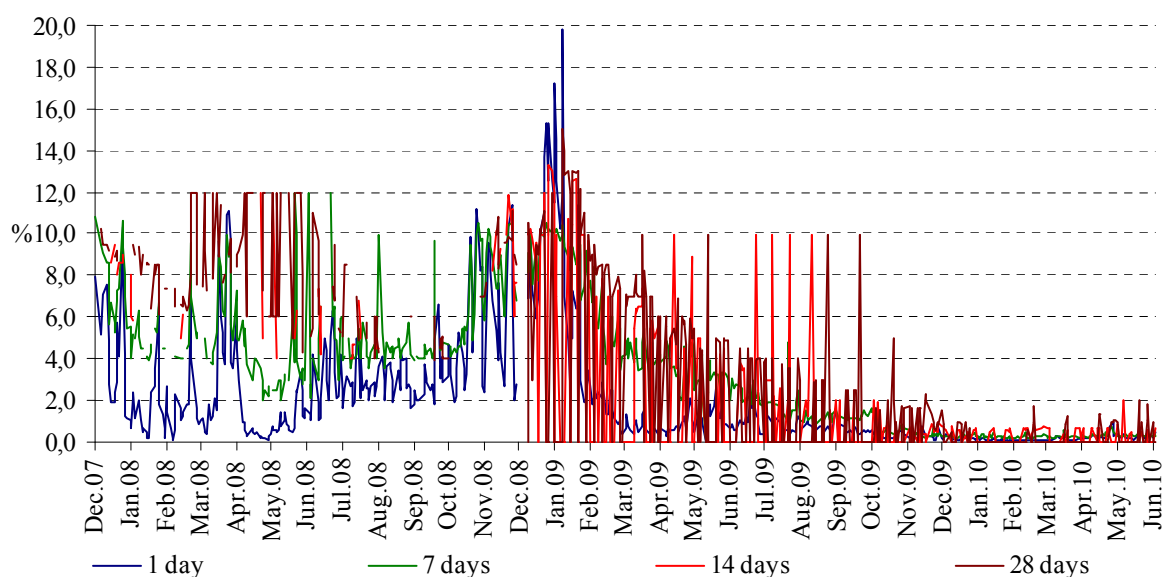
Rates on REPO operations are growing.

The average weighted rate on 1-day operations in the sector of the automatic REPO in Q2 2010 increased and was 0.25% (in Q1 2010 – 0.12%). Its maximum level was 0.93% and minimum – 0.08%.

Rate fluctuations on 7-day REPO operations in Q2 2010 were within the range of 0.21% to 0.76% (the average weighted rate was 0.29%), on 14-day REPO operations – from 0.35% to 2.00% (the average weighted rate was 0.62%), and on 28-day REPO operations – from 0.90% to 2.00% (the average weighted rate was 1.39%) (figure 36).

figure 36

Dynamics of rates on REPO operations, %



Source: Kazakhstan Stock Exchange

The market capacity still remains insignificant. The market is characterized by a small number of instruments of pledge and low activity of the market players.

In Q2 2010 the transaction volumes in the sector of the automatic REPO increased by 14.6% as compared to the previous quarter. At the same time, the volumes on 7-day and 28-day REPO operations decreased as compared to Q1 2010.

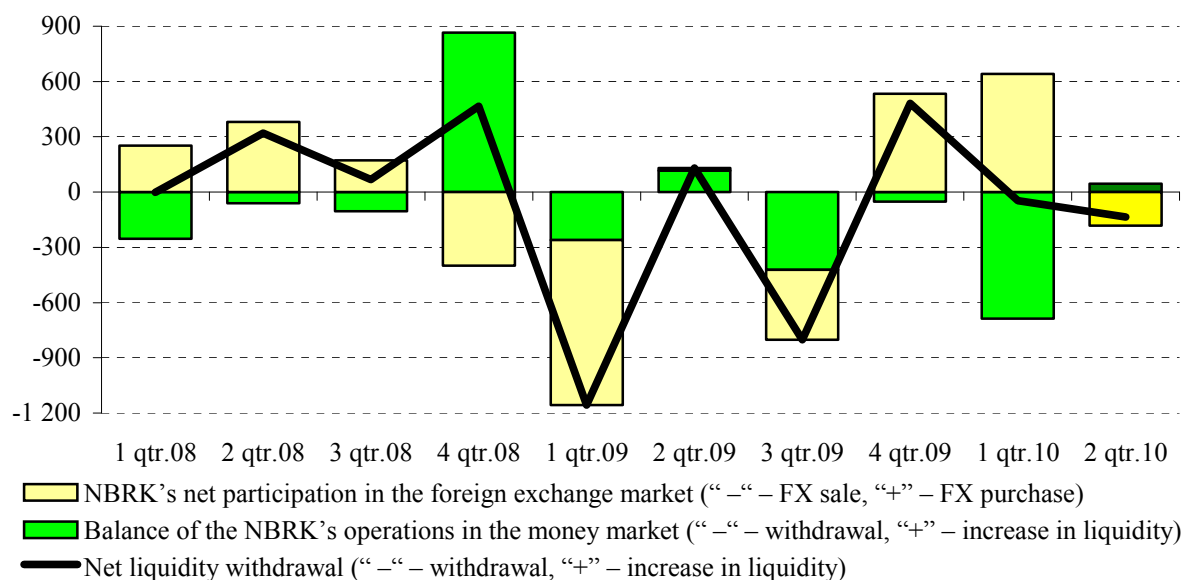
4. Monetary Policy Instruments and Operations

In Q2 2010 the situation in the financial market was stable, banks had sufficient Tenge liquidity.

In Q2 2010 the National Bank's operations in the financial market resulted in the withdrawal of the Tenge liquidity mainly because of the purchase and sale of foreign exchange by the National Bank in the domestic foreign exchange market (figure 37).

figure 37

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



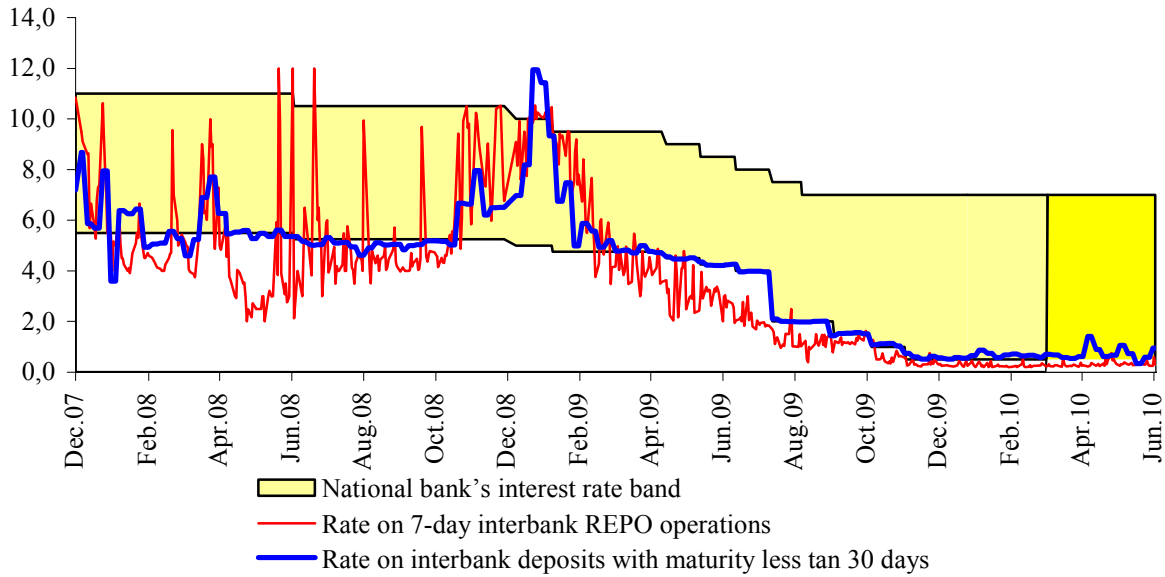
Source: National Bank of the Republic of Kazakhstan

In Q2 2010 the National Bank's rate band remained unchanged. From April 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%.

Maintaining stable liquidity situation in the financial market was conducive to a horizontal trend in the dynamics of the money market interest rates, i.e. the volatility of interest rates was insignificant. On average, in April-June 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 0.77% in Q2 2010. The average weighted rate on interbank 7-day REPO operations was 0.29% (figure 38).

figure 38

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

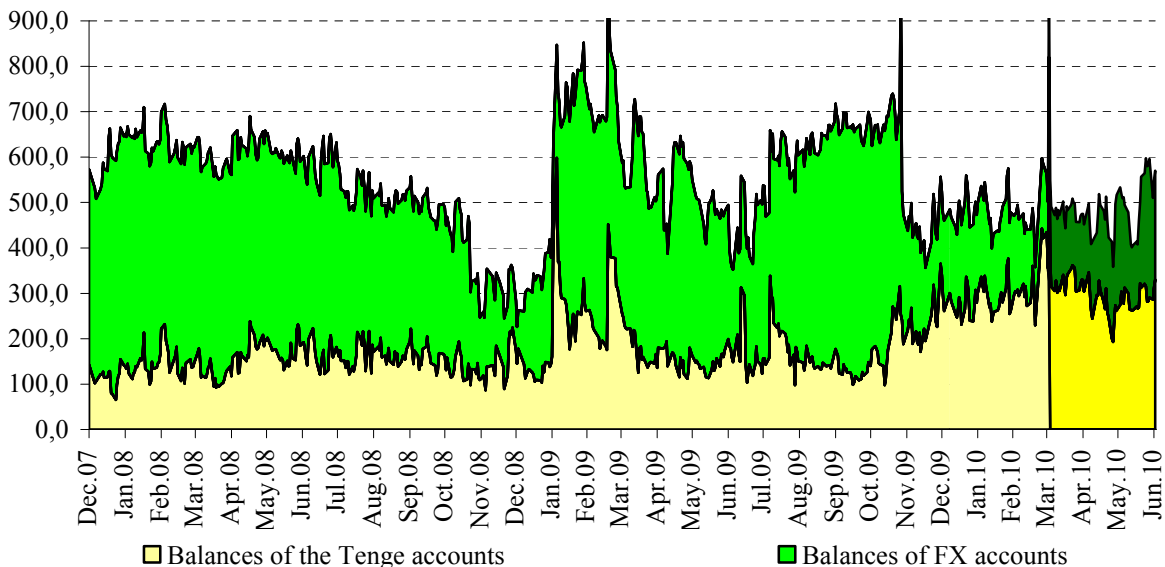


Source: National Bank of the Republic of Kazakhstan

In Q2 2010, there was no stable trend in relation to correspondent account balances of banks with the National Bank. In April, correspondent account balances of banks in foreign currency were relatively stable, in May-June they started to grow gradually. Correspondent account balances of banks in the domestic currency were characterized by a higher degree of volatility with a slight growing trend (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

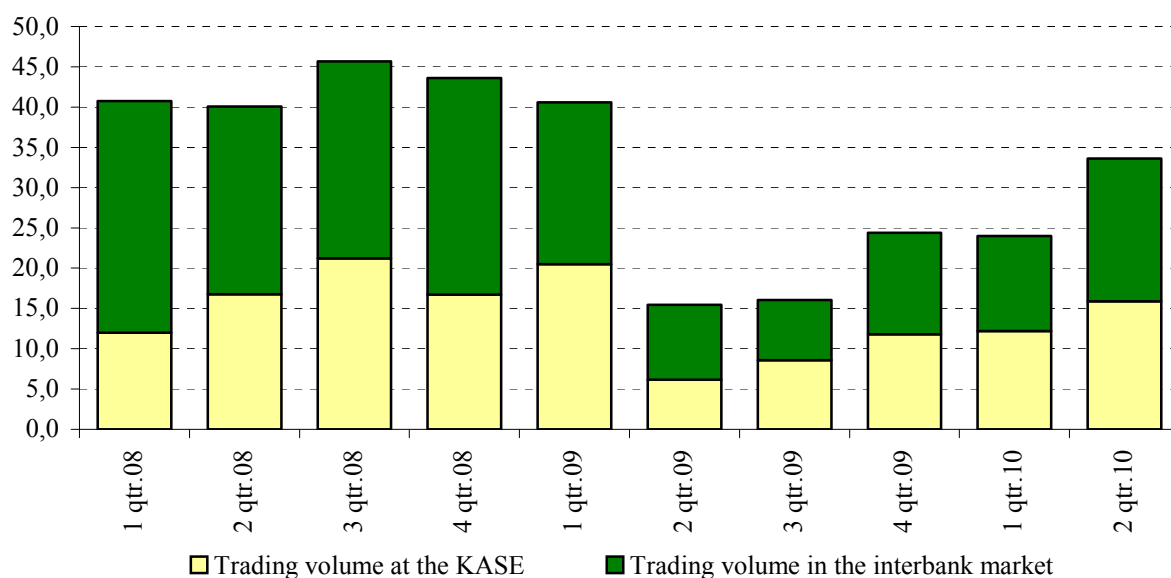
The situation in the domestic foreign exchange market was characterized by the excess of the foreign currency demand over its supply.

In Q2 2010 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank foreign exchange market amounted to US\$ 33.6 bln. having increased by 39.8% as compared to Q1 2010.

The volume of trades in the Dollar position at the Kazakhstan Stock Exchange increased by 15.9% as compared to Q1 2010 and amounted to US\$ 30.0 bln. (net trades at the Kazakhstan Stock Exchange made up 78% of gross trades). In the off-exchange foreign currency market the volume of transactions in the second quarter of 2010 increased by 50.0% as compared to the previous quarter and amounted to US\$ 17.7 bln. (figure 40).

figure 40

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

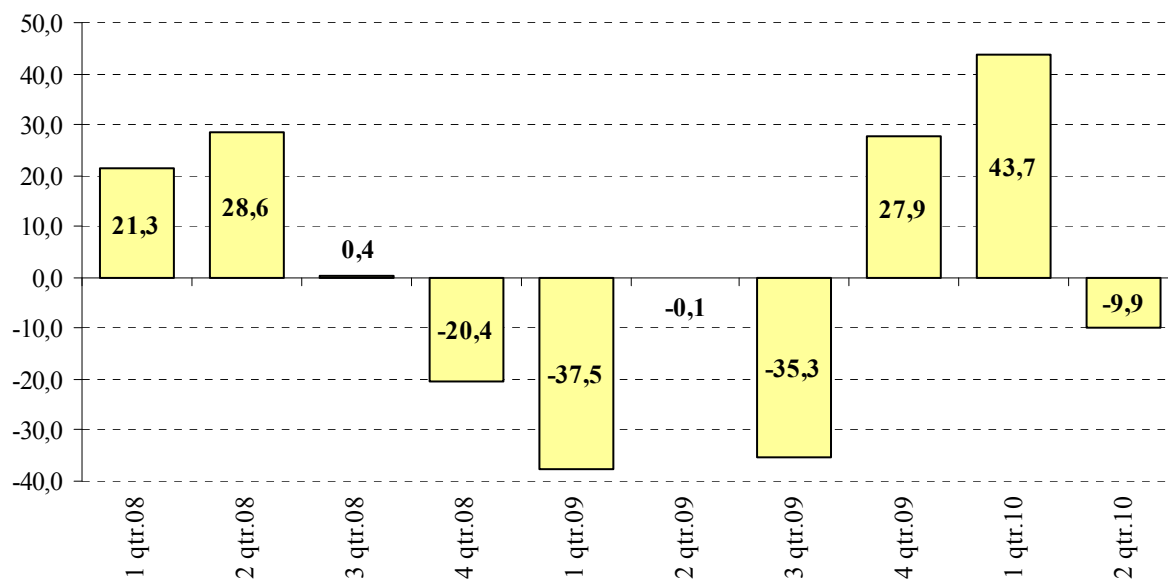


Source: National Bank of the Republic of Kazakhstan

Based on Q2 2010 the National Bank's participation coefficient in the Kazakhstan Stock Exchange was (-)9.9%, whereas in Q1 2010 it was equal to 43.7% (figure 41). Thus, in Q2 2010 the National Bank was primarily the seller of foreign exchange in the domestic foreign exchange market.

figure 41

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



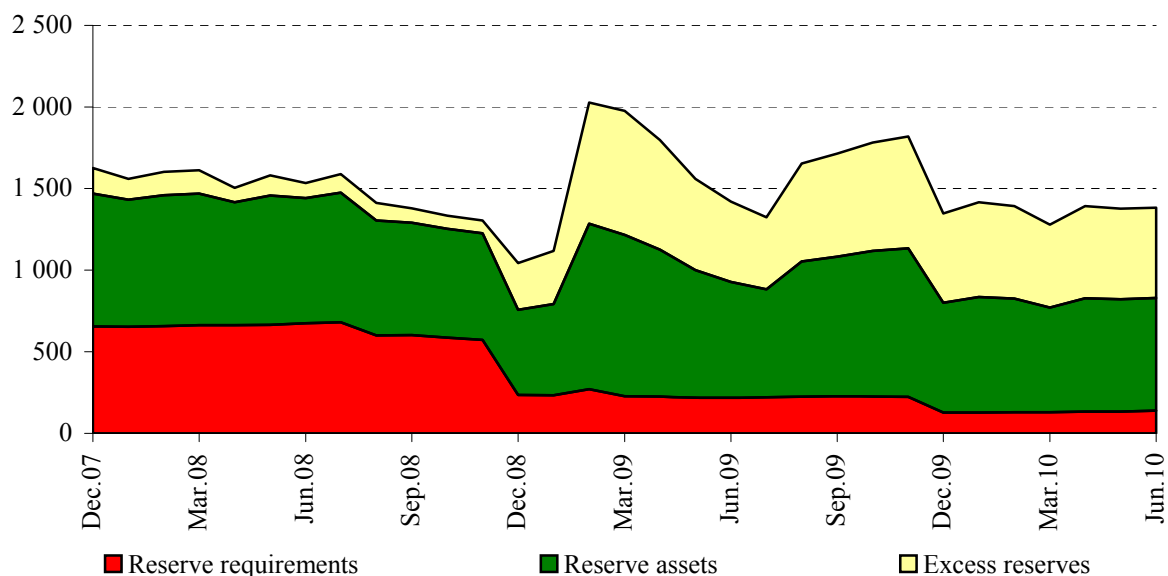
Source: National Bank of the Republic of Kazakhstan

4.2. Minimum Reserve Requirements

On average, in April-June 2010 reserve assets exceeded the required reserving volume by 5.1 times (in Q2 2009 – by 3.6 times) (figure 42).

figure 42

Compliance with minimum reserve requirements, KZT bln.



Source: National Bank of the Republic of Kazakhstan

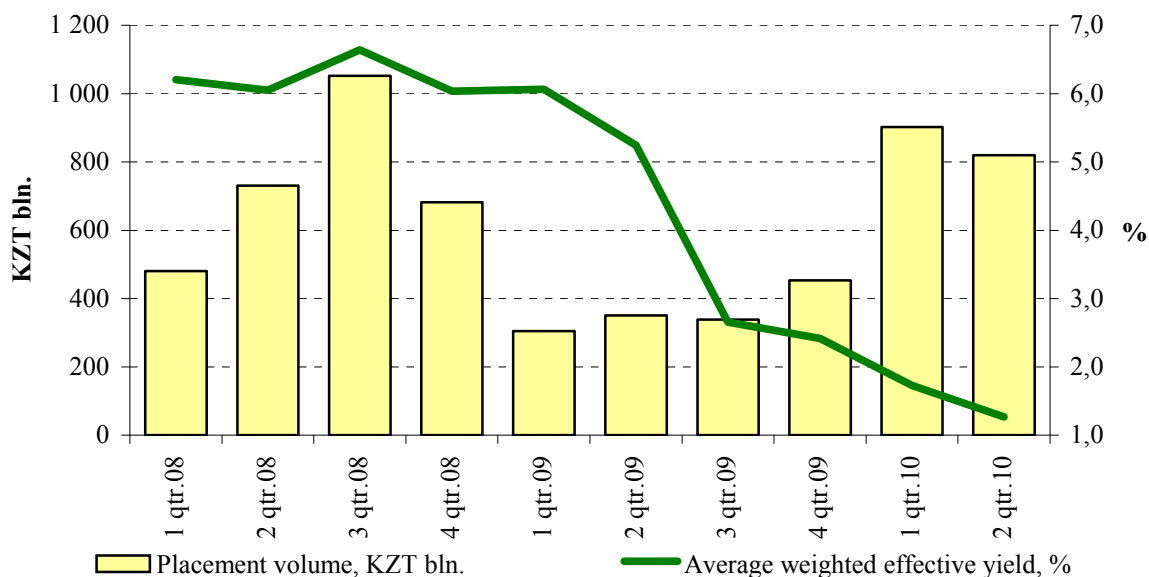
4.3. Open Market Operations

In Q2 2010 the demand of banks for short-term notes of the National Bank remained high. In April-June 2010 short-term notes with maturities of 3 and 6 months were issued.

Volume of short-term notes issued in Q2 2010 decreased by 9.1% as compared to Q1 2009 and amounted to KZT 819.9 bln. This accounted for over 85% of the aggregate demand of the market participants for these types of government securities. The average weighted yield on issued notes decreased from 1.73% in Q1 2010 to 1.27% in Q2 2010. (figure 43).

figure 43

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

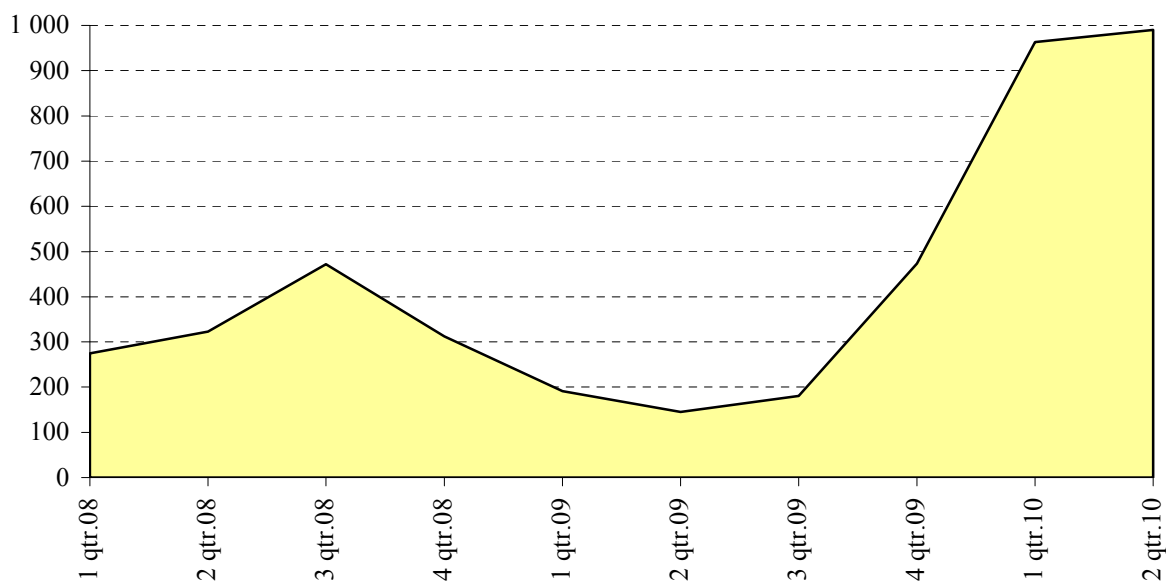


Source: National Bank of the Republic of Kazakhstan

At end-June 2010 the volume of short-term notes in circulation amounted to KZT 990.3 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

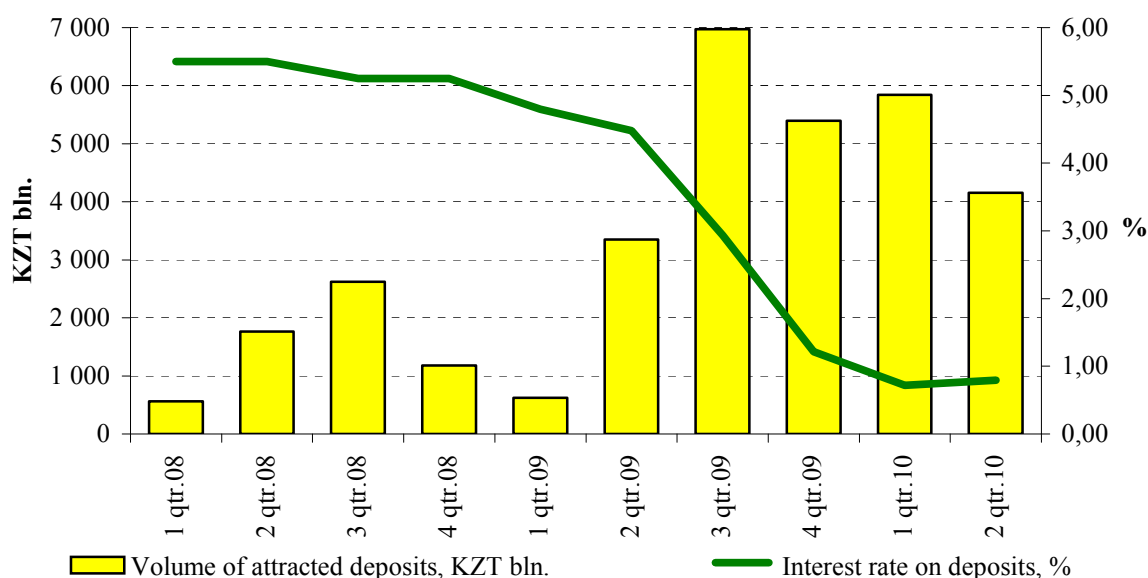
4.4. Standing Facilities

In Q2 2010 the volume of bank deposits with the National Bank decreased to some extent as compared to the previous quarter. Nonetheless, the volumes of attraction remained high: the peak of attraction occurred in April, in May-June the attraction volumes somewhat decreased. In total, during April-June 2010 KZT 4156.4 bln. of deposits was attracted, which is by 28.8% below the volume of Q1 2010 and is greater by 26.9% than the volume in Q2 2009.

The average interest rate on deposits increased from 0.72% in Q1 2010 to 0.79% in Q2 2010 (figure 45).

figure 45

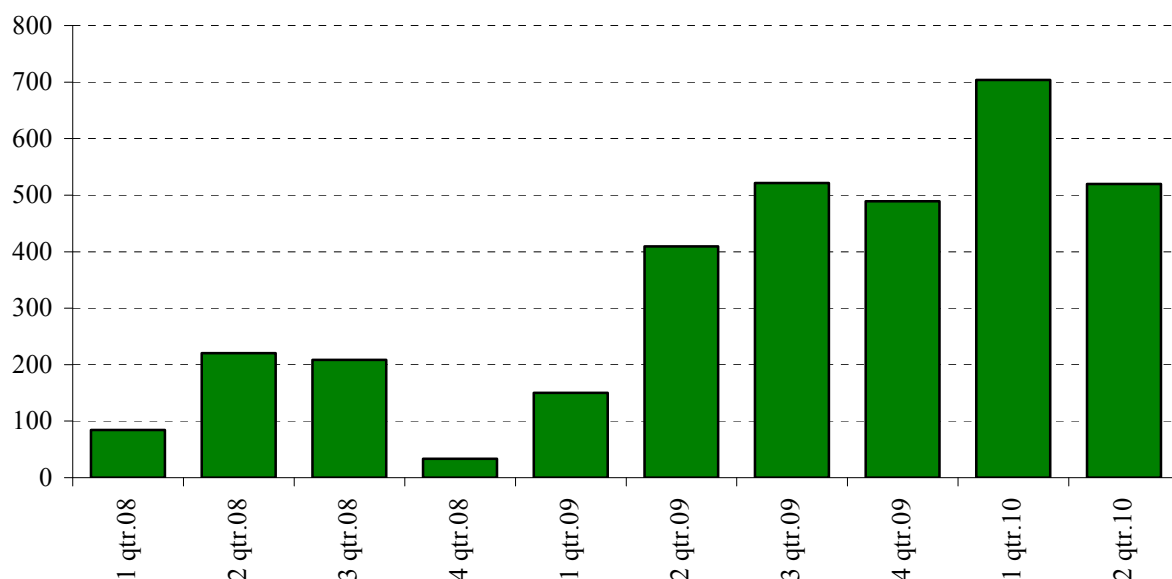
Volume and interest rates on deposits attracted by the National Bank (for the period)



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 26.2% to KZT 519.7 bln. in June 2010 as compared to March 2010 (figure 46).

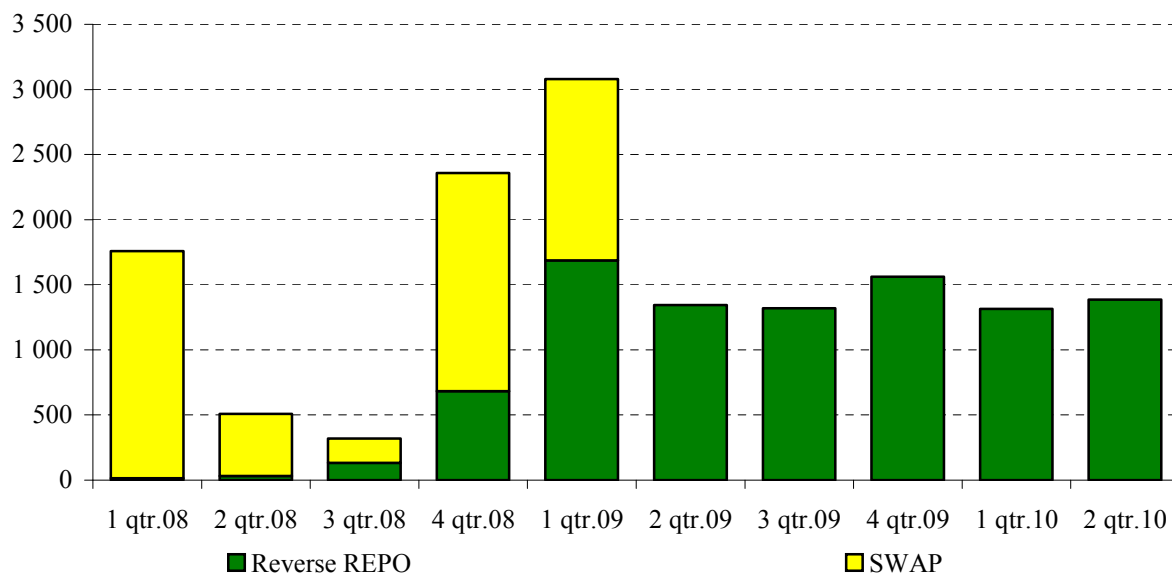
figure 46

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 Q2 2010 the National Bank continued to provide refinancing loans to the banking sector through reverse REPO operations. Total volume of reverse REPO operations in April-June 2010 amounted to KZT 1385.2 bln. (figure 47).

figure 47

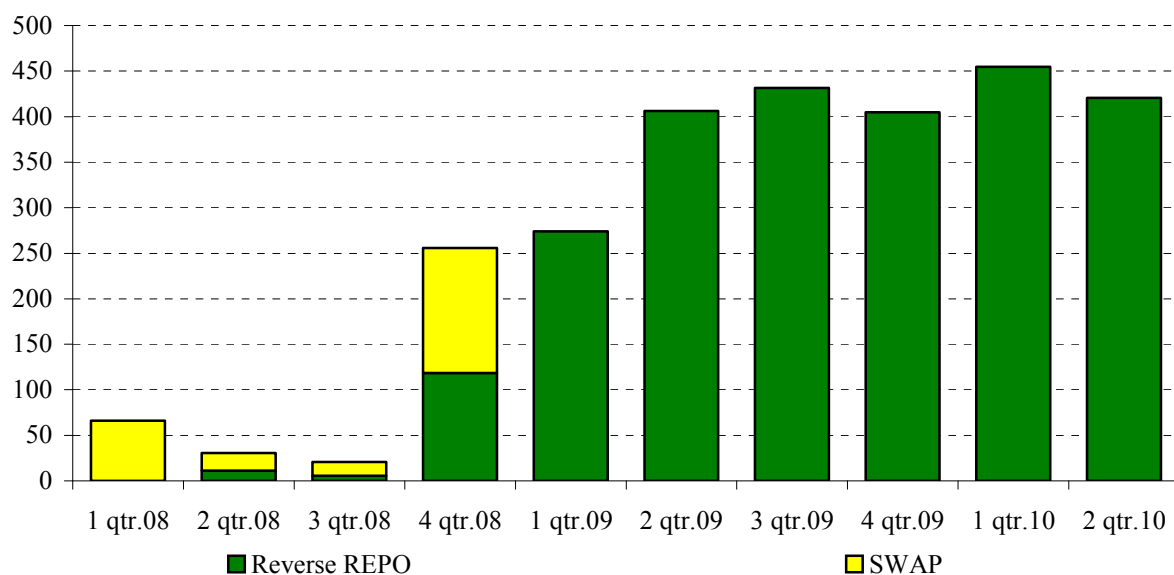
Volume of the National Bank's refinancing operations, KZT billion (for the period)


Source: National Bank of the Republic of Kazakhstan

At end-June 2010 the outstanding debt on reverse REPO operations amounted to KZT 420.5 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