National Bank of the Republic of Kazakhstan

Inflation Report for the Third 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

Figures

Таблицы

Summary

In 2009 inflationary processes in Kazakhstan have a slowdown trend. The disinflation process in Kazakhstan has been observed since September 2008. The devaluation of the Tenge implemented in February 2009 somewhat slowed down the process due to the increased inflationary expectations, however, already in March the situation in the consumer market had stabilized.

Inflation in January-September 2009 was at 4.7%, being by 3.4 pp lower than in January-September 2008. Based on September 2009, the annual inflation was 6.0%, which is over one and a half time less than in December 2008 and over three times less than in August 2008 when the maximum level for the recent years was reached.

The slowdown of inflation occurs against the decrease in the business activity. So, in the first half of 2009 real GDP reduced by 2.3%. The reduction of output can be seen in many industries. The volume of industrial output reduced, including in the manufacturing industry, as well as cargo turnover, the amount of construction works, and retail turnover.

A limited consumer demand also has a dampening effect on inflation due to the retained low growth rates in the income of the population.

Despite reduced business activity in the economy, in Q3 2009 the situation in the labor market remains stable, this is supported by the gradual decrease in the unemployment rate.

The situation in the global commodity markets is characterized by relative stability. Prices for oil, metals increased to some extent and prices for wheat decreased. This contributed to insignificant appreciation of industrial output of the Kazakhstani enterprises. However, a moderate growth in the world prices do not have a significant impact on inflationary processes within the country.

Low inflationary background in the economy allowed the National Bank pursuing the monetary policy aimed at ensuring the stability of the exchange rate of the Tenge and stability of the country's financial sector. Specifically, the National Bank continued providing refinancing loans to the banking sector through conducting the reverse REPO operations.

In Q3 2009 the rate band on the National Bank's operations was changed. The official refinancing rate was reduced from 8.5% to 7.0%. From August 10 the rate on deposits attracted from banks with maturity of 7 days was reduced to 2%. Moreover, the National Bank started attracting deposits with maturity of one month at the rate of 2.5%.

The reduced inflation rate in Q3 2009 allowed the National Bank revising and changing its annual inflation forecast for 2009 to 8.0%.

Evaluation of the Inflation Forecast for the Third Quarter of 2009

The actual inflation rate in Q3 2009 (0.9%) was significantly lower than the projected rate (1.6-1.8%) published in the previous issue of the Inflation report. In July inflation was in line with expectations, in August it was lower than the projected level by 0.1 pp and in September – lower by 0.3 pp.

In Q3 2009 there was a reduction of prices for foodstuffs. Inflation processes were largely built up under the impact of increased process for paid services provided to the population, mainly due to the increase of prices and tariffs of the educational institutions because of the beginning of a new academic year (the increase in tariffs happened in September) as well as utilities due to the increase in prices for electric energy and cold water supply.

The growth of prices occurred against increased prices for fuel and lubricants which was most likely caused by the beginning of harvesting.

The decrease in prices for foodstuffs occurred, in the first instance, under the impact of the seasonality factor. So, prices were decreased for fruits and vegetables production, eggs and dairy products, which is common for such period.

The actual inflation rate in annual terms at end-September 2009 was also lower than the projected one, published in the previous issue of the Inflation report. Thus, in September 2009 the annual inflation was at 6.0% while the forecast was 6.8-7.0%.

Inflation Forecast for the Fourth Quarter 2009

In Q4 2009 inflation is expected to be within 1.8-2.0% (in Q4 2008 – 1.3%).

As a rule, the situation in the consumer market in the recent months is characterized by the increase in prices. This is related to the seasonality factor and the growth in demand during public holidays. As a result, prices show their highest level during this period as compared to the rest of the year. However, this year the consumer demand remains limited. Most likely, this situation will remain till the year end and no significant rise in prices is expected.

While analyzing the situation of the past years, one may expect that after seasonal reduction of prices for fruit and vegetables in Q3 of this year, they are expected to rise in October-December. In addition, growth of prices for such items as eggs, dairy and meat products is anticipated. Therefore, the rise in prices for foodstuffs is expected in Q4.

By the end of the year some fall in prices for fuel and lubricants is expected. At the same time, the possibility of rise in prices for some types of utilities such as hot water supply, gas supply and electric energy is left open because of the beginning of the heating season.

In 2009 the National Bank pursues the monetary policy aimed at ensuring the stability of the exchange rate of the Tenge and maintaining the financial sector stability.

Specifically, in 2009 the National Bank provides banks with short-term liquidity through conducting reverse REPO operations. The list of collateral items for such operations was revised. The official refinancing rate was gradually reduced from 11.0% at the beginning of the year to 7.0% in September 2009.

The maintaining of the stable exchange rate of the Tenge after the devaluation implemented in February 2009 allowed considerably reducing devaluation expectations, the situation in the money market and foreign exchange market remains stable. The exchange rate of the Tenge has been stable since February and until now and is within the range of KZT 148-151.1 US$.

These measures of the National Bank allowed stabilizing the situation in the banking sector. Currently banks have sufficient resources to conduct their own operations.

The trends established this year in the consumer market will remain. The inflation will stay within the controllable range and based on 2009 the inflation is expected to be at the level not exceeding 8.0 (Figure 1).

Figure 1

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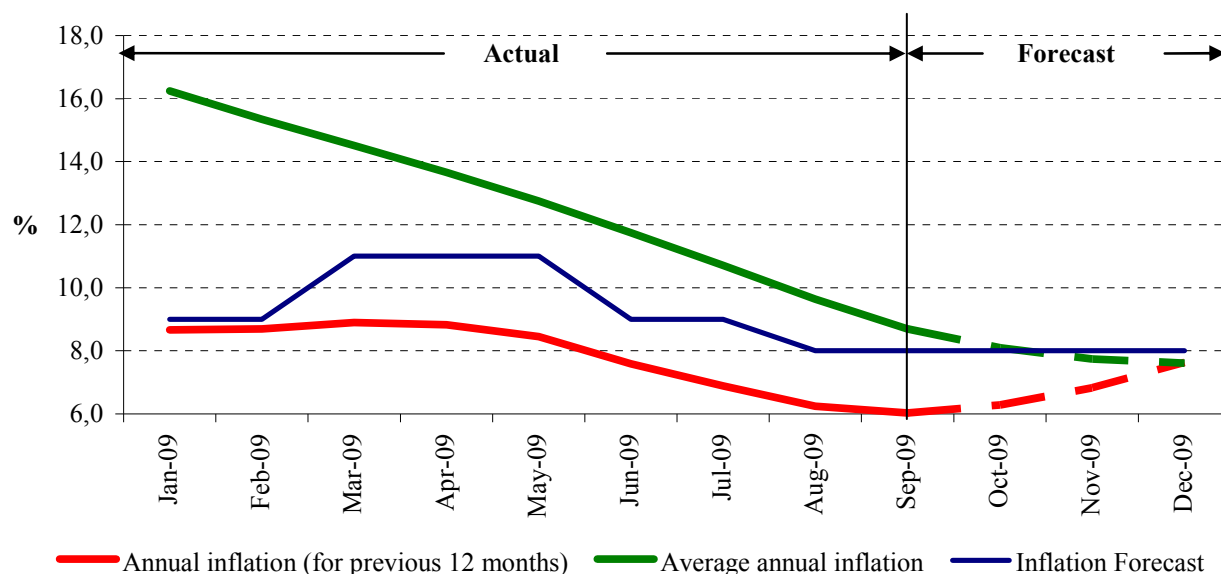
Source: National Bank of the Republic of Kazakhstan

Inflation Forecast for 2010

In Q4 2009 the National Bank will start drafting the Monetary Policy Guidelines for the coming mid-term period. The document will contain the targets for key monetary policy indicators including the inflation rate and monetary aggregates will be determined as well as the key measures to be taken by the National Bank to reach those targets.

The main operations of the National Bank will still be the issue of short-term notes, deposit-taking from banks, and provision of refinancing loans.

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

The National Bank will undertake measures aimed to ensure the stability of the exchange rate of the Tenge.

Alongside with that the National Bank expects the situation in the consumer market to remain stable in 2010. However, certain degree of revival of business activity in Kazakhstan may lead to insignificant acceleration of inflationary processes that will result in some increase of the inflation rate as compared to the numbers for 2009.

The inflation forecast for the first quarter 2010 is 2.0-2.2% (in Q1 2009 – 2.0%). As a whole, this level is in line with the inflationary trends of the 1st quarter which were typical of the previous years.

These expectations are related to the fact that, in the first instance, the inflation processes in the near term will take place under the impact of the seasonality factor. This implies the decrease of its level in the beginning of the year as compared to Q4 of the previous year. The reduction in prices for some types of goods and services is expected such as meat and dairy products, fuel and lubricants, individual types of utilities, and transportation services.

In addition, in the first half of 2010 the consumer demand in all likelihood will remain limited, no dramatic growth in lending activity of the banking sector is anticipated, and, as a result, the economy growth rates will not be high.

Based on March 2010 the annual inflation is expected to be at 7.0-7.2%.

1. Inflationary Processes

1.1. Consumer Prices

In Q3 2009 the slowdown in the inflation rates continued. If during the period of July-September 2007-2008 inflation was demonstrating high rates largely caused by the unstable situation in the global commodity markets, in 2009 the inflation return to its former level typical of such period.

Thus, in Q3 2009 the inflation was accelerating with lower rates both as compared to Q3 2008 and as compared to the previous quarter. In July-September 2009 the inflation was at 0.9%. The rise in prices was in the first instance caused by the increase in the cost of paid services provided to the population and non-food items by 2.4% and 1.9%, respectively. Prices for foodstuffs have been decreasing over the whole period resulting in the overall decrease in prices of 0.1% (Figure 2).

Figure 2

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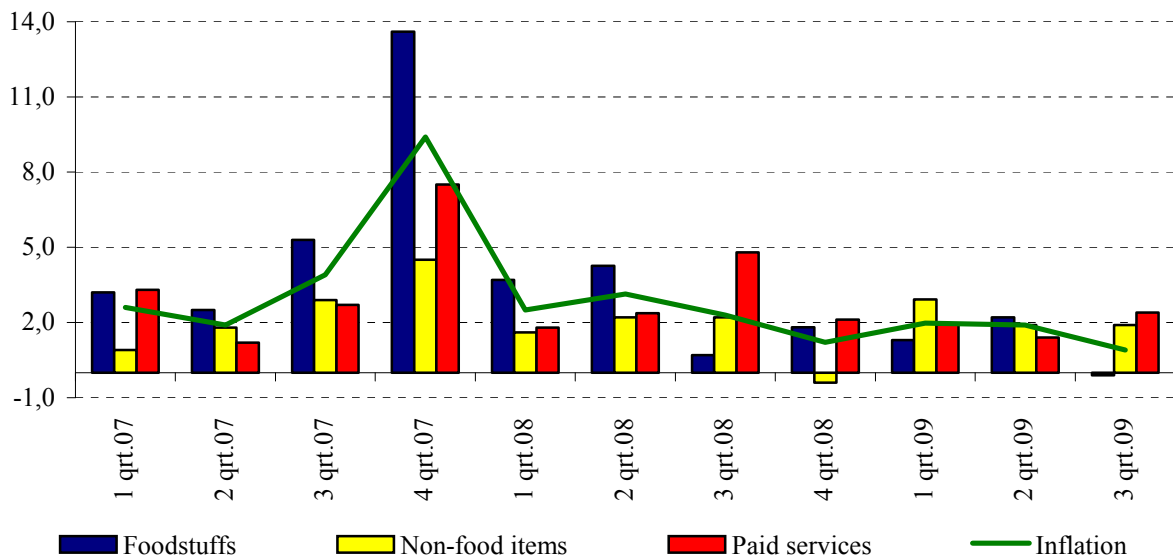
Source: Statistics Agency of the Republic of Kazakhstan

The major growth in prices in Q3 2009 fell on such goods and services as gasoline – by 15.1%, sugar – by 7.1%, services by educational institutions – by 6.5%, medical services – by 2.6%, utilities – by 2.4%, including electric energy – by 7.9%, cold water supply – by 3.2%.

The decrease in prices for certain foodstuffs should be also noted. Fruits and vegetables became cheaper by 13.2%, eggs – by 0.9%, dairy products – by 0.6%.

Inflation in January-September 2009 was 4.7% having significantly reduced as compared to January-September 2008 (8.1%).

In Q3 2009 the annual inflation kept going down. Based on September 2009 its rate amounted to 6.0% (in December 2008 – 9.5%) which is over three times less than the maximum level for the last years established in the summer months of 2008.

If last year the main growth in prices in the consumer market fell on foodstuffs, in the current year the structure of the inflationary processes buildup has changed. In the beginning

of the year the major price growth was in the paid services and foodstuffs, in Q3 the determining role was played by the increase in the cost of paid services to the population, the pressure from non-food items increased.

Disinflation in Q3 2009 was caused by the significant slowdown in the prices for foodstuffs where the annual price change was 4.3% based on September 2009. The cost of non-food items increased by 6.5% in annual terms, paid services to the population – by 8.0% (Figure 3).

Figure 3

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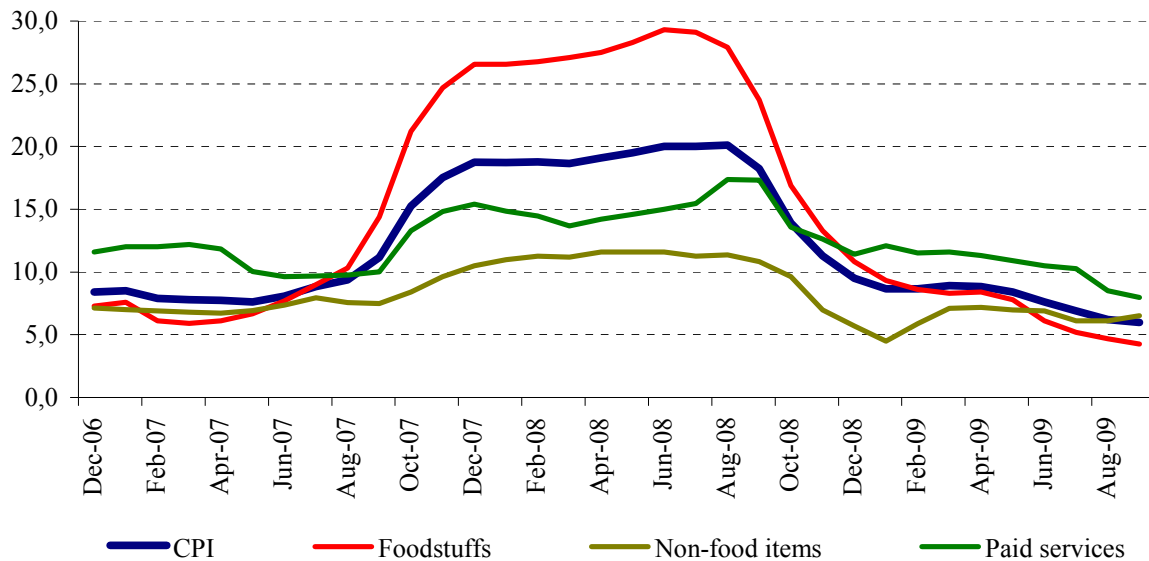
Source: Statistics Agency of the Republic of Kazakhstan

1.2. Core Inflation

The indicators of core inflation in Q3 2009 alike the headline inflation demonstrated the slowdown in their growth as compared to Q3 2008 and Q2 2009 (Figure 4).

In Q3 2009 the headline inflation indicator was at a lower level than the core inflation indicators, except for core inflation-5. This was largely caused by a significant decrease in the price of fruits and vegetables based on its high percentage in the structure of the consumer basket.

Core inflation indicators in annual terms demonstrate the downward trend alike the headline inflation indicator. In September 2009 all indicators of core inflation appeared to be at a lower level as compared to December 2008. This indicates the overall slowdown of 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)**
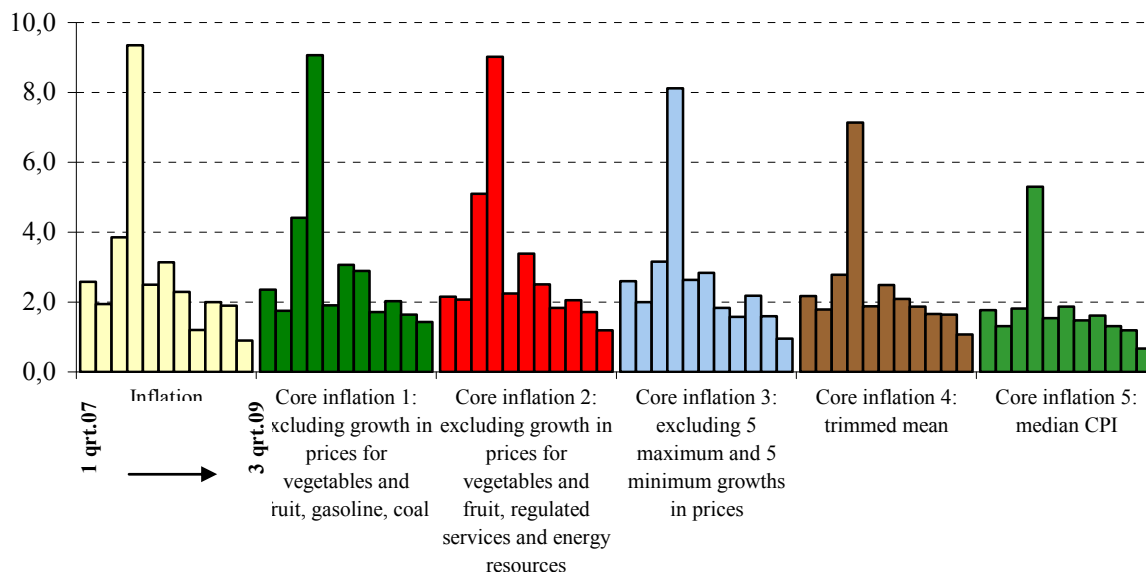
Source: Statistics Agency of the Republic of Kazakhstan

Based on September 2009 all indicators of core inflation except for core inflation-5, in annual terms exceeded the headline inflation indicator. This was caused by the decreased prices for fruits and vegetables production, significant drop in prices for eggs as well as small annual growth of gasoline prices and certain types of regulated services excluded while calculating these indicators of core inflation (Figure 5).

Figure 5

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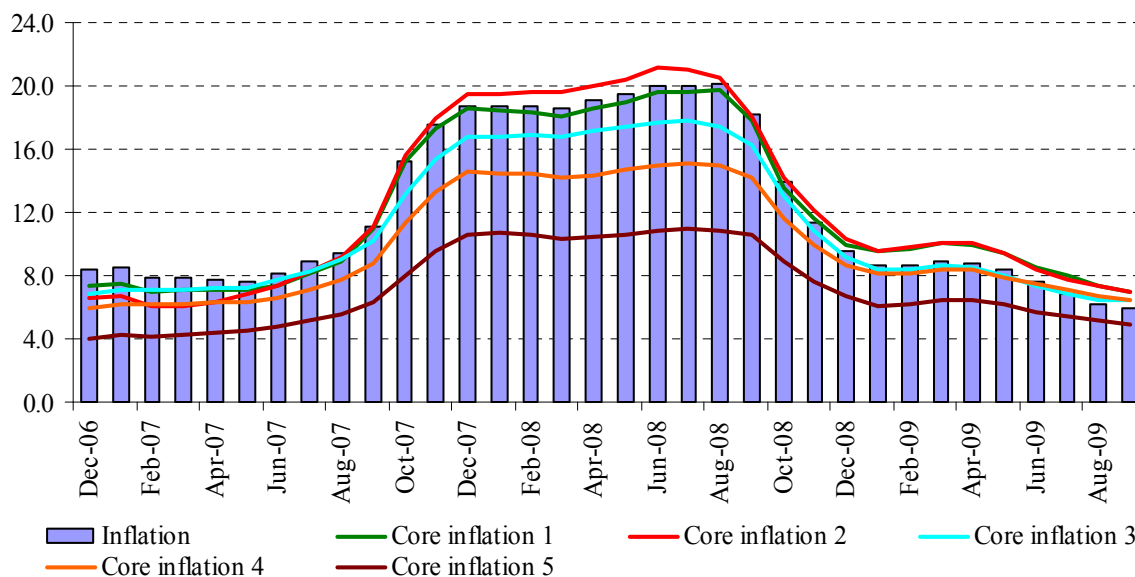
Source: Statistics Agency of the Republic of Kazakhstan

1.3. Prices in the real Sector of the Economy

1.3.1. Prices in the Industry

The producer prices have been rising since Q2 2009, after their fall observed during three consecutive quarters. In Q3 2009 the rise in prices was 11.7% (in Q3 2008 – decrease by 0.9%). The cost of output increased by 12.2%, including interim consumption products – by 13.6%, means of productions – by 0.4%. Consumer goods appreciated by 0.8%, services of production nature – by 3.7%.

In July-September 2009 producer prices in the mining industry increased by 14.2% (in July-September 2008 – reduction by 4%). This was caused by the growth of prices for certain types of energy resources. In particular, the cost of oil extraction in Q3 2009 increased by 16.9%, cost of gas condensate grew up by 7.7%. In general, over the period of July through September 2009 the cost of energy resources increased by 14.4% whereas in the respective period of 2008 their cost reduced by 4.9%.

Under the impact of pricing environment in the raw commodity sector and metallurgy the growth rate of prices in the manufacturing industry in Q3 2009 accelerated to 8.3% (in Q3 2008 – 4.7%). Prices in the metallurgical industry increased by 17.4%, food production including drinks and tobacco increased by 0.4%, oil refined products increased in price by 7.7%.

Growth in prices in the production and distribution of electric energy, gas and water in Q3 2009 also accelerated as compared to Q3 2008 making 7.4%. This was caused by the increased cost of electric energy (Q3 2008 – growth by 8.4%).

In September 2009 the reduction in prices in the industrial production amounted to 22.3% in annual terms (September 2009 versus September 2008) (Figure 6).

Figure 6

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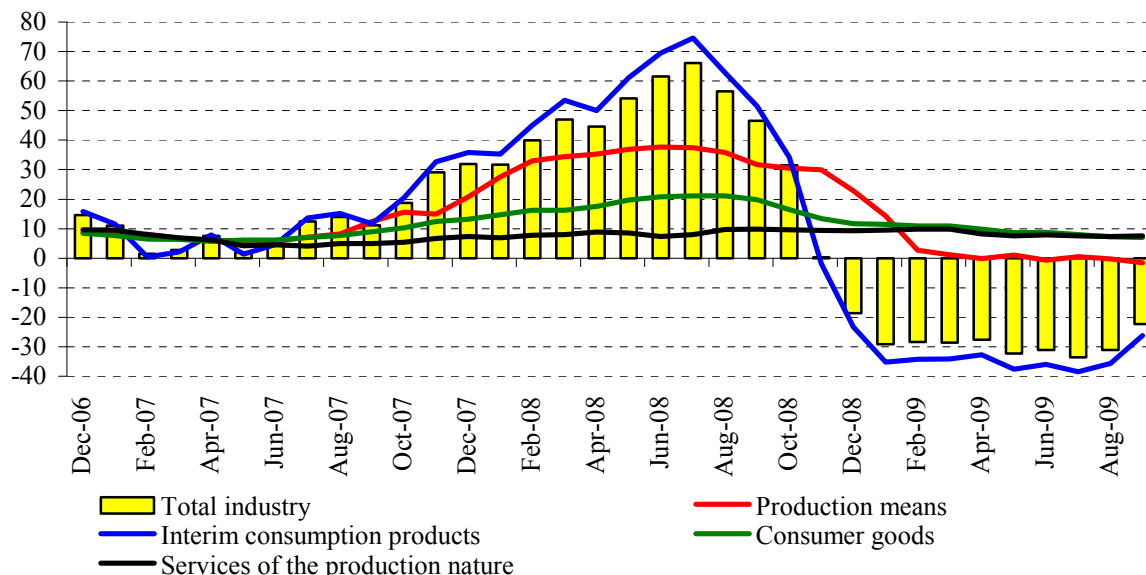
Source: Statistics Agency of the Republic of Kazakhstan

Manufactured products in annual terms became cheaper by 23.7% including the interim consumption products – by 26.2%, means of production – by 1.6%, whereas the growth of prices for consumer goods amounted to 7.0%. Services of production nature appreciated by 7.6%.

The main reason for such reduction in prices in the industrial production was deterioration in the pricing environment of the global market caused by the drop in prices for oil and gas, ferrous and non-ferrous metals as well as the stagnation and price reduction in the manufacturing industry.

1.3.2. Prices in Agriculture

In Q3 2009 prices for agricultural production realized across all channels decreased by 0.4% (in Q3 2008 – growth by 1.6%). The dynamics of prices in agriculture was impacted by their depreciation for plant production and appreciation in stock-breeding.

Over July-September the cost of plant production depreciated by 1.3%, being caused by the decreased prices for grain cultures by 1.1% as well as for vegetables and potatoes – by 3.2% and 3.3%, respectively.

The cost of animal products in the reviewed period increased by 1.1%, while prices for meat and poultry increased by 1.6%, eggs became more expensive by 6.9% and the cost of unpasteurized milk decreased by 3.9%.

Based on September 2009, annual growth in prices for agricultural production while continuing to slowdown amounted to 1.8%. At that, the plant production became cheaper by 0.4%, animal products appreciated in price – by 4.8% (Figure 7).

Figure 7

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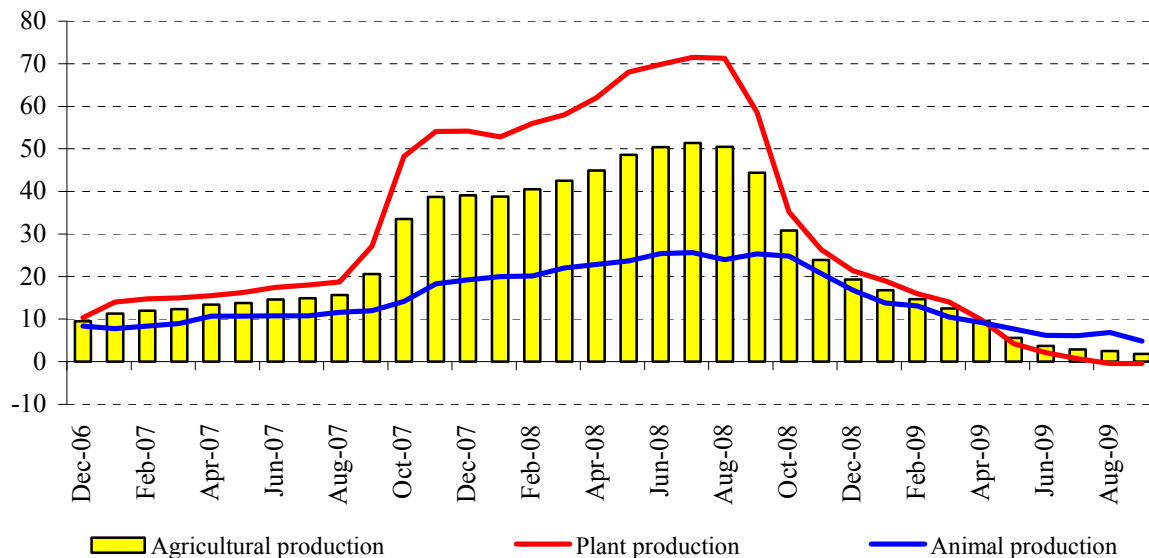
Source: Statistics Agency of the Republic of Kazakhstan

1.3.3. Enterprise Monitoring

In Q3 2009 as compared to the previous quarter the decline in the demand for final products of enterprises continued. This is evidenced by a generalized indicator – the diffusion index of the change in the demand for final products from 47.7 in Q2 2009 to 46.9 in Q3 2009 (Figure 8). The reduction in the indicator was mentioned by 28% of interviewed enterprises (in Q2 2009 – 28.9%), increase – 21.8% (in Q2 2009 –24.3%).

The decline in the demand occurred in such industries as "agriculture", "trade", "real estate operations", "construction", and "hotels and restaurants". The growth of the indicator was observed in such industries as "mining industry", "transport and communications" and

"production and distribution of electric energy, gas and water". In the manufacturing industry the level of demand remained virtually at the level of the previous quarter.

In Q4 2009 as compared to Q3 2009 a certain slowdown in the demand for final products in the economy as a whole is expected: the diffusion index of the change in the demand grew up to 47.9. At the same time 16.1% of enterprises participating in the survey anticipate the increase in the demand for final products, and 20.3% of enterprises – its reduction.

The situation with prices for final products in Q3 2009 was characterized by the slowdown in the growth rates of the indicator as compared with the previous quarter: the diffusion index of the change in the demand reduced to 54.5 (compared to 56.0 in Q2 2009). The percentage of enterprises where prices for the output decreased grew up to 12.6% (in the previous quarter – 10.5%), and the percentage of respondents that indicated growth in the indicator reduced to 21.6% (inQ2 – 22.4%).

The slowdown of the price growth occurred in the majority of sectors of the economy except such industries as "production and distribution of electric energy, gas and water" and "mining industry" where the increase in the growth rates of the indicator was observed. In agriculture the prices for final products have dropped considerably as compared to the previous quarter.

In Q4 2009 the diffusion index of the change in prices for final products has slightly reduced against the previous quarter to 53.9. This is mainly related to the decrease in the number of enterprises anticipating the rise in prices – to 15.3%. At the same time, the number of enterprises not expecting the change in prices increased – to 77.4% (in Q3 2009 – 65.7%).

In Q3 2009 the growth rates of prices for raw commodities and materials continued to grow remaining at a high level in the economy as a whole: the diffusion index of the change in prices for raw commodities and materials reached 70.4. The highest growth in prices occurred in such industries as "agriculture", "construction" and "production and distribution of electric energy, gas and water". In general for the sample, the number of enterprises that indicated the growth in prices for raw commodities and materials increased to 51.7% (from 49.2% in Q2 2009). The percentage of enterprises that indicated the reduction in prices for raw commodities and materials didn't change as compared to the previous quarter amounting to 3.5%.

As for Q4 2009, the diffusion index of the change in prices for raw commodities and materials has dropped to the mark of 63 which means that enterprises expect further growth of prices but with notably lower rates. Despite its significant decrease to 35.5%, the percentage of enterprises expecting the price growth in Q4 2009 remains high, while the percentage of enterprises expecting the reduction of the indicator decreased to 2.1% (Figure 8).

Thus, based on the dynamics of the respective diffusion indices expectations of enterprises in respect of Q4 2009 are associated, in the first instance, with a notable decrease of the growth rates of prices for raw commodities and materials.

Figure 8

Diffusion indices of the change in demand and prices

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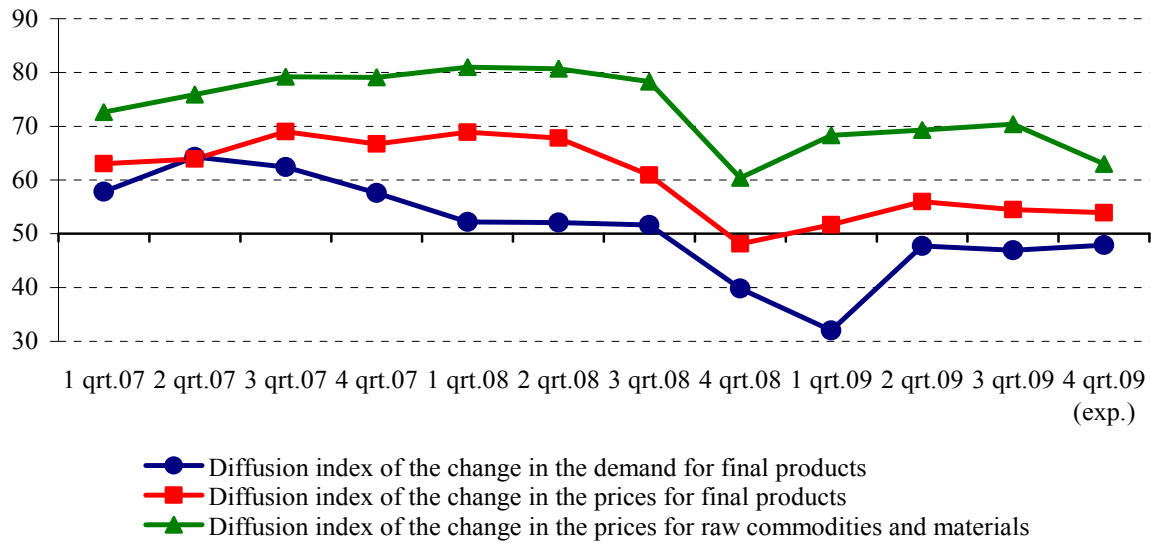
Source: National Bank of the Republic of Kazakhstan

2. Inflation Factors

2.1. Aggregate Demand

In Q2 2009 the GDP based on the final consumption method according to estimates reduced as compared to the respective quarter of 2008 by 5.9% (in the previous quarter – growth by 0.3%). The reason for the decline in the indicator was a significant decrease in the gross fixed capital formation (by 25.9%) whereas the household and general government spending on final consumption increased by 1% and 7.3%, respectively.

The contribution by households and the general government in the GDP growth was 0.6% each, while the contribution of the gross fixed capital formation showed negative sign and was (-)5,7% (Figure 9).

Figure 9

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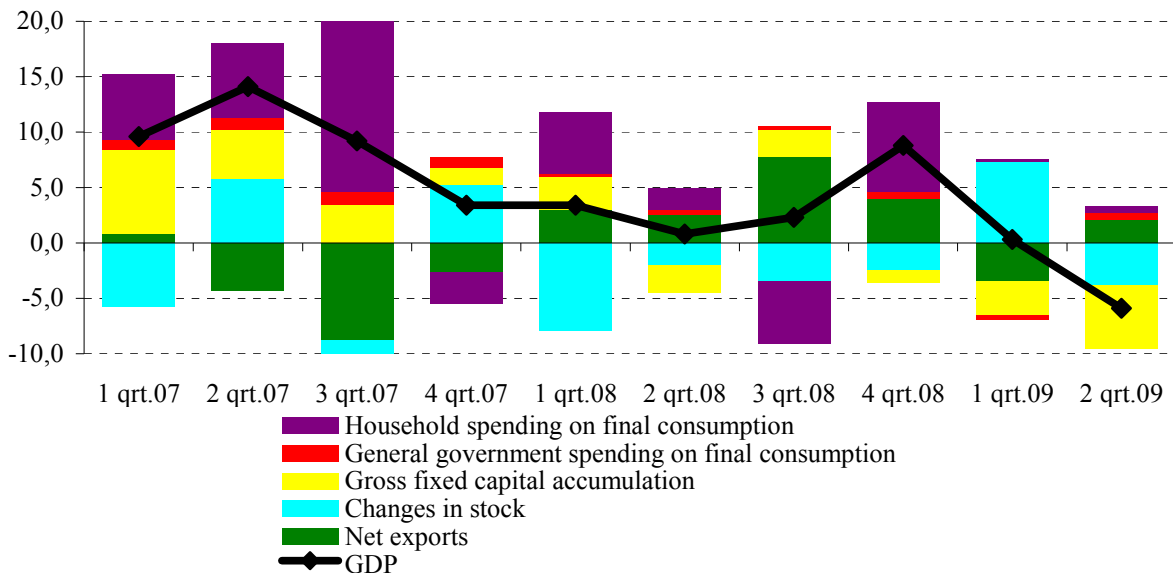
Source: Data from the Statistics Agency of the Republic of Kazakhstan, calculations by the National Bank of the Republic of Kazakhstan

2.1.1. Individual Consumption and Investment Demand

Household spending on final consumption in Q2 2009 increased as compared to the respective period of 2008 by 1.0% (in Q1 2009 – by 0,3%).

The growth of per capita income in real terms has slowed down making 2.9% (in Q1 2009 – by 5.2%), and retail sales reduced by 13.6% (in Q1 2009 – by 3.6%) (Figure 10).

Against the slowdown in the growth of real cash income and decline in the retail sales the growth in households' income may be caused by the following factors.

Figure 10

Dynamics of personal spending and income
(as % of the respective period of the previous year)
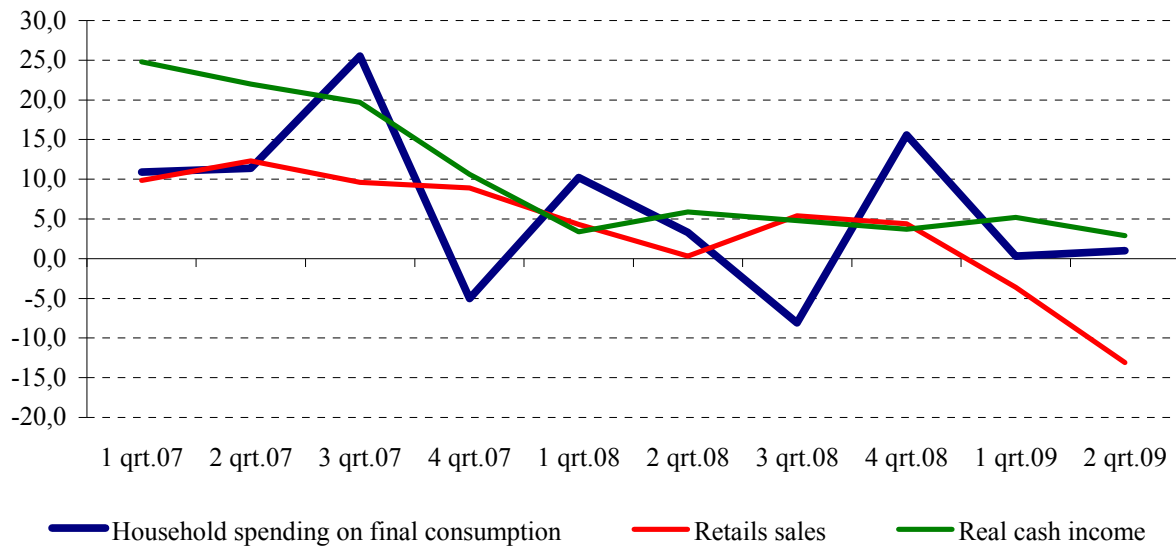
Source: Data from the Statistics Agency of the Republic of Kazakhstan, calculations by the National Bank of the Republic of Kazakhstan

Profitable exchange rate which has established as a result of the implemented devaluation enables natural persons-holders of foreign currency deposits to withdraw part of their cash, without any effect on the principal amount of deposit, and spend it for consumption purposes, thus resulting in the decline of foreign currency denominated household savings in Q2 2009 by 6.1%.

The consuming behavior patterns among the population have changed. In order to optimize expenditures, preference is made to goods purchased in the markets, the volume of purchases of new products declines, the consumption of services related to renovations increases and led to more than a two-fold growth in the segment of provided services in Q2 2009 as compared to Q1.

In Q2 2009 as compared to the respective period of 2008, a total volume of spending on gross savings in the GDP structure decreased by 37.9% making negative contribution to the GDP of (-)9.5%. The most significant impact on the decline of this indicator was made by the decreased spending on gross fixed capital formation which decreased by 25.9% (Figure 11).

Despite the decline in the gross fixed capital formation volume in the GDP structure, investment activity in the economy in Q2 2009 increased significantly. Fixed capital investments overcoming a negative trend that existed during two consecutive periods have increased by 16.4% over the reporting period (Figure 11). The growth in the fixed capital investment volumes was mainly achieved due to the foreign capital inflow, the nominal volume of foreign investments increased threefold in Q2 2009 as compared to the similar period of 2008.

Figure 11

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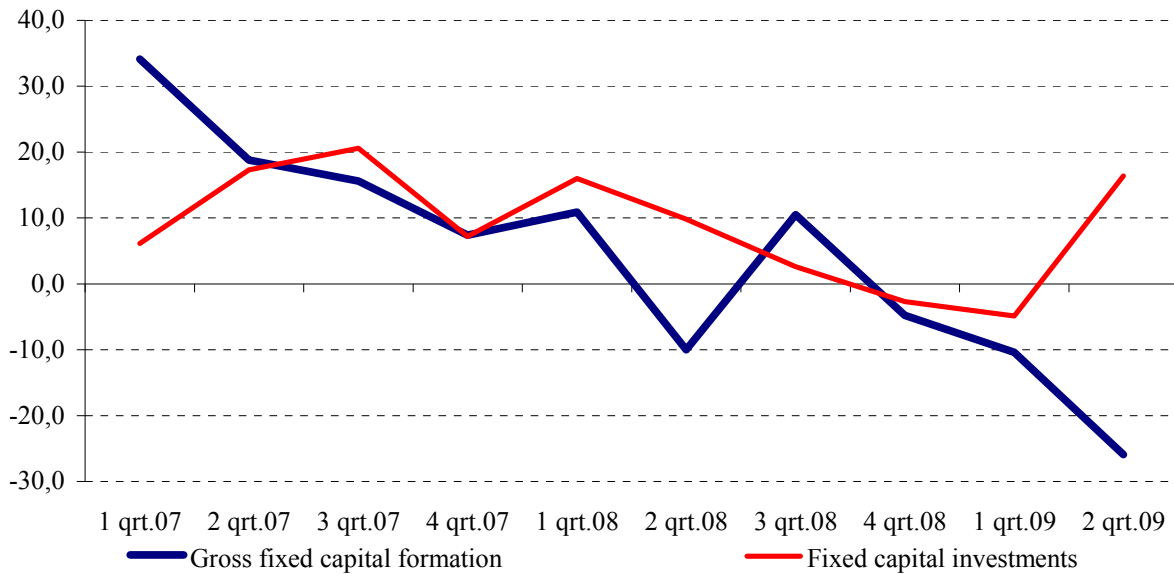
Source: Data from the Statistics Agency of the Republic of Kazakhstan, calculations by the National Bank of the Republic of Kazakhstan

2.1.2. Government Consumption

Spending on final consumption by general government in Q2 2009 as compared to the respective period of 2008 increased, according to the estimate, by 7.3% (in Q1 2009 – decrease by 4.7%).

In Q2 2009 the state budget spending totaled to KZT 1 088 bln. or 16.9% of GDP. As compared to the indicators for the respective period of 2008, it increased by 9.9%.

Current state budget expenditures increased by 20.6% as compared to the respective period of 2008 and were secured by the growth in costs on wages, service purchases and transfers to natural persons. Capital expenditures of the state budget in the second quarter of 2009 increased by 19.5% as compared to the respective period of 2008, mainly because of the growth of expenditures for fixed capital formation and overhaul expenditures. Domestic budget credits worth KZT 729.3 mln. were provided in Q2 2009. Expenditures related to financial asset purchases decreased by 51.1% as compared to the respective period of 2008, however, they showed a threefold increase compared to Q1 of the current year.

In Q2 2009 state budget revenues amounted to KZT 905.5 bln. or 14% of GDP which is by 5.9% more than in the respective period of the previous year. In the structure of the state budget revenues two items still prevail: tax revenues – 57.7% and official transfers – 38.7%. A high percentage of official transfers was secured by the receipt to the republican budget of the guaranteed and targeted transfers from the National Fund of the Republic of Kazakhstan in the amount of KZT 218.9 bln. and 131.5 bln, respectively.

In general, in Q2 of this year the indicators of tax revenues decreased insignificantly as compared to those for the respective period of 2008. However, revenues on corporate income tax decreased by 46.7%, which is caused by the downward change in the tax treatment of payment rates.

In Q2 2009 as compared to Q2 2008 the volume of non-tax revenues increased significantly by 53.1% and proceeds from the sale of fixed capital dropped by 45.6%.

As the expenditures were in excess of revenues to the state budget, in Q2 2009 the deficit of KZT 182.5 bln. (2.8% of GDP) showed up whereas in Q2 2008 the deficit was KZT 135.4 bln (Figure 12). Without transfers from the National Fund Q2 2009 would have ended with the non-oil deficit of KZT 532.9 bln.

Figure 12

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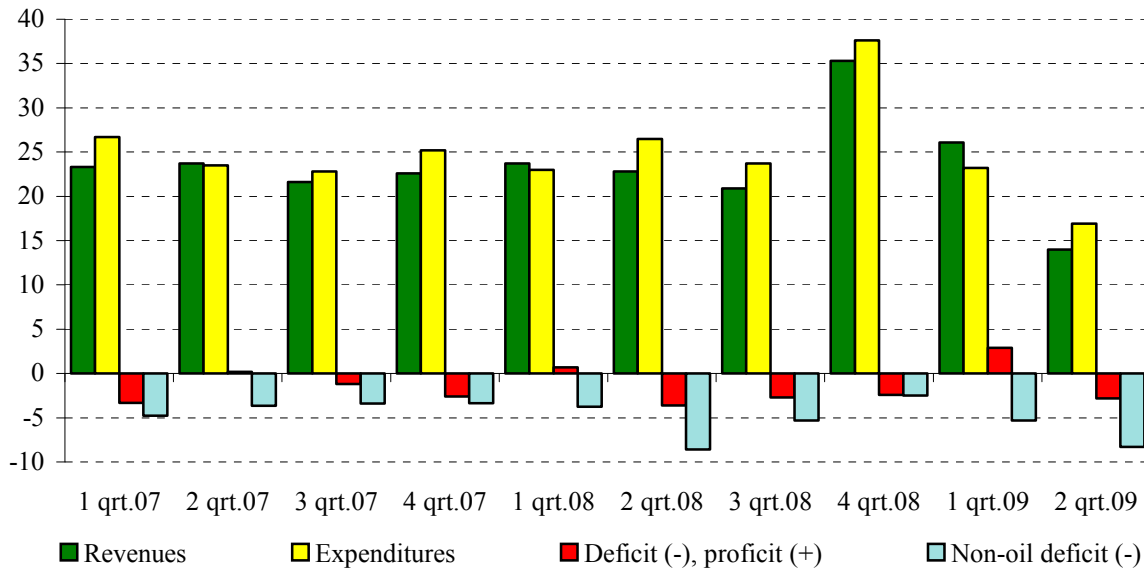
Source: Ministry of Finance of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

During Q2 2009 the Ministry of Finance borrowed KZT 167.3 bln. through the issue of government securities for the purposes of funding the potential state budget deficit. During the same period debentures were also extinguished on securities issued earlier for the amount of KZT 60.5 bln. As a result, account balances of the Government of the Republic of Kazakhstan with the National Bank increased by KZT 75.6 bln.

Government domestic debt for Q2 2009 increased to KZT 960.55 bln. (made up 6.2% of GDP) i.e. by 12.5% as compared to the outcome of Q1 2009 (5.4% of GDP) and was secured with the issue of long-term treasury bonds. External government debt in Q2 2009 (1.5% of GDP) increased by 0.8%. as compared to the indicator in Q1 of this year (1.5% of GDP).

2.1.3. External Sector

− **World Prices**

In Q2 2009 the situation in the global commodity markets was characterized by the growth in prices for some commodities: there was a growth in prices for oil, metals, sugar, and wheat. Thus, in April-June 2009 world prices for copper grew by 33.7% and on average for the period amounted to US$ 4663 per ton, for aluminum – by 17.8% and US$ 1485 per ton, respectively. In Q2 2009 lead became more expensive – by 35.1% and on average for the period the price was at 150 cents per kilo, zinc – by 27.9% and 147 cents per kilo, respectively (Figure 13).

Figure 13

Dynamics of world prices for metals
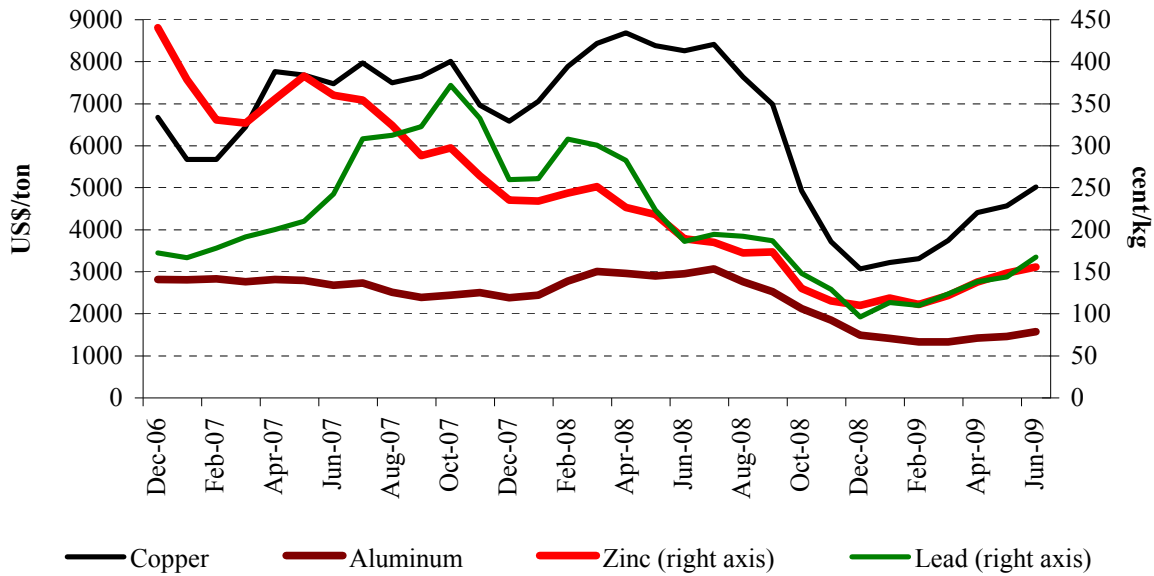
Source: World Bank

In April-June 2009 there was a gradual growth in prices for oil in the global markets. As a whole, during Q2 2009 oil prices (Brent) grew up by 46.5% and on average amounted to US$ 59.1 per barrel (Figure 14).

World prices for wheat were characterized by insignificant volatility. In April and May prices for wheat increased and in June they started to decrease again. As a whole, in Q2 2009 the world price for wheat (Canada) increased by 6.4% and on average amounted to US$ 325.5 per ton.

Figure 14

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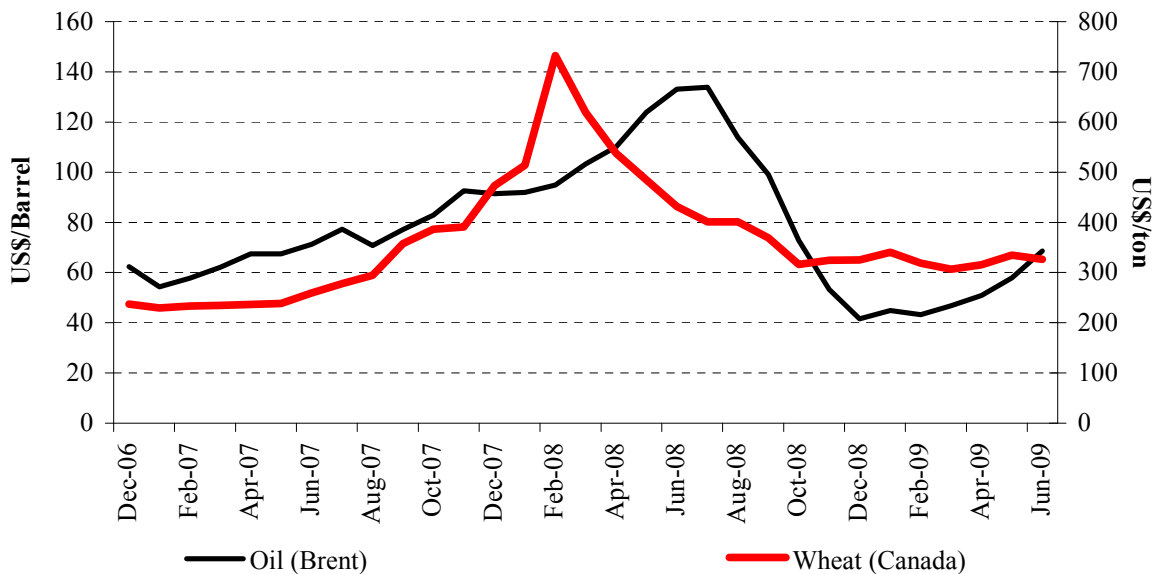
Source: World Bank

‒ **Balance of Payments**

Based on Q2 2009 the current account balance deficit was at the level of US$ 2.6 bln. (Figure 15).

Figure 15

Current account balance, US$ mln

Source: National Bank of the Republic of Kazakhstan

The pricing environment of the global energy carriers and the adjustment of the domestic exchange rate were the determining factors that impacted on the current account status. Export proceeds from commodities in Q2 2009 reduced by 52.0% as compared to Q2 2008 whereas expenditures for commodity imports – by 28.3%. Thus, the trade balance was at the level of US$ 2.1 bln, having reduced by almost 4.5 times compared to the respective period of 2008. The deficit in the balance of services as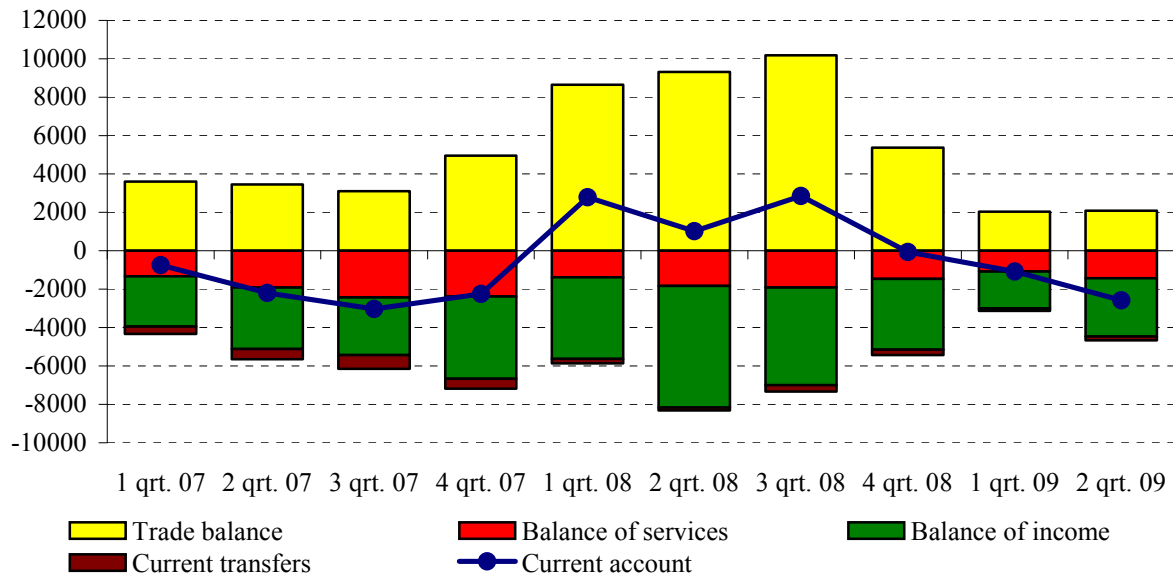 compared to Q2 2008 decreased by 22.3% and amounted to US$ 1.4 bln., and the deficit in the income balance – by 2.1 times to US$ 3.0. Net payments to nonresidents under current transfers amounted to US$ 192.2 mln. having increased by 32.5%.

The net inflow of resources on financial account operations was US$ 758.9 mln. (in Q2 2008 – the outflow of US$ 478.3 mln.). Foreign assets of residents (except for reserve assets) increased by US$ 1.4 bln. in Q2 2009 being 3.4 times less than the growth indicator in the respective period of 2008. Foreign liabilities of residents increased by US$ 2.2 bln, which is twice as less than the similar indicator of Q2 2008. With the growth of inflows in the form of direct investments (US$ 2.1 bln.) the decrease of foreign liabilities was primarily caused by the banking sector operations for the external debt extinction of US$ 2.6 bln.

The negative balance of payments for Q2 2009 was US$ 945.0 mln. compared to the proficit in the balance of payments of US$ 2.1 bln. in Q2 2008.

‒ **Terms of trade and real effective exchange rate**

In Q2 2009 the aggregate terms of trade index was by 42.4% lower than that for Q2 2008. Alongside with that, the terms of trade with the Euro zone countries deteriorated by 57.9%, and with Russia – by 15.0% (
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
Export prices	56.1	61.1	61.9	8.0	-47.0	-52.5
Import prices	27.6	44.9	57.1	29.7	-1.2	-15.8
Terms of trade	**20.2**	**12.0**	**3.5**	**-17.0**	**-45.8**	**-42.4**
including:						
The Euro zone countries						
Export prices	54.4	62.5	63.5	-0.1	-54.2	-56.5
Import prices	15.8	29.5	51.9	27.5	17.7	0.1
Terms of trade	**28.3**	**27.7**	**9.5**	**-22.5**	**-57.8**	**-57.9**
Russia						
Export prices	30.1	37.6	34.6	8.6	-28.3	-36.2
Import prices	42.8	48.9	47.6	22.7	-28.6	-25.5
Terms of trade	**-8.9**	**-7.9**	**-9.0**	**-11.9**	**0.4**	**-15.0**

Source: National Bank of the Republic of Kazakhstan

Based on Q2 2009 as compared to the previous period the index of the real effective exchange rate of the Tenge depreciated by 9.8%. The Tenge has appreciated versus the CIS currencies basket by 12.3%, versus the basket of other currencies - by 8.8%.

In Q2 2009 the Tenge has depreciated in real terms against the US Dollar by 5.9%, against the Euro – by 10.2%, and against the Russian ruble – by 13.4% (Figure 16).

Figure 16

Indices of real exchange rates of the Tenge
(December 2000 = 100%)
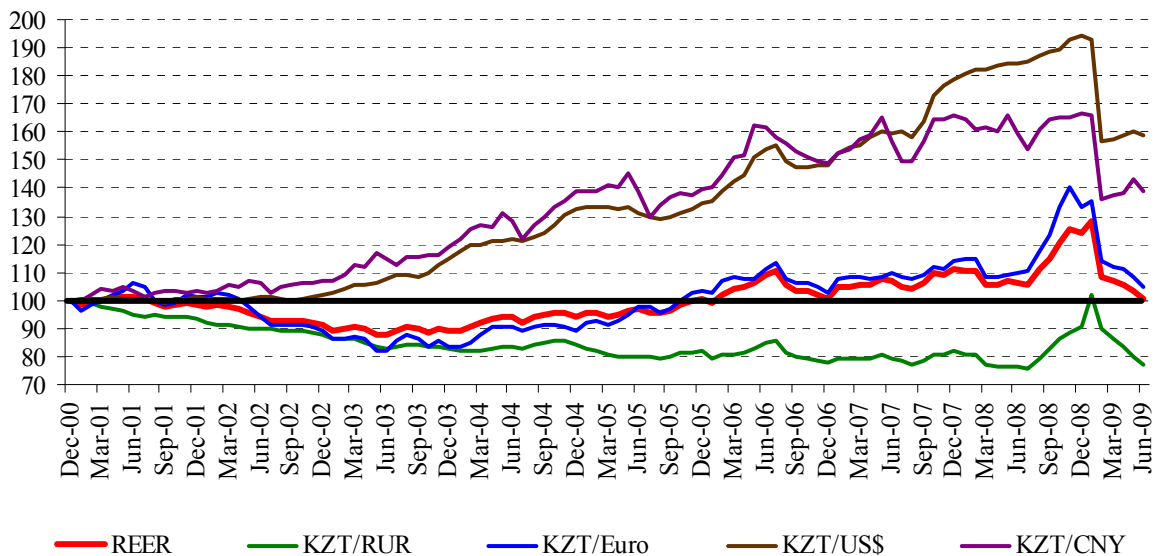
Source: National Bank of the Republic of Kazakhstan

In analyzing the impact of a relative change in the exchange rate of the Tenge on the outcomes of trade operations, one should take into account the country and the commodity

structure of foreign trade. In the trade with the European countries and the Dollar zone exports of oil and other raw commodities dominate i.e. commodities less exposed to the impact of the relative change in the exchange rate. And in the structure of trade with the Russian Federation such commodity groups are dominant that are most sensitive to the relative change in the exchange rate, particularly consumer goods. As a whole, the devaluation of the Tenge allowed reducing the consumer imports volumes including those from the Russian Federation.

- **Nominal Exchange Rate of the Tenge**

In Q3 2009 the situation in the domestic foreign exchange market was relatively stable. In general, based on the outcomes of the quarter the exchange rate of the Tenge depreciated against the US Dollar by 0.35% – from 151.43 KZT/US$ to 150.95 KZT/US$. Since the beginning of the year the Tenge has depreciated against the US Dollar in nominal terms by 25.0%.

The average weighted stock exchange rate of the Tenge for Q3 2009 was KZT 150.77 per 1 US Dollar. During the quarter the Tenge was fluctuating against the US Dollar within the range of KZT 150.33-150.95 per 1 US Dollar (Figure 17).

In July, August and September the exchange rate of the Tenge against the US Dollar depreciated by 0.2%, 0.1% and 0.1%, 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.

Figure 17

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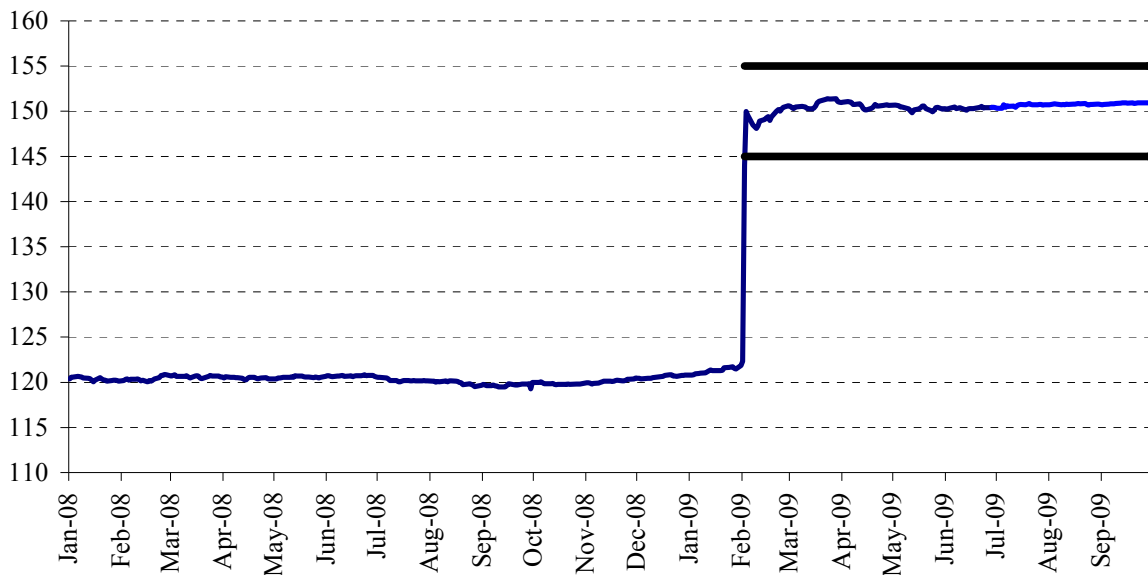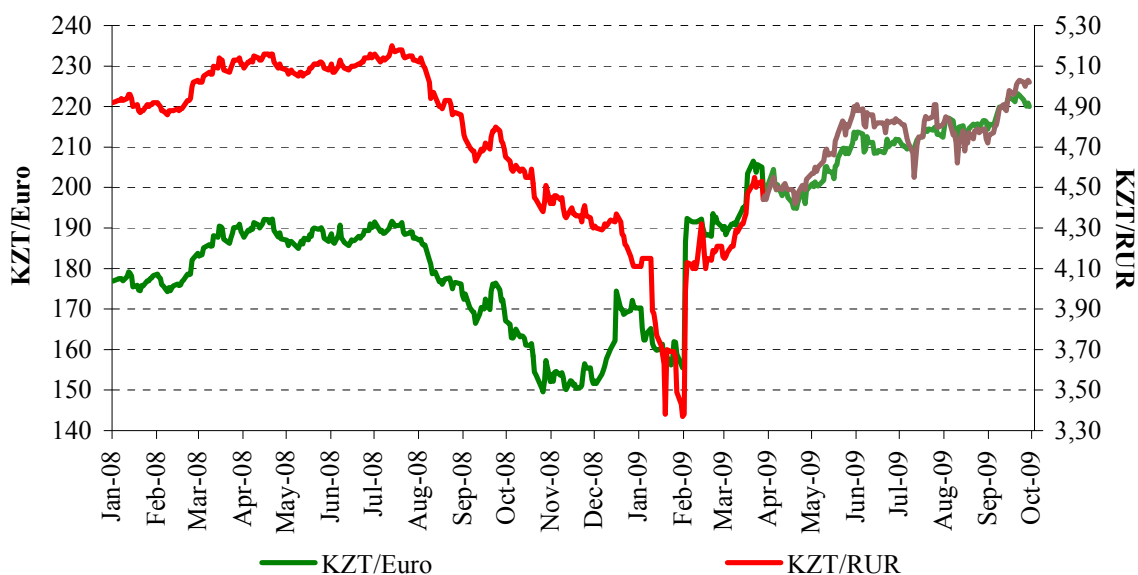

Source: National Bank of the Republic of Kazakhstan

In general, the official exchange rate of the Tenge versus the Euro and the Russian ruble has depreciated over Q3 2009 by 4.4% and 4.1%, 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 Q2 2009 amounted to KZT 3654.5 bln, according to the National Bank's estimates. Affected by the negative impact of reduced production in the industry, construction, trade, and transport, GDP has decreased, according to estimates, by 3.8% in real terms compared to Q2 2008 (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)
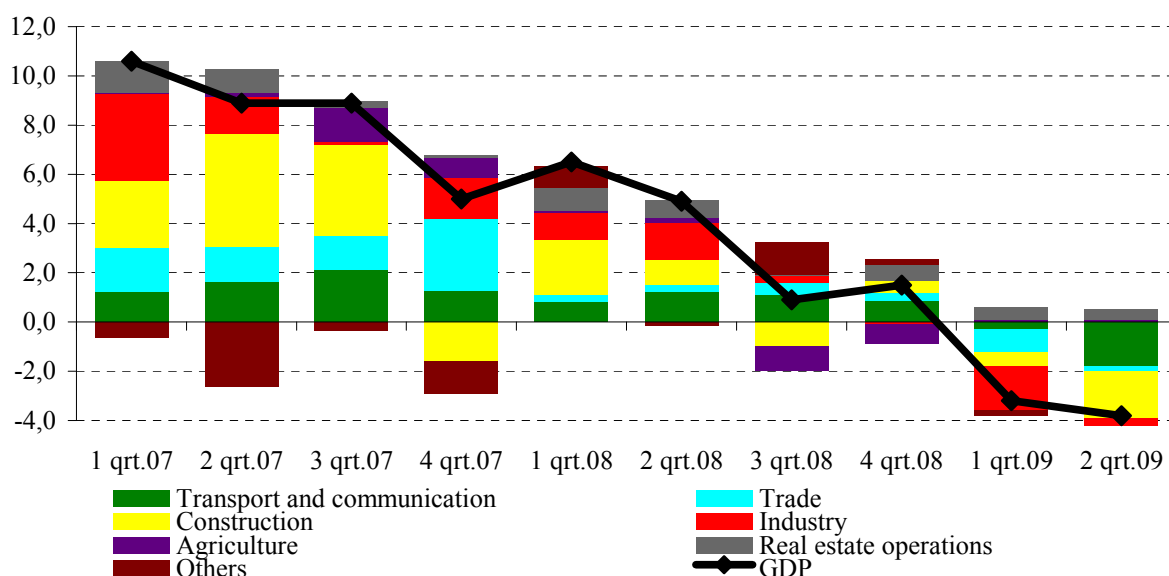
Source: Data of the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

Quantum index of the transport in real prices as compared to Q2 2008 decreased by 16.3%, construction – by 11.5%, trade – by 1.6%, industry – by 0.8%, bringing in a negative contribution in the GDP formation. Growth rates in such sectors as agriculture, financial activities, and public administration slowed down, where the indices reduced to 102.1%, 100.2%, 105.6%, respectively. There was an increase in the growth rate in the area of public administration where the index amounted to 108.0%, growth in real estate operations remained at the level of the previous quarter (3.8%).

2.3. Labor Market

2.3.1. Employment and Unemployment

In Q3 2009 a number of people employed in the economy increased, mainly owing to the implementation of the Road Map by the Government in 2009 that is aimed at the support of employment. They totaled to 7.9 mln. people, being by 0.7% greater than in the previous period. The number of employees grew by 1.1% to 5.3 mln. people, self-employed – by 0.1%, amounting to 2.7 mln. people.

In the structure of employees, 4.3 mln. individuals were working in public and non-public institutions (80.9% of all employees), employees working for natural persons – 0.7 mln. individuals (12.7%), at farms – 0.3 mln. individuals (6.3%).

 In Q3 2009 the number of unemployed was 535.7 thousand individuals, having decreased by 5.7% as compared to the previous period, and by 0.9% - as compared to Q3 2008 (Figure 20).

Figure 20

The structure of economically active population, mln. individuals

Source: Statistics Agency of the Republic of Kazakhstan

In July and August 2009 the structural changes in the composition of employees continued. The main sectors that contributed to the growth of employment compared to the respective period of the previous year were public administration, education and public healthcare, production and distribution of electric energy, gas and water. The largest outflow of the employed fell on the manufacturing industry, construction and financial sector.

In Q3 2009 as compared to the previous period the growth in the employment rate is observed in agriculture being caused by the seasonality factor, in construction which is associated with the stepping up of the Government to finance the uncompleted construction facilities, as well as in the public health care. The increase of employment in the public administration was secured by the cancellation of moratorium for occupation of administrative public vacant positions.

The highest decrease in employment happened in the manufacturing industry, trade, and transport being related to the continuing decline in these sectors.

The growth in the number of individuals employed in the economy in Q3 2009 ensured the decrease in the unemployment rate from 6.7% (Q2 2009) to 6.3% (Figure 21).

Figure 21

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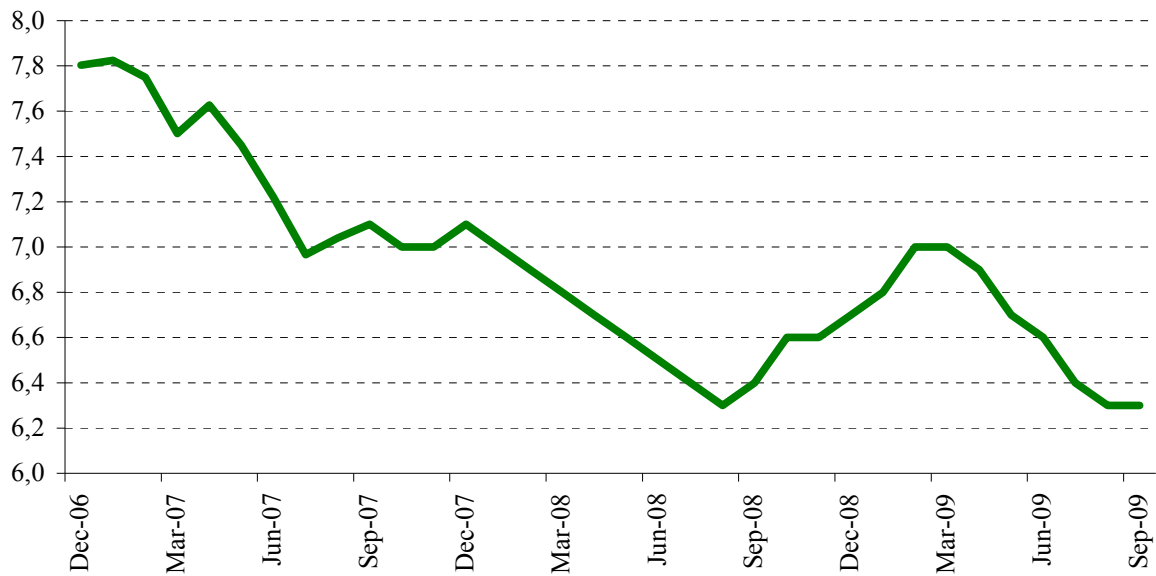
Source: Statistics Agency of the Republic of Kazakhstan

2.3.2. Wages and Productivity

In Q2 2009 nominal wages continued to grow as they did during 2008 and Q1 of this year, though the dynamics of this rate slowed down. Nonetheless, as compared to the number for the respective period of 2008, the average monthly salaries and wages increased in nominal terms by 10.2% (in Q1 2009 the growth accounted for 13.1%).

The reduced inflation background contributed to the growth of salaries and wages in real terms that increased by 1.8% (versus the respective period of 2008). In Q2 2008 the nominal growth of salaries and wages was 19.6%, however, because of the impact of high price level the real growth at that time was 0.1% only.

In June 2009 as compared to June 2008 in nominal terms the salaries and wages of the individuals employed in the public sector demonstrated the highest increase: in the public healthcare – by 27.1%, in the public administration sector – by 24.8%, in education – by 23.0%. As a whole, the growth was observed in all types of economic activities except for the financial sector where the nominal salary was reduced by 8.3%. The growth in salaries and wages is associated with the indexation of payouts to the public sector employees, allocation of public funds for the support of the economy and construction sector, and improvement of the pricing environment for the main items of Kazakhstani exports.

Despite the decrease, the highest level of salaries and wages is still maintained in the financial sector, followed by the mining industry and the real estate sector, and the lowest level is observed in the fishery, agriculture, public healthcare, and education.

The reduced GDP against the hidden unemployment in the labor market (transfer to a part-time working week, reduced business day, provision of unpaid leaves) resulted, according to the National Bank's estimate, in the reduced labor productivity in Q2 2009 by 3.8% (Figure 22).

Figure 22

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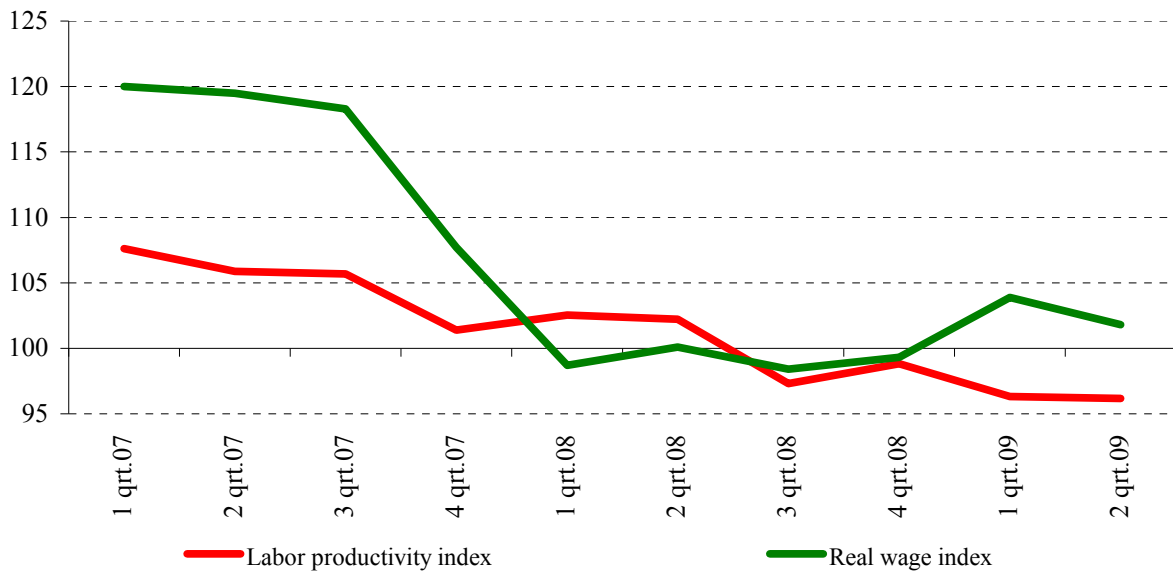
Source: The Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan
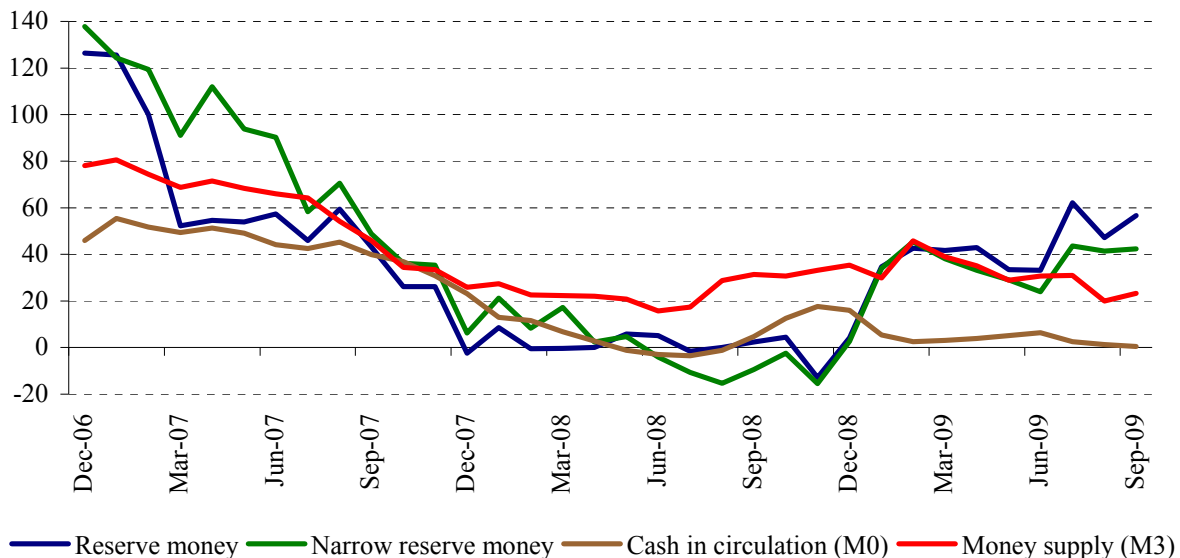
3. Money Supply

3.1. Monetary Aggregates

In Q3 2009 the annual dynamics of monetary aggregates (excluding cash in circulation) demonstrated rather impressive yet slowing down 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 Q3 2009 expanded by 17.7% and amounted to KZT 2 747.7 bln. at end-September 2009. Narrow reserve money in Q3 2009 expanded by 15.9% to KZT 2 201.6 bln.

In September 2009 as compared to September 2008 reserve money expanded by 56.6%. This expansion occurred mainly owing to the crediting of funds of the NWF "Samruk-Kazyna" to the Tenge correspondent accounts of some banks with the National Bank.

Net international reserves of the National Bank in September 2009 as compared to September 2008 decreased by 8.7% to US$ 20.0 bln. Within their structure net currency reserves decreased as a result of FX sales in the domestic foreign exchange market, servicing of the Government's external debt and reduction of foreign currency balances of banks' correspondent accounts with the National Bank. The reduction was not offset by the re-conversion of the National Fund's assets and by the receipt of currency to the Government's accounts with the National Bank, as well the growth of assets denominated in gold.

In September 2009 as compared to September 2008 net domestic assets of the National Bank increased as a result of increased claims on financial organizations on refinancing loans and reduced liabilities to banks on short-term notes (see. 5. Monetary Policy Instruments and Operations).

Narrow reserve money expanded in September by 42.4% as compared to September 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)**

	Q4 08	Q1 09	Q2 09	Q3 09
Net international reserves	**12.6**	**-2.2**	**-12.3**	**-8.7**
Net domestic assets	**38.2**	**108.2**	**143.6**	**153.5**
Net claims on the Government	133.5	-45.6	-108.1	-173.2
Claims on financial institutions	53.7	203.8	231.8	188.6
Claims on the rest of the economy	1.6	4.1	-4.1	в 443.4 раза
Other net domestic assets	7.1	-99.1	-122.9	-254.2
Reserve money	**4.2**	**41.7**	**33.1**	**56.6**
Narrow reserve money	**2.6**	**38.0**	**24.0**	**42.4**

Source: National Bank of the Republic of Kazakhstan

3.1.2. Money Supply

Over Q3 2009 money supply has grown by 6.9% to KZT 7 255.0 bln. In September 2009 as compared to September 2008 its growth accounted for 23.3% as a result of an increase in net foreign and domestic assets of the banking system (Table 3).

Table 3

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

	Q4 08	Q1 09	Q2 09	Q3 09
Net foreign assets	**233.2**	**599.2**	**1439.7**	**99.4**
Domestic assets	**1.9**	**10.6**	**9.5**	**10.7**
Claims on the Government	159.2	-117.3	-80.9	-75.4
Claims on the economy	7.1	18.2	17.7	16.7
Other net domestic assets	-24.0	-49.3	-48.9	-40.5
Money supply	**35.4**	**38.9**	**30.6**	**23.3**
Cash in circulation	16.0	3.1	6.4	0.4
Deposits of residents	39.1	45.0	34.8	26.9

Source: National Bank of the Republic of Kazakhstan

In the structure of net foreign assets of the banking system in September 2009 as compared to September 2008 net foreign assets of banks increased against the decrease in net international reserves of the National Bank. The growth in net foreign assets of banks was caused both by the revaluation of their volumes as a result of the Tenge devaluation implemented in February 2009 and by the reduction in the liabilities of banks to non-residents.

The growth in domestic assets of the banking system was secured by the growth in the volumes of credits to the economy whereas net claims on the Government and 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 residents' deposits in the banking system were fixed as compared to the growth raters of cash in circulation. As a result, the percentage of deposits in the structure of money supply increased from 86.3% in September 2008 to 88.8% based on September 2009.

Money multiplier decreased from 3.35 in September 2008 to 2.64 in September 2009 as a result of outstripping expansion rates of reserve money as compared to growth rates of money supply. The reasons for that were the increased reserving coefficient due to accumulation of significant excessive reserves by banks as well as the decreased cash preference coefficient due to higher growth rates of deposits as compared to the growth of cash in circulation (Figure 24).

Figure 24

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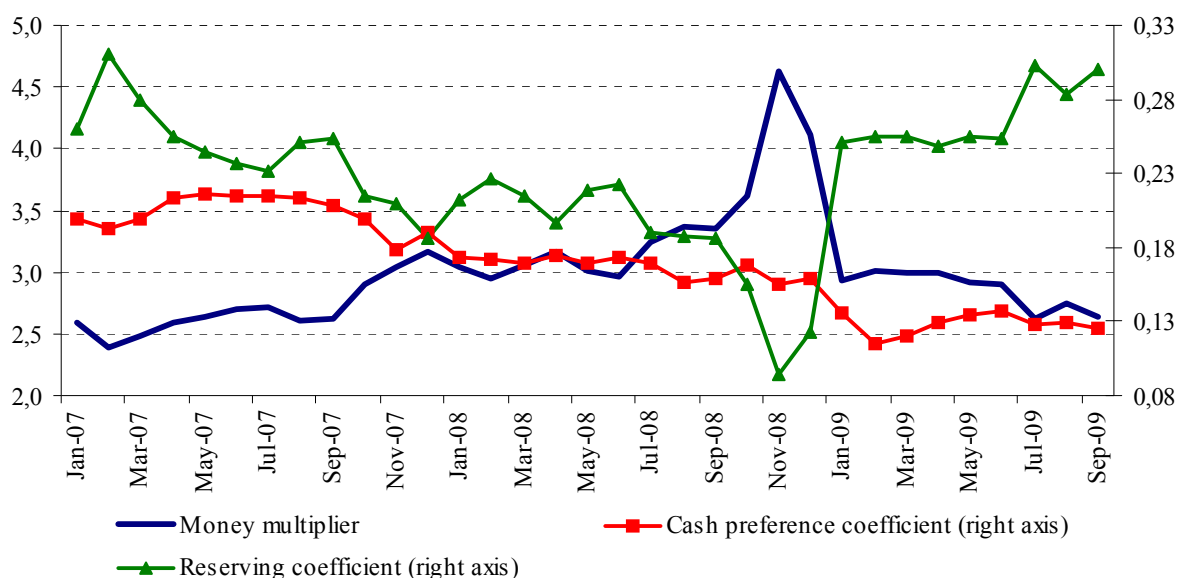
Source: National Bank of the Republic of Kazakhstan

3.1.3. Cash in Circulation

Volume of cash in circulation in Q3 2009 contracted by 1.1% to KZT 809.7 bln. The main reason for the contraction was the growth in net inflows from sales of goods, services and completed works, net inflows from FX sales, net inflows on loans to natural persons and legal entities. The contraction in the volume of cash in circulation was partially neutralized by the growth of net payouts of salaries and wages.

In September 2009 as compared to September 2008 cash in circulation increased insignificantly, by 0.4%. This shows that the effect of factors ensuring growth of cash (increase of wages and pensions) was virtually offset by the effect of factors that contributed to the reduction (increased volumes of foreign cash sales by exchange offices, growth in the deposit balances, proceeds from sales of goods, works and services, etc.).

In Q3 2009 as compared to Q3 2008 payouts of cash from the bank cash departments reduced by 5.7% to KZT 2569.0 bln, receipts to the bank cash departments – by 6.1% to KZT 2489.2 bln. As a result, net payouts from the bank cash departments amounted to KZT 79.8 bln.

3.2. Financial Market

3.2.1. Deposits of Residents

Deposits of residents at end-September 2009 amounted to KZT 6 445.3 bln, having increased by 8.0% over Q3 2009. Deposits of legal entities increased by 5.7%, natural persons – by 14.3%.

As compared to the respective month of the previous year, the volume of deposits of residents with depository institutions grew up by 26.9% in September 2009. Alongside with that there was an outstripping growth of deposits of legal entities as compared to deposits of natural persons. In addition, the growth in foreign currency deposits, even excluding the effect of the Tenge devaluation, also outstripped the growth of deposits in the domestic currency (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
Residents' deposits	**39,1**	**45,0**	**34,8**	**26,9**
Deposits of the population	*2,8*	*7,3*	*10,6*	*20,7*
Transferable deposits	7,7	1,6	5,4	23,0
In the domestic currency	*10,1*	*-1,2*	*3,7*	*10,5*
In foreign currency	*-5,5*	*17,7*	*17,2*	*106,6*
Other deposits	2,2	7,9	11,3	20,4
In the domestic currency	*-6,9*	*-38,9*	*-30,0*	*-29,8*
In foreign currency	*16,1*	*80,0*	*75,7*	*106,0*
Deposits of non-bank legal entities	*60,2*	*66,1*	*46,7*	*29,6*
Transferable deposits	48,2	110,6	95,4	79,2
In the domestic currency	*43,0*	*90,7*	*70,7*	*44,7*
In foreign currency	*71,9*	*189,4*	*195,3*	*202,9*
Other deposits	66,0	41,4	18,9	2,7
In the domestic currency	*55,7*	*5,8*	*-2,5*	*-14,6*
In foreign currency	*85,5*	*94,1*	*49,7*	*22,7*

Source: National Bank Republic of Kazakhstan

Lower rates of the increase in deposits of natural persons can be explained by the fact that after the devaluation financial behavior patterns of the population became more cautious and a part of depositors started withdrawing their foreign currency deposits to save them in "socks". The foreign currency component of the deposit base of natural persons, after the Tenge devaluation, has started to reduce from March 2009 by 2% a month on average. However, well-balanced policy of the National Bank supported, in addition to many official statements, by practical confirmation of the announced band of the Tenge exchange rate fluctuations against the US Dollar, began to pay off. This July foreign currency deposits of natural persons grew up by 5.2% against the previous month, in August – by 11.9%, and in September – by 0.6%.

In August 2009 the amount of people's foreign exchange savings for the first time exceeded the one trillion threshold amounting to KZT 1 076.2 bln at end-September.

In September 2009 the average weighted interest rate on the Tenge time deposits of non-bank legal entities was 4.3% (in September 2008 – 4.4%), and on deposits of natural persons – 4.7% (11.7%).

3.2.2. Credits to the Economy

In Q3 2009 the total debt on credits provided by banks to the economy reduced by 1.0% to KZT 8 026.3 bln. Alongside with that credits to the population reduced by 2.3%, to legal entities – by 0.5% as compared to Q2 2009.

The lending volume increased by 10.1% versus September 2008, however, excluding the devaluation effect, the reduction, according to the estimate, was 0.7%.

The average weighted rate on credits provided to legal entities in September 2009 as compared to September 2008 reduced from 14.7% to 13.8%. The reduction in the parameters of interest rates was observed in all positions, both by types of currencies and terms of lending. Largely this is related to the allocation of the public funds to support the economy both through new credits at a rate lower than the market and through the refinancing of the existing debt.

The average weighted rate on credits to natural persons decreased insignificantly in September 2009 as compared to September 2008, from 18.8% to 18.5%, with the growth in rates (c 23.9% to 31.5%) being observed only on short-term credits provided in the Tenge (Figure 25).

Figure 25

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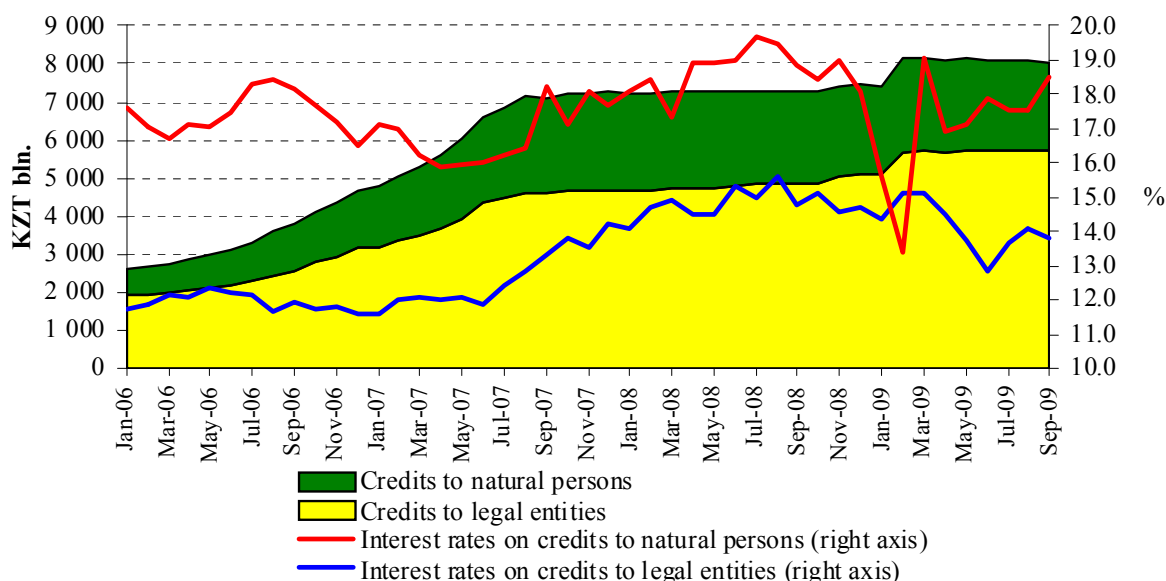
Source: National Bank of the Republic of Kazakhstan

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. There was a decrease in credits provided for consumer purposes as well as for construction and purchase of residential estate by individuals.

In a sectoral breakdown, the highest debt on bank credits falls on non-production sphere and individual entrepreneurship (40.5%), trade (22.9%), construction (19.4%), and industry (9.9%).

− **Credits to legal entities**

The volume of credits to legal entities in September 2009 as compared to September 2008 grew up by 17.1%. Credits to legal entities in the domestic currency reduced in annual terms by 1.2%, credits in foreign currency increased by 37% (if the devaluation effect was excluded, the growth, by the estimate, would have accounted for 10.8%) (Figure 26).

Figure 26

Dynamics of Credits to Legal Entities
(as % of the respective period of the previous year)
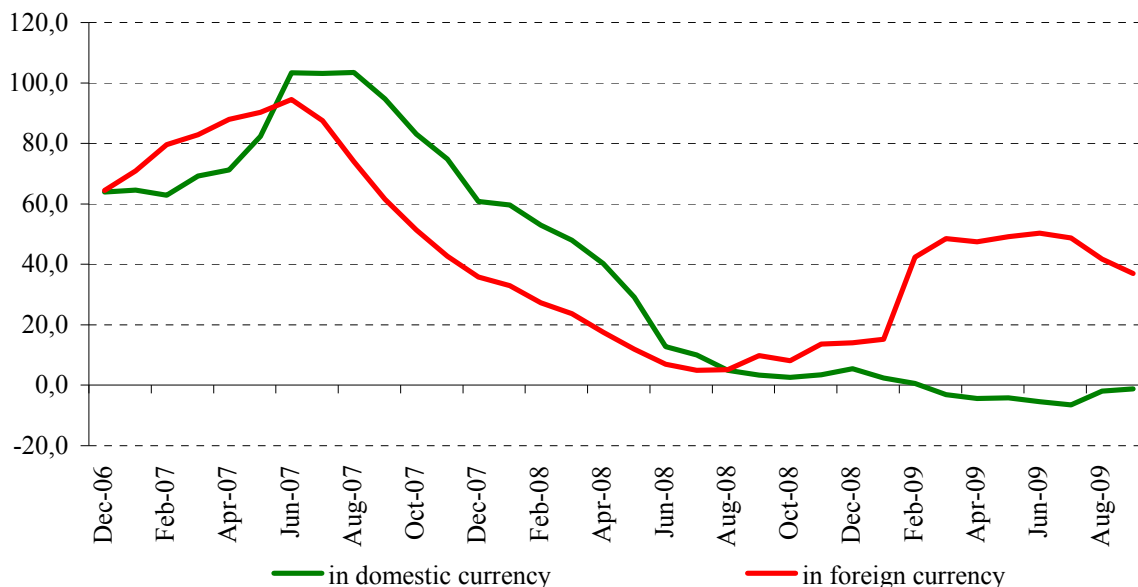
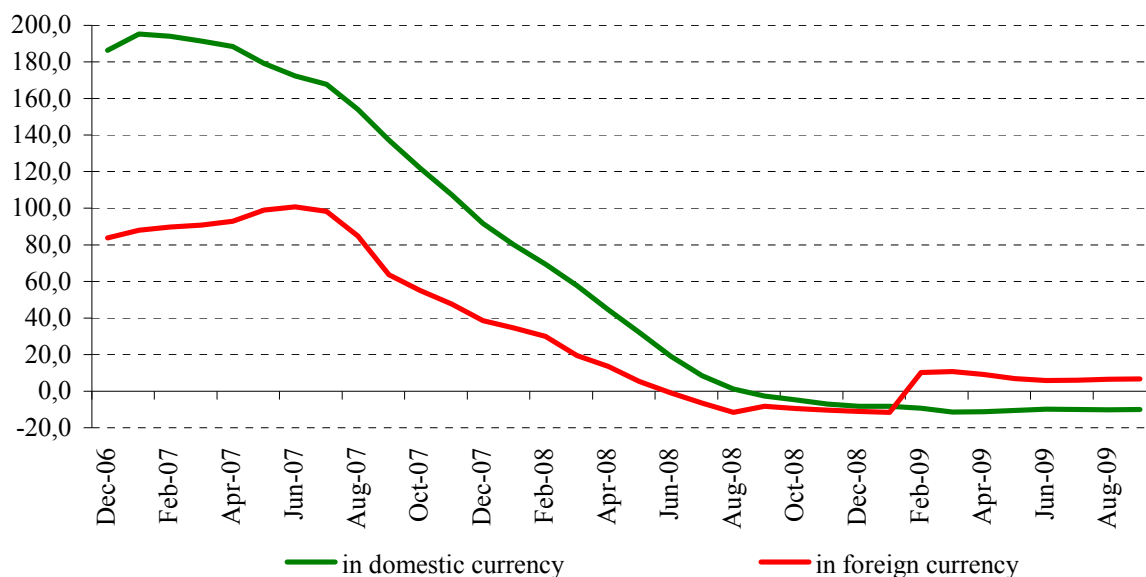Source: National Bank of the Republic of Kazakhstan

The percentage of medium- and short-term credits in the total volume of credits to legal entities was 78.5% at end-September (in September 2008 – 71.0%).

− **Credits to the Population**

The volume of credits to the population in September 2009 as compared to September 2008 decreased by 4.1%. In the structure of credits to the population credits in the domestic currency have demonstrated a decrease of 10.1% while foreign currency credits have demonstrated an increase of 6.7% (Figure 27).

Figure 27

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

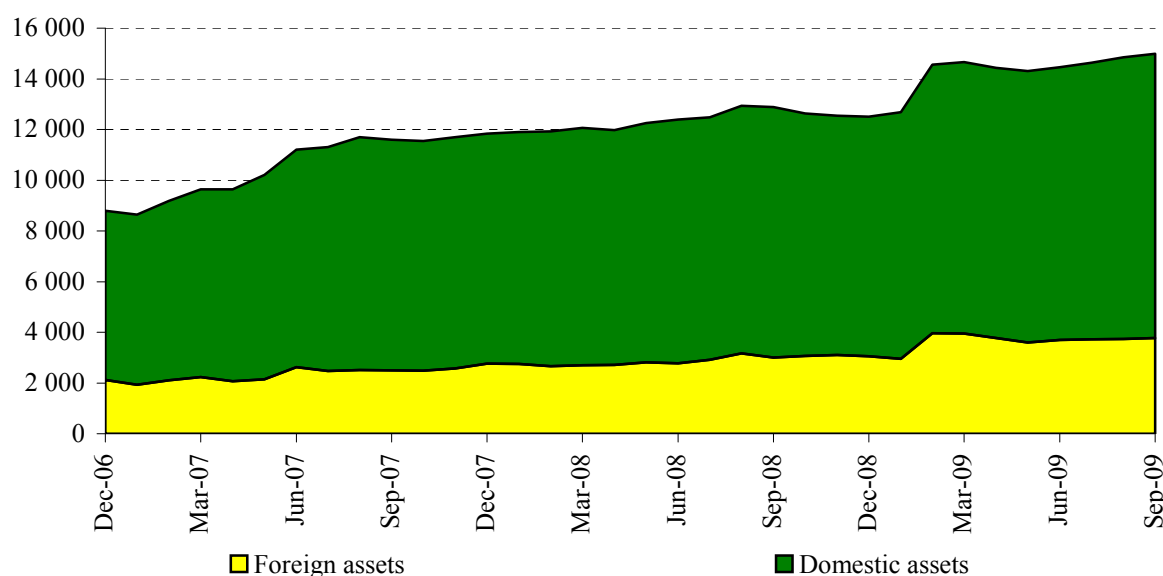Source: National Bank of the Republic of Kazakhstan

3.2.3. Bank Assets and Liabilties

− **Assets**

In Q3 2009 the size of banks' assets calculated according to the Monetary Survey increased by 3.7% to KZT 14.9 trln. In annual terms (in September 2009 as compared to September 2008) banks' assets increased by 16.4%, and excluding the devaluation effect – by 3.3% (Figure 28).

Figure 28

Dynamics of bank assets, KZT bln

Source: National Bank Republic of Kazakhstan

Foreign assets of banks at end-September 2009 comprised 25.% of total assets or US$ 25.0 bln. As compared to June 2009 they increased by 2.2%, and as compared to September 2008 – increased by 25.4%.

In the structure of foreign assets in September 2009 credits provided to non-residents amounted to 56.4% (in September 2008 – 54.2%), deposits placed with non-residents – 23.7% (in September 2008 – 26.3%), securities of non-residents – 4.9% (in September 2008 – 9.3%).

Domestic assets in September 2009 comprised 74.8% or KZT 11.2 trln., including domestic assets in the domestic currency comprised 55.0% or KZT 6.2 tln, in foreign currency – 45.0% or KZT 5.1 trln. (

Figure 29). Over June-September 2009 domestic assets increased by 4.2%, including assets in the domestic currency increased by 4.5%, assets in foreign currency increased by 3.8%. In annual terms the growth of these indicators reached 18.6%, 6.6% and 37.6%, respectively.

Figure 29

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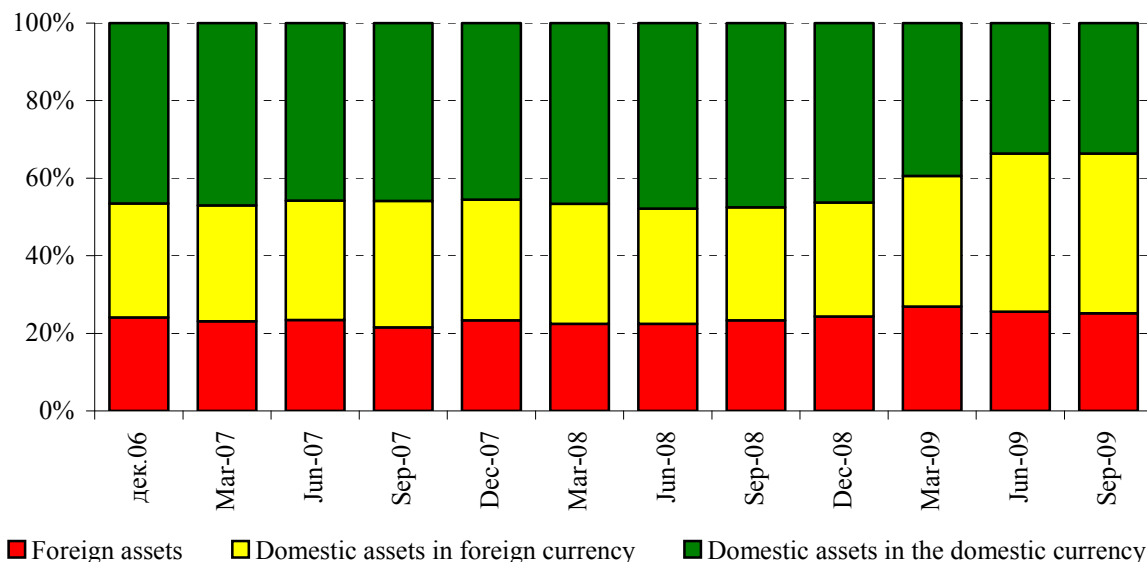
Source: National Bank of the Republic of Kazakhstan

In September 2009 as compared to September 2008 the quality of banks' assets deteriorated significantly. The percentage of bad loans increased from 3.3% to 30.0% while the percentage of standard loans reduced (from 44.0% to 27.5%) and doubtful loans (from 52.7% to 42.5%). In addition, in the structure of doubtful loans there is a migration towards the lower quality assets: the percentage of the 5th category increased (from 2.1% to 4.9%) with concurrent reduction in the percentage of the 1st category (from 31.9% to 19.1%). This shows the remaining threat of a further reduction in the quality of the banks' assets.

− **Liabilities**

In Q3 2009 total liabilities of banks calculated in line with the Monetary Survey increased by 5.0% and amounted to KZT 11.8 trln. at end-September. In annual terms (in September 2009 as compared to September 2008) banks' liabilities increased by 12.8%, and they would have decreased by 1.9% without the devaluation effect (Figure 30).

Figure 30

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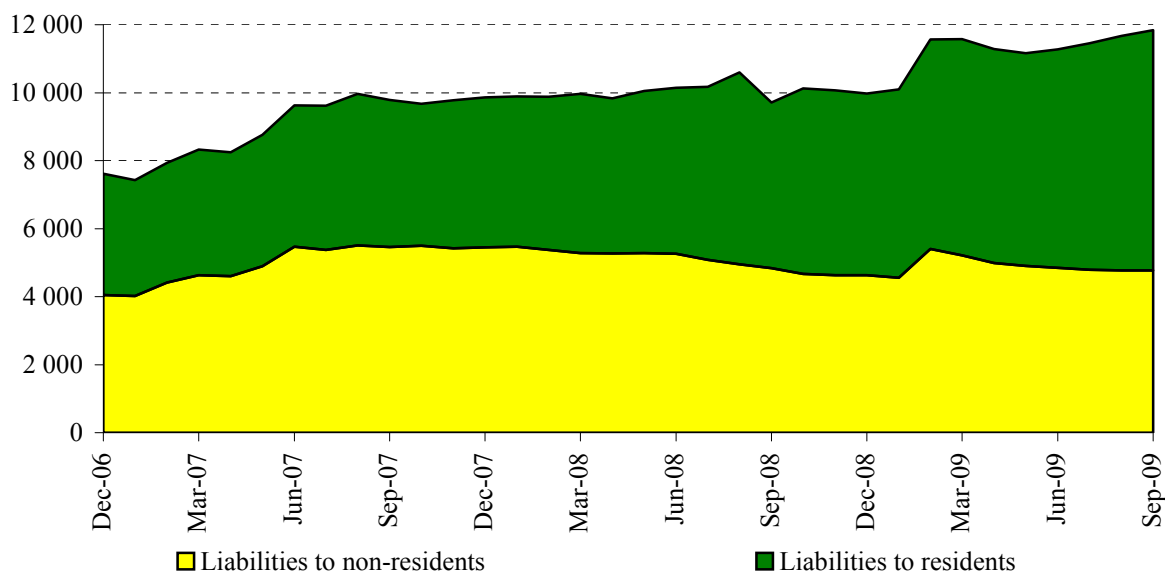
Source: National Bank of the Republic of Kazakhstan

Banks' liabilities to non-residents in September 2009 as compared to September 2008 decreased by 1.6% to KZT 31.6 bln. In annual terms, banks' liabilities to non-residents reduced by 1.6%. At end-September 2009 they comprised 40.3% of the volume of bank liabilities.

In the structure of banks' liabilities to non-residents in September 2009 credits to non-residents increased to 7.8% from 5.0% in September, liabilities on securities – to 9.5% from 6.0%. On the contrary, credits from non-residents decreased to 79.5% from 87.0% in September 2008.
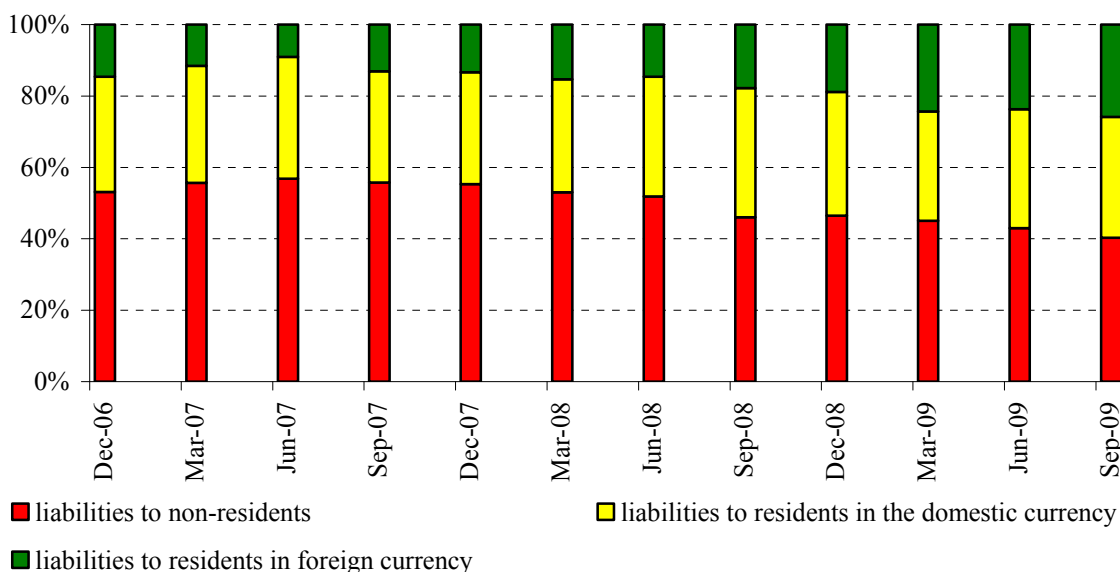
Over June-September 2009 liabilities to non-residents increased by 10.1% to KZT 7.1 tln, including liabilities in the domestic currency – by 6.8% to KZT 4.0 tln, liabilities in foreign currency – by 14.6% to KZT 3.1 trln. In annual terms, the growth of these indicators comprised 24.8%, 5.6% and 63.9%, respectively (Figure 31).

At end-September 2009 in the structure of liabilities to non-residents the percentage of transferable and other deposits of government non-financial organizations virtually didn't change making up 22.9% (in September 2008 – 22.2%). The percentage falling on deposits of non-government financial organizations has reduced over the period from 32.1% to 29.1%, and households – from 27.1% to 26.2%.

Thus, consequences of the global financial and economic instability continued having its negative effect on the development of the banking sector in Kazakhstan also in Q3. Reduced quality of banks' loan portfolios became of the major challenges. However, over a half of bad loans in the banking sector and over one third of assets fall on those banks that undergo the debt restructuring process. A further development of the banking system in Kazakhstan will depend on how successfully two strategic banks will implement their plan for the restructuring of foreign debts.

Figure 31

**Structure of bank liabilities, %**

■ liabilities to non-residents   □ liabilities to residents in the domestic currency

■ liabilities to residents in foreign currency

Source: National Bank of the Republic of Kazakhstan

3.2.4. Financial Market Rates

In Q3 2009 interest rates in the interbank market lowered. The KazPrime indicator decreased from 11.79% on average in Q2 2009 to 7.65% on average in Q3. At end-June the indicator was 10.00%, and at end-September – 6.30% (Figure 32).

Figure 32

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

——— KazPrime-3M   ——— Oficial refinance rate
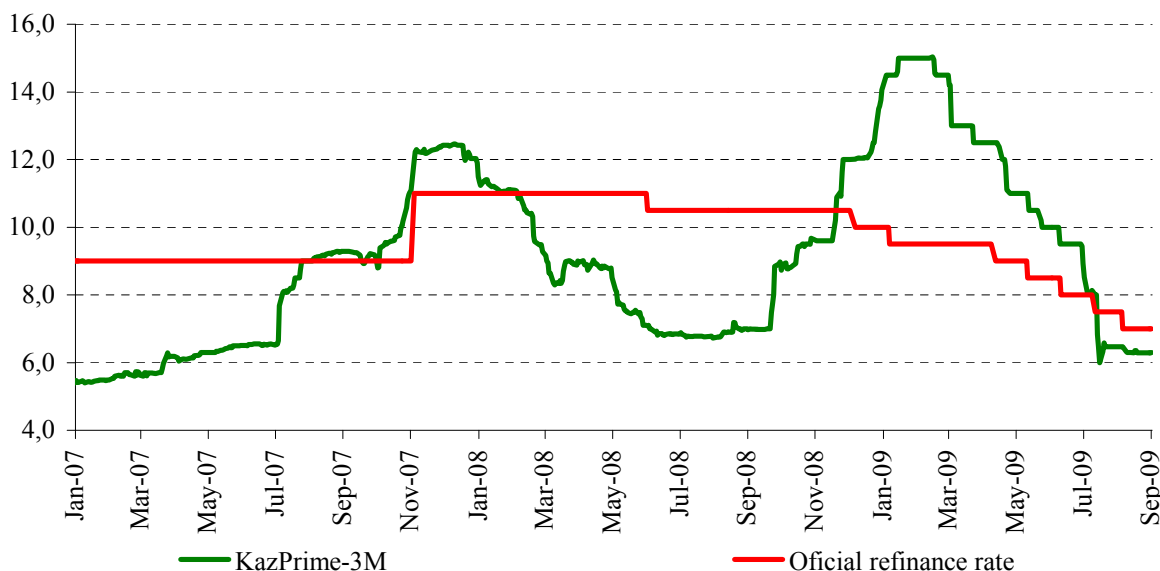
Source: Kazakhstan Stock Exchange, National Bank of the Republic of Kazakhstan

The main factor for the reduced KazPrime rate is the increase in the volume of liquidity offered in the money market.

Rates on REPO operations are also decreasing.

The average weighted rate on 1-day operations in the automatic REPO sector in Q3 2009 decreased and made 0.86% (in Q2 – 1.00%). Its maximum level was 2.21%, and minimum – 0.38%.

Fluctuations of the rate on 7-day REPO operations in Q3 2009 were within the range of 0.39% to 4.79%. The average weighted rate on 7-day REPO operations in Q3 2009 was 1.68%, whereas in Q2 it was 3.65%.

The average-weighted rate on 14-day REPO operations in Q3 2009 amounted to 2.55% (in Q2 – 5,64%). Rates fluctuated within the range of 1.20% to 10.00%.

As for 28-day REPO operations the average weighted rate reduced from 5.67% in Q2 to 3.58% in Q3 2009. Its maximum level was 10.00%, minimum – 2.84% (Figure 33).

Figure 33

Dynamics of rates on REPO operations, %
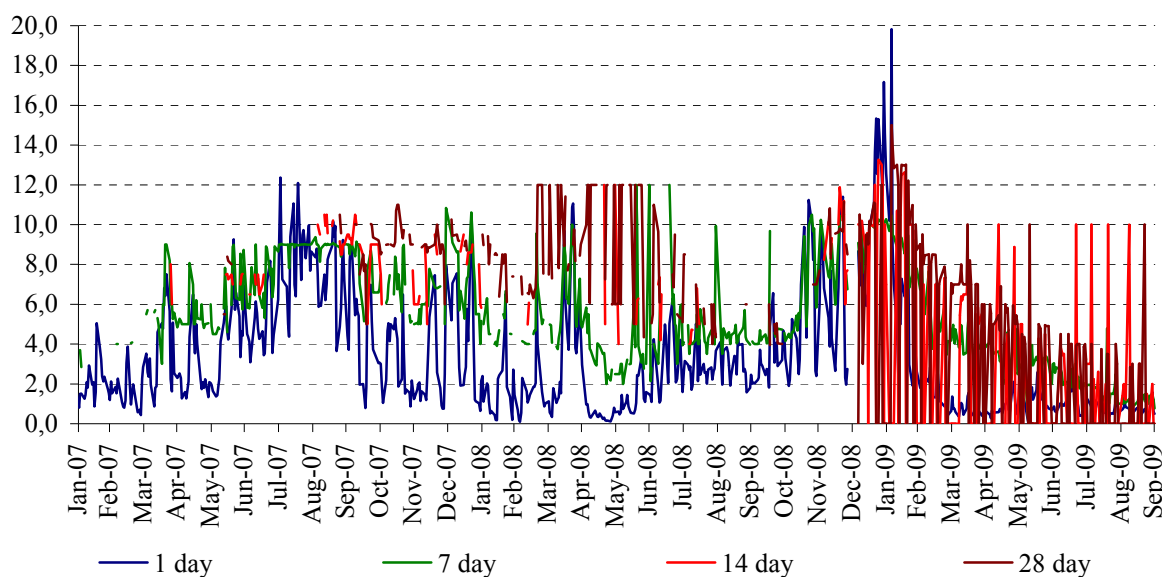
Source: Kazakhstan Stock Exchange

Volatility of rates in the money market remains high, being related to the small capacity of the market, its insufficient depth, the lack of a sufficient quantity of collateral instruments, and low activity of the market participants. In addition, the market rates pretty often fall beyond the rate band of the National Bank, thus not allowing regarding it as an efficient tool for stabilization of money market rates. However, the situation with liquidity improves and the reduced rates in the market are the sign of gradual stabilization.

Volumes of transactions in the automatic REPO sector in Q3 2009 increased by 10.3% as compared to the previous quarter.
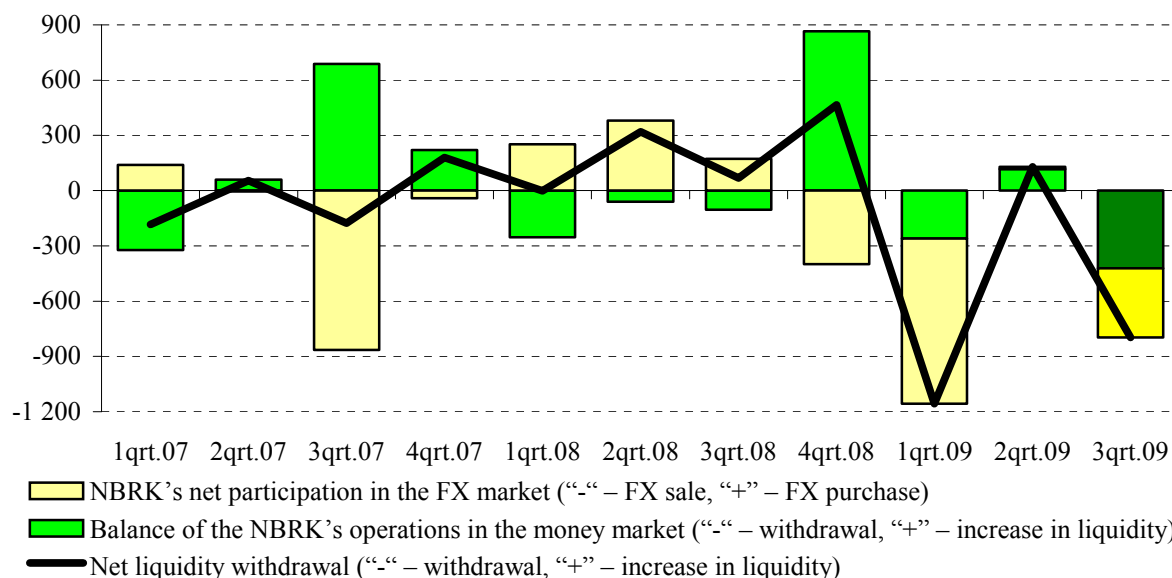
4. Monetary Policy Instruments and Operations

In Q3 2009 the situation in the financial market was stable, banks had sufficient Tenge liquidity available.

As a result, in Q3 2009 the National Bank's financial market operations have resulted in the withdrawal of the Tenge liquidity mainly due to the increased volumes of deposits attracted from banks by the National Bank (Figure 34). The National Bank was withdrawing liquidity throughout the entire period.

Figure 34

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

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

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

Net liquidity withdrawal ("-" – withdrawal, "+" – increase in liquidity)

Source: National Bank of the Republic of Kazakhstan

As part of the measures for ensuring the financial sector stability, the National Bank in Q3 2009 continued to gradually reduce interest rates on its own operations. From July 10, 2009 the official refinancing rate was reduced from 8.5% to 8.0%, from August 10, 2009 – to 7.5%, from September 4, 2009 – to 7.0%. From August 10, 2009 the interest rate on deposits attracted from banks was reduced from 4.0% to 2.0% on 7-day deposits. In addition, the National Bank started attracting deposits with one-month maturity at 2.5%.

Stabilization of the situation with liquidity in the financial market was accompanied by the rates decrease in the money market. On average in July-September, 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 in Q3 2009 was at 2.87%. The average weighted rate on the 7-day interbank REPO operations was 1.68% (Figure 35).

Figure 35

**Boundaries of the National Bank's interest rates band, %**
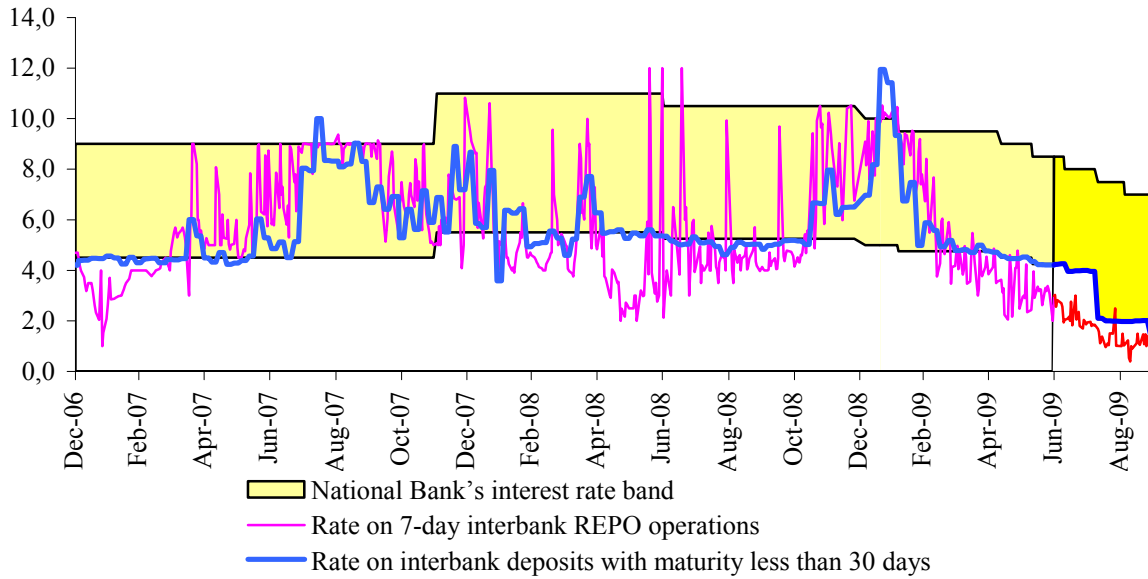
Source: National Bank of the Republic of Kazakhstan

In Q3 2009 there was an increase of banks' correspondent account balances with the National Bank, both in the domestic and foreign currency (Figure 36). In July 2009 correspondent account balances in foreign currency decreased and in August-September their volume began to gradually increase. Correspondent account balances in foreign currency tended to gradually decrease during the entire period.

Figure 36

Balances of correspondent accounts with the National Bank, KZT bln
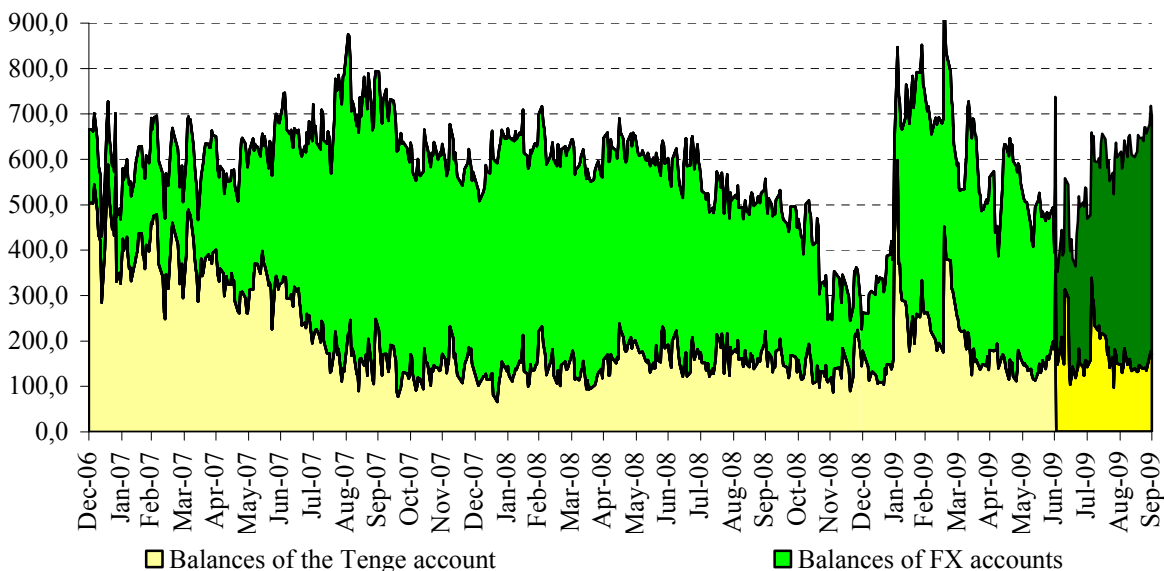
Source: National Bank of the Republic of Kazakhstan

### 4.1. Interventions in the Domestic Foreign Exchange Market

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

In Q3 2009 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank FX market amounted to US$ 16.0 bln, having increased by 3.7% as compared to Q2 2008 (US$15.5 bln.).

The volume of trades in Dollar position at the Kazakhstan Stock Exchange increased by 39.6% as compared to Q2 2009 and amounted to US$ 8.6 bln. (net trades at the Kazakhstan Stock Exchange made up 84% of gross trades). In the off-exchange foreign currency market the volume of transactions in the third quarter of 2009 decreased by 19.8% as compared to the previous quarter and amounted to US$ 7.5 bln. (Figure 37).

Figure 37

**Volume of trading in the domestic exchange market, US$ bln.**
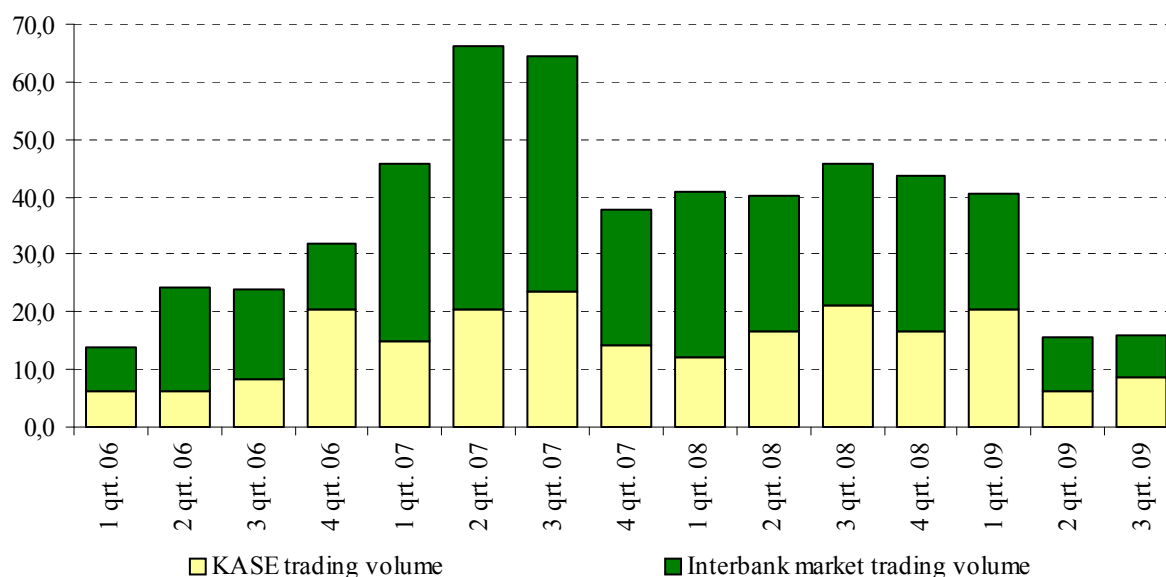
Source: National Bank of the Republic of Kazakhstan

Based on Q3 2009 the National Bank was primarily a seller of foreign exchange in the domestic exchange market. The National Bank's participation coefficient in the Kazakhstan Stock Exchange was (-)35.3%, whereas in the previous quarter the NBRK's participation was minimal and the participation coefficient was (-)0.1%. The National Bank's participation in the trading in July was the most significant and was the result of the increased devaluation expectations of the population and enterprises.

4.2. Minimum Reserve Requirements

The lowering of the norms of minimum reserve requirements that have occurred in the beginning of the year resulted in building up of a significant volume of excessive reserves by banks. On average, in July-September 2009 reserve assets exceeded the required reserving volume by 3.4 times (Figure 38).

Figure 38

Compliance with minimum reserve requirements, KZT bln.
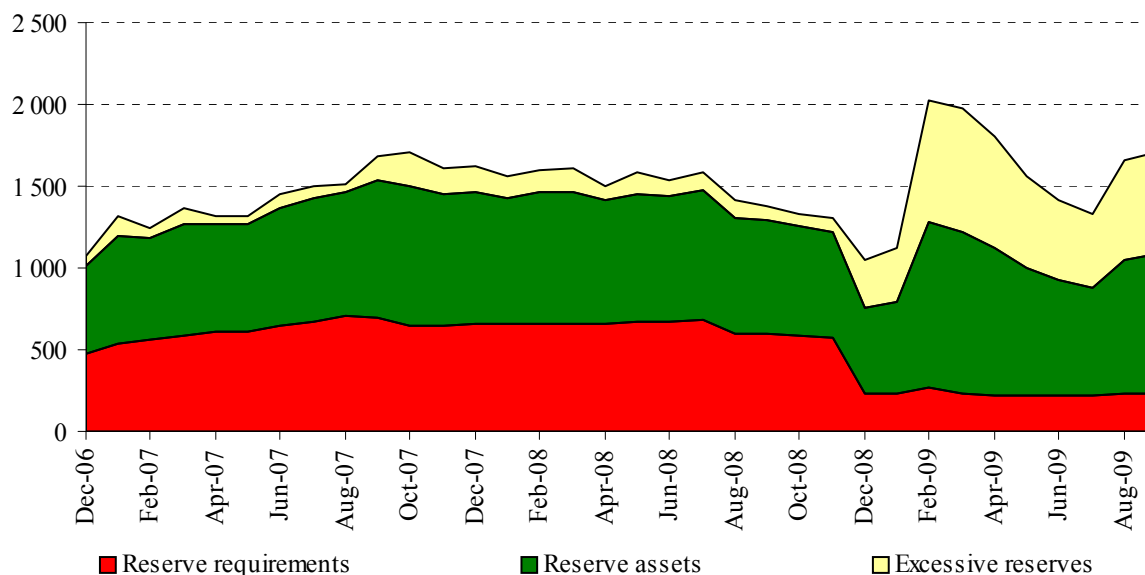
Source: National Bank of the Republic of Kazakhstan

4.3. Open Market Operations

In Q3 2009 demand for short-term notes of the National Bank on the part of banks remained high. However, with a view to re-direct participants of the short-term government securities market to government securities of the Ministry of Finance, the National Bank reduced the volume of the short-term notes issue. As a result, in July-September 2009 the National Bank satisfied the demand of banks for these instruments not to the full extent.

Since banks had significant liquidity reserve placed with the National Bank, the decision was made to suspend the issue of 28-day notes from August 10, 2009 and to begin placing 3- and 6-months notes with the target yield of 2.9% and 3.3% (+/-0.1%), respectively.

The volume of issued short-term notes in July-September 2009 was lower compared to Q2 2009 by 3.4% and amounted to KZT 338.0 bln. This accounted for 72.2% of the aggregate demand of the market participants for these types of government securities.

Notes were issued for 1, 3 and 6 months. The average weighted yield on placed notes reduced from 5.24% in Q2 2009 to 2.66% in Q3 2009 (Figure 39).

At end-September 2009 the volume of short-term notes in circulation amounted to KZT 180.2 bln, which exceeded the volume at end-June 2009 by 24.2% and was by 2.6 times less than the volume at end-September 2008 (Figure 40).

Figure 39

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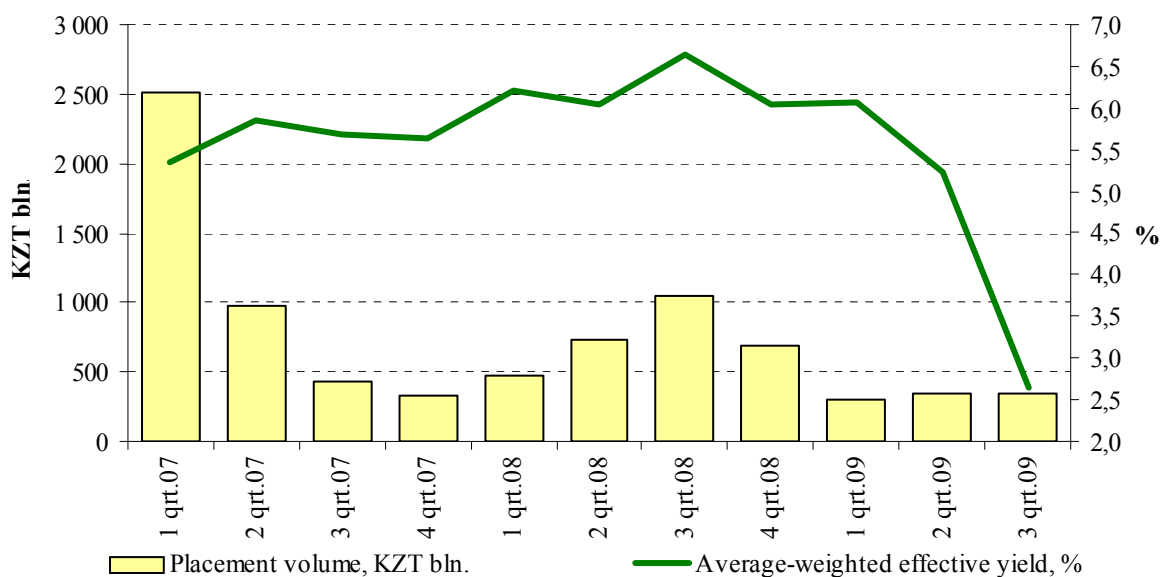
Source: National Bank of the Republic of Kazakhstan

Figure 40

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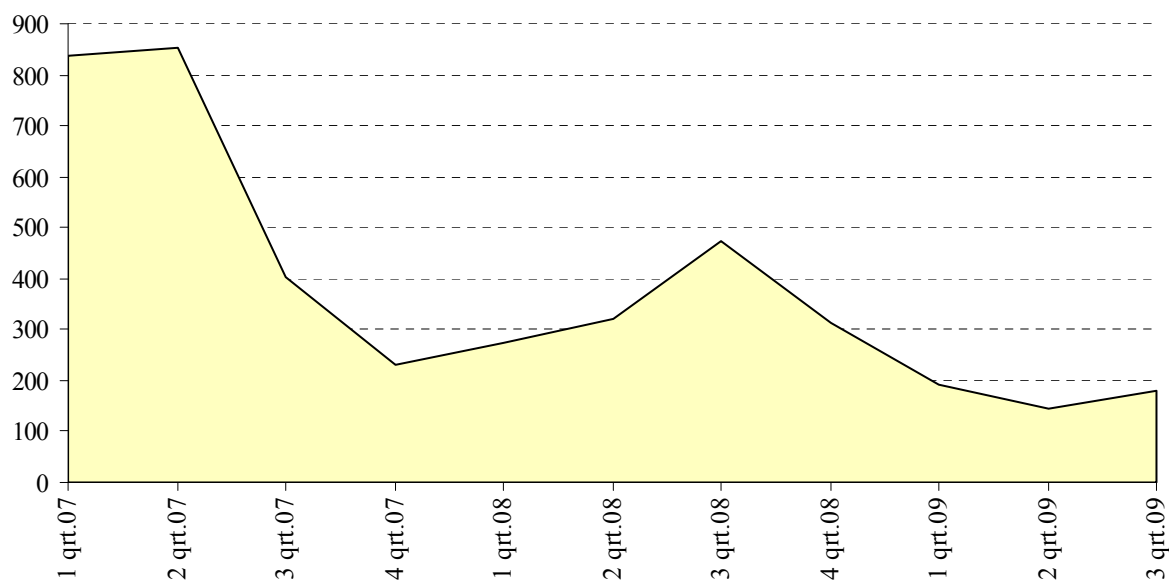
Source: National Bank of the Republic of Kazakhstan

4.4. Standing Facilities

In Q3 2009 there was a significant growth in the volumes of banks' deposits with the National Bank against both the previous quarter and the number for the respective period of 2008. Monthly amounts of attracted deposits exceeded KZT 2 trln. As a whole, over July-September 2009, deposits worth KZT 6971.6 bln. have been attracted, which is by 2.1 times higher than the volume of Q2 2009 and by 2.7 times higher than the volume of Q3 2008.

A stable situation with the Tenge liquidity in the banking sector helped the National Bank make the decision to change the maturities and interest rates on attracted deposits. From August 10, 2009 the National Bank has been attracting deposits from banks for 7 days at 2.0% per annum, for 1 month – at 2.5% per annum.

In Q3 2009 the average interest rate was at 2.93% (Figure 41).

Figure 41

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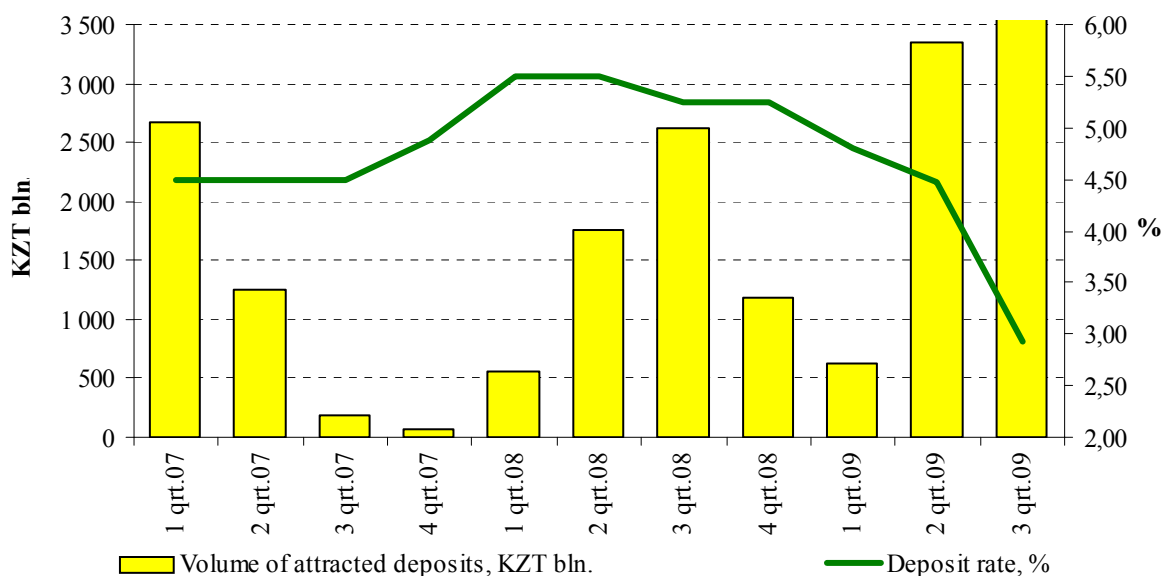
Source: National Bank of the Republic of Kazakhstan

Growth in volumes of deposits attracted from banks was accompanied with growth in the amount of the National Bank's outstanding liabilities on these deposits by 27.4% amounting to KZT 521.7 bln. in September 2009 as compared to June 2009 and by 2.5 times as compared to September 2008 (Figure 42).
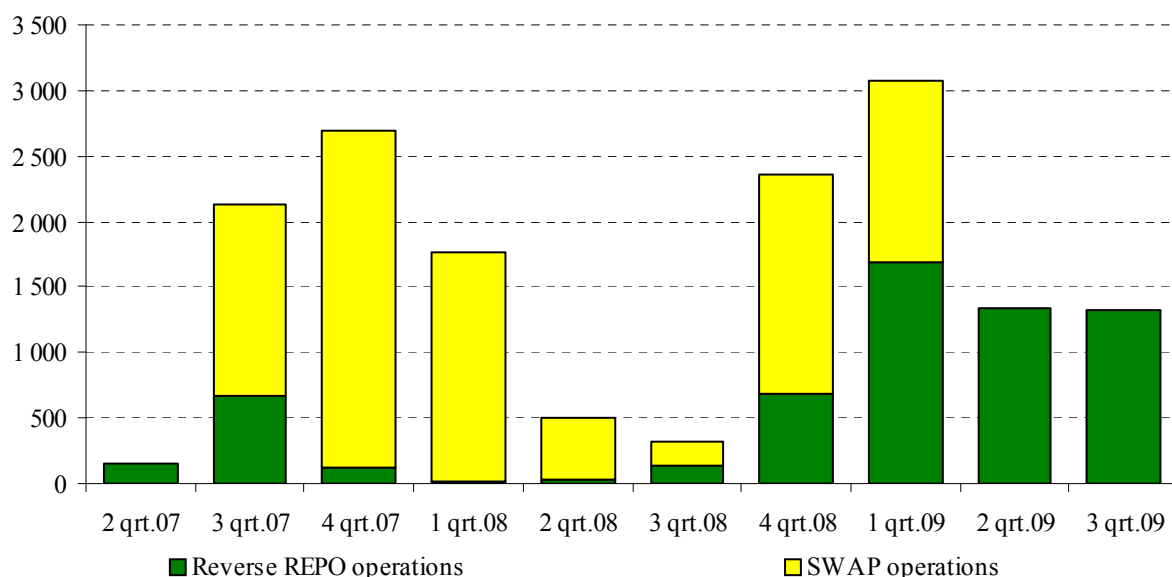
Figure 42

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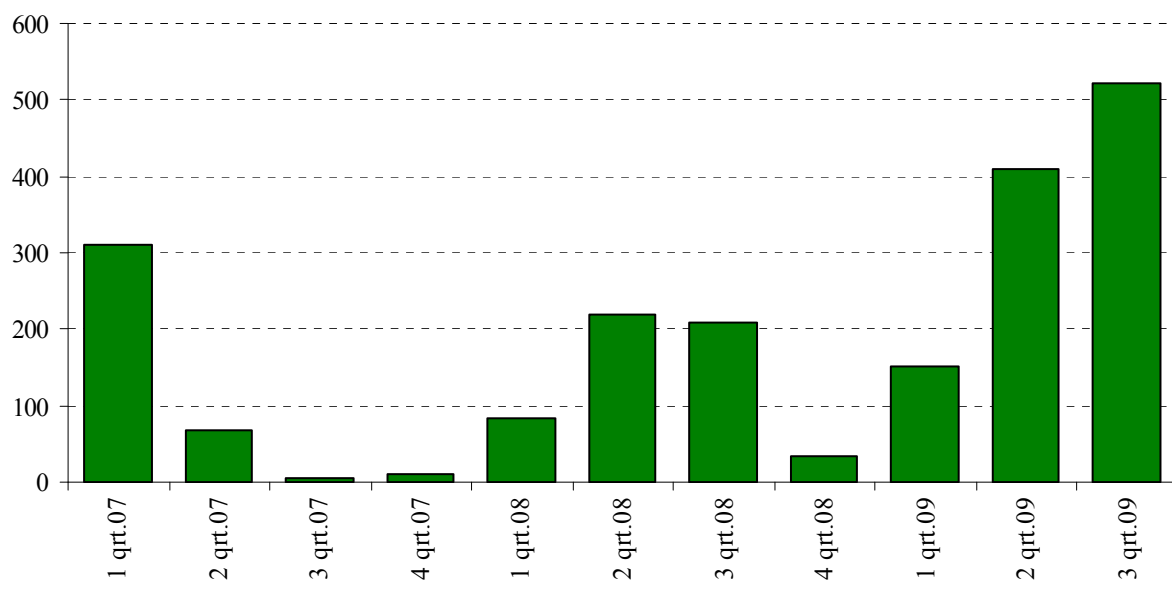
Source: National Bank of the Republic of Kazakhstan

In addition to sterilization operations, the National Bank in Q3 2009 continued providing refinancing loans to the banking sector through reverse REPO operations. The total volume of reverse REPO operations in July-September 2009 amounted to KZT 1319.7 bln. (Figure 43).
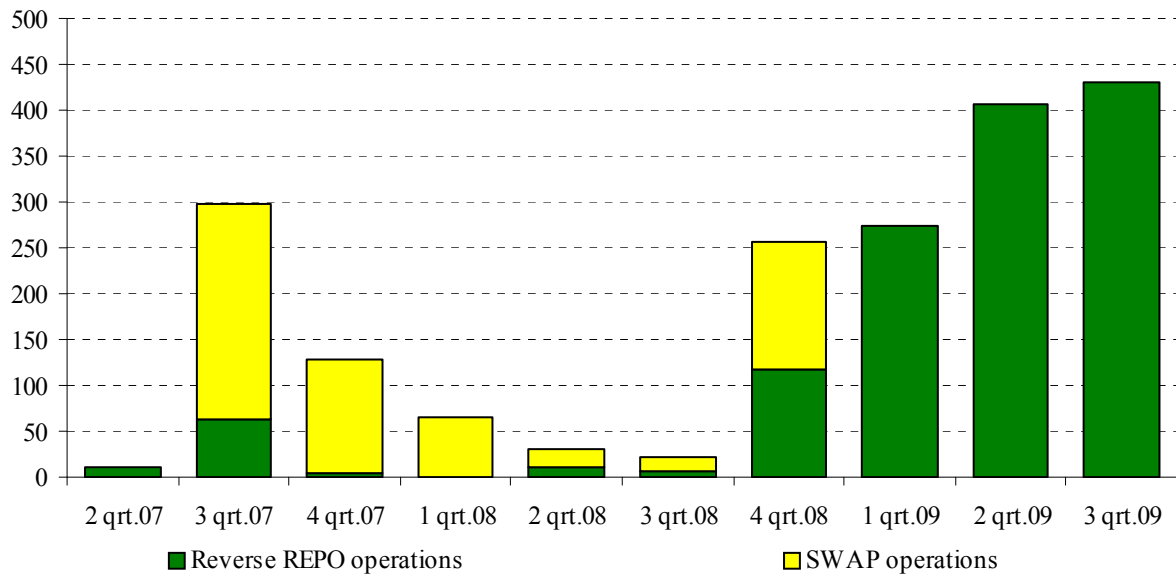
Figure 43

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

Source: National Bank of the Republic of Kazakhstan

At end-September 2009 the outstanding debt on reverse REPO operations amounted to KZT 431.5 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