National Bank
of the Republic of Kazakhstan

Inflation Report
for the Fourth Quarter 2009

Table of Contents

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

Tables

Summary

In 2009, the inflation rates in Kazakhstan were steadily decreasing. Based on 2009, the inflation was at 6.2%. This inflation rate is 1.5 times lower as compared to the inflation in 2008.

Low business activity, stagnation in the lending activity of banks, low growth rates of real cash income of the population, limited consumer demand were the major factors for a decrease in the inflationary background in the economy.

Nonetheless, it should be mentioned that the macroeconomic situation in Kazakhstan in 2009 is characterized by a greater stability as compared to the situation in 2007-2008. At the same time, if in the first half of the year the output volume in the most sectors of the economy (manufacturing industry, construction, cargo turnover, retail sales), decreased, in the second half of 2009 a break point outlined. According to the tentative estimates, the real GDP growth was 1% based on 2009.

World prices in the commodity markets in 2009 remain volatile. At the same time, there was a growth in prices for oil and metals whereas the wheat prices had been gradually decreasing. The growth in the world prices resulted in the increased prices for industrial products of the Kazakhstani producers, nonetheless, it didn't have a significant impact on the inflationary processes in the consumer market.

A minimal inflationary background allowed the National Bank to implement the monetary policy aimed at ensuring the stability of the exchange rate of the Tenge and the stability of the country's financial sector. In particular, the National Bank continued providing refinancing loans to the banking sector.

The need to retain gold and foreign currency reserves and maintain the competitiveness of the domestic producers urged the National Bank to revise its approaches to the foreign exchange policy. In February 2009, a new exchange rate band was fixed at KZT 150/1US$ +/-3%. This allowed significantly reduce devaluation expectations in the market.

In 2009, the National Bank had gradually decreased the official refinancing rate from 10.5% to a historically minimum level – 7.0%. In March 2009 minimum reserve requirements to banks had been reduced from 2% to 1.5% on the domestic liabilities and from 3% to 2.5% - on other liabilities. In November 2009, separate minimum reserve requirements of 0% on all bank liabilities had been established for the banks that were in the process of their debt restructuring in order to maintain their current liquidity.

Measures taken allowed stabilizing the situation in the financial market. The demand for the National Bank's resources from banks decreased whereas the volume of operations on liquidity withdrawals increased. As a result, banks have accumulated a significant volume of liquidity in the form of the National Bank's instruments while there was no growth in the credits to the economy.

In these circumstances, the National Bank made some adjustments to its monetary policy instruments. Maturities were increased and interest rates were reduced on deposits attracted from banks and short-term notes issued by the National Bank.

Evaluation of the Inflation Forecasts for the 4th Quarter 2009 and for 2009 as a Whole

The actual inflation rate in Q4 2009 (1.4%) was lower than the forecast (1.8-2.0%), which was published in the previous issue of the Inflation Report. The inflation had been lower than the forecast throughout the period.

In Q4 2009, prices for foodstuff grew slowly which is not typical for such period. The increase in prices was 0.6% only, which is minimal from a historical point of view, except for Q4 1998 when prices for foodstuff were decreasing.

The inflationary processes were building up mainly under the influence of increased prices for paid services to the population. In their structure the highest increase in prices was in regulated services. The impact on the part of non-food items was insignificant and the price dynamics for these items was mainly determined by the seasonality factor.

In 2009 the inflationary background in the economy remained minimal. As a result, the situation in the consumer market was characterized by a gradual decline in inflation. It accelerated insignificantly only at the end of the year due to the increased consumer demand and the seasonality factor.

The actual inflation rate in annual terms at end 2009 was also below the forecast published in the previous issue of the Inflation Report. So, in December 2009 the annual inflation was at 6.2% with the forecast of 8.0% (figure 1).

figure 1

Actual and forecasted inflation in 2009
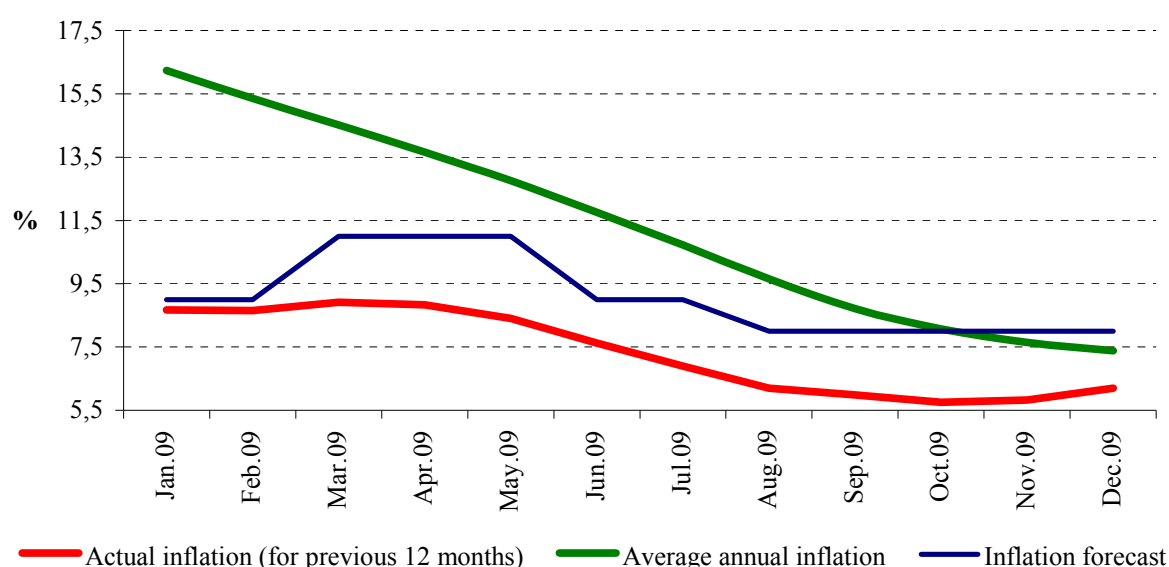
Source: National Bank of the Republic of Kazakhstan

Inflation Forecast for 2010

A slow recovery of the global economy, moderate world prices in the commodity markets including prices for the major items of Kazakhstan's export, remaining uncertainty in the global financial market will be the main factors determining the tendencies of economic development of the Republic of Kazakhstan.

In 2010, further reduction in the inflationary pressure is not expected. This is associated with a number of factors, which may have a negative impact on the pricing environment in the consumer market of Kazakhstan.

First, an increase in salaries and wages, social benefits and retirement benefits from the budget scheduled for 2010 may result in some increase in the consumer demand, which, in its turn, will create an inflationary pressure.

Second, the increased customs duties for imported products due to the establishment of the Customs Union from January 1, 2010 may result in the growth in prices for imported goods and in the inflation as a whole, with a certain time lag.

Third, recovery of business activity in Kazakhstan in 2010 as a result of anti-crisis measures taken by the government, which will entail the growth in demand and the risk of increased inflationary pressure.

In 2010, inflation is forecasted to be within the range of 6.0-8.0%.

For the purposes of increasing flexibility of pricing, from February 5, 2010 the band of the Tenge fluctuations will be extended: KZT 150/1US$ (+)10% or KZT 15, (-)15% or KZT 22.5.

The inflation forecast for Q1 2010 is 2.5-2.7% (in Q1 2009 – 2.0%). Generally, this level is in line with the inflation trends of Q1, which were typical of the recent years.

These expectations are related to the fact that, in the first instance, the inflation in the near term will be built up under the influence of the seasonality factor. The decrease in prices for certain commodities and services is anticipated (meat and dairy products, fuel and lubricants, certain utility services, and transport services).

Based on March 2010, the annual inflation is expected to be at 6.9-7.1%.

The inflation forecast for Q2 2010 is 1.3-1.5% (in Q2 2009 – 1.9%), which corresponds to the annual inflation of 6.4-6.6% at end-June 2010.

The situation in the consumer market in this period is built up mainly under the influence of the seasonality factor, which, in its turn, leads to decreased prices for certain food items (eggs, dairy products, fruits and vegetables, meat products, and education services).

1. Inflationary Processes

1.1. Consumer Prices

In Q4 2009, the price growth rates in the consumer market were not high as compared to the respective period in the past years. So, if in October-December 1999-2006 the inflation on average exceeded 3%, in October-December 2009 it was 1.4%.

Foodstuffs appreciated by 0.6%, non-food items – by 1.5%, paid services to the population – by 2.5% (figure 2).

figure 2

Dynamics of quarterly inflation and its components
(as % of the previous year)
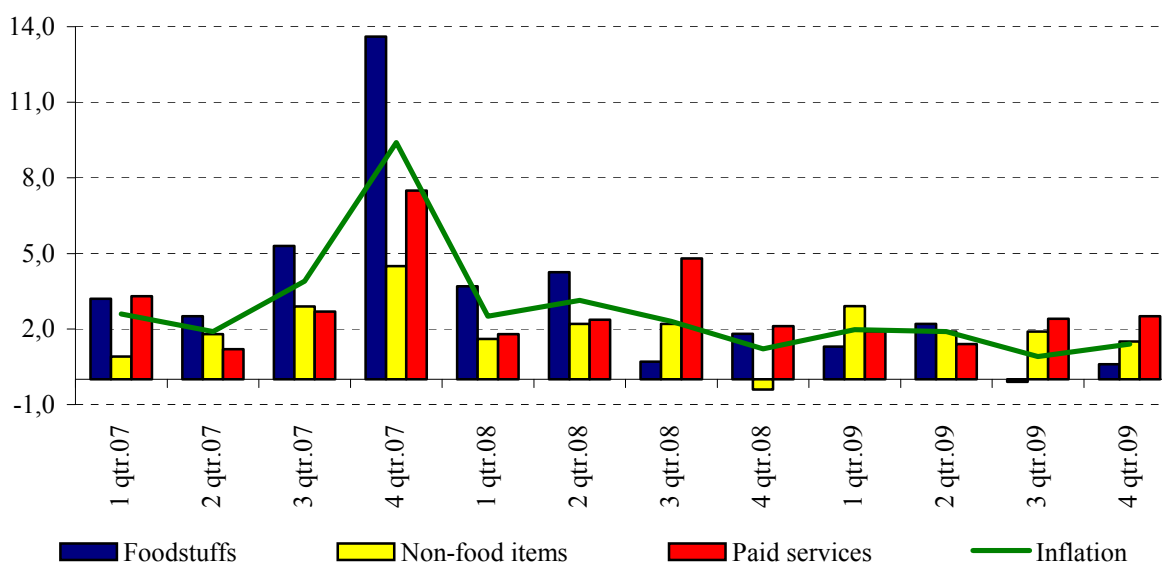
Source: Statistics Agency of the Republic of Kazakhstan

The main growth in prices in Q4 2009 was for such goods and services as sugar – by 9.1%, eggs – by 7.9%, dairy products – by 4.5%, hot water supply – by 7.2%, cold water supply – by 3.7%.

The decreased prices for some food items should be also noted. The price for fruits and vegetables decreased by 6.1%, bread and cereals – by 1.7%.

In Q4 2009, some acceleration of annual inflation was observed. Based on December 2009, the inflation rate was 6.2% (in September 2009 – 6.0%). Nonetheless, this number is three times less than the maximum level for the most recent years, which was observed in the summer months of 2008.

If in 2008 the major increase in prices in the consumer market fell on foodstuffs, in 2009 the structure of the inflationary processes' buildup changed. In the beginning of the year a major growth in prices fell on paid services and foodstuffs, in Q4 the trend established in Q3 continued. The determining role during these periods was played by the appreciation of paid services to the population, and the pressure from non-food items increased, alongside with that the impact of food items reduced significantly.

The price of food items based on December 2009 in annual terms increased by 3.0%, non-food items – by 8.6%, paid services to the population – by 8.4% (figure 3).

figure 3

Dynamics of annual inflation and its components
(as % of the respective month of the previous year)
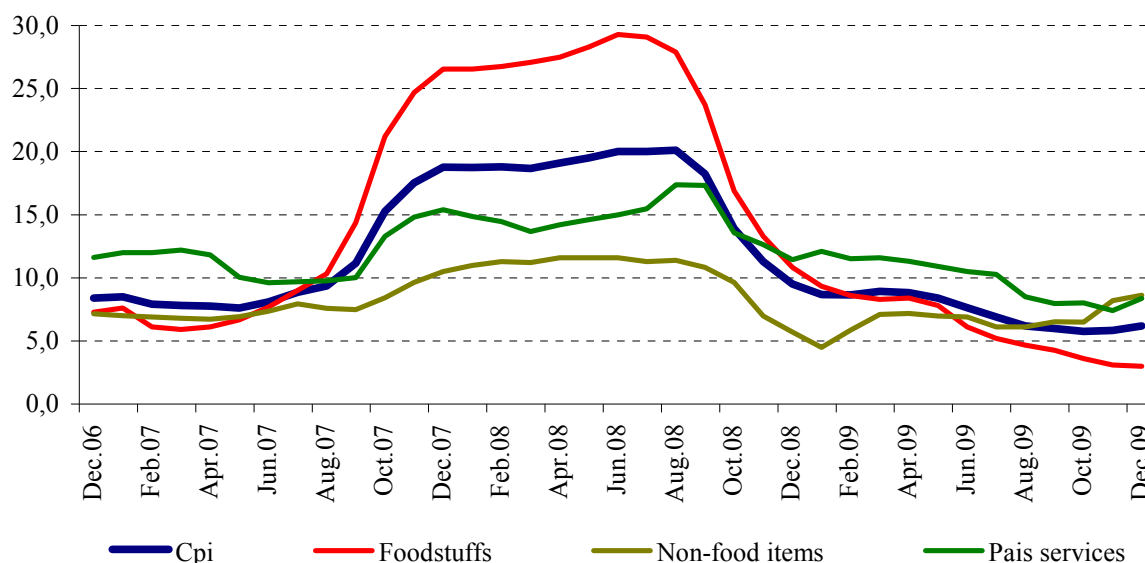
Source: Statistics Agency of the Republic of Kazakhstan

1.2. Core Inflation

The indicators of core inflation in Q4 2010 alike the headline inflation demonstrated higher growth rates, as compared to Q3 2009. At the same time, as compared to Q4 2008, the increase was observed in the core inflation-1 only (figure 4).

In Q4 2009 the headline inflation was at a lower level as compared to core inflation indicators, except for core inflation-2. This was caused, to a greater extent by significantly decreased prices for fruits and vegetables based on its large share in the structure of the consumer basket.

In October-December 2009 a slowdown in core inflation-2, core inflation-4 and core inflation-5 was observed in annual terms while the growth rates of core inflation-1 and core inflation-3 remained virtually unchanged. At the same time, in December 2009 as compared to December 2008 all indicators of core inflation were at a lower level. 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 4

**Dynamics of quarterly inflation and core inflation
(as % of the previous period)**
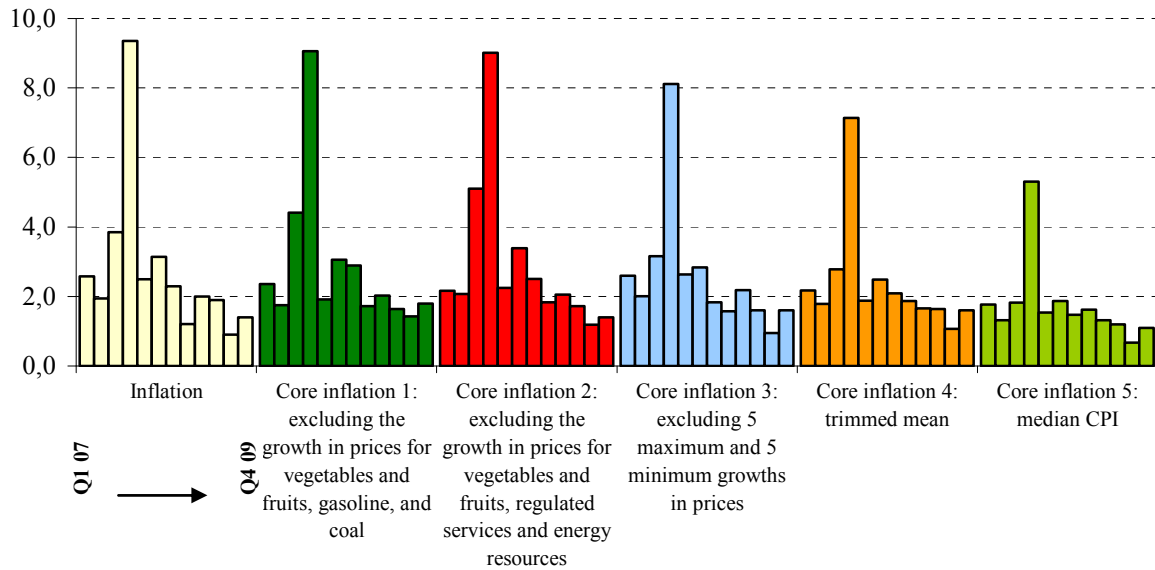
Source: Statistics Agency of the Republic of Kazakhstan

Based on December 2009, core inflation-1, core inflation-2 and core inlation-3 in annual terms exceeded the headline inflation indicator. This was caused by decreased prices for vegetables and fruits, significant decrease in prices for eggs, fats and oils as well as moderate annual growth in prices for gasoline and certain types of regulated services that are excluded when calculating these indicators of the core inflation (figure 5).

figure 5

**Dynamics of annual inflation and core inflation
(as % of the respective quarter of the previous year)**
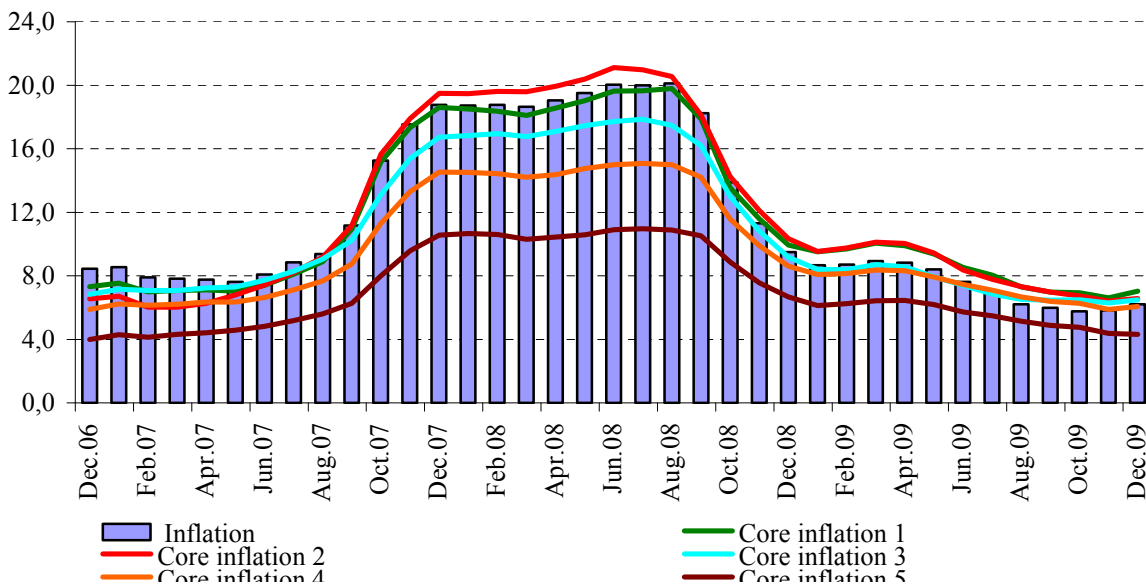
Source: Statistics Agency of the Republic of Kazakhstan

1.3. Prices in the Real Sector of the Economy

1.3.1. Prices in the Industry

After the fall in prices observed during three consecutive quarters, from Q2 2009, impacted by the implemented Tenge devaluation, prices in the industry started to grow. In Q4 the growth in the industrial producer prices slowed down as compared to the previous quarter accounting for 7.0% (Q4 2008 – decrease by 36.6%). The cost of the output increased by 7.2%, including the interim consumption products – by 7.8%, means of production – by 3.8%. The price for consumer goods increased by 2.1%, for production services – by 1.4%.

In October-December 2009 as compared to the previous period the price growth rate in the mining industry slowed down to 9.5% (respective period of 2008 – decrease by 48.6%). The reason for the slowdown was the decrease in the growth of prices for major energy resources. In particular, the price of oil extraction in Q4 2009 increased by 11.8% (Q3 2009 – growth by 16.9%), the cost of gas condensate increased by 1.2% (7.7%). In general, the cost of energy resources increased by 9.9% (14.4%), while in the respective period of 2008 it decreased by 47.5%.

Influenced by the pricing environment in the raw commodity segment, the price growth rate in the manufacturing industry in Q4 2009 also slowed down making 3.6% (Q4 2008 – decrease by 15.8%). Prices in the metallurgical industry increased by 8.5%, the cost of foodstuff production including beverages and tobacco decreased by 1.9%, and refined products appreciated by 9.6%.

In the production and distribution of electric energy, gas and water in Q4 2009 the slowdown in growth was also observed, which accounted for 2.7% and was caused by lower growth rates in prices for electric energy.

In December 2009 the growth in prices in the industry in annual terms (December 2009 versus December 2008) accounted for 31.0% (figure 6).

The cost of output in annual terms increased by 32.6%, including the interim consumption products – by 36.0%, consumer goods – by 9.3%, whereas the means of production became cheaper by 1.7%. The cost of production services increased by 6.5%.

figure 6

Dynamics of the producer price index
(as % of the respective month of the previous year)
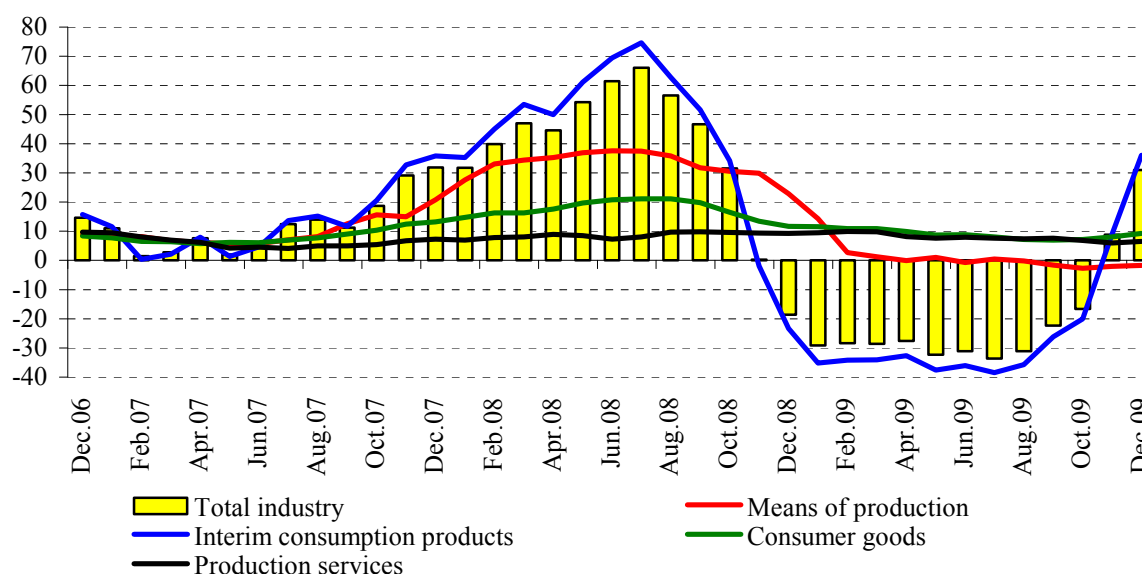
Source: Statistics Agency of the Republic of Kazakhstan

1.3.2. Prices in Agriculture

In Q4 2009 prices for agricultural production realized across all channels decreased by 10.7% as compared to the previous period (in Q4 2008 – growth by 4.1%). The dynamics of prices in agriculture was impacted by their depreciation for plant production and appreciation in stock-breeding.

Over October-November the plant production depreciated by 21.2%, which was caused by the decrease in prices for grain crops – by 23.2% as well as for potatoes and vegetables (by 18.4% and 11.8%, respectively). Heavy yield in grains in Kazakhstan and the countries importing wheat from Kazakhstan caused problems with selling grains which resulted in the drop of prices for wheat and became a determining factor in the decreased prices in agriculture.

Influenced by the seasonality factor, the cost of animal products in Q1 2010 appreciated by 3.7%, while prices for meat and poultry decreased by 0.4%, eggs became more expensive by 13.5%, and the price for unpasteurized milk increased by 13.6%.

Based on December 2009, prices for agricultural products in annual terms decreased by 12.7%. At that, the plant production became cheaper by 23.0%, and animal products appreciated in price by 1.2% (figure 7).

figure 7

Dynamics of the agricultural price index
(as % of the respective month of the previous year)
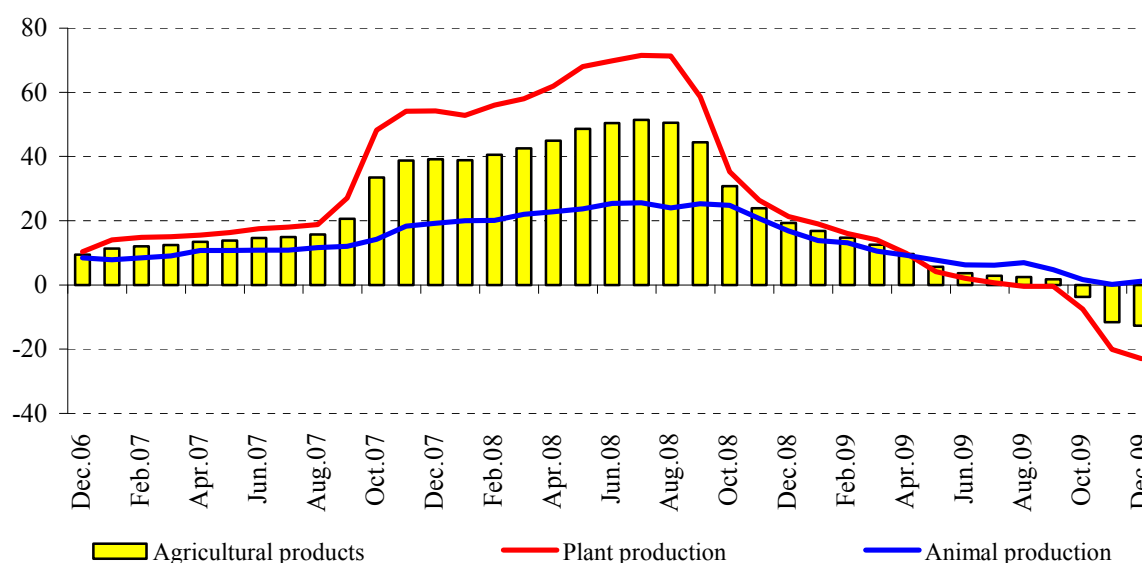
Source: Statistics Agency of the Republic of Kazakhstan

1.3.3. Enterprise Monitoring

In Q4 2009 as compared to the previous quarter there was a further decrease in demand for final products of enterprises. This is evidenced by the change in a generalized indicator – diffusion index of the change in the demand for final products – to 44.5 from 46.8 in Q3 2009 (figure 8). The decrease in the indicator was noted by 31.6% of interviewed enterprises (in Q3 2009 – 28.1%), the increase – by 20.5% (in Q3 2009 – 21.7%).

The reduction in the demand occurred in such sectors of the economy as "construction", "trade", agriculture", "real estate operations" and "manufacturing industry". Growth of the indicator was observed in such industries as "production and distribution of electric energy, gas and water", "hotels and restaurants" and "mining industry".

In Q1 2010 as compared to Q4 2009 a slowdown of reduction in the demand for final products is anticipated in the economy as a whole: diffusion index of the change in the demand grew up to 47.9. The increase in the demand for finished products is anticipated by 14.8% of enterprises participating in the survey, and the decrease – by 19.1%.

The situation with prices for finished products of enterprises in Q4 2009 was characterized by the further slowdown 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 53.0 (in Q3 2009 – 54.5). The percentage of enterprises with decreased prices for their products as compared to the previous quarter remained virtually unchanged making 12.7% (in the previous quarter – 12.6%), and the percentage of respondents who noted the increase in the indicator went down to 18.6% (in Q3 – 21.7%).

The slowdown of growth in prices have occurred in the majority of economic sectors except for the mining industry where this indicator virtually remained at the level of the previous quarter. In agriculture reduction of prices for finished products slowed down as compared to the previous quarter.

In Q1 2010 the diffusion index of the change in the prices for finished products grew up, as compared to the previous quarter, to 57.9. This is primarily associated with an increase in a percentage of enterprises anticipating the increase in prices – to 21.1% (in Q4 2009 – 18.6%). At the same time, the percentage of enterprises anticipating the decrease in prices decreased notably – to 5.4% (in Q4 2009 – 12.7%).

In Q4 2009 there was a slowdown of growth rates in prices for raw commodities and materials, which remain at a high level in the economy as a whole: diffusion index of the change in the prices for raw commodities and materials was 68.8. The slowdown in the growth rates occurred in such industries as "agriculture", "construction", "production and distribution of electric energy, gas and water" and "manufacturing industry". The growth in prices was observed in such industries as "hotels and restaurants", "mining industry", "transport and communications", "real estate operations" and "trade".

Based on the sample as a whole, the number of enterprises which noted the increase in prices for raw commodities and materials went down to 47.9% (in Q3 – 51.7%). The number of enterprises which noted the decrease in prices for raw commodities and materials didn't change significantly as compared to the previous quarter amounting to 3.1% (in Q3 2009 – 3.4%).

In Q1 2010 the diffusion index of the change in the prices for raw commodities and materials went down to 67.5 meaning that enterprises anticipate a further growth in prices but at lower rates. At the same time, the percentage of enterprises anticipating a growth in prices in Q1 2010 remains high (43.4%), and the percentage of enterprises anticipating the decrease in the indicator decreased to 1.2% (figure 8).

Thus, based on the dynamics of relevant diffusion indices, anticipations of enterprises about the 1st quarter of 2010 are primarily associated with the increase in prices for final products and with some slowdown in the growth of prices for raw commodities and materials.

figure 8

Diffusion indices of the change in demand and prices

Diffusion index of the change (growth/decrease) in demand for final products
Diffusion index of the change (growth/decrease) in prices for final products
Diffusion index of the change (growth/decrease) in demand for raw commodities and materials
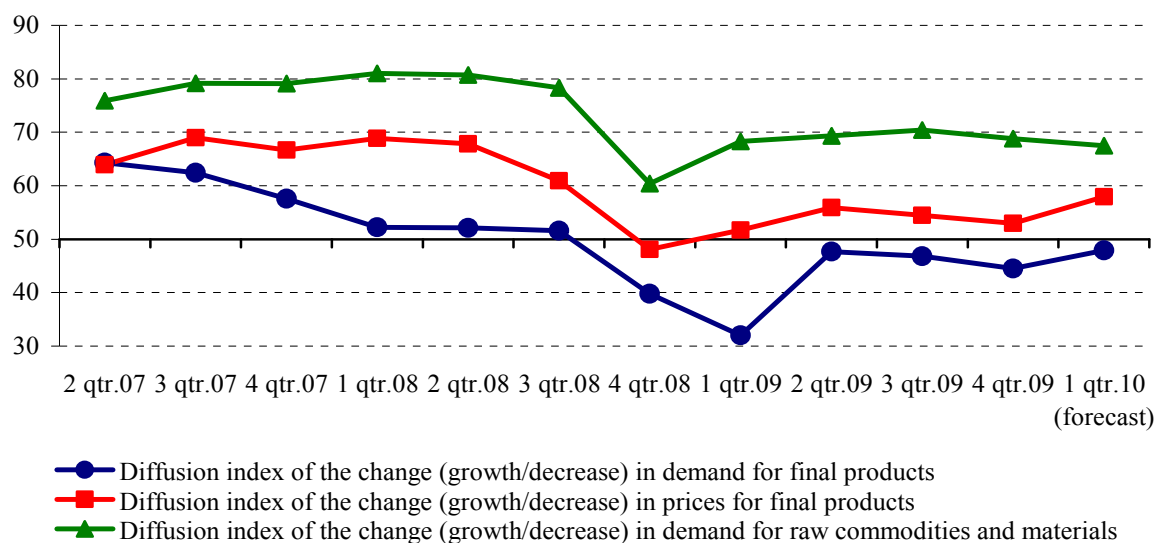
Source: National Bank of the Republic of Kazakhstan

2. Inflation Factors

2.1. Aggregate Demand

In Q3 2009 the GDP based on the final consumption method according to estimates as compared to the respective quarter of 2008 increased in real terms, according to the estimate, by 11.9% (in the previous quarter – decrease by 5.9%).

The reason for the GDP growth was an increase of its all three key components: spending on final consumption of goods and services (by 4.1%), gross formation (by 13.4%), net exports (by 103.1%). A significant drop in imports as compared to exports resulted in the increased gap between these components thus causing such significant growth in the net exports.

Net exports' contribution to the GDP growth accounted for 5.8%, by households – 3.4%, gross fixed capital formation – 3.1% (figure 9).

figure 9

Contribution of components of aggregate demand to the growth in GDP, %
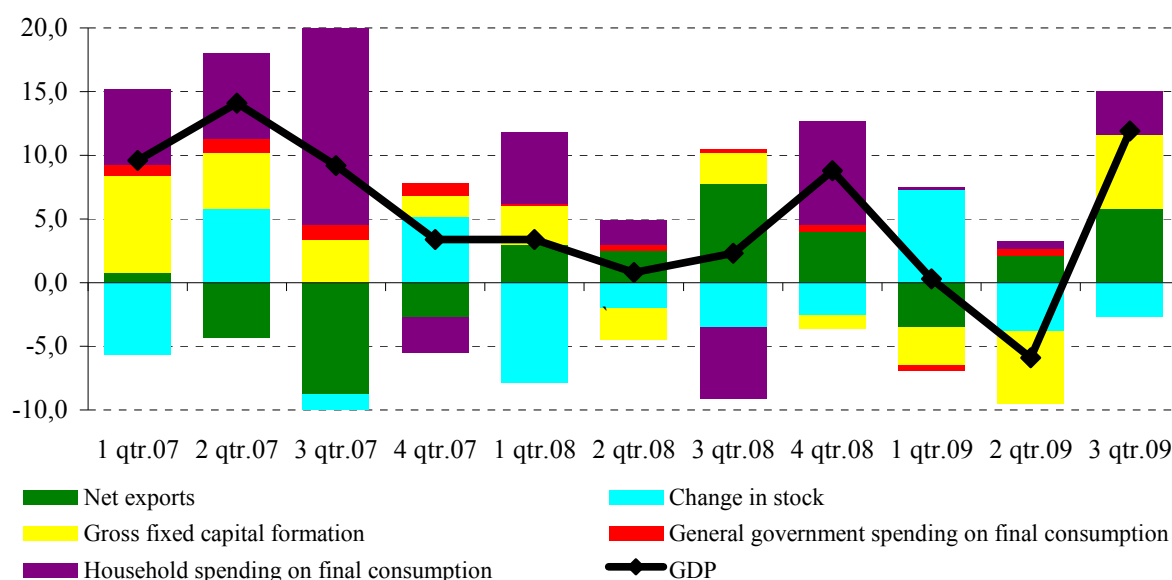
Source: Information by the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

2.1.1. Individual Consumption and Investment Demand

Household spending on final consumption in Q3 2009 increased as compared to the respective period of 2008 by 5.4% (in Q2 2009 – growth by 1.0%).

The growth of per capita income in real terms continued to slow down making 2.1% (in Q2 2009 – growth by 2.9%), and retail sales reduced by 15.3% (in Q2 2009 – decrease by 13.1%) (figure 10).

figure 10

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

Source: Information by the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan
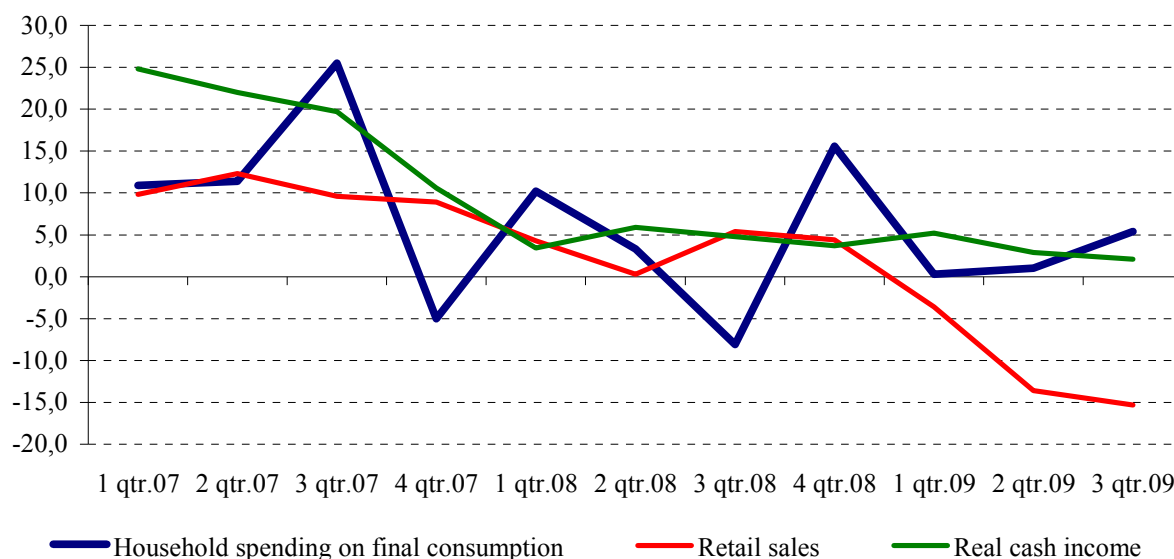
Against the backdrop of slowdown of real cash income and the decrease in retail sales, the growth in household spending may be caused by the following factors:
- change in the consuming behavior patterns among the population with regard to the increase in the extent of rationality of purchases and increased significance of a commodity price, due to that preference to a greater extent is made to purchases in the public markets and via unorganized (street) trading;
- change in the financial behavior patterns among the population with regard to the increased process of mobilization of cash income, which caused the growth of savings volumes of natural persons with banks by 14.3% in Q3 2009;
- impact of the seasonality factor since the household spending on final consumption also includes consumptions of goods and services in kind produced for own consumption and received as a labor compensation.

In Q3 2009 as compared to the respective period of 2008 a total volume of spending on gross savings in the GDP structure increased by 13.4%, making positive contribution to the GDP growth of 3.1%. The increase in gross formation was mainly caused by the growth of spending on gross fixed capital formation, which increased by 23.1% (figure 10).

Despite the growth in the volumes of gross fixed capital formation in the GDP structure, investment activity in the economy in Q3 2009 declined. A significant role in maintaining investment activity is played by the foreign capital inflow. Foreign fixed capital investments in nominal terms increased in Q3 2009 as compared to the same period of 2008 by 65.4%, investments from the budget funds – by 24.5%, investments from own funds decreased by 16.9%, from borrowed funds –by 4.9%. As a result, the volume of fixed capital investments decreased in real prices, according to the estimate, by 3.8% (figure 11).

figure 11

**Dynamics of spending on investments in fixed capital
(as % of the respective period of the previous year)**
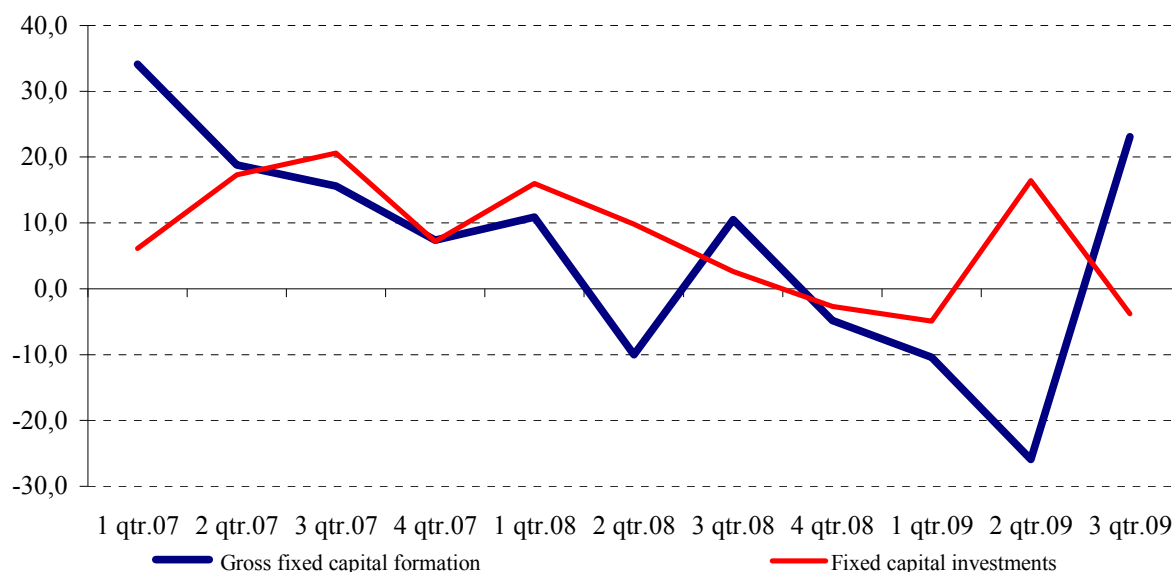
Source: Information of the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

2.1.2. Government Consumption

Spending on final consumption by general government in Q3 2009 as compared to the respective period of 2008 increased, according to the estimate, by 0.5% (in Q2 2009 – by 7.3%).

During Q3 2009 the state budget spending totaled to KZT 1 020 bln. or 9.1% of GDP. As compared to the indicators for the respective period of 2008, it decreased by 2.4%.

Current state budget expenditures increased by 19.3% as compared to the respective period of 2008 and were secured by the increased costs on service purchases, costs on wages and current transfers to natural persons. Capital expenditures of the state budget in Q3 2009 decreased by 4.4% as compared to the respective period of 2008, mainly because of the decrease in expenditures for fixed capital acquisition and formation. In Q3 2009, the volume of domestic budget credits amounted to 4.6% of the level of Q3 2008. Expenditures related to financial asset purchases decreased by 70.9% as compared to the respective period of 2008.

In Q3 2009, state budget revenues amounted to KZT 875.4 bln. or 7.8% of GDP, which is by 5.4% less than in the respective period of the previous year. In the structure of the state budget revenues two items keep prevailing: tax revenues (60.3%) and official transfers (35.9%). High percentage of official transfers was secured by the receipt of the guaranteed and targeted transfers from the National Fund of the Republic of Kazakhstan to the republican budget in the amount of KZT 299.1 bln. and KZT 15 bln., respectively.

As a whole, in Q3 2009 indicators of tax revenues decreased by 32.2% as compared to the respective period of 2008, the decrease was due to the reduced revenues from corporate income tax and value-added tax.

As compared to Q3 2008, in Q3 2009 the volume of non-tax revenues increased significantly by 59.9%, and revenues from the fixed capital sales remained at the existing level.

As the state budget expenditures were in excess of revenues, in Q3 2009 the deficit of KZT 145.0 bln. (1.3% of GDP) showed up whereas in Q3 2008 the deficit was KZT 119.8

bln. (figure 12). It should be noted that without transfers from the National Fund of KZT 314.1 bln., Q3 2009 would have ended with the non-oil deficit of KZT 459.1 bln.

figure 12

Execution of the state budget, % of GDP
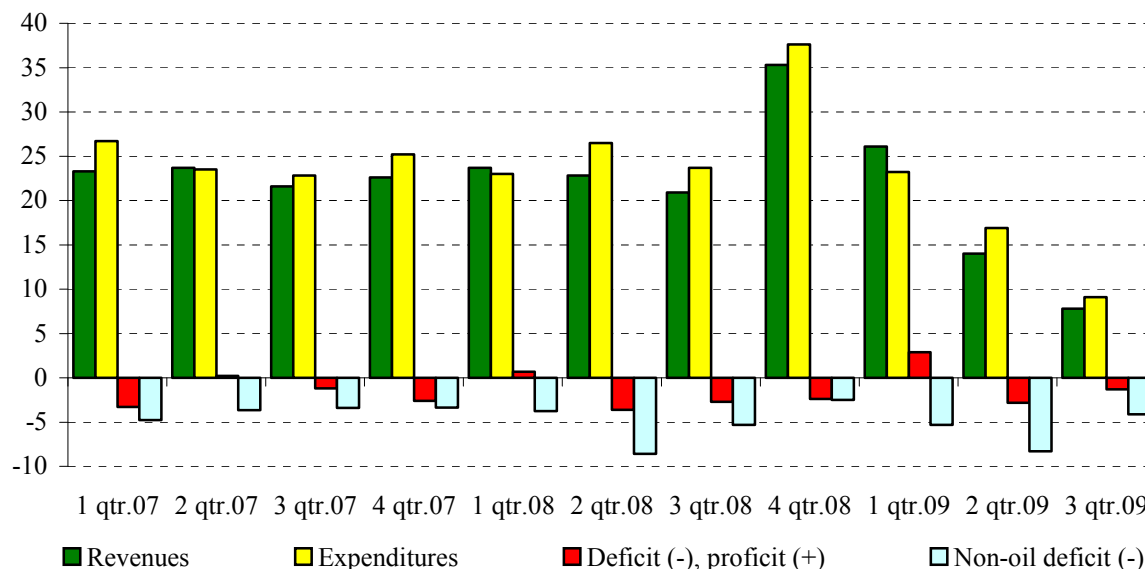
Source: Ministry of Finance of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

During Q3 2009 the Ministry of Finance borrowed KZT 216.2 bln. mainly (by 98.4%) by issuing government issue-grade securities. During the same period debentures were also extinguished on securities issued earlier for the amount of KZT 55.6 bln. As a result, account balances of the Government of the Republic of Kazakhstan with the National Bank increased by KZT 15.6 bln.

Government domestic debt for Q3 2009 increased to KZT 1 120.1 bln. (7.2% of GDP), i.e. by 16.6% as compared to the performance in Q2 2009 (6.2% of GDP) and was secured by the issue of government long-term treasury bonds and medium-term obligations (MEOKAM). The Government's external debt in Q3 2009 increased by 3.5% as compared to the indicator in Q2 2009 (1.5% of GDP) and amounted to US$1.6 bln. (1.6% of GDP).

2.1.3. External Sector

– **World Prices**

In Q3 2009 the situation in the global commodities markets was characterized by the volatility of prices for certain commodities. So, in July-September 2009 world prices for copper increased by 23.6% and were on average at $US 5859 per ton during the period, for lead – by 31.7% and 1952.8 cents per kilo, for zinc – by 21.0% and 176.1 cents per kilo, respectively. Prices for aluminum in July-August had an upward trend whereas in September they decreased insignificantly. In general, during Q3 2009 prices for aluminum increased by 16.5%, having reached US$1812 per ton, on average. (figure 13).

figure 13

Dynamics of world prices for metals
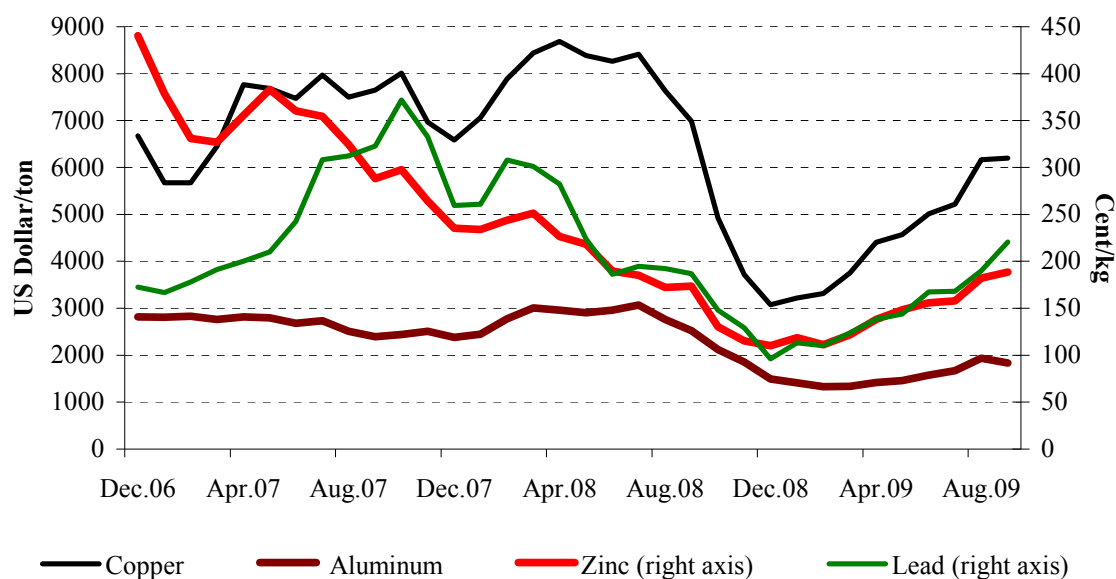
Source: World Bank

In July-September 2009 world oil prices remained volatile without a stable trend. So, in July prices had a downward trend, in August they started gradually growing again, and in September oil prices dropped below the average monthly level of June 2009. On the whole, over Q3 2009 oil prices (Brent) decreased by 1.4% and were on average at US$ 68.4 per barrel (figure 14).

World prices for wheat were also unstable, and during Q3 2009 they demonstrated a steady downward trend. In general, over July-September 2009 the world price for wheat (Canada) decreased by 20.7% and was at US$ 271.2 per ton.

figure 14

Dynamics of world prices for oil (Brent) and wheat (Canada)
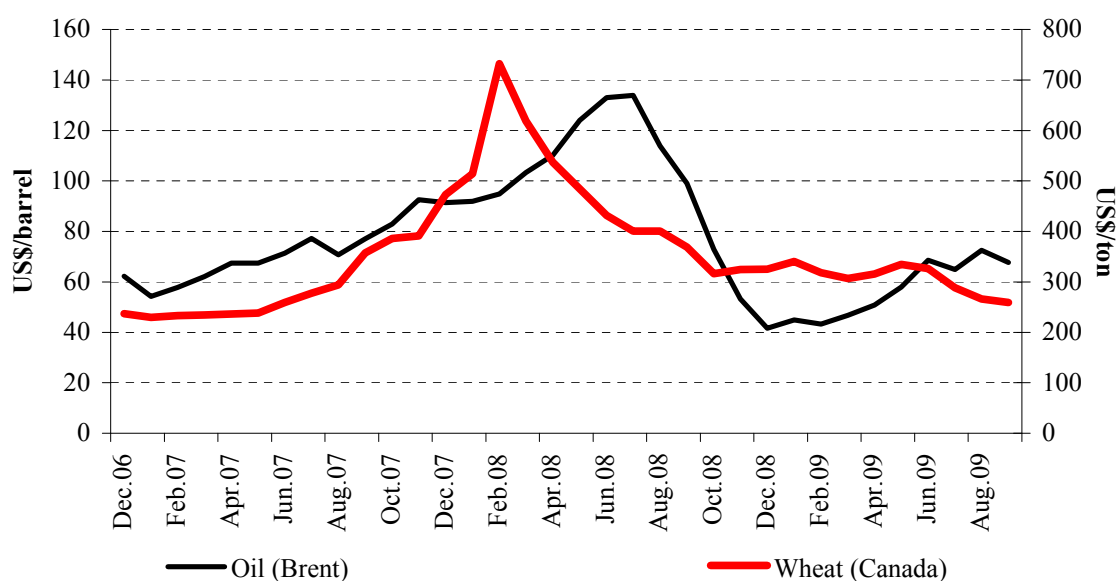
Source: World Bank

− **Balance of Payments**

Based on Q3 2009, the current account balance deficit was at the level of US$ 544.5 mln. (figure 15).

figure 15

Current account balance, US$ mln.

Proceeds from commodity exports in Q3 2009 decreased by 41.9% as compared to Q3 2008, whereas expenditures on commodity imports – by 33.1%. Thus, trade balance was at US$ 4.9 bln., having decreased by more than twice as compared to the respective period of 2008. The deficit in the balance of services as compared to Q3 2008 decreased by 6.6%, the deficit in the income balance – by 31.1%. Net payments to non-residents under current transfers decreased by 39.1%.
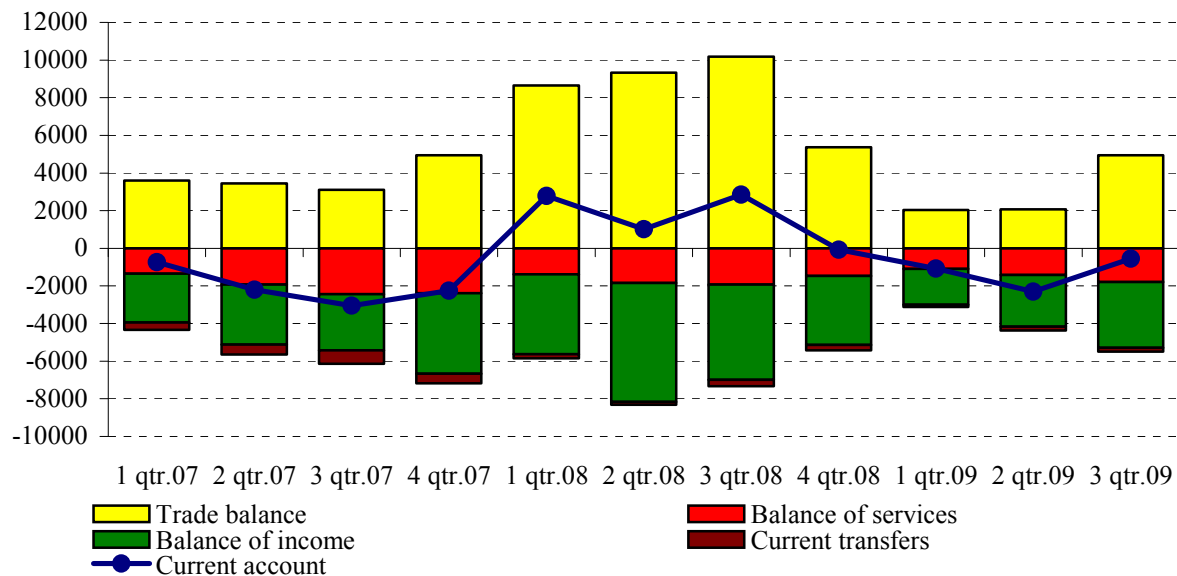
The net inflow of resources on financial account operations was US$ 2.3 bln. (in Q3 2008 – US$ 1.3 bln.). Foreign assets of residents (except for reserve assets) increased in Q3 c2009 by more than US$ 2.0 bln., being by 2.6 times less than the increase in the respective period of 2008. Foreign liabilities of residents increased by US$ 4.3 bln., being by 1.5 times less than the same indicator in Q3 2008.

As a result, the positive balance of payments for Q3 2009 amounted to US$ 1.8 bln. (in Q3 2008 - US$ 1.2 bln.).

− **Terms of trade and the real effective exchange rate**

In Q3 2009 the aggregate terms of trade index was by 34.4% lower than that for Q3 2008 Alongside with that, the terms of trade with the Euro zone countries deteriorated by 59.2%, and with Russia – by 16.4%. (table 1).

table 1

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

	Q1 08	Q2 08	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09
Export prices	56.1	61.1	61.9	8.0	-47.0	-52.5	-44.9
Import prices	27.6	44.9	57.1	29.7	-1.2	-15.8	-18.2
Terms of trade	**20.2**	**12.0**	**3.5**	**-17.0**	**-45.8**	**-42.4**	**-34.4**

| including:							
The Euro zone countries							
Export prices	54.4	62.5	63.5	-0.1	-54.2	-56.5	-49.9
Import prices	15.8	29.5	51.9	27.5	17.7	0.1	12.8
Terms of trade	**28.3**	**27.7**	**9.5**	**-22.5**	**-57.8**	**-57.9**	**-59.2**
Russia							
Export prices	30.1	37.6	34.6	8.6	-28.3	-36.2	-35.8
Import prices	42.8	48.9	47.6	22.7	-28.6	-25.5	-23.2
Terms of trade	**-8.9**	**-7.9**	**-9.0**	**-11.9**	**0.4**	**-15.0**	**-16.4**

Source: National Bank of the Republic of Kazakhstan

Based on Q3 2009, as compared to the previous period, the index of the real effective exchange rate of the Tenge depreciated by 2.9%. The Tenge has appreciated versus the CIS currencies basket by 1.9%, %, versus the basket of other currencies – by 3.2%.

Over Q3 2009 the Tenge has appreciated in real terms against the US Dollar by 0.3%, it devaluated by 3.5% 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%)
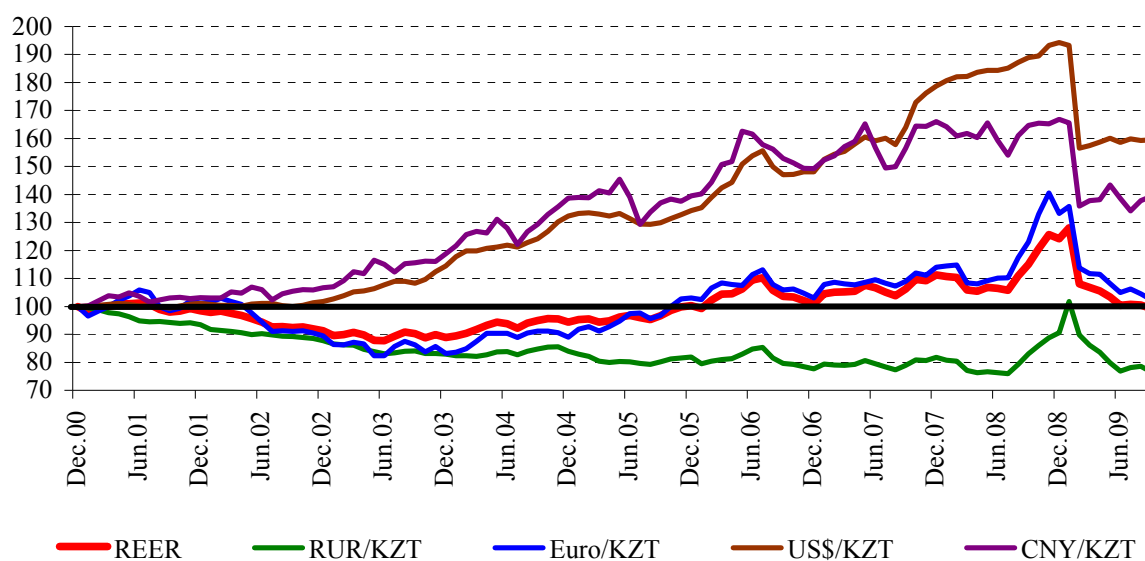
Source: National Bank of the Republic of Kazakhstan

− **Nominal Exchange Rate of the Tenge**

In Q4 2009 the situation in the domestic foreign exchange market was relatively stable. In general, based on the quarterly performance, the exchange rate of the Tenge has appreciated versus the US Dollar by 1.6% – from KZT 150.95/US$ to KZT 148.46/ US$. Since the beginning of the year in nominal terms the Tenge has depreciated against the US Dollar by 22.9%.

Average weighted exchange rate of the Tenge for Q4 2009 at the stock exchange was KZT 149.68/US$. During the quarter the exchange rate of the Tenge versus the US Dollar was changing within the range of KZT 148.30-150.99/US$ (figure 17).

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.

figure 17

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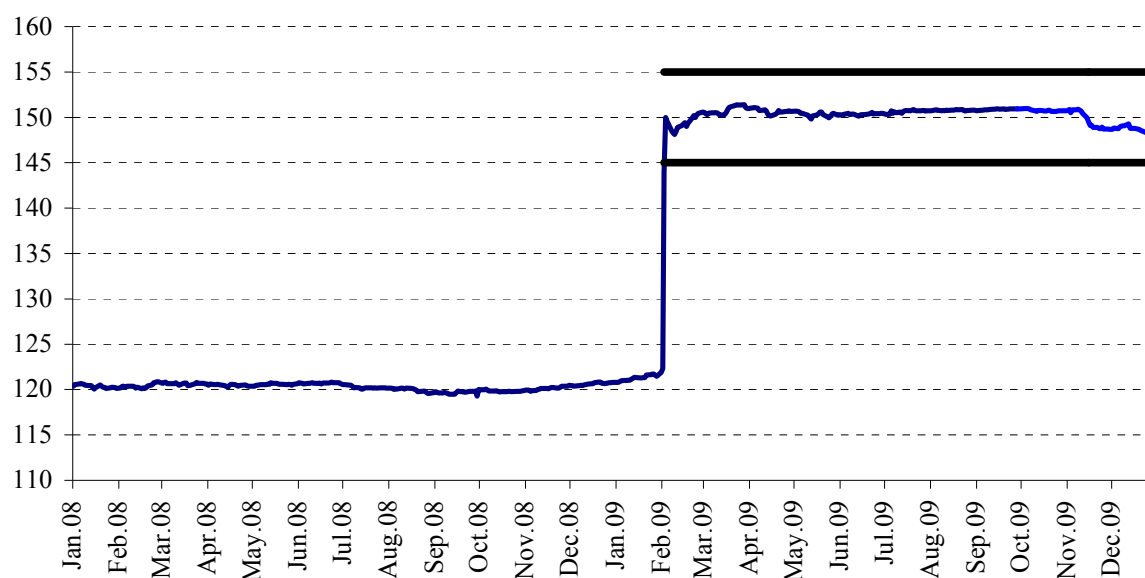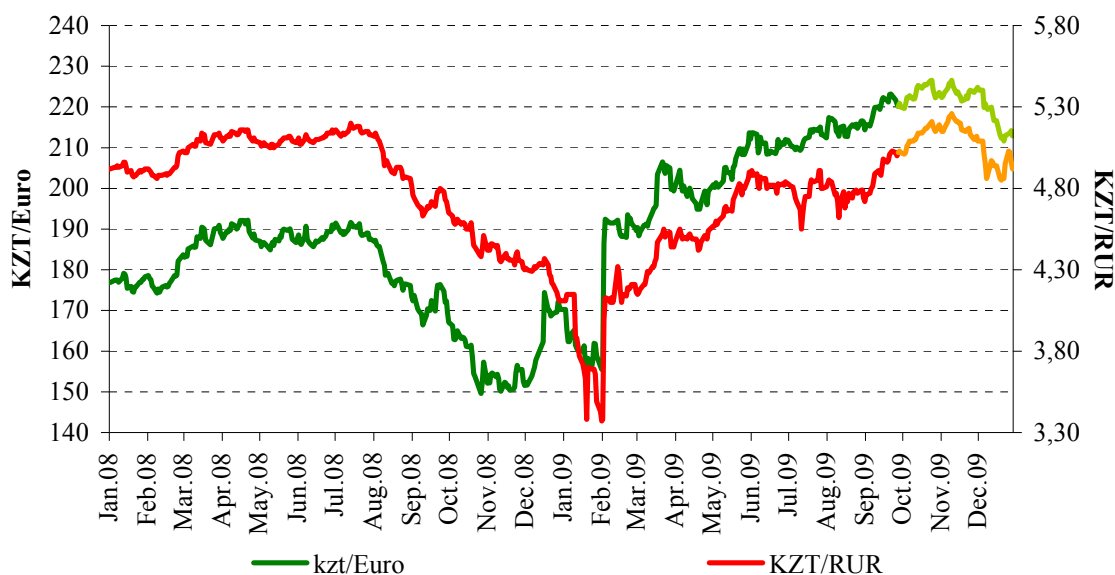

Source: National Bank of the Republic of Kazakhstan

On the whole, the official exchange rate of the Tenge in Q4 2009 appreciated against the Euro and the Russian ruble by 3.3% and 2.0%, respectively (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 GDP output in Q3 2009, according to the National Bank's estimates, amounted to KZT 4498.0 bln. in current prices. Being negatively influenced by the decrease in production in construction sector, transport, real estate operations, and financial activity, the GDP in real terms decreased, according to estimates, by 0.3% versus Q3 2008 (in Q2 2009 – decrease by 3.8) (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)
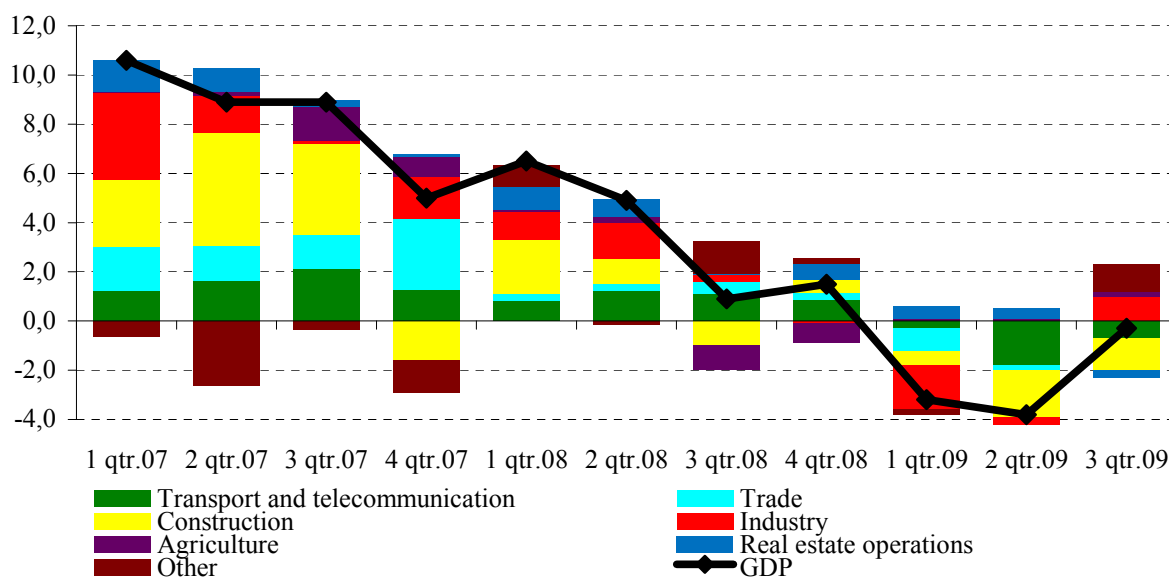
Source: Information of the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

Lowering in the depth of the GDP decline was to a greater extent caused by the improved situation in production of commodities, where the output volume reached 100% of the level of Q3 2008, after three consecutive quarters of recession.

In the reviewed period the index of physical volume in the transport sector in real prices, as compared to Q3 2008, decreased by 9.2%, in the construction sector – by 7.7%, real estate operations – by 4.1%, financial activity – by 26.6%, bringing a negative contribution to the GDP formation. The growth rates in agriculture, public administration, and healthcare slowed down, with their indices going down to 101.4%, 105.2%, and 103.8%, respectively. At the same time, the situation in industry and trade improved where indices grew up to 104.4% and 100%, the growth rate in communications (111.2%) and education (103.4%) increased.

2.3. Labor Market

2.3.1. Employment and Unemployment

In Q4 2009 the number of people employed in the economy, according to tentative estimates, was 7.9 mln., having decreased by 0.2% versus the previous period. The decrease in the number of the employed was caused by the accomplishment of the key measures under the Road Map Project in the reporting quarter. At the same time, the number of employees reached 5.3 mln. (growth by 0.4%), self-employed – 2.7 mln. (decrease by 1.4%).

In the structure of employees, 4.3 mln. individuals (80.8% of all employees) were working in public and non-public institutions, for natural persons – 0.7 mln. individuals (13.0%), at farms – 0.3 mln. individuals (6.2%).

In Q4 2009 the number of unemployed amounted to 531 800 having decreased by 0.7% as compared to the previous period and by 4.9% versus Q4 2008 (figure 20).

figure 20

The structure of economically active population, mln. individuals

Source: Statistics Agency of the Republic of Kazakhstan

In October and November 2009 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 public administration, education, and healthcare, production and distribution of electric energy, gas and water. The largest

percentage of outflow of the employed was in the manufacturing industry, construction and financial activity.

Influenced by the seasonality factor, the number of the employed in agriculture decreased whereas the increased consumer activity by the year-end increased the number of employees in the area of trade.

The decreased number of employed people in some industries was offset by its growth in other industries, which resulted in the unchanged unemployment rate in Q4 2009, according to preliminary information, of 6.3% (figure 21).

figure 21

Actual unemployment rate, %
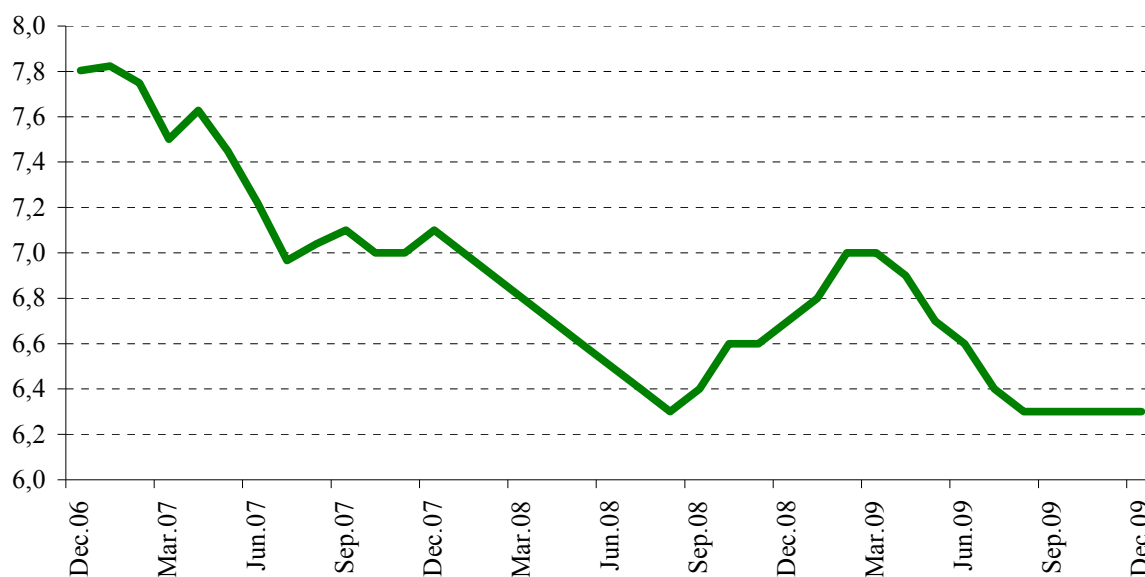
Source: Statistics Agency of the Republic of Kazakhstan

2.3.2. Wages and Productivity

In Q3 2009 the growth rate of nominal wages continued to slow down. Nonetheless, as compared to the respective period of 2008, average monthly wages increased in nominal terms by 8.7% (in Q2 2009 – by 10.2%).

The reduced inflation background contributed to the increase in wages in real terms, which increased by 2.2% versus the respective period of 2008.

In November 2009, as compared to November 2008, the highest increase in wages in nominal terms occurred in the public sector: in healthcare – by 26.7%, in the public administration sector – by 22.5%, in education – by 20.4%. Generally, the growth was observed in all sectors of the economy, except for ex-territorial entities, where nominal wages decreased by 0.4%.

The highest level of wages is still observed in the financial sector, mining industry and in the sector of the real estate operations, and the lowest – in fishery, agriculture, education, and healthcare.

The decrease in GDP against the backdrop of hidden unemployment in the labor market (making employees go on half-time, reduced work day, providing an unpaid leave), resulted, according to the National Bank's estimate, to decreased labor productivity in Q3 2009 by 1.7% (figure 22).

figure 22

**Dynamics of labor productivity and real wages
(as % of the respective period of the previous year)**
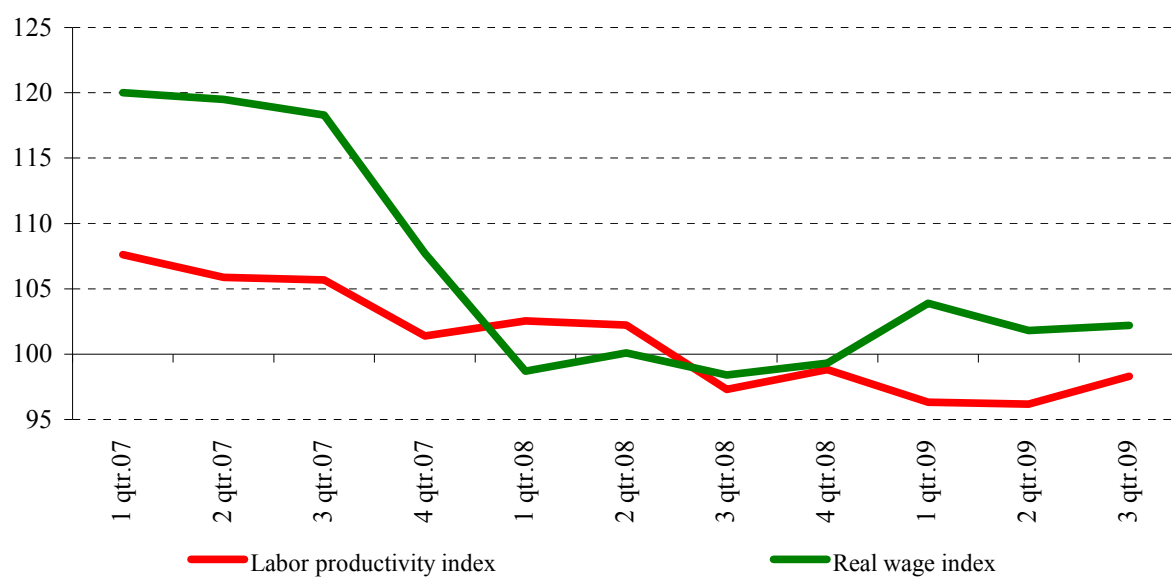
Source: Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan
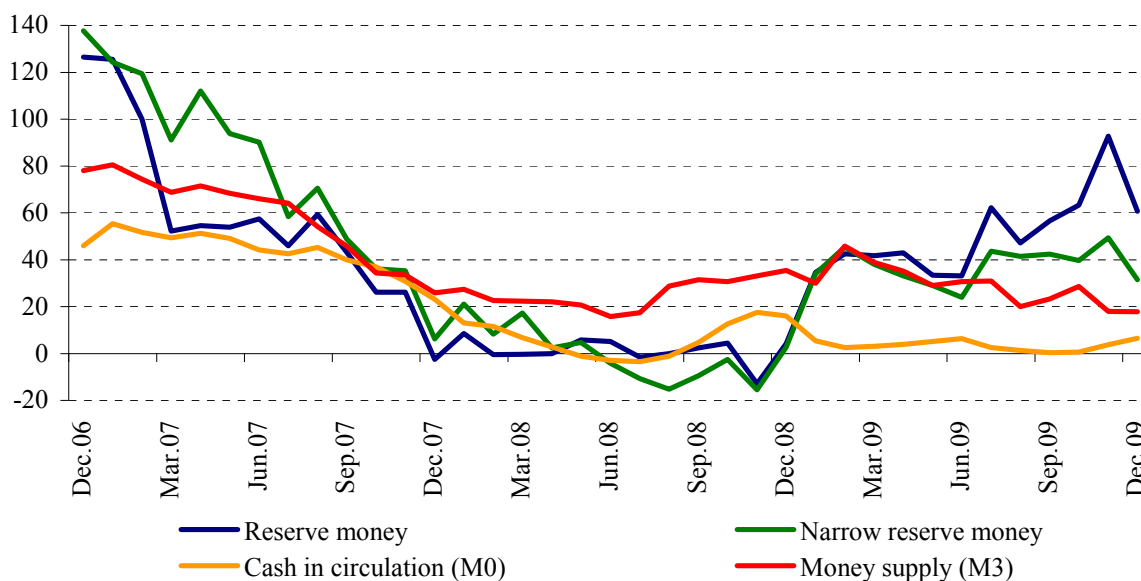
3. Money Supply

3.1. Monetary Aggregates

In Q4 2009 annual dynamics of monetary aggregates (excluding cash in circulation) demonstrated rather 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 has contracted over Q3 2009 by 10.8% and amounted to KZT 2451.2 bln. Narrow money also contracted in Q4 2009 by 10.9% to KZT 1962.1 bln.

In December 2009, as compared to December 2008, reserve money expanded by 60.7%. Such expansion was mainly ensured due to crediting of money of the NWF "Samruk-Kazyna" to correspondent accounts of some banks with the National Bank denominated in the Tenge.

Net international reserves of the National Bank increased by 14.2% to US$ 22.7 bln. in December 2009 as compared to December 2008. Within their structure, despite FX sales in the domestic foreign exchange market and operations on the servicing of the Government's external debt, net currency reserves increased as a result of increased balances of bank correspondent accounts in foreign currency with the National Bank and currency proceeds to the Government's accounts with the National Bank. Assets denominated in gold also increased.

In December 2009, as compared to December 2008, net domestic assets of the National Bank increased, mainly because of the significant increase in claims on financial institutions on refinancing loans (see 4. Monetary Policy Instruments and Operations).

Narrow reserve money in December 2009 expanded by 31.5% as compared to December 2008 (table 2).

table 2

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

	Q1 09	Q2 09	Q3 09	Q4 09
Net international reserves	**-2.2**	**-12.3**	**-8.7**	**14.2**
Net domestic assets	**108.2**	**143.6**	**153.5**	**167.0**
Net claims on the Government	-45.6	-108.1	-173.2	-902.5
Claims on financial institutions	203.8	231.8	188.6	184.3
Claims on the rest of the economy	4.1	-4.1	by 443.4 times	by 459.6 times
Other net domestic assets	-99.1	-122.9	-254.2	-205.7
Reserve money	**41.7**	**33.1**	**56.6**	**60.7**
Narrow reserve money	**38.0**	**24.0**	**42.4**	**31.5**

Source: National Bank of the Republic of Kazakhstan

3.1.2. Money Supply

During Q3 2009, money supply increased by 1.8% to KZT 7386.5 bln. In December 2009 as compared to December 2008, its growth accounted for 17.9% mainly 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)

	Q1 09	Q2 09	Q3 09	Q4 09
Net foreign assets	**599.2**	**1439.7**	**99.4**	**170.4**
Domestic assets	**10.6**	**9.5**	**10.7**	**2.1**
Claims on the Government	-117.3	-80.9	-75.4	-57.9
Claims on the economy	18.2	17.7	16.7	10.4
Other net domestic assets	-49.3	-48.9	-40.5	-42.8
Money supply	**38.9**	**30.6**	**23.3**	**17.9**
Cash in circulation	3.1	6.4	0.4	6.5
Deposits of residents	45.0	34.8	26.9	19.7

Source: National Bank of the Republic of Kazakhstan

In the structure of net foreign assets of the banking system in December 2009 as compared to December 2008 net foreign assets increased, both of banks and the National Bank. The growth of net foreign assets of banks was caused by revaluation of their volumes as a result of the Tenge devaluation implemented in February 2009 and by the decreased claims of non-residents on banks.

In December 2009 as compared to December 2008, the growth in the domestic assets of the banking system was secured by the increase in the volumes of credits to the economy, net claims on the Government, while other net domestic assets of the banking system decreased.

The analysis of the dynamics of the main components of money supply shows that outstripping growth rates of deposits of residents in the banking system were fixed as compared to the growth rates of cash in circulation. As a result, the share of deposits of residents in the structure of the money supply increased from 86.3% in December 2008 to 87.6%, based on December 2009.

The money multiplier decreased from 4.11 in December 2008 to 3.01 in December 2009 as a result of outstripping rates of growth in the reserve money as compared to the growth rates in the money supply. The reasons for that were the increased reserve ratio due to accumulation of significant excessive reserves by banks as well as the decreased cash preference ratio due to higher growth rates of deposits as compared to the growth in cash in circulation (figure 24).

figure 24

Dynamics of money multiplier and its components
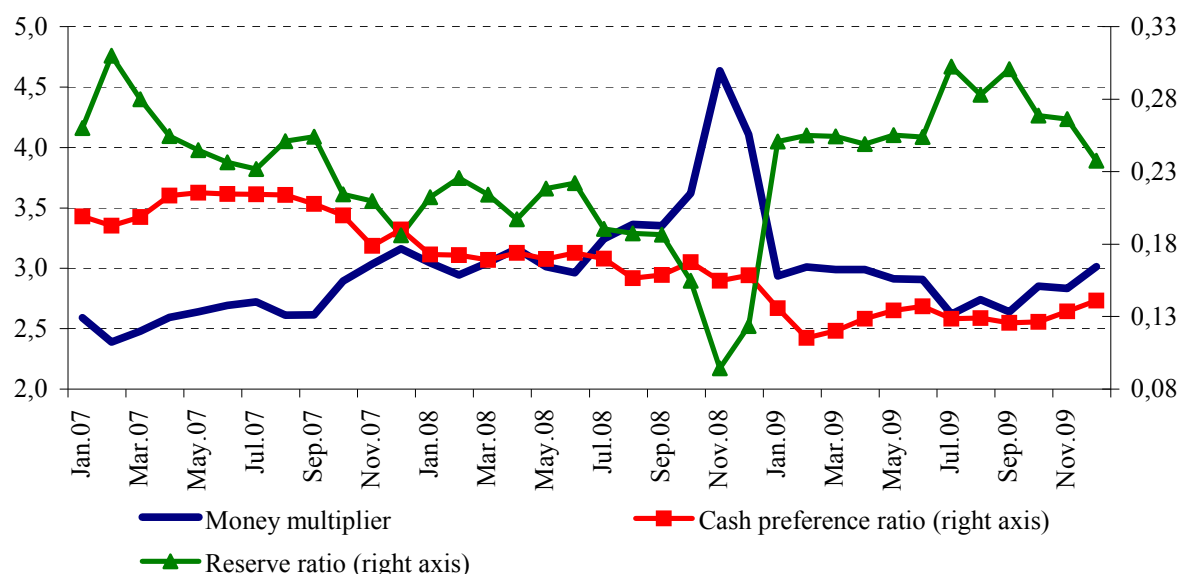
Source: National Bank of the Republic of Kazakhstan

3.1.3. Cash in Circulation

The volume of cash in circulation in Q4 2009 increased by 12.8% to KZT 913.5 bln. The main reason for the increase was the growth in net pay outs of wages, which at the same time was partially offset by the growth in net proceeds from the sale of goods, services and performed works, net foreign exchange proceeds, net proceeds from loans to natural persons and legal entities.

In December 2009 as compared to December 2008, cash in circulation increased by 6.5%. 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 Q4 2009 as compared to Q4 2008, payouts of cash from bank cashier departments increased by 1.4% to KZT 2877.6 bln., cash receipts to bank cashier departments decreased by 3.6% to KZT 2613.8 bln. As a result, net payouts from bank cashier departments amounted to KZT 263.7 bln.

3.2. Financial Market

3.2.1. Deposits of Residents

At end-December 2009 deposits of residents amounted to KZT 6 473.0 bln., having increased by 0.4% over Q4 2009. Deposits of legal entities decreased by 0.6%, deposits of natural persons increased by 3.1%.

As compared to the respective month of 2008, total volume of deposits of residents with depository institutions grew up by 19.7% in December 2009. At the same time, deposits of legal entities demonstrated the slowdown in growth whereas the dynamics in deposits of natural persons were characterized by the accelerating trend. Also, foreign currency deposits as before were growing at higher rates as compared to the Tenge deposits (table 4).

table 4

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

	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09
Deposits of residents	**39.1**	**45.0**	**34.8**	**26.9**	**19.7**
Deposits of the population	*2.8*	*7.3*	*10.6*	*20.7*	*28.5*
Transferable deposits	7.7	1.6	5.4	23.0	36.3
in the domestic currency	*10.1*	*-1.2*	*3.7*	*10.5*	*14.0*
in foreign currency	*-5.5*	*17.7*	*17.2*	*106.6*	*177.1*
Other deposits	2.2	7.9	11.3	20.4	27.5
in the domestic currency	*-6.9*	*-38.9*	*-30.0*	*-29.8*	*-7.2*
in foreign currency	*16.1*	*80.0*	*75.7*	*106.0*	*70.0*
Deposits of non-bank legal entities	*60.2*	*66.1*	*46.7*	*29.6*	*16.3*
Transferable deposits	48.2	110.6	95.4	79.2	64.5
in the domestic currency	*43.0*	*90.7*	*70.7*	*44.7*	*41.4*
in foreign currency	*71.9*	*189.4*	*195.3*	*202.9*	*152.7*
Other deposits	66.0	41.4	18.9	2.7	-4.4
in the domestic currency	*55.7*	*5.8*	*-2.5*	*-14.6*	*-12.3*
in foreign currency	*85.5*	*94.1*	*49.7*	*22.7*	*8.0*

Source: National Bank of the Republic of Kazakhstan

Measures taken by the government to maintain financial stability enhanced the level of confidence of the population in the banking system, which served as the basis for accelerated growth of the deposit base of natural persons whereas the decrease in volumes of funds coming as part of the anti-crisis actions caused a slowdown effect on the growth of deposits of legal entities.

The average weighted interest rate on the Tenge time deposits of non-bank legal entities was 4.5% in December 2009 (in December 2008 – 5.7%), and on deposits of natural persons – 10.0% (11.3%).

3.2.2. Credits to the Economy

In Q4 2009 the total debt of bank credits to the economy decreased by 4.8% to KZT 7 644.1 bln. Credits to the population decreased by 3.6%, and credits to legal entities – by 5.2%.

The lending volume increased by 2.5% versus December, including the increase in credits to legal entities by 5.8%, while credits to natural persons decreased by 4.8%.

The average weighted rate on credits to legal entities decreased in December 2009 as compared to December 2008 from 14.7% to 12.7%. The decrease in rates was observed both broken down by currencies and by maturities, which is in many respects related to the government's support of the economy through new lending at a rate lower than the market a well as through the refinancing of the existing debt.

The average weighted rate of credits to natural persons increased in December 2009 from 18.1% to 20.1%, at the same time the rate growth was observed in relation to credits

provided in the domestic currency, being caused by the increase in rates on short-term Tenge loans (from 23.6% to 32.2%) (figure 25).

figure 25

Dynamics of credits to the economy and their interest rates
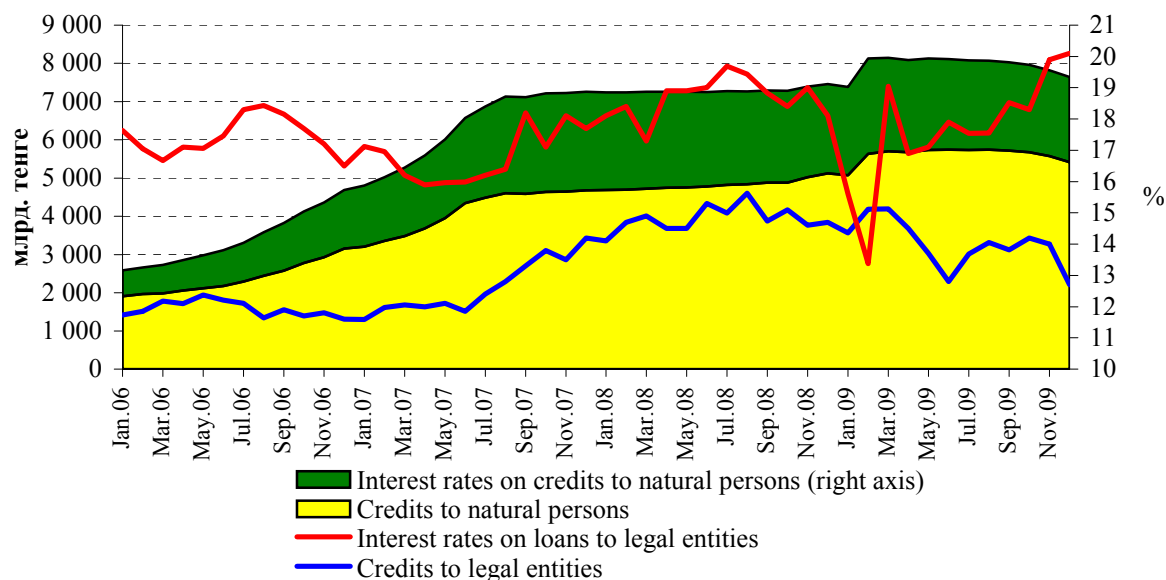
Source: National Bank of the Republic of Kazakhstan

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 (40.5%), trade (23.6%), construction (18.8%), and industry (9.5%).

−   **Credits to Legal Entities**

The volume of credits to legal entities increased by 5.8% in December 2009 as compared to the same period of 2008. Credits of legal entities in the domestic currency decreased by 2.6% in annual terms, and credits in foreign currency increased by 14.9% (without regard to the devaluation, the decrease accounted for 7.0%, according to the estimate) (figure 26).

figure 26

Dynamics of credits to legal entities
(as % of the respective period of the previous year)
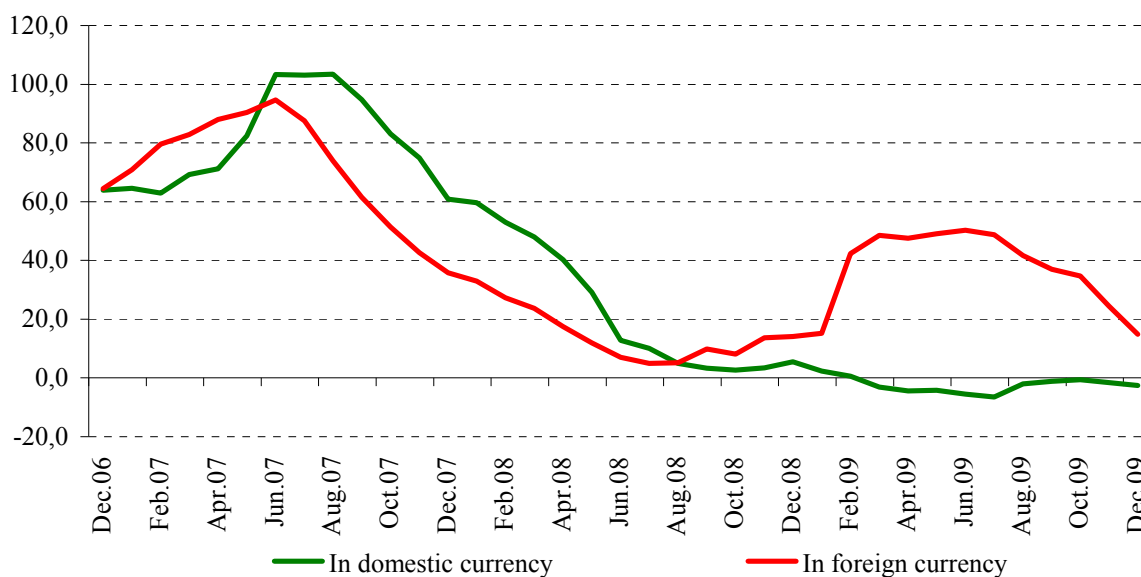
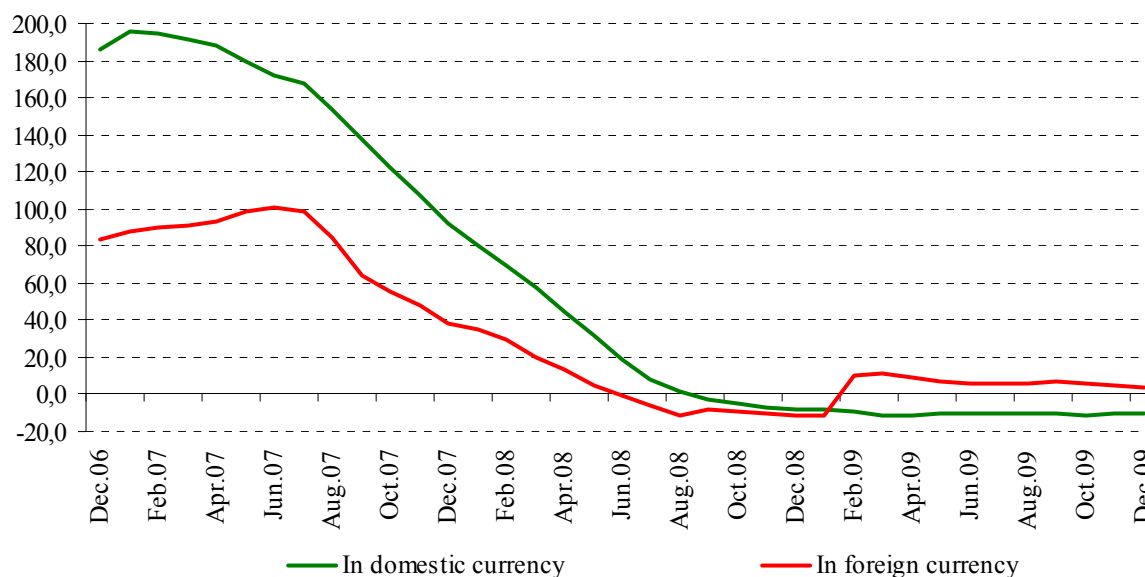Source: National Bank of the Republic of Kazakhstan

The share of medium- and long-term credits at end-December 2009 amounted to 78.7% in the total volume of credits to legal entities (in December 2008 – 71.9%).

− **Credits to the Population**

The volume of credits to natural persons decreased by 4.8% in December 2009, as compared to the same period of 2008. In the structure of credits to the population, credits in the domestic currency have demonstrated the decrease by 9.8% and credits in foreign currency demonstrated a growth by 4.2% (figure 27).

figure 27

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

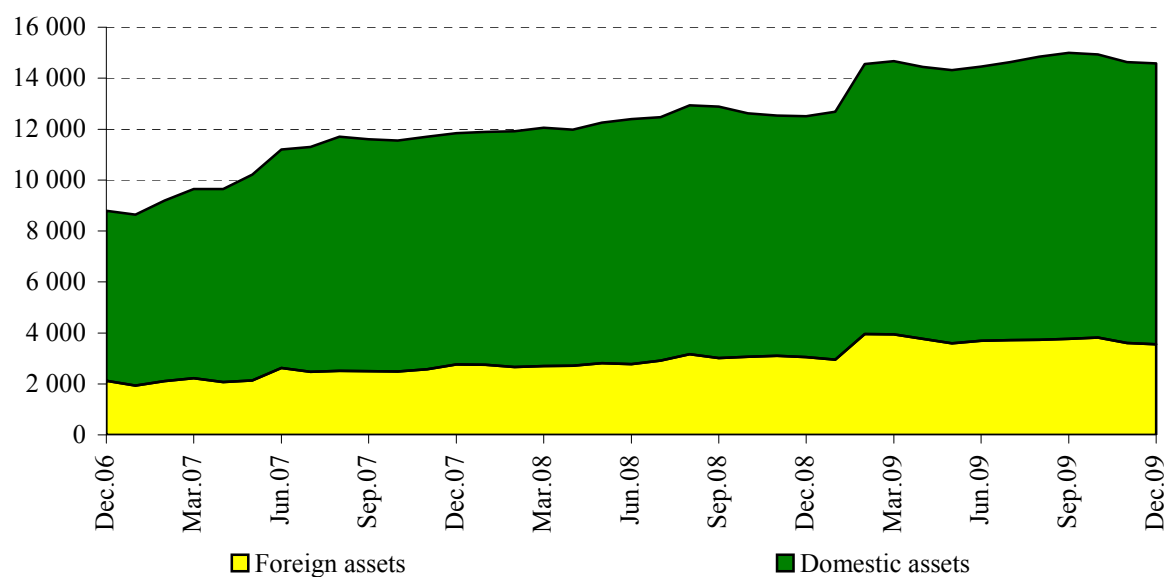Source: National Bank of the Republic of Kazakhstan

3.2.3. Bank Assets and Liabilities

− **Assets**

In Q4 2009, the amount of bank assets calculated under the Monetary Survey decreased by 2.7% to KZT 14.6 trln. Bank assets increased by 16.6% in annual terms (in December 2009 as compared to December 2008 (figure 28).

figure 28

Dynamics of bank assets, KZT bln.

Source: National Bank of the Republic of Kazakhstan

Foreign assets of banks at end-December 2009 accounted for 24.4% of the total volume of assets or US$ 23.9 bln. They have decreased by 5.8% as compared to September 2009 and compared to December 2008 they increased by 16.6%.

In the structure of foreign assets in December 2009, credits to non-residents reached 55.5% (in December 2008 – 53.7%), deposits placed with non-residents – 23.2% (in December 2008 – 25.5%), securities of non-residents – 5.1% (in December 2008 – 9.6%).

Domestic assets in December 2009 accounted for 75.6% or KZT 11.0 trln., where assets in the domestic currency amounted to 60.8% or KZT 6.7 trln., and assets in foreign currency – 39.2% or KZT 4.3 trln

figure 29).

During September-December 2009 domestic assets decreased by 1.7%, where assets in the domestic currency increased by 8.8% and assets in foreign currency decreased by 14.4%. In annual terms, the growth of these indicators reached 16.6%, 15.9% and 17.8%, respectively.

figure 29

Structure of bank assets, %
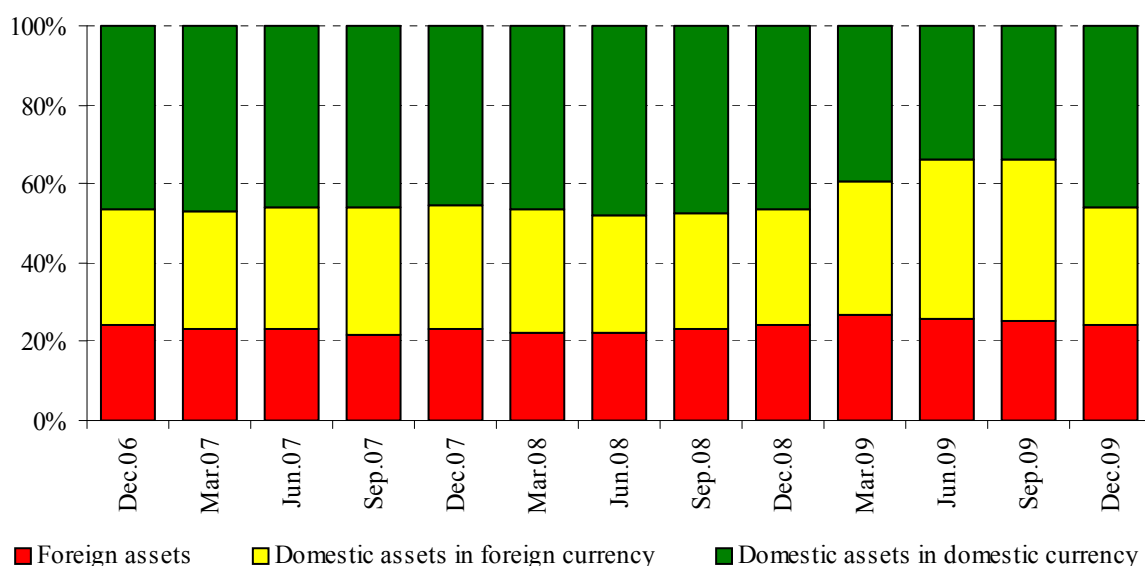
Source: National Bank of the Republic of Kazakhstan

In December 2009 as compared to December 2008, the quality of bank assets deteriorated dramatically. The percentage of bad assets increased from 3% to 30.6% while the percentage of standard assets decreased (from 60.4% to 25.4%) and doubtful assets increased (from 36.6% to 44.0%). Moreover, there is a migration of assets in the structure of doubtful assets towards the lower quality assets: the percentage of the 5th category increased (from 1.9% to 5.9%). This is an evidence of the remaining threat of a further reduction in the quality of bank assets.

A high level of credit risk and deteriorating quality of the credit portfolio still represent weak aspects of the Kazakh banking system. The quality of credit portfolio of Kazakh banks deteriorated virtually in all sectors of the economy. At the same time, the major portion of non-performing credits falls on two banks which are restructuring their liabilities – BTA and Alliance Bank.

- **Liabilities**

In Q4 2009, total bank liabilities calculated in line with the Monetary Survey decreased by 3.0% and amounted to KZT 11.5 trln. at end-December 2009. In annual terms (in September 2009 as compared to December 2008), bank liabilities increased by 15.2% (figure 30).

figure 30

Dynamics of bank liabilities, KZT bln.
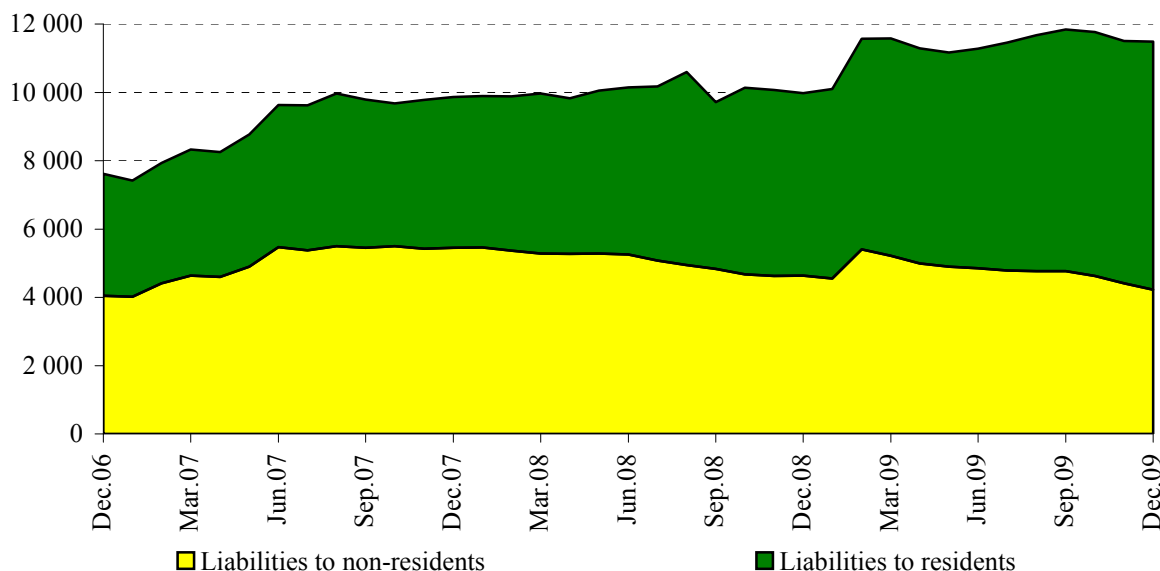
Source: National Bank of the Republic of Kazakhstan

Bank liabilities to non-residents decreased by 11.5% to US$ 28.4 bln. in December 2009 as compared to September 2009. In annual terms bank liabilities to non-residents decreased by 9.0%. At end-December 2009 they accounted for 36.8% of the volume of bank liabilities.

In the structure of bank liabilities to non-residents in December 2009, liabilities on deposits of non-residents increased to 12.0% from 6.6% in December 2008, liabilities on securities – from 5.1% to 9.4%. Credits from non-residents, however, decreased to 75.4% 86.1% in December 2008.

During September-December 2009, liabilities to residents increased by 2.7% to KZT 2.7 trln., where liabilities in the domestic currency increased by 11.0% to KZT 4.5 trln., foreign liabilities decreased by 8.3% to KZT 2.8 trln. In annual terms, the growth of these indicators accounted for 36.1%, 29.0% and 49.2%, respectively (figure 31).

At end-December 2009, the share of transferable and other deposits of non-government non-financial institutions in the structure of liabilities to residents decreased to 21.0% (in September 2009 – 22.8%). The share of deposits of non-government non-financial institutions decreased over the period from 28.9% to 26.8%, and the share of households' deposits remained virtually unchanged accounting for 26.1% (in September 2009 – 26.0%).

Thus, the global financial and economic instability continued its negative impact on the banking sector development in the 4th quarter. The reduced quality of the banks' credit portfolio remained one of the crucial problems. One more bank (JSC "Temirbank", subsidiary of JSC"BTA Bank) announced its technical default and started the process of restructuring and recapitalization.

Generally, as a result of the implemented set of measures for stabilization of the banking sector, bank liabilities to non-residents have gradually decreased, with their

percentage in the total liabilities decreasing from 46.5% at the beginning of 2009 to 36.8% at end-December 2009.

figure 31

Structure of bank liabilities, %
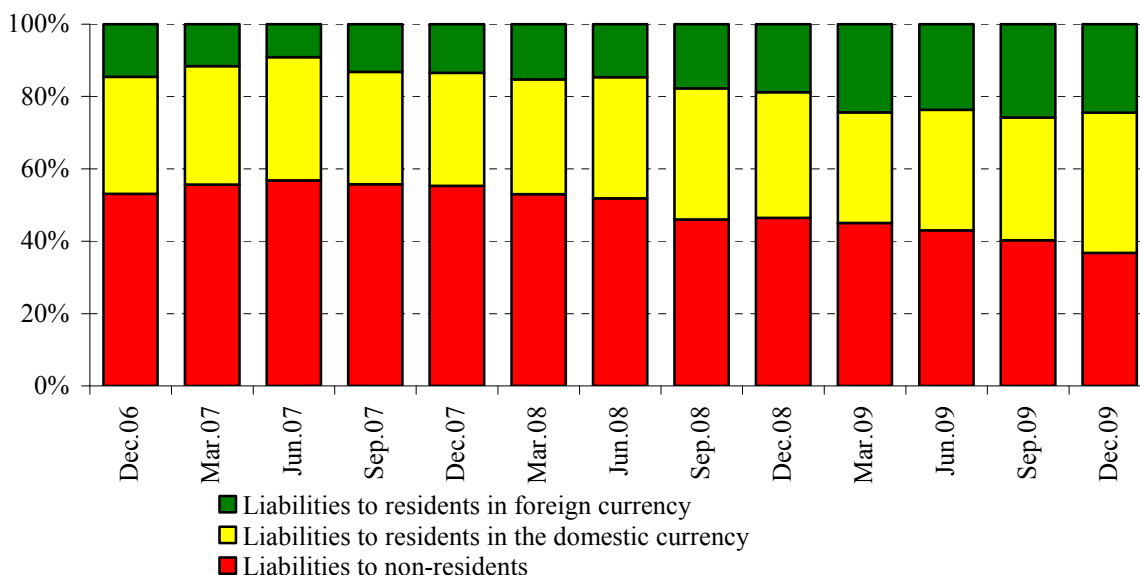
Source: National Bank of the Republic of Kazakhstan

3.2.4. Financial Market Rates

In Q4 2009 there was a decrease in the interbank market interest rates.

The KazPrime indicator decreased from 7.65% on average in Q3 2009 to 5.15% to on average in Q4 2009. This indicator was 6.30% at end-September 2009 and 2.71% - at end-December. (figure 32). The main factor for the decrease in the KazPrime rate is the increased volume of liquidity offered in the money market.
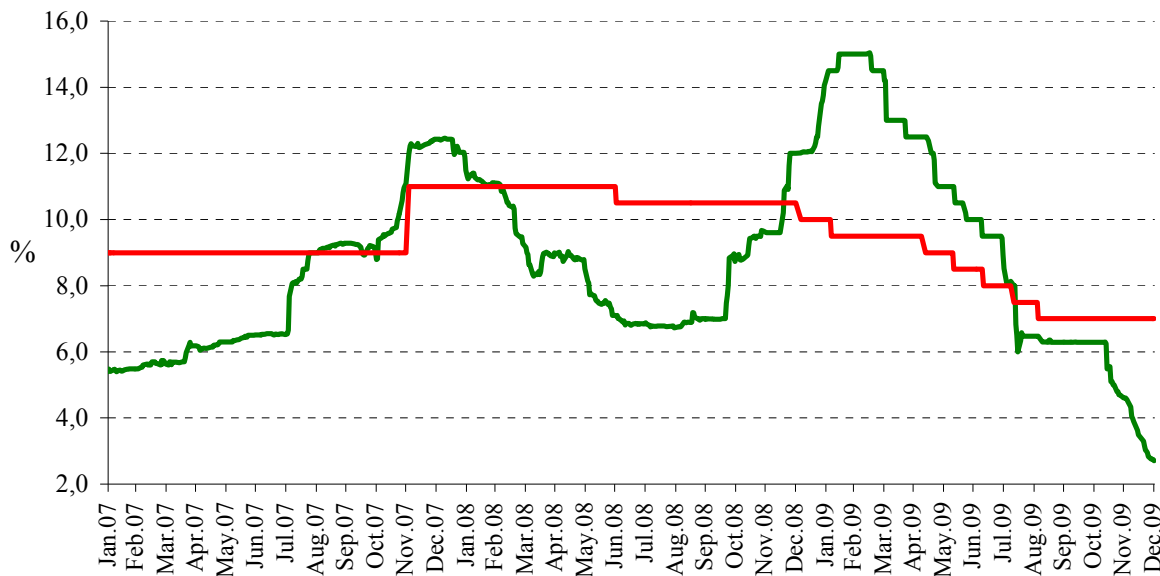
Rates on REPO operations also decrease.

The average weighted rate on 1-day operations in the sector of the automatic REPO in Q4 2009 decreased and was 0.43% (in Q3 2009 – 0.86%). Its maximum level was 0.90% and minimum – 0.12%.

Rate fluctuations on 7-day REPO operations in Q4 2009 were within the range of 0.22% to 1.63% (the average weighted rate was 0.62%), on 14-day REPO operations – from 0.40% to 2.00% (the average weighted rate was 0.70%), and on 28- day REPO operations – from 0.60% to 10.00% (the average weighted rate was 1.85%) (figure 33).
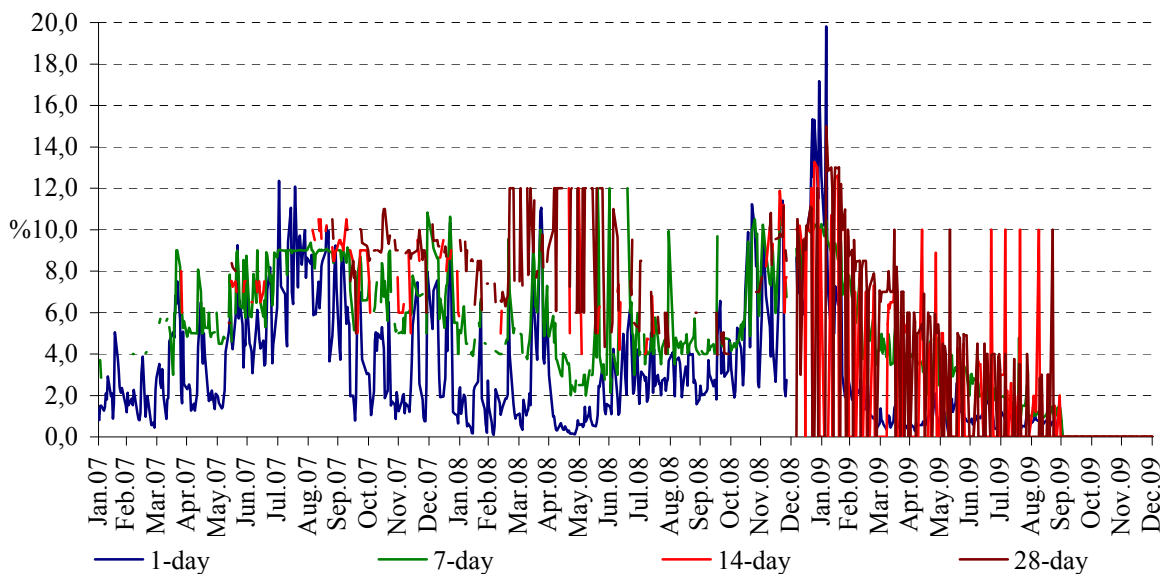
figure 32

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

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

figure 33

Dynamics of rates on REPO operations, %

Source: Kazakhstan Stock Exchange

The rate volatility in the money market remains high, this fact being related to the small capacity of the market, its insignificant depth, the lack of a sufficient quantity of collateral instruments, and low activity of the market participants. Moreover, often times market rates fall beyond the National Bank's rate band, and this fact doesn't allow regarding it as an effective instrument for stabilization of the money market rates. However, the situation with liquidity is improving and the decrease in the money market interest rates is a sign of a gradual stabilization.

The transaction volumes in the sector of the automatic REPO decreased by 8.8% in Q4 2009 as compared to the previous quarter and by 42.7% as compared to Q4 2008. At the

same time, the volumes on 1-day and 28-day REPO operations decreased as compared to Q3 2009, and as compared to Q4 2008 – on 1 day, 7-day and 28-day operations..
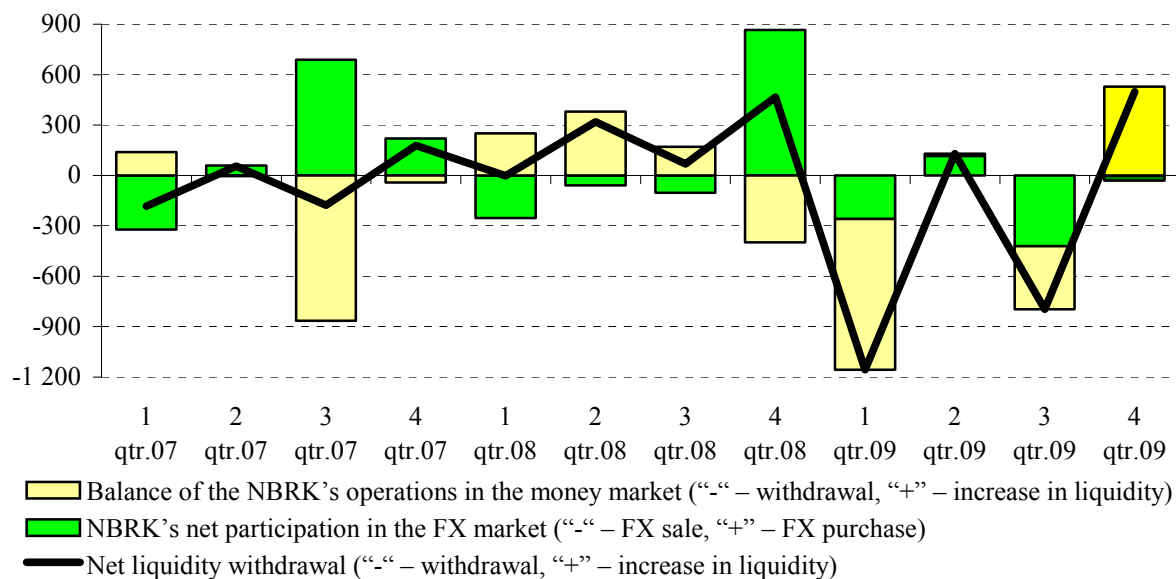
4. Monetary Policy Instruments and Operations

In Q4 2009, the situation in the financial market was stable, banks had sufficient Tenge liquidity.

During Q4 2009 the National Bank's operations in the financial market resulted in the provision of Tenge liquidity mainly from the FX purchases in the domestic FX market (figure 34).

figure 34

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

Balance of the NBRK's operations in the money market ("-" – withdrawal, "+" – increase in liquidity)

NBRK's net participation in the FX market ("-" – FX sale, "+" – FX purchase)

Net liquidity withdrawal ("-" – withdrawal, "+" – increase in liquidity)
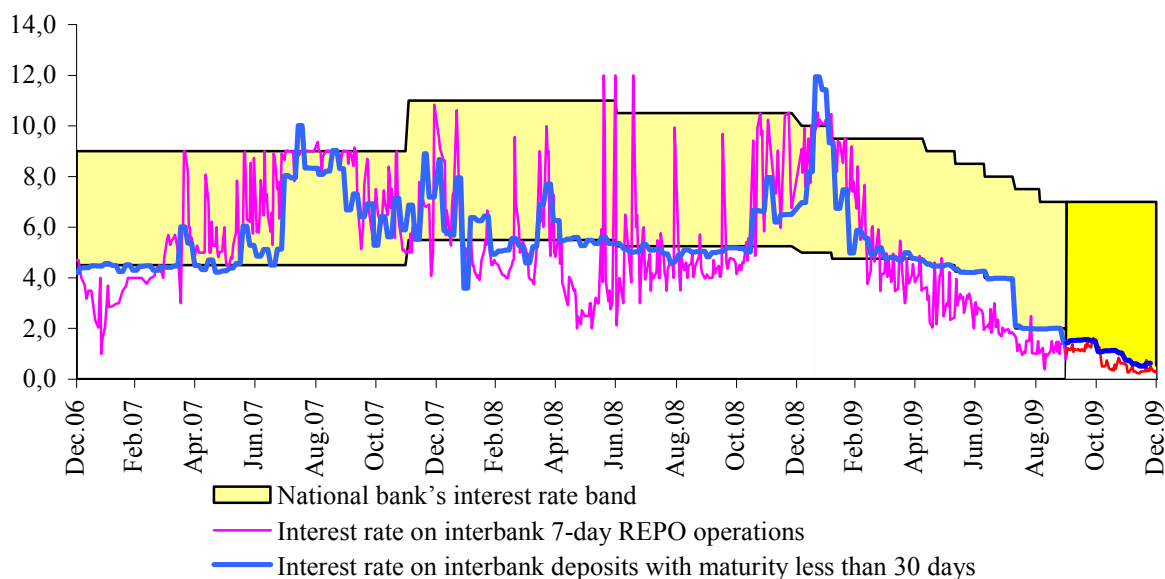
Source: National Bank of the Republic of Kazakhstan

In Q4 2009 the National Bank continued decreasing the rate on deposits attracted from banks. Throughout the period, interest rates on deposits had been decreasing by 50 basis points a month. From December 1, 2009 they were fixed at 0.5% on 7-day deposits and at 1.0% on 1-month deposits.

The official refinancing rate remained unchanged at 7.0% per annum.

Stabilization of situation with liquidity in the financial market was accompanied by gradual decrease in the money market rates. On average, in October-December 2009, 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 at 1.09% in Q4 2009. The average weighted rate on interbank 7-day REPO operations was 0.62% (figure 35).

figure 35

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

- National bank's interest rate band
- Interest rate on interbank 7-day REPO operations
- Interest rate on interbank deposits with maturity less than 30 days

Source: National Bank of the Republic of Kazakhstan

In Q4 2009 there was a growth in the bank correspondent account balances with the National Bank in the domestic currency whereas the foreign currency balances decreased, and this trend remained steady throughout the entire period (figure 36).

figure 36

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

□ Balance of the Tenge accounts   ■ Balance of the FX accounts
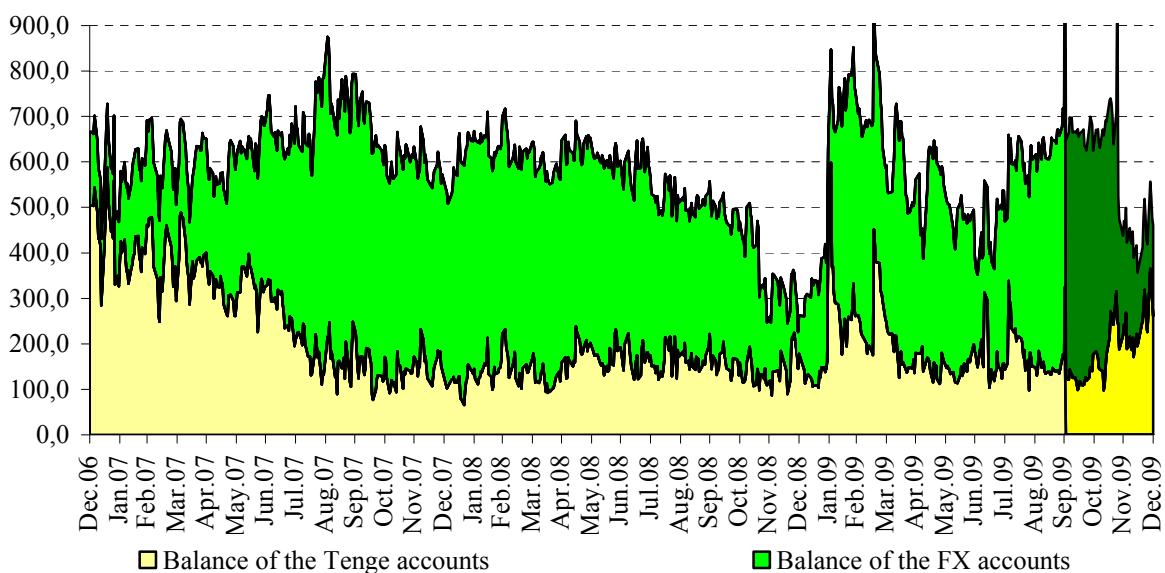
Source: National Bank of the Republic of Kazakhstan

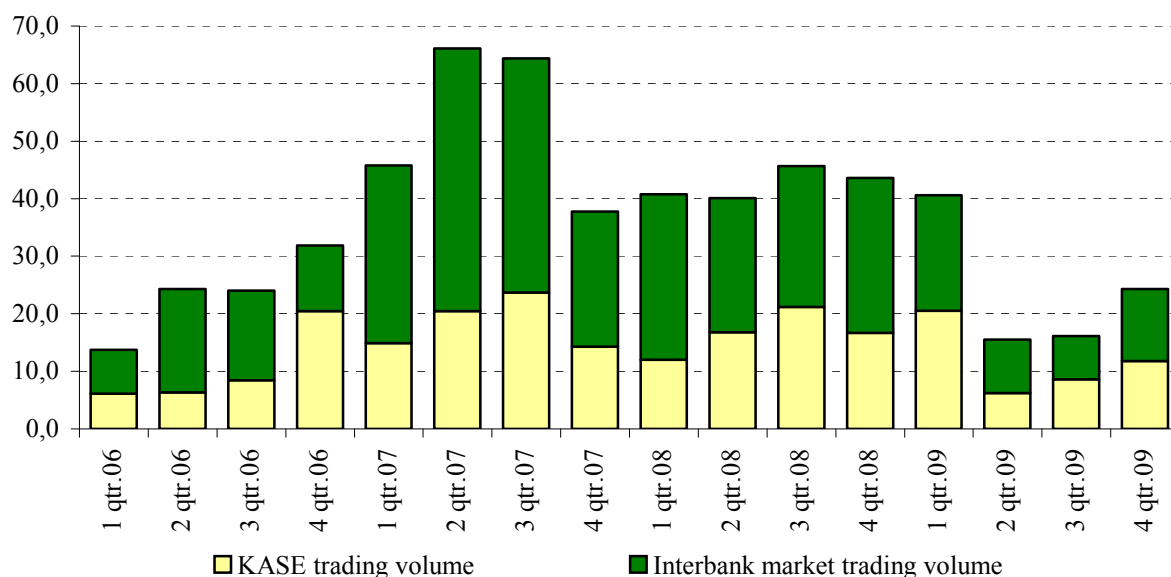## 4.1. Interventions in the Domestic Foreign Exchange Market

The situation in the domestic foreign exchange market was characterized by a relative stability and by the increase in trading volumes at the Kazakhstan Stock Exchange as compared to the previous quarter.

In Q4 2009 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank FX market amounted to US$ 24.3 bln. having increased by 51.5%) as compared to Q3 2009 (US$ 160 bln.).

The volume of trades in the Dollar position at the Kazakhstan Stock Exchange increased by 37.2% as compared to Q3 2009 and amounted to US$ 11.8 bln. (net trades at the Kazakhstan Stock Exchange made up 89.5% of gross trades). In the off-exchange foreign currency market the volume of transactions in the Q3 2009 increased by 67.8% as compared to the previous quarter and amounted to US$ 12.5 bln. (figure 37).

figure 37

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

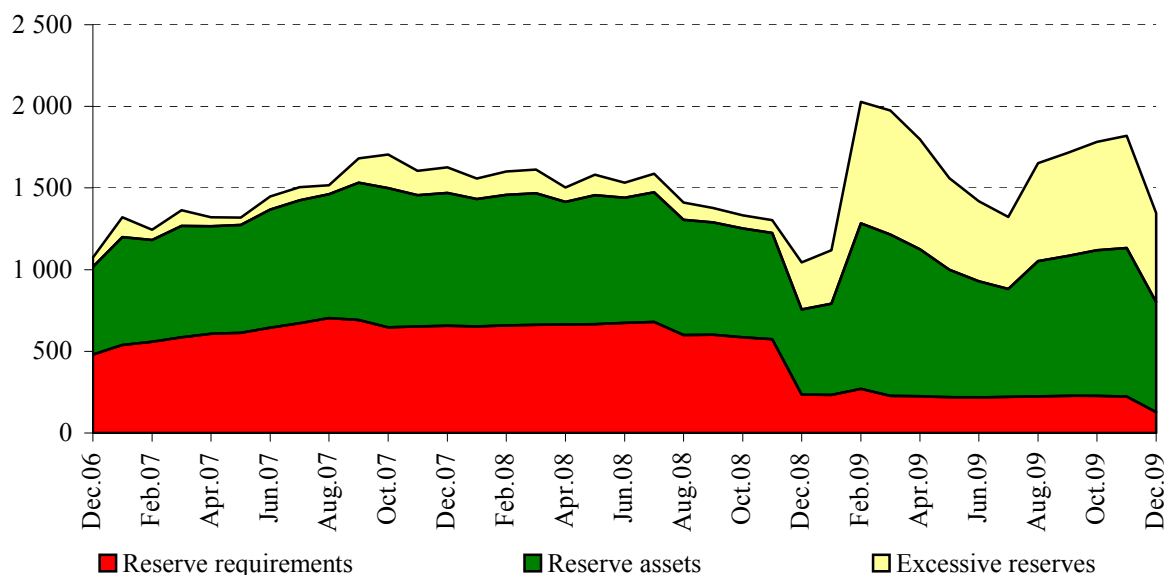Source: National Bank of the Republic of Kazakhstan

As a result of the Tenge appreciation trend outlined in Q4 2009, the National Bank was primarily the buyer of foreign exchange in the domestic foreign exchange market, based on the performance in the quarter. The National Bank's participation coefficient in the Kazakhstan Stock Exchange was 27.6 whereas in the previous quarter the National Bank was primarily the seller of foreign exchange and the participation coefficient, respectively, was equal to (-)35.3%.

4.2. Minimum Reserve Requirements

With a view to regulate short-term liquidity of banks undergoing restructuring, individual minimum reserve requirements had been established for them from November 30, 2009 - 0 percent for domestic liabilities and 0 percent for other bank liabilities.

The individual minimum reserve requirements for banks undergoing restructuring in established in Q4 2009 resulted in the decrease in the aggregate volume of minimum reserve requirements and volume of reserve assets of the banking system. On average, during October-December 2009, reserve assets exceeded the required reserving volume by 4.5 times (in Q3 2009 – by 3.4 times). (figure 38).

figure 38

Compliance with minimum reserve requirements, KZT bln.

Source: National Bank of the Republic of Kazakhstan

4.3. Open Market Operations

In Q4 2009 the demand of banks for short-term notes of the National Bank remained high. Due to accumulation of a high volume of liquidity in the National Bank's instruments, starting from August 2009, the National Bank has suspended issuing 28-day notes.

In October-December 2009 short-term notes with maturities of 3 and 6 months with target yield of 2.9 and 3.3% (+/-0,1%), respectively, were issued.

Volume of short-term notes issued in Q4 2009 was the highest for the whole year. It increased by 34.3% as compared to Q3 2009 and amounted to KZT 453.9 bln. This accounted for about 80% of the aggregate demand for these government securities on the part of the market participants. The average weighted yield on placed notes decreased from 2.66% in Q3 2009 to 2.41% in Q4 2009 (figure 39).

At end-December 2009, 2010 the volume of short-term notes in circulation accounted for KZT 473.3 bln., which is 2.6 times higher than the volume at end-September 2009 and by 1.5 times higher than that at end-December 2008 (figure 40).

figure 39

Volume of placed short-term notes and their yield (for the period)
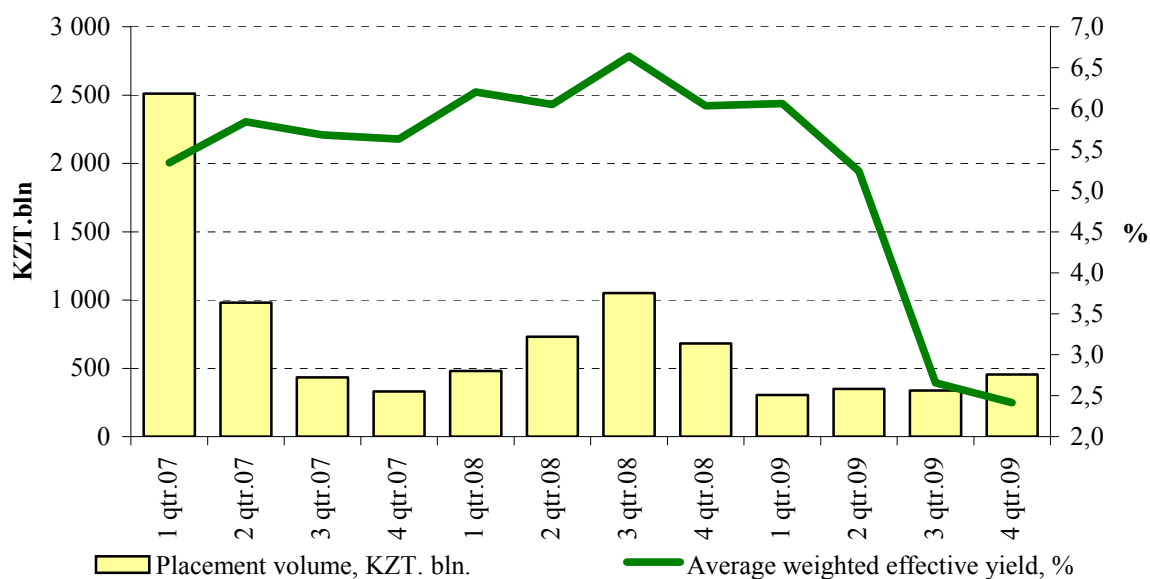
Source: National Bank of the Republic of Kazakhstan

figure 40

Short-term notes in circulation, KZT bln. (at the end of the period)
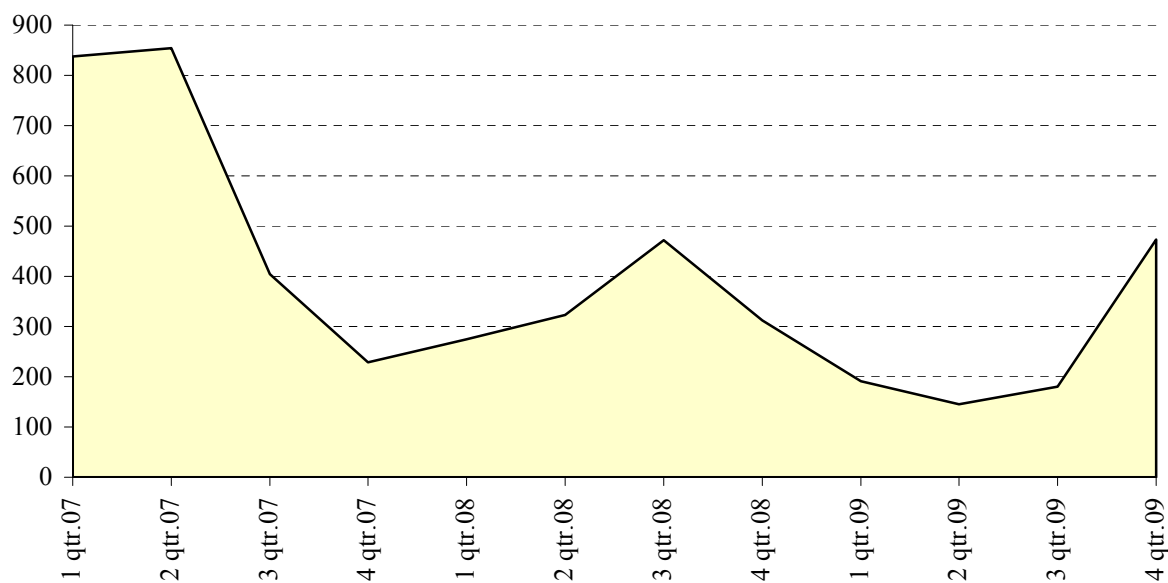
Source: National Bank of the Republic of Kazakhstan

4.4. Standing Facilities

In Q4 2009 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 average monthly amount of attracted deposits was about KZT 1.8 tln. In total, during October-December 2009, KZT 5393.3 bln. of deposits was attracted, which is by 22.6% less than the volume of Q3 2009 and is greater by 4.6 times than the volume in Q4 2008.

A stable situation with the Tenge liquidity in the banking sector contributed to the fact that the National Bank was every month decreasing its rates on deposits attracted from banks.

From October 1, 2009 the National Bank had established the rate for 7-day deposits at 1.5%, for 1-month deposits – at 2.0%, from November 1, 2009 – 1.0% and 1.5%, from December 1, 2009 – 0.5% and 1.0%, respectively.

In Q4 2009 the average interest rate on deposits was at 1.21% (figure 41).

figure 41

**Volume of deposits and interest rates on deposits attracted by the National Bank (for the period)**
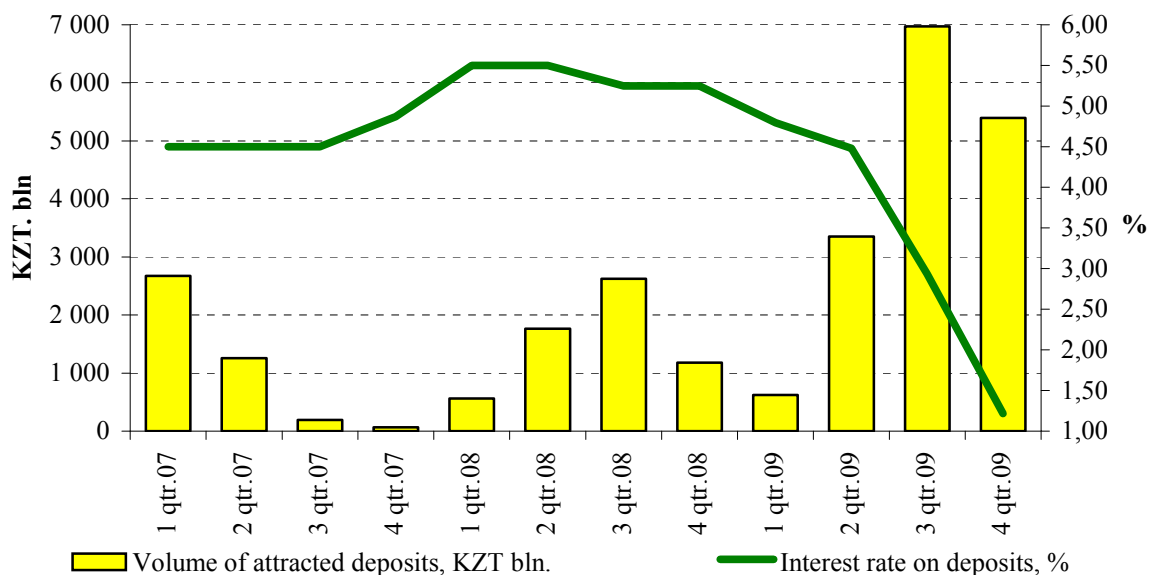
Source: National Bank of the Republic of Kazakhstan

The decrease in the volumes of attracted deposits was accompanied by the decreased volume of outstanding liabilities of the National Bank on those deposits by 6.3% to KZT 488.9 bln. in December 2009 as compared to September 2009. At the same time, deposit balances increased by 14.8 times as compared to December 2008 (figure 42).

figure 42

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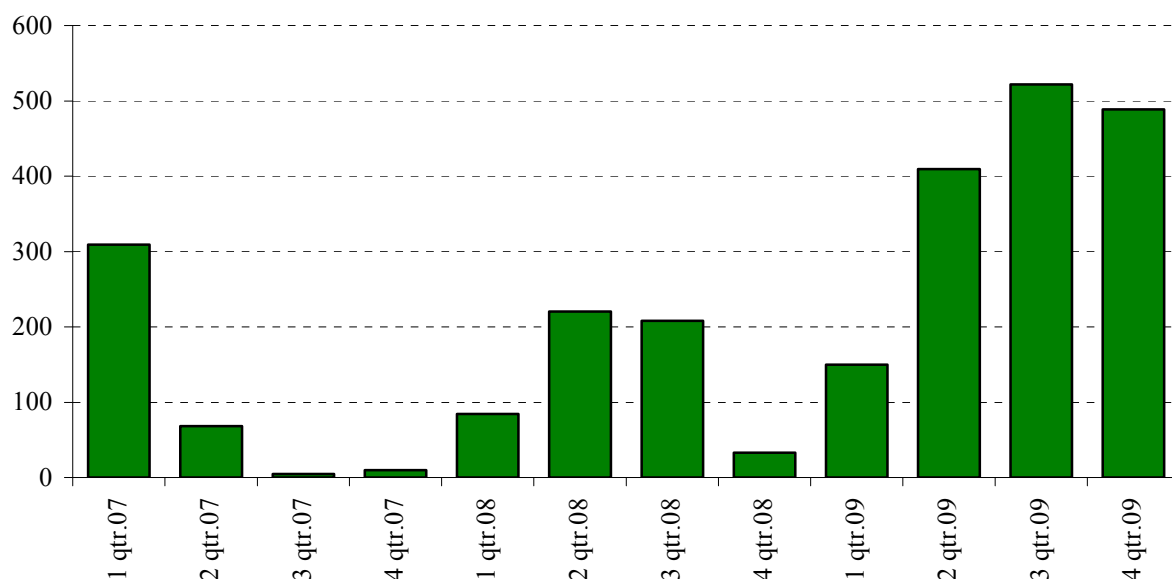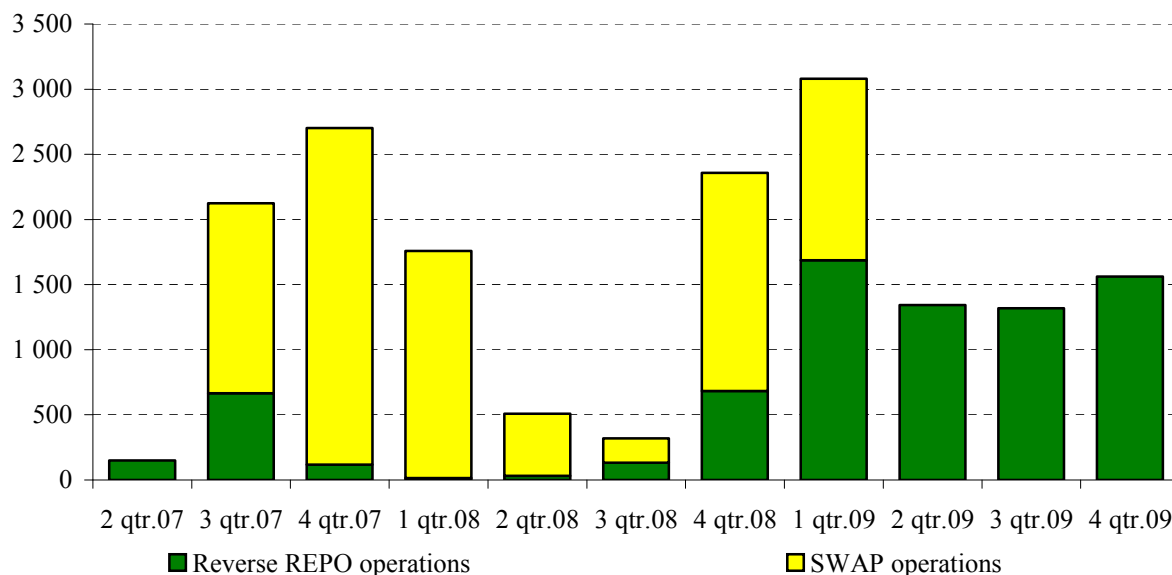

Source: National Bank of the Republic of Kazakhstan

In addition to sterilization operations, in Q4 2009 the National Bank continued to provide refinancing loans to the banking sector through reverse REPO operations. Total volume of reverse REPO operations in October-December 2009 amounted to KZT 1561.2 bln. (figure 43).

figure 43

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

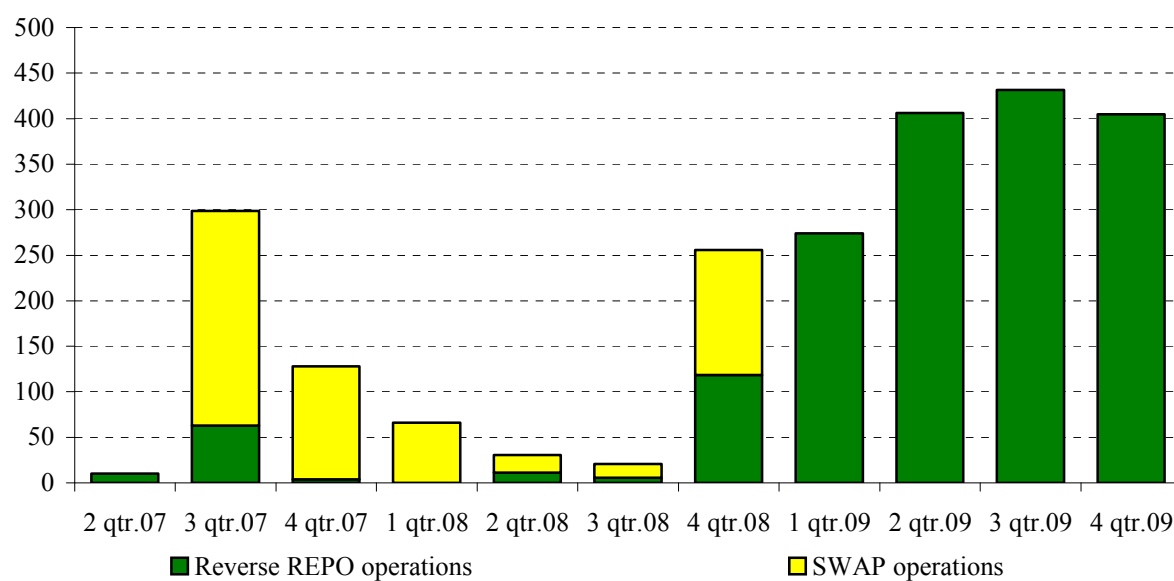■ Reverse REPO operations   □ SWAP operations

Source: National Bank of the Republic of Kazakhstan

At end-December 2009 the outstanding debt on reverse REPO operations amounted to KZT 404.9 bln. (figure 44).

figure 44

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

Source: National Bank of the Republic of Kazakhstan