National Bank of the Republic of Kazakhstan

Inflation Report for the Second Quarter of 2009

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Basic Terms and Definitions

In Section 3. 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

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 4. 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 5. 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 6. Monetary Policy Instruments and Operations

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

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

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Summary

In 2009 the macroeconomic situation in Kazakhstan was characterized by several processes. For the first time since 1999 the real GDP decreased by 2.2% in Q1 2009. The decline in production was observed in many industries. Thus, in January-June 2009 as compared to January-June 2008 the volume of industrial output reduced, including in the manufacturing industry, cargo turnover, retail turnover.

Despite reduced business activity in the economy, in Q2 2009 the tendency for stabilization of situation in the labor market outlined, being accompanied by a gradual reduction of the unemployment level. Low growth rates of personal income retained.

The growth in world prices for certain raw commodities (oil, metals) contributed to the increase in prices for the industrial output of the Kazakhstani producers.

Nonetheless, the situation in the consumer market of Kazakhstan in Q2 2009 remained stable. Inflation in April-May 2009 was at 1.9% (in Q2 2008 – 3.1%), annual inflation based on the June 2009 numbers amounted to 7.6%, having decreased from 9.5% in December 2008.

A low inflationary background in the economy enabled the National Bank to implement the monetary policy aimed at ensuring 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 April-June 2009 the rate band on the National Bank's operations had been gradually changed. The official refinancing rate was reduced from 9.5% to 8.5%.

The reduced inflation rates in the second quarter of 2009 allowed the National Bank revising and reducing its annual inflation forecast for 2009 from 11.0% to 8.0-8.5%. It's worth mentioning here that risks remain whose realization can result in the increased inflationary background in the economy. Out of those risks the following should be highlighted: the growth of inflation rates in the countries – main trading partners, shocks in the domestic and global markets of individual goods and services, potential increase in tariffs for paid services (gas, water and electricity supply).

Evaluation of the Inflation Forecast for the Second Quarter of 2009

The actual inflation rate in Q2 2009 (1.9%) was entirely in line with the forecast for the period (1.7-1.9%), which was published in the previous issue of the Inflation Report. Inflation in April and May exceeded the expectations for the period by 0.1 pp only.

It should be noted here that in April the build up of inflationary processes occurred under the impact of the increase in prices for foodstuffs and non-food items, in May – foodstuffs, and in June the pressure increased again from non-food items.

In April-June there was a gradual stabilization of situation with prices for detergents and scouring products, personal care products, medical supplies, and nonetheless, despite for the slowdown, third growth is still high.

In Q2 2009 the determinant in the increase in prices for foodstuffs was the increase in prices for fruit and vegetable products, sugar and soft drinks.

It should be noted here that in Q2 2009 the growth rates on prices for fruit and vegetables were somewhat higher as compared to previous years. In Q2 in 2003-2008 the average annual increase in the price for these products was 4.7%, and in 2009 – 7.0%. The increase in price for sugar in 2009 is accounted by the growth in world prices for this commodity. Thus, in 2003-2008 in the same period prices of sugar, as a rule, changed insignificantly or decreased, while in Q2 2009 the price for sugar increased significantly (by 11.7%).

It is also worth mentioning the reduced prices in Q2 2009 for such goods and services as dairy products, fats and oils, eggs, gasoline, some types of utilities.

Actual inflation rate at end-June 2009 in annual terms didn't exceed the forecast published in the pervious Inflation Report. Thus, in June 2009 annual inflation was at 7.6% with a forecast of 7.5-7.7%.

Inflation Forecast for 2009

In 2009 the situation in the consumer market will remain stable. After the Tenge devaluation implemented in February 2009, the situation in the consumer market deteriorated to some extent. This was accompanied by the build up of inflationary expectations, frenzy in certain markets of goods and services. In these circumstances the National Bank increased the annual inflation forecast for 2009 from 9.0% to 11.0%.

However, due to the decline in economic growth, low growth rates of money income of the population, and limited consumer demand the inflation rates were not high. During the period from March to June 2009 the inflation rate didn't exceed the value for February 2009, which evidences an insignificant inflationary effect from the Tenge devaluation.

In these circumstances the National Bank reduced its annual inflation forecast to 9.0% in June 2009 (Figure 1), and in August 2009 it reduced the inflation forecast to 8.0-8.5%.

Figure 1

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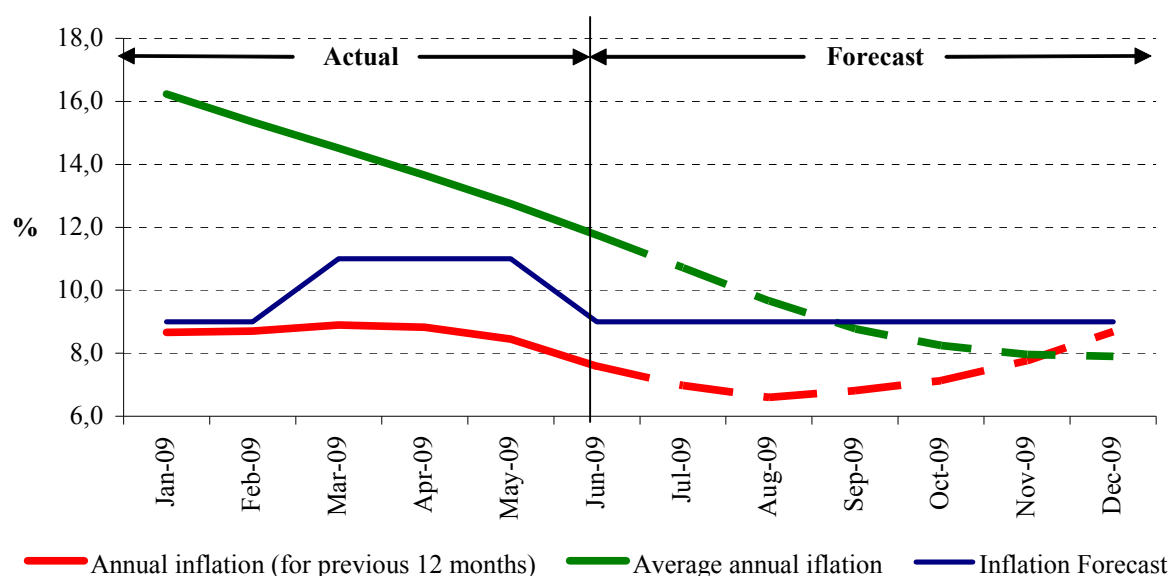
Source: National Bank of the Republic of Kazakhstan

In the second half of 2009 the National Bank will continue taking measures aimed at maintaining the stability of the exchange rate and stability of the country's financial sector. The National Bank will continue conducting refinancing operations. This doesn't preclude the presence of a further decrease of the official refinancing rate, however, it will be determined by the annual inflation dynamics, since the level of the official refinancing rate should remain positive in real terms.

Despite low inflation rates, risks for increased inflationary pressure in the economy remain. These risks, in the first instance, are associated with the increased inflation in the countries – main trading partners (Russia, Ukraine, China), with shocks in the global and domestic markets of individual commodities and services.

This will require urgent measures to be taken by the Government aimed to prevent an unjustified growth in tariffs for certain types of services, to decrease the level of monopolization in the market, stabilize the markets of individual commodities including by introducing import restrictions, export customs duties, etc.

The inflation forecast for Q3 2009 is 1.6-1.8% (in Q3 2008 – 2.3%). In general, this level is in line with inflationary tendencies of the 3rd quarter which are typical for the previous years, except for 2007-2008.

These expectations are associated with the fact that, in the first instance, the build up of inflation will occur under the impact of the seasonality factor. The period from July to September is as a rule characterized by the lowest inflation rates in a year. Reduced prices for individual types of foodstuffs (fruit and vegetables, meat products, dairy products) can be observed.

At the same time, the growth of prices for fuel and lubricants, transportation services, and services from educational institutions is anticipated.

Based on September 2009, the annual inflation is expected at 6.8-7.0%.

The inflation forecast for Q4 2009 is 3.0-3.2% (in Q4 2008 – 1.3%), which is in line with the annual inflation of 8.0-8.5% at December-end 2009.

As a rule, the situation in the consumer market in the last months of a year is characterized by the increase in prices. This is associated with the seasonality factor and the growth of demand during public holidays. By analyzing the situation of the past years, one can expect that in Q4 2009 there will be growth in prices for such goods and services as fruit and vegetables, eggs, meat and dairy products, clothes and footwear, some types of utilities.

1. Inflationary Processes

1.1. Consumer prices

Devaluation of the Tenge implemented in February 2009 didn't result in a jump in consumer prices, contrary to expectations. Nonetheless, its effect appeared to be extended in the time and continued, according to estimates, 3-4 months. After low inflation rates in the period from October 2008 to January 2009, which was not typical of the period – less than 0.4% per month on average, in February-May 2009 a monthly inflation increased to 0.7-0.8%. Although these rates are common for the spring months, in the absence of other fundamental factors of inflation this increase may be explained by the impact in the change of the Tenge exchange rate. In addition, the "overextension in time" was caused by administrative curbing of a sharp price growth.

Nonetheless, in Q2 2009 inflation was growing at a lower rate – both compared to Q2 2008 and to the previous quarter. In April-June 2009 the inflation was at 1.9%. The growth in prices was mainly caused by the fact that foodstuffs and non-food items became more expensive by 2.2% and 1.9%, respectively. Paid services became more expensive by 1.4% (Figure 2).

Figure 2

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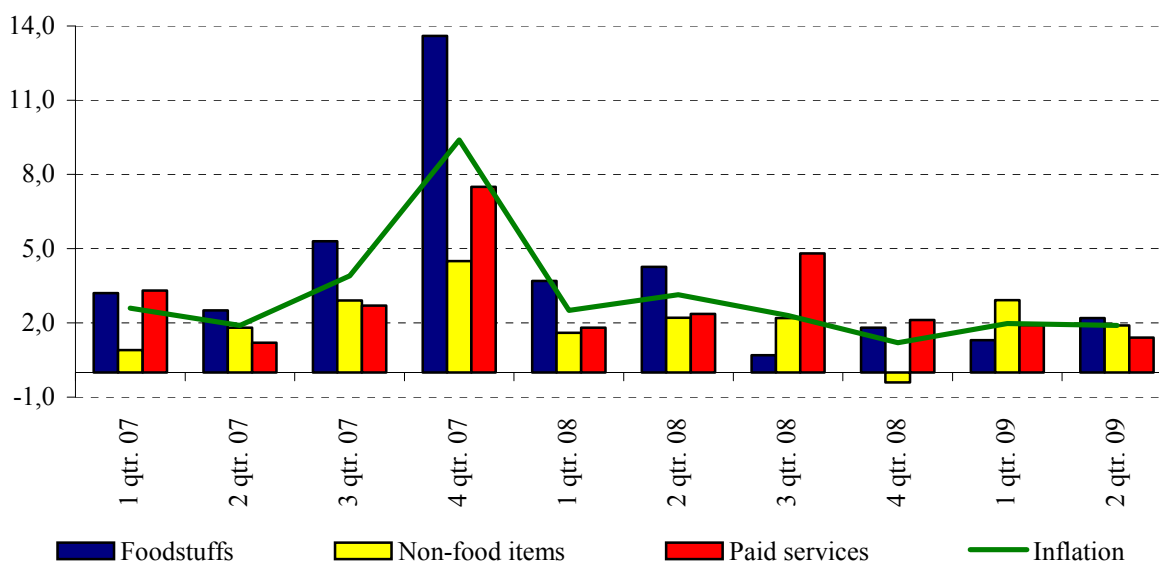
Source: Statistics Agency of the Republic of Kazakhstan

The major growth in prices in Q2 2009 fell on such goods and services as sugar – by 11.7%, fruit and vegetables – by 7.0%, soft drinks – by 4.8%, medical supplies – by 4.9%, medical services– by 5.0%, transportation services – by 3.4%. The reduced prices for individual goods are worth mentioning. Eggs became cheaper by 6.9%, sunflower oil – by 4.4%, dairy products – by 2.3%, gasoline –by 0.7%.

The inflation for the first half of 2009 was 3.9% having slowed down considerably as compared to January-June 2008 (5.7%).

In Q2 2009 the slowdown of the annual inflation continued. Based on June 2009 its rate was 7.6% (in December 2008 – 9.5%) being by over 2.5 times lower than the maximum level for the last years in the summer months of 2008.

The disinflation process was caused by a significant slowdown in the growth of prices for foodstuffs in respect of which the annual change in prices was 6.1% based on June 2009. Nonetheless, a further slowdown in the annual inflation rate is limited by a high although slowing rate of the change in prices for paid services to the population (10.5% in annual terms). Annual change in prices for non-food items during Q2 2009 was virtually stable (Figure 3).

Figure 3

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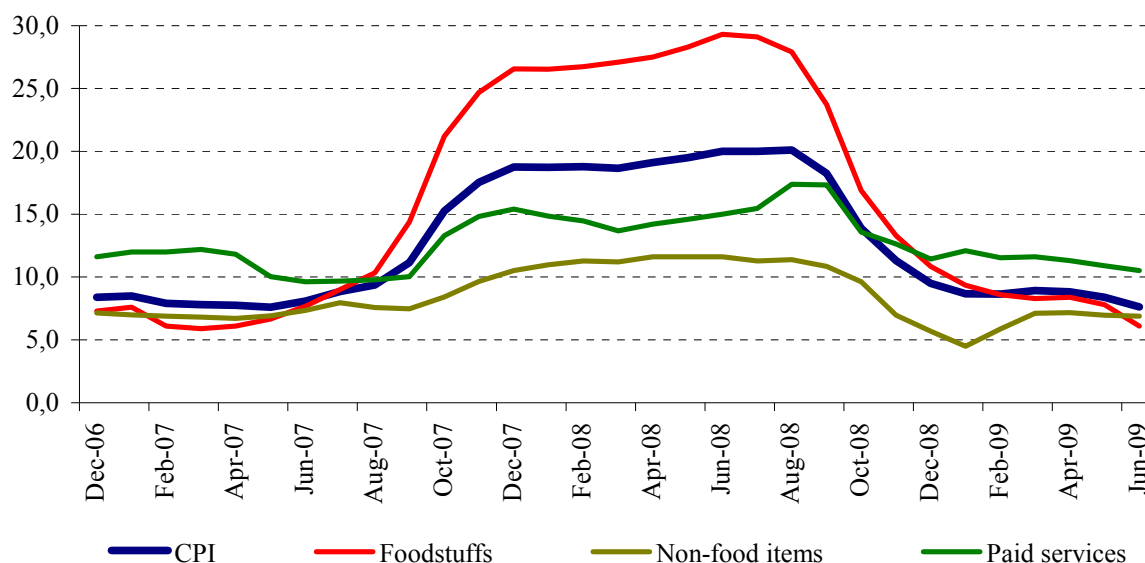
Source: Statistics Agency of the Republic of Kazakhstan

1.2. Core Inflation

Indicators of core inflation in Q2 2009 just like headline inflation demonstrated a slowdown in the growth as compared to Q2 2008 and Q1 2009 (Figure 4).

Higher rates of growth in prices for the consumer basket components excluded in the calculation of core inflation, caused the increase of headline inflation over the core inflation indicators in Q2 2009, as compared to other components.

Indicators of core inflation in annual terms as well as the headline inflation indicator demonstrate the slowing down trend. In June 2009 all indicators of core inflation were at a lower level as compared to December 2008. This evidences the overall slowdown of inflationary processes, despite sharp deviations (growth or decrease) in the dynamics of prices for individual commodities and services that "fall out" of the general trend.

Figure 4

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

Source: Statistics Agency of the Republic of Kazakhstan

Based on June 2009 the indicators of core inflation-1 and core inflation-2 in annual terms exceeded the headline inflation indicator, that was caused by the reduction of gasoline prices (by 26.1%), diesel fuel (by 27.4%), excluded in the calculation of these indicators of core inflation (Figure 5).

Figure 5

**Dynamics of annual inflation and core inflation
(as % of the respective month of the previous period)**

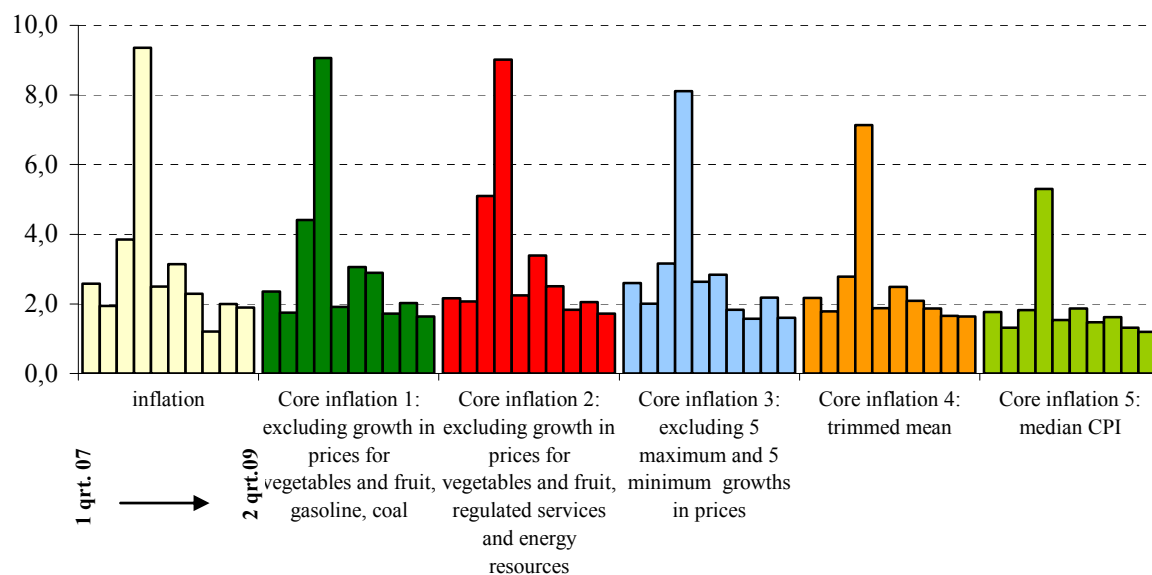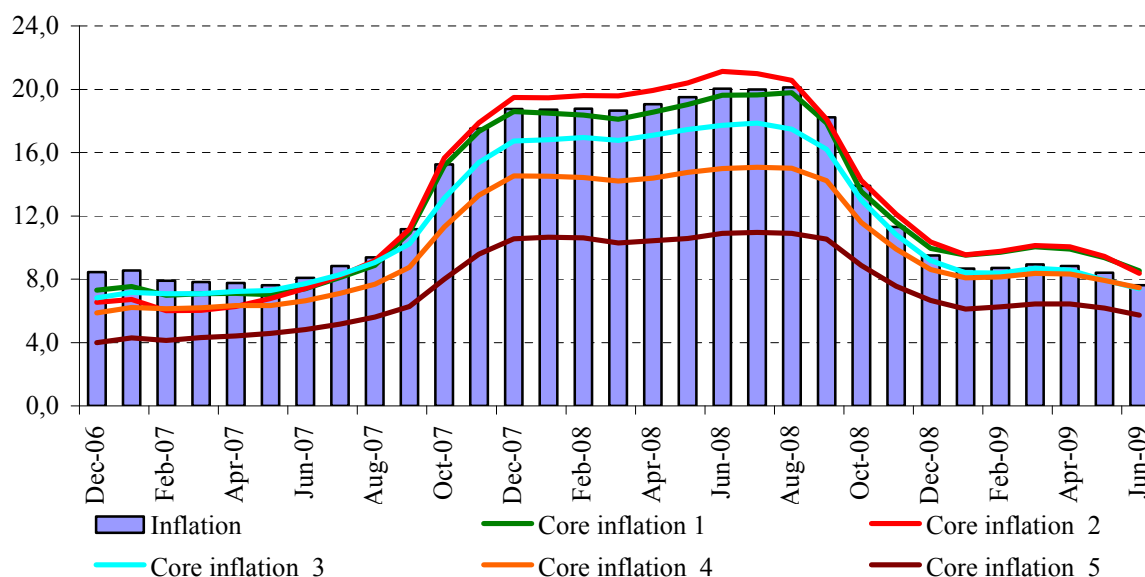Source: Statistics Agency of the Republic of Kazakhstan

1.3. Prices in the Real Sector of Economy

1.3.1. Prices in the Industry

In Q2 2009 producer prices increased by 17.5% (Q2 2008 – growth by 22%), breaking the downward tendency that was observed during three preceding periods. Manufactured production appreciated by 18.8%, including the interim consumption products – by 21.3%, means of production – by 0.6%. Consumer goods grew in price by 2.4%, services of production nature became cheaper – by 0.4%.

In April-June 2009 prices of enterprises in the mining industry increased by 32.4% (Q2 2008 –growth by 27.2%), the reason for that was the increase in prices for some types of raw energy resources. Particularly, the price for oil extraction in Q2 2009 increased by 44.7%, the cost of gas condensate grew up by 18.6%. As a whole, energy resources became more expensive by 33.3% from April to June 2009, whereas in the respective period of 2008 the increase in price was by 26.1%.

After their fall by 7.1% in the previous period, in Q2 2009 prices in the manufacturing industry grew up by 2.1% (Q2 2008 – growth by 13.4%). Prices in the metallurgical industry increased by 6.5%, production of foodstuffs including drinks and tobacco appreciated by 1.2%, oil refined products became cheaper by 6.1%.

Prices and tariffs in the production and distribution of electric energy, gas and water in Q2 2009 increased by 2.9% (Q2 2008 – growth by 3.6%).

In June 2009 the reduction in prices in the industrial production accounted for 31.1% in annual terms (June 2009 versus June 2008) (Figure 6).

Figure 6

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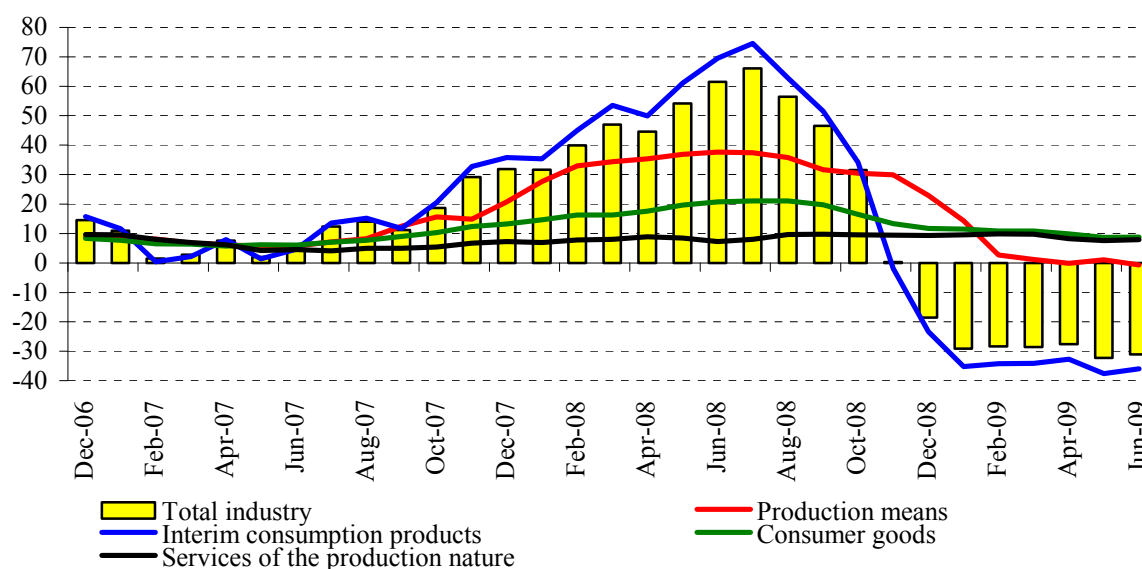
Source: Statistics Agency of the Republic of Kazakhstan

The output became cheaper by 32.8%, including the interim consumption production – by 36%, means of production – by 0.7%, whereas the annual growth of consumer prices accounted for 8.8%. Services of the production nature appreciated by 7.9%.

The main reasons for reduced prices in the industrial production in annual terms were the deteriorated competition environment in the global market caused by the fall in prices for

energy resources, mainly, oil and gas, ferrous and non-ferrous metals, as well as the stagnation and reduction of prices in the manufacturing industry.

1.3.2. Prices in Agriculture

In Q2 2009 prices for agricultural production realized through all channels reduced by 2.1% (Q2 2008 – growth by 6.2%). The dynamics of prices in agriculture was built up mainly under the pressure of cheapened animal products and, to a smaller extent, plant production.

In April-June 2009 the reduction in prices for agricultural production was 3.4%, where the cost of unpasteurized milk decreased by 13.6%, eggs – by 11%, meat and poultry became more expensive by 1.2%.

Plant production in the reviewed period became cheaper by 1.1%, being caused by reduced prices for grain – by 1.6%, whereas the cost of vegetables increased by 3.1%, potatoes – by 2.3%.

Based on June 2009 annual growth in prices for agricultural production while continuing to slow down amounted to 3.7%. At the same time the plant production appreciated by 2.1%, and animal products – by 6.2% (Figure 7).

Figure 7

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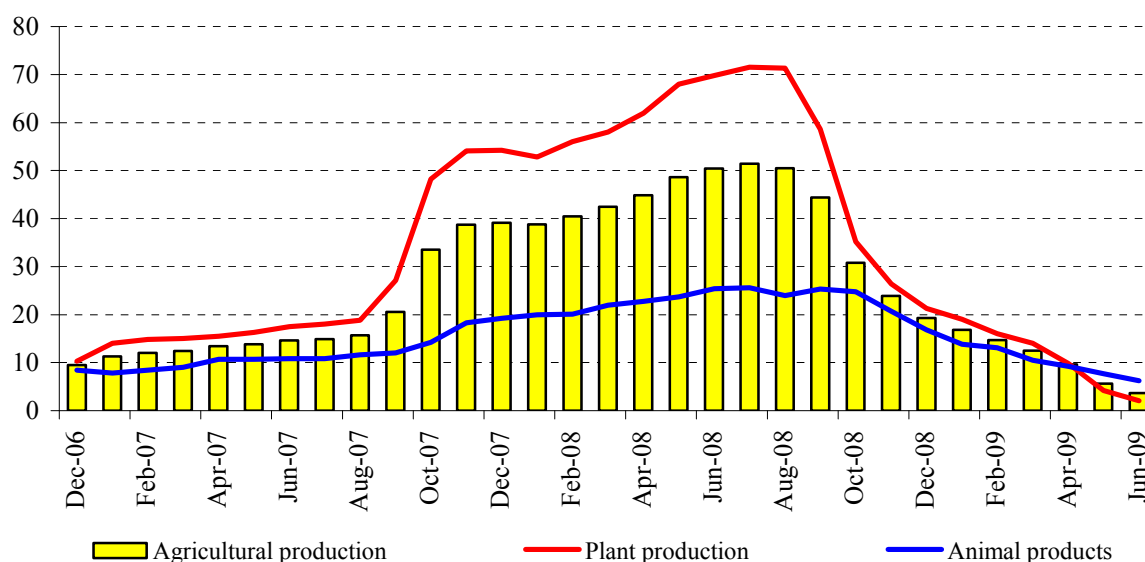
Source: Statistics Agency of the Republic of Kazakhstan

In Q2 2009 as compared to the previous quarter the decrease in the demand for final products of enterprises virtually discontinued in the economy as a whole. This is evidenced by a generalized indicator – the diffusion index of the change in the demand for final products of the industry whose value amounted to 47.9 (Figure 8). Reduction of the indicator was mentioned only by 28.9% of interviewed enterprises (in Q1 2009 – 46.6%), increase – 24.6% (in Q1 2009 –10.5% only).

The slowdown in the rates of reduction in the demand occurred in the majority of industries of the economy expect for the industry "production and distribution of electric energy, gas and water". At the same time poor growth of the demand can be observed in such industries as "transport and communications", "hotels and restaurants", "manufacturing industry", "mining industry".

In Q3 2009 as compared to the previous quarter some growth in the demand for final products is expected in the economy as a whole: the diffusion index of the change in the demand was 53.7. The increase in the demand for final products is expected by 19.9% of enterprises participating in the survey, and the reduction – by 12.5%.

The situation with prices for final products in Q2 2009 is characterized by a notable increase in the growth rates of the indicator as compared to the previous quarter: the diffusion index of the change in prices for final products amounted to 55.9 (versus 51.7 in Q1 2009). The growth in prices in Q2 2009 was indicated by 22.3% of enterprises (in Q1 – 22.1%), and the percentage of enterprises where prices for production reduced accounted for 10.5% only (in the previous quarter – 18.6%). The growth of prices occurred virtually in all sectors of economy except for such industry as agriculture where the slowdown in the price reduction rates was observed.

In Q3 2009 the diffusion index of the change in prices for final products is estimated virtually at the level of the previous quarter – 55.7. This means that enterprises expect a further growth in prices at the same rate as in Q2 2009. This is associated with the concurrent reduction in the percentage of enterprises that indicated both the reduction in prices (4.6%), and their increase (15.9%) with a significant increase in the percentage of enterprises which do not expect any change in prices (79.5%).

In Q2 2009, despite an insignificant increase (by 1 point), the diffusion index of the change in prices reflects high growth rates in prices for raw commodities and materials in the economy as a whole (the index value amounted to 69.3). The highest price growth occurred in such industries as "hotels and restaurants", "transport and communications", "agriculture", "production and distribution of electric energy, gas and water" and "construction". In general in the sample, the enterprises that indicated the growth in prices for raw commodities and materials reduced to 49.3% (from 51.4% in Q1 2009). The percentage of enterprises that indicated the reduction in prices for raw commodities and materials reduced to 3.5% (from 7.6% in Q1 2009).

For Q3 2009 the diffusion index of the change in prices for raw commodities and materials decreased to 64.9, meaning the expectation by the enterprises of a further growth in prices but at lower rates. At the same time, despite significant reduction to 38.1%, still there is a high percentage of enterprises that expect the growth in prices in Q3 2009, while the percentage of enterprises expecting the reduction of the index reduced to 1.1% (Figure 8).

Thus, based on the dynamics of relevant diffusion indices, in this quarter as compared to Q2 2009, enterprises expect the increase in the demand for final products and the slowdown of price growth, both for final products and for raw commodities and materials.

Figure 8

Diffusion indices for changes in demand and prices
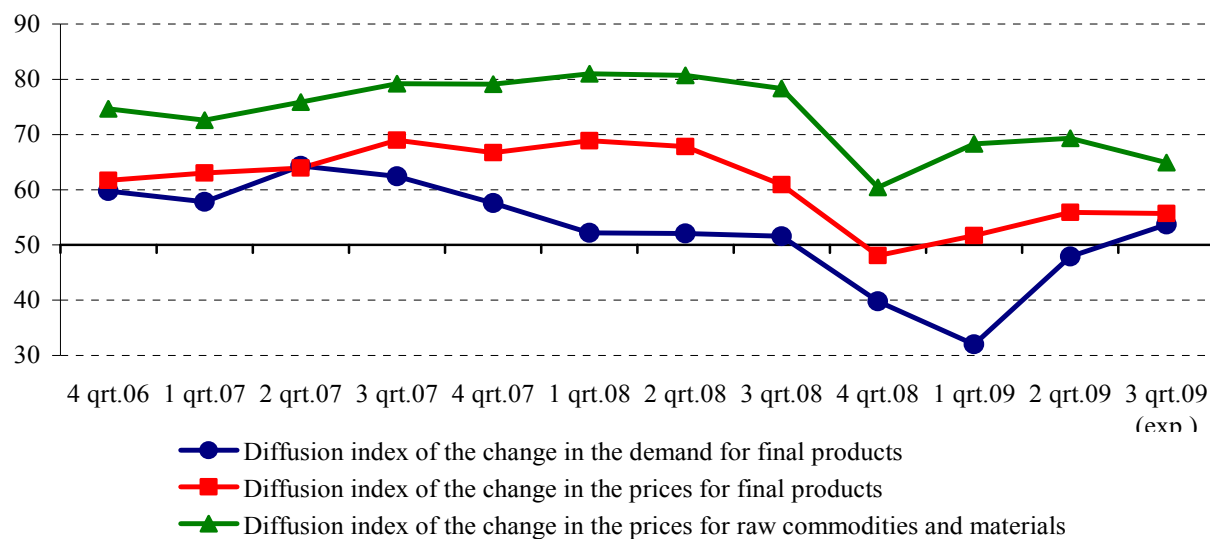
Source: National Bank of the Republic of Kazakhstan

2. Inflation Factors

2.1. Aggregate Demand

In Q1 2009 the growth rates in the GDP consumption, by estimate, amounted to 0.3% as compared to the respective period of 2008, being considerably lower than the indicator of the previous quarter (8.8%). The reason for that was a significant reduction in the household spending on final consumption whose indicator of contribution to the GDP growth after the increase to 8.1% in the previous quarter made up only 0.2% in Q1 2009 (Figure 9).

Figure 9

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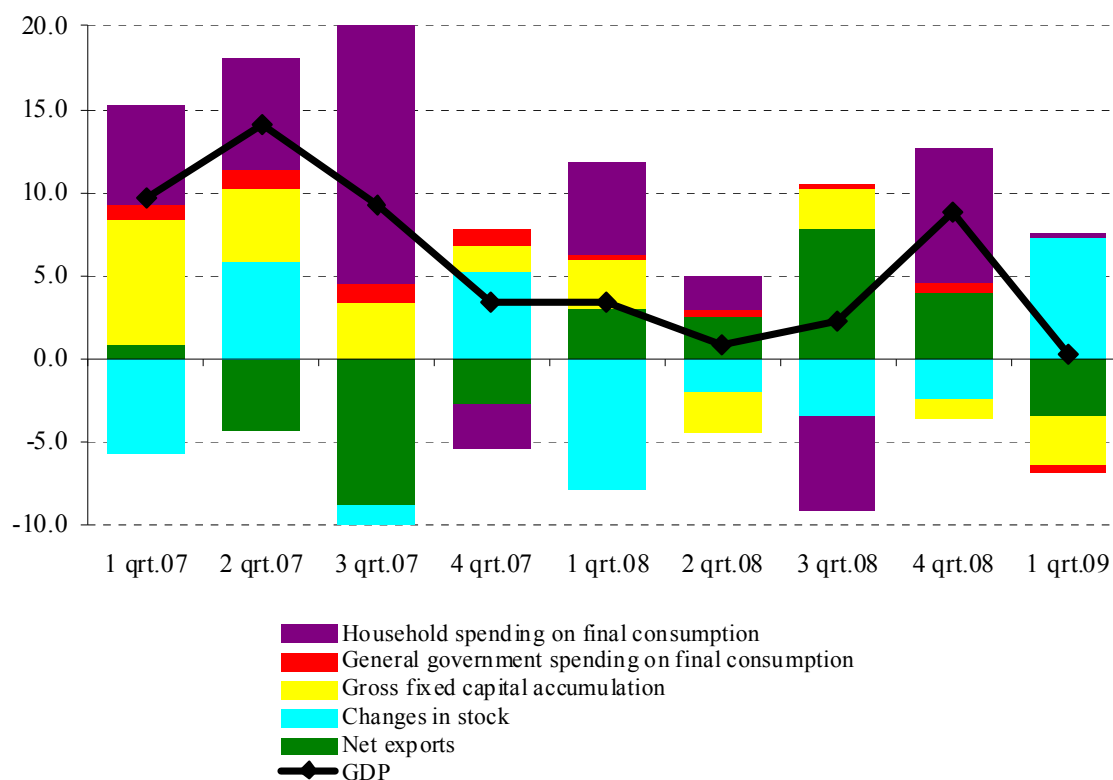
Source: Data by the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

2.1.1. Individual Consumption and Investment Demand

Household spending on final consumption in Q1 2009 were virtually at the same level as in the respective period of 2008 (increase by 0.3%), whereas in Q4 2008 the growth was estimated at 15.6%. At the same time, the growth of per capita income even accelerated to 4.1% in real terms (in Q4 2008 the growth was 2.2%).

The absence of growth in the consumption is likely to be explained by the situation in the economy, in the financial market and by the exchange rate of the Tenge. High devaluation expectations remaining approximately during one month after the devaluation of the Tenge in February 2009, reduced confidence in the banking system, including the uncertainty about prospects of the top banks, growth of unemployment in the first quarter of 2009 caused the increased money saving practice, mainly, in the form of foreign cash.

Consequently, the retail turnover in Q1 2009 reduced by 3.6% whereas in Q4 2008 there was a growth of 4.4% (Figure 10).

Figure 10

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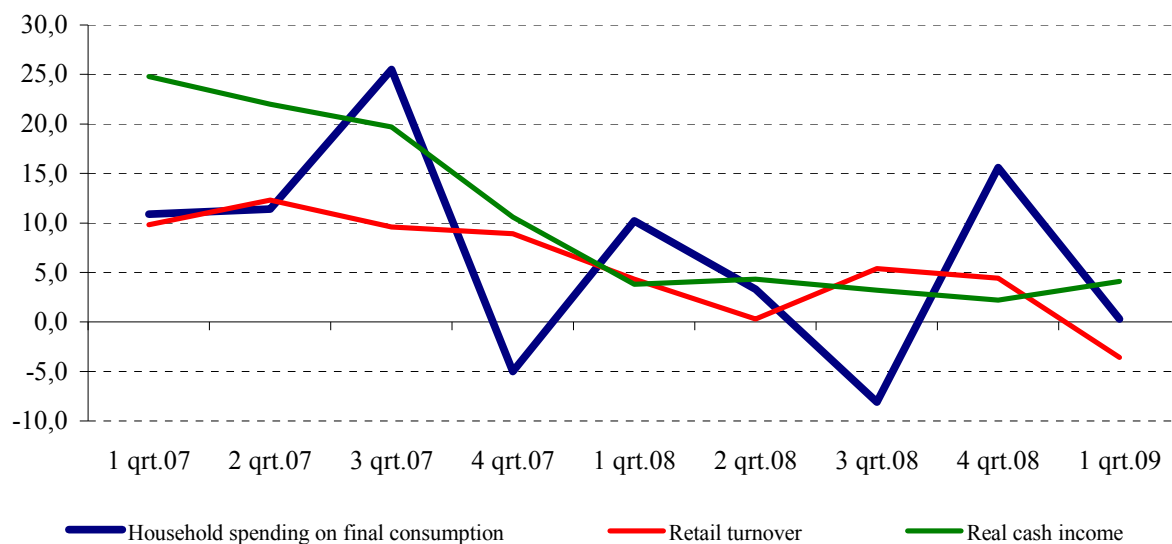
Source: Data of the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

Reduced investments in fixed capital continuing over the last two consecutive months caused the reduction of gross fixed capital accumulation in the structure of GDP. In Q1 2009 in relation to Q1 2008 expenses for gross fixed capital accumulation in the structure of GDP decreased by 10.4% (Figure 11).

Figure 11

**Dynamics of spending on investments in fixed capital
(as % of the respective period of the previous year)**
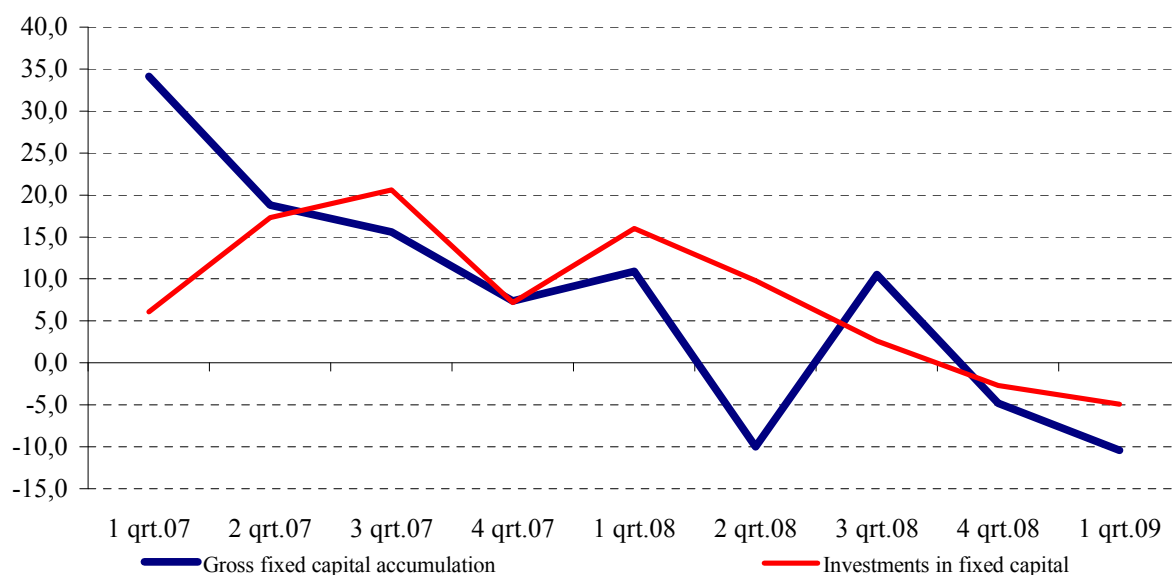
Reduction in the volume of investments in fixed capital in Q1 2009 was mainly due to their reduction in the industry. And although there was activation of investment activity in the manufacturing industry and in production and distribution of electric energy, gas and water, a sharp drop in the volumes of fixed capital investments in the mining industry contributed to their reduction in the industry as a whole. Such reduction was also not offset by a considerable growth in fixed capital investments in transport and communications.

Volumes of fixed capital investments decreased nearly in all financing sources, especially from borrowed funds. The exception were foreign investments whose percentage in the total volume of investments in Q1 2009 exceeded 40% and virtually equaled to the percentage of own funds of enterprises.

2.1.2. Government Consumption

General government spending on final consumption in Q1 2009 as compared to the respective period of 2008 decreased, according to estimates, by 4.7% (in Q4 2008 growth – by 7.8%).

In Q1 2009 the state budget spending was KZT 709.8 bln. or 23.2% of GDP. It reduced by 1.8% compared to the indicators for the respective period of 2008.

Current state budget expenditures increased by 18.9% as compared to the respective period of 2008 and were secured by the growth in transfers to natural persons, payroll expenditures, as well as services procurements. Capital expenditures reduced by 40.1%, mainly due to the reduced expenditures for fixed capital formation and acquisition. There were no budget credits in Q1 2009. Expenditures related to the purchase of public financial assets decreased by 61.1%.

In 2009 the Tax Code of the Republic of Kazakhstan became effective in its new version and is aimed at liberalization of tax treatment, transfer of tax burden onto primary sectors of the economy. In line with this, the taxation system was partially changed i.e. some taxes were eliminated and some were introduced, and rates on the remaining taxes were changed.

In Q1 2009 the state budget revenues amounted to KZT 797.1 bln. or 26.1% of GDP, being by 6.8% greater than those of the respective period of the previous year. In the structure of the state budget revenues still two items prevail: tax revenues – 64.7% and official transfers – 31.4% (in Q4 2008 the percentage of transfers amounted to 40.3%). High percentage of official transfers was ensured by the guaranteed transfer of KZT 250 bln. from the National Fund to the republican budget.

Overall decline in the economic activity in the country appeared to be one of the major factors of educed revenues in Q1 2009 as compared to the respective period of 2008 in relation to virtually all major types of taxes. In addition to that the rates on corporate income tax, value added tax were reduced, instead of the regression taxation scale a flat scale of social tax was introduced. In addition, royalty was replaced with the mineral extraction tax.

As compared to Q1 2008 the volume of non-tax revenues in Q1 2009 increased by 17.6%, while proceeds from the sale of fixed capital reduced more significantly – by 48.0%.

As a result of surplus of revenues over the state budget spending in Q1 2009 there appeared to be the proficit of KZT 87.3 bln. (2.9% of GDP), whereas in Q! 2008 the proficit was KZT 23.2 bln. (Figure 12). It should be noted that without guaranteed transfers from the National Fund Q1 would have ended with the non-oil deficit of KZT 162.7 bln.

Figure 12

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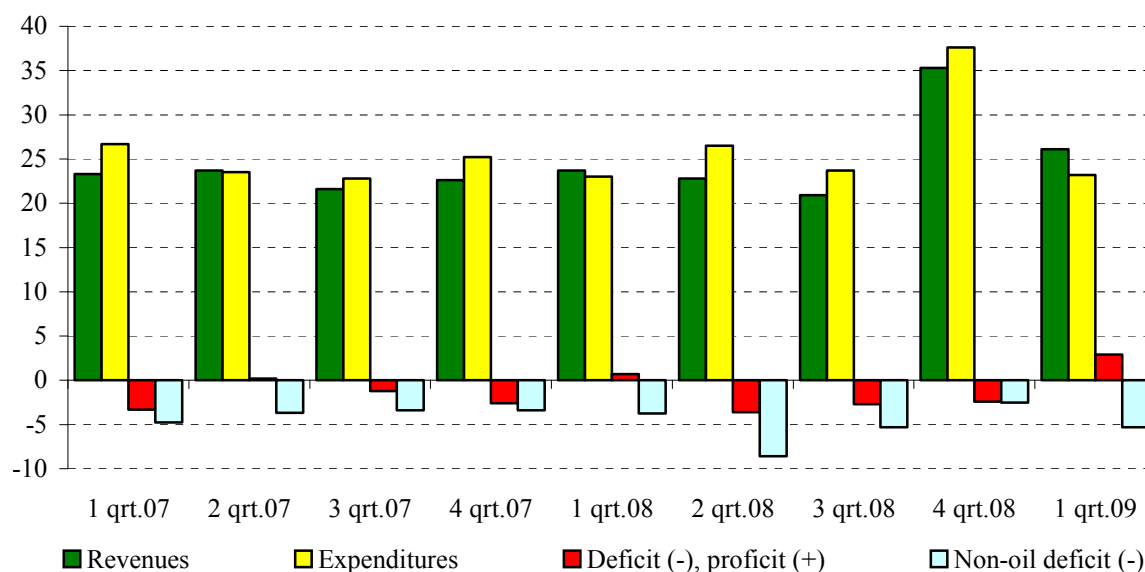
Source: Ministry of Finance of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

During Q1 2009 the Ministry of Finance borrowed KZT 103.0 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 68.9 bln. as a result, account balances of the Government of the Republic of Kazakhstan with the National Bank increased by KZT 121.4 bln.

Government domestic debt for Q1 2009 increased to KZT 854.0 bln. or by 4.1% as compared to the outcome of Q4 2008 and was secured with the issue of long-term treasury bonds and long-term (saving) treasury obligations. External government debt in Q1 2009 decreased to US$ 1.6 bln. or by 2.8%.

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
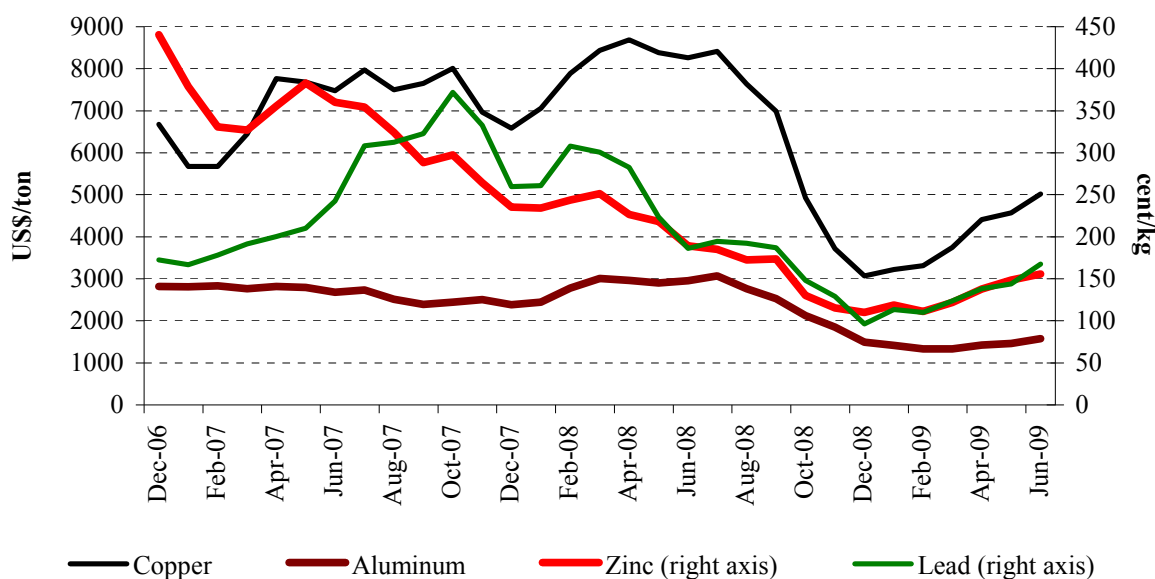
Source: World Bank

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 13).

Figure 14

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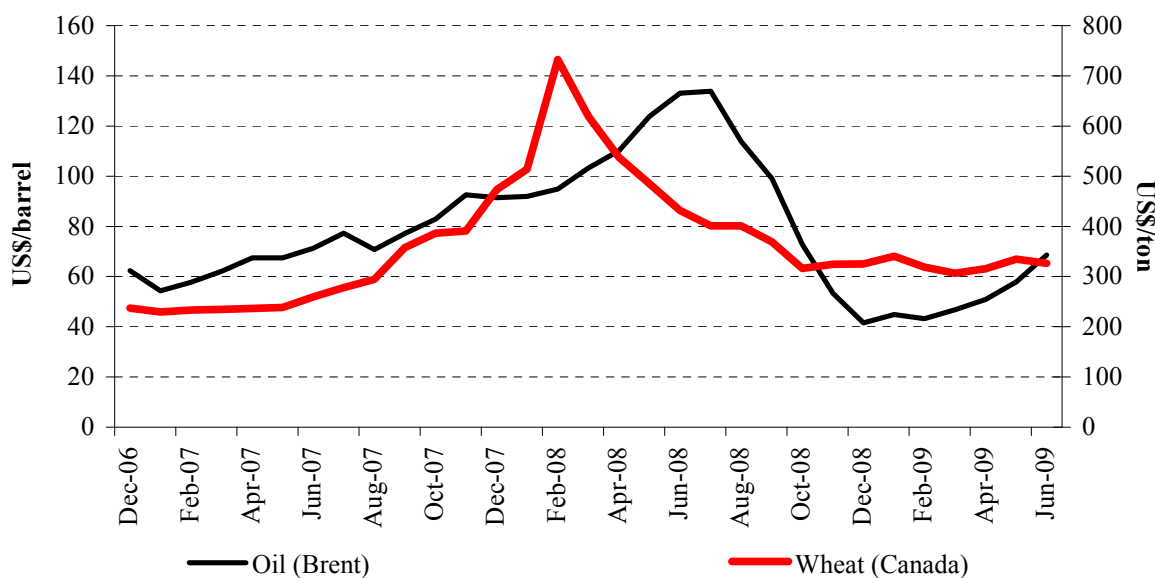
Source: World Bank

– **Balance of Payments**

Based on Q1 2009 the current account balance deficit was at the level of US$ 1.0 bln. (Figure 15).

Figure 15

Current account balance, US$ mln.
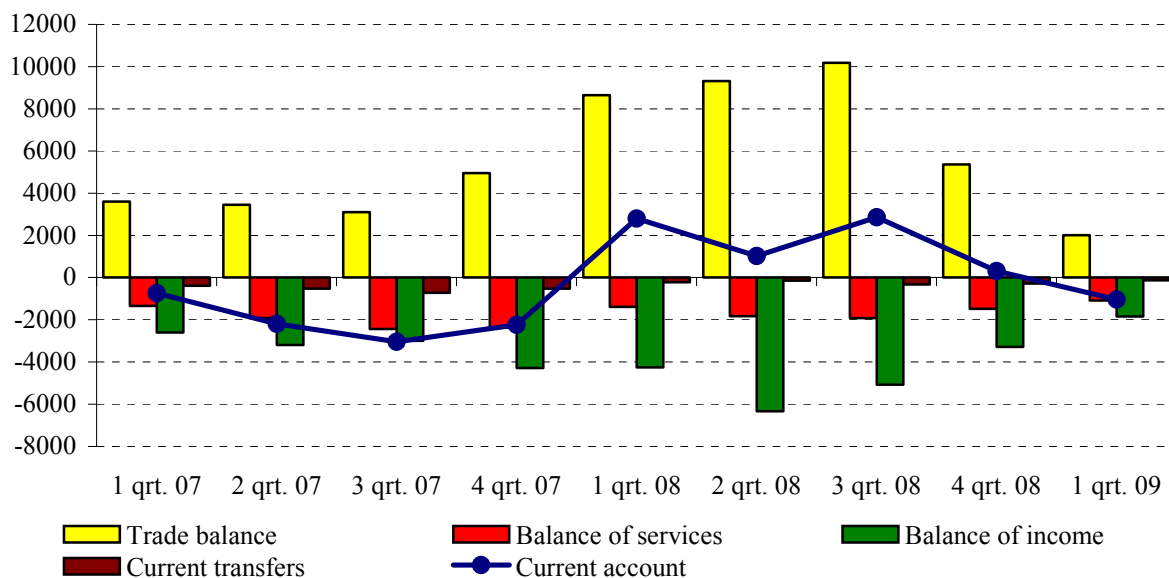
Source: National Bank of the Republic of Kazakhstan

Deterioration in the pricing environment of the global energy carriers and the adjustment of the domestic currency exchange rate had a major impact on the current account status. Export proceeds from commodities in Q1 2009 reduced by 48.8% as compared to Q1 2008 whereas expenditures for commodity imports – by 15.7%. Thus, the trade balance was at the level of US$ 2.0 bln., having reduced by more than 4 times compared to the respective period of 2008. The deficit in the balance of services as compared to Q1 2008 decreased by 22.1% and amounted to US$ 1.1 bln., and the deficit in the income balance – by 2.3 times to US$ 1.8 bln. Payments to nonresidents under current transfers amounted to US$ 130.7 mln. having decreased by 41.1%.

The net inflow of resources on financial account operations was US$ 3.3 bln. (in Q1 2008 there was an outflow of US$ 1.2 bln). Foreign assets of residents decreased by US$ 3.9 bln. in Q1 2009 as compared to their growth of US$ 5.2 bln. in the respective period of 2008. Foreign liabilities of residents decreased by US$ 59.8 mln. in Q1 2009. With the growth of inflows in the form of direct investments (US$2.4 bln.) the decrease of foreign liabilities was primarily caused by the banking sector operations for the external debt extinction of US$ 3.6 bln.

The negative balance on the balance of payments operations for Q1 2009 was US$ 551.4 mln. compared to the proficit in the balance of payments of US$ 1.0 bln. in Q1 2008.

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

In Q1 2009 the aggregate terms of trade index was by 45.8% lower than that for Q1 2008. Alongside with that, the terms of trade with the Euro zone countries deteriorated by 57.8%, and those with Russia – remained unchanged (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
Export prices	56,1	61,1	61,9	8,0	-47,0
Import prices	27,6	44,9	57,1	29,7	-1,2
Terms of trade	**20,2**	**12,0**	**3,5**	**-17,0**	**-45,8**
including:					
The Euro zone countries					
Export prices	54,4	62,5	63,5	-0,1	-54,2
Import prices	15,8	29,5	51,9	27,5	17,7
Terms of trade	**28,3**	**27,7**	**9,5**	**-22,5**	**-57,8**
Russia					
Export prices	30,1	37,6	34,6	8,6	-28,3
Import prices	42,8	48,9	47,6	22,7	-28,6
Terms of trade	**-8,9**	**-7,9**	**-9,0**	**-11,9**	**0,4**

Source: National Bank of the Republic of Kazakhstan

The dynamics of the exchange rate of the Tenge versus major currencies in Q1 2009 were establishing under the impact of the Tenge devaluation implemented in February 2009 as well as the devaluation of currencies of the countries – trading partners. At end-March 2009 the index of the real effective exchange rate of the Tenge was by 14.1% lower than in December 2008, while the Tenge has weakened in real terms by 7.4% versus the CIS currencies basket and by 16.3% - versus the currency basket of other countries

Over Q1 2009 the Tenge has depreciated in real terms versus the US Dollar by 19.0%, Euro – by 16.1%, and the Russian ruble – by 4.9% (Figure 16).

Figure 16

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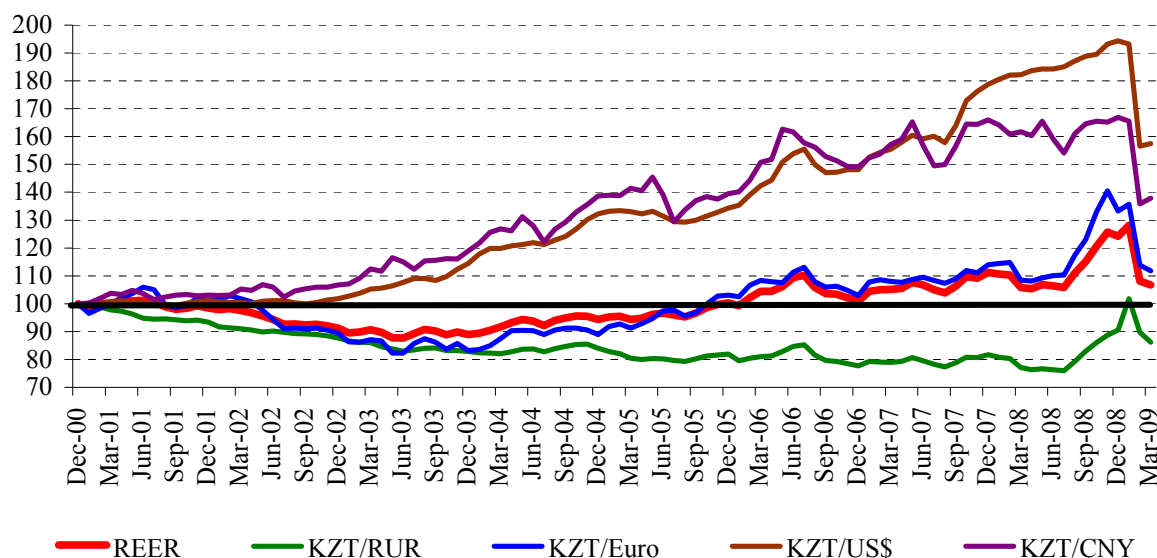
Source: National Bank of the Republic of Kazakhstan

The adjustment of the Tenge exchange rate allowed supporting both domestic producers and exporters, reflecting on the outcomes of trading operations based on the results of the reviewed period.

– **Nominal Exchange Rate of the Tenge**

In Q2 2009 the situation in the domestic foreign exchange market was relatively stable. As a whole, based on the results of the quarter the Tenge exchange rate has appreciated versus US Dollar by 0.4% from KZT 151.08/US$ to KZT 150.43/ US$. Since the beginning of the year the Tenge has depreciated against the US Dollar in nominal terms by 24.5%.

The average weighted stock exchange rate of the Tenge for Q2 2009 was KZT 150.45 per 1 US Dollar. During the quarter the Tenge was fluctuating against the US Dollar within the band of KZT 149.82-151.08 per 1 US Dollar (Figure 17).

Figure 17

Dynamics of the nominal exchange rate of the Tenge against the U.S. Dollar
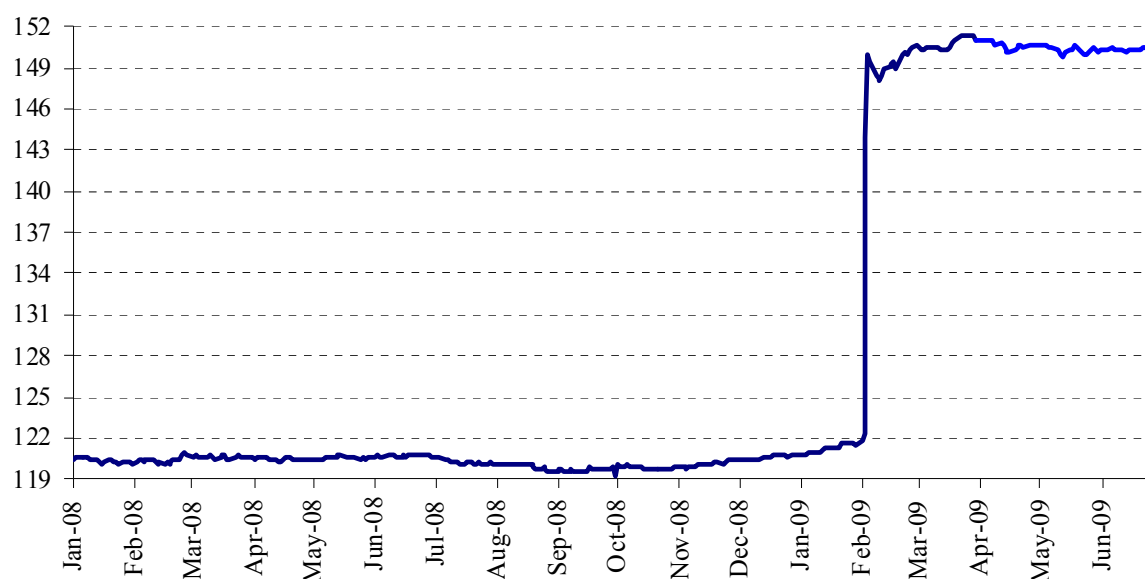
Source: National Bank of the Republic of Kazakhstan

Since the volumes of transactions in the Euro and the Russian ruble remain insignificant in the stock exchange segment of the domestic foreign exchange market, 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.

In general, the official exchange rate of the Tenge versus the Euro and the Russian ruble has depreciated over Q2 2009 by 5.5% and 8.6%, respectively (Figure 18).

Figure 18

Dynamics of the official exchange rate of the Tenge against the Euro and the Russian ruble
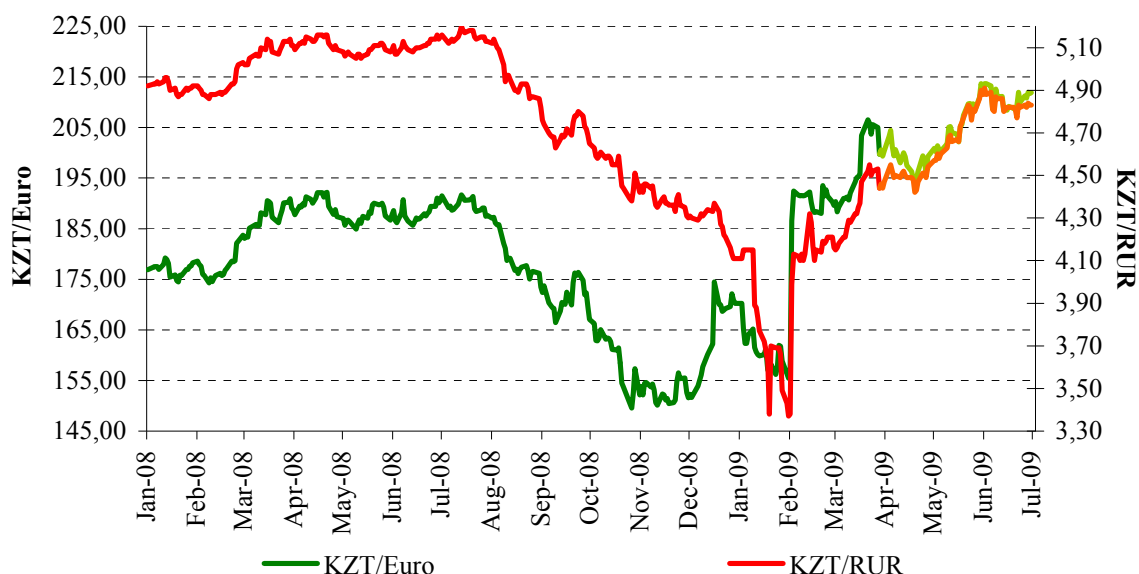
Source: National Bank of the Republic of Kazakhstan

2.2. Production

The GDP output in Q1 2009 amounted to KZT 3055.3 bln. in current prices. Affected by the negative impact of reduced production in the industry, construction, trade, and transport, GDP has decreased by 2.2% in real terms compared to Q1 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)
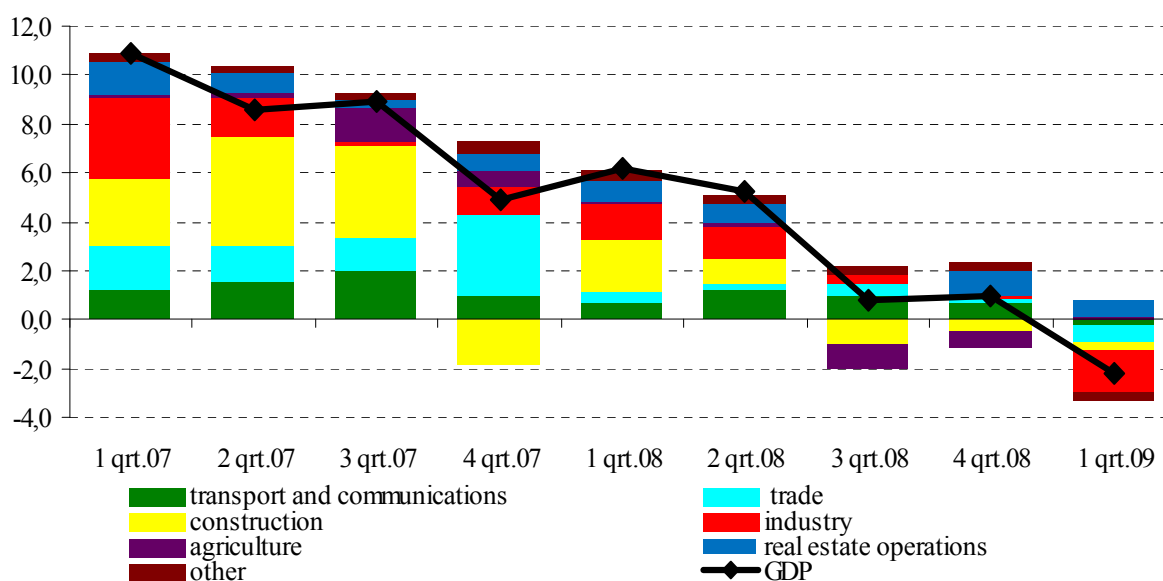
Source: Data of the Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan

Quantum index of construction in real prices as compared to Q1 2008 decreased by 6.6%, trade – by 5.3%, industry – by 5.0%, transport – by 5.0%, bringing in a negative contribution in the GDP formation. Growth rates in such sectors as agriculture, real estate operations, hotel and restaurant business, communication, and financial activities slowed down significantly, where the indices reduced to 103.6%, 103.8%, 104.0%, 104.2%, and 107.1%, respectively. There was an increase in the growth rate in the area of public administration where the index amounted to 109.3%.

2.3. Labor Market

2.3.1. Employment and unemployment

In Q2 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 0.8% greater than in the previous period. The number of employees grew by 0.2% to 5.2 mln. people, self-employed – by 2.1%, amounting to 2.7 mln. people.

In the structure of employees of public and non-public institutions 4.2 mln. individuals were working (81.1% of all employees), employees working for natural persons – 0.7 mln. individuals (12.6%), at farms – 0.3 mln. individuals (6.3%).

In the second quarter of 2009 a number of the unemployed was 568.1 thousand individuals having decreased by 2.6% as compared to the previous period, and by 2.0% - versus Q2 2008 (Figure 20).

Figure 20

The structure of economically active population, mln.individuals
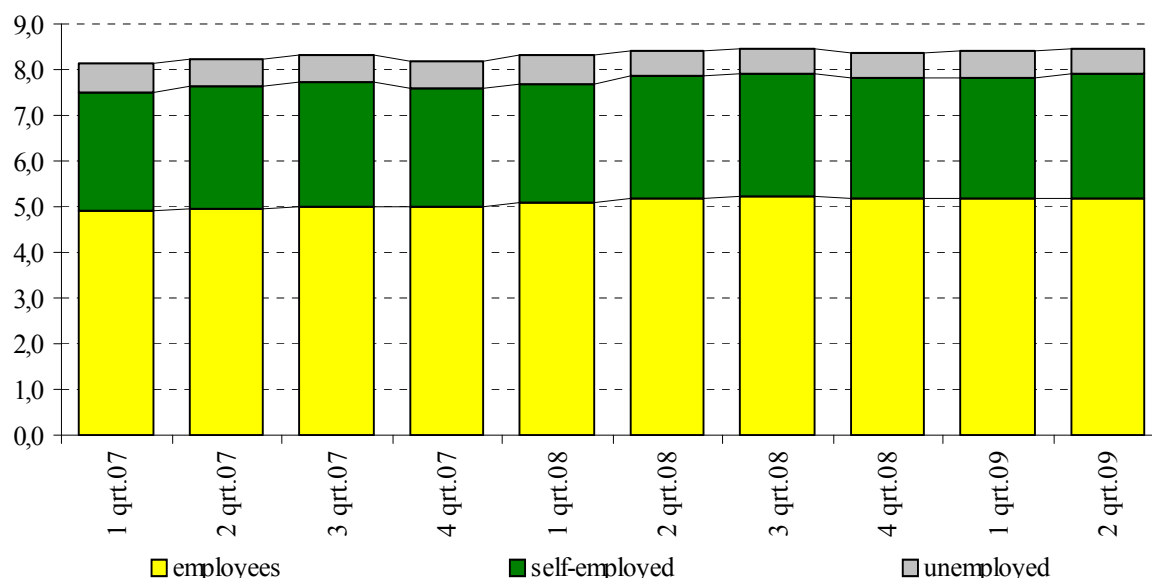
Source: Statistics Agency of the Republic of Kazakhstan

In May 2009 the structure of hired employees changed.

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. The largest outflow of the employed fell on the manufacturing industry and construction.

As compared to the previous quarter, the number of the employed demonstrated the highest increase in agriculture being caused by the seasonality factor, in the public healthcare, construction being caused by the stepping up of the Government to finance the uncompleted construction facilities. The highest decrease in employment happened in the industry, especially in the manufacturing industry and trade, being related to the continuing decline in these sectors, as well as in the public administration due to the policy of job-cutting in the public institutions.

The growth in the number of individuals employed in the economy in Q2 2009 ensured the decrease in the unemployment rate from 6.9% to 6.7% (Figure 21).

Figure 21

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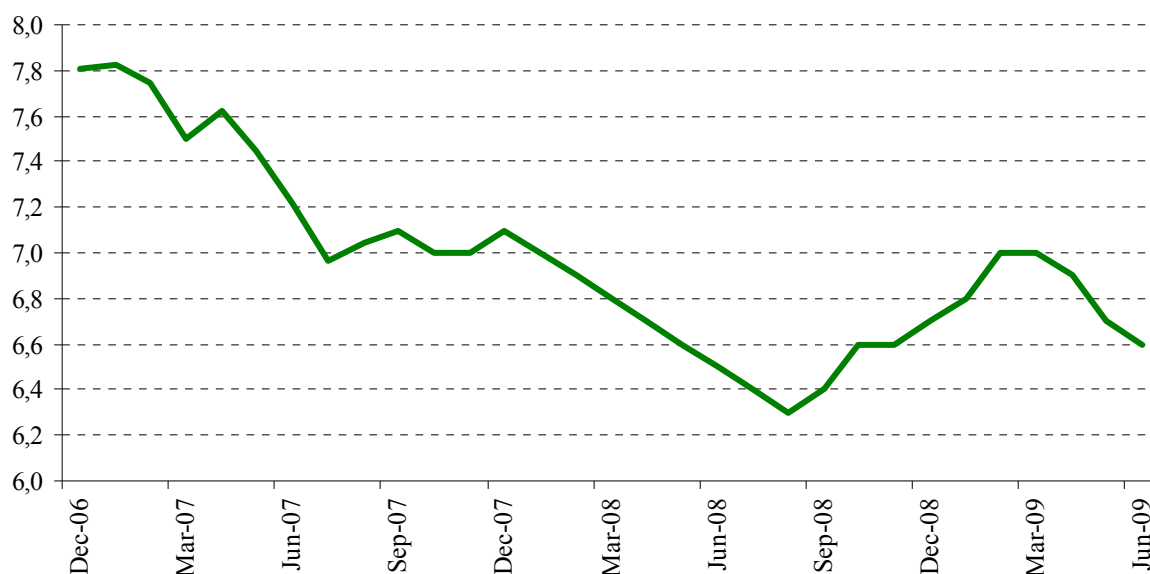
Source: Statistics Agency of the Republic of Kazakhstan

2.3.2. Wages and productivity

In Q1 2009 nominal wages continued to grow as they did during 2008, 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 by 13.1% (Q4 2008 – growth by 10.7%).

The slowdown of the growth rates in consumer prices had a favorable impact on the increase of the purchasing capacity of the population and contributed to the growth in salaries and wages in real terms that increased by 3.9% (versus the respective period of 2008), whereas a quarter before the reduction was 0.7%.

In March 2009 as compared to March 2008 salaries of employees funded from the budget have increased to the greatest extent: in the public administration sector, in public healthcare, in education as well as in the construction sector. This is related to the indexation of salaries and wages paid out from the budget as well as with the allocation of public resources for the support of the construction sector. The reduction of salaries happened in the financial sector, in transport and communications as well as in trade. Nonetheless, the highest level of salaries remains in the financial sector, mining industry, in the real estate sector, and the lowest level of wages in the agricultural sector, education, public healthcare.

The reduced GDP against the reduction in the number of the employed in the economy resulted, according to the National Bank's estimate, to the reduced labor productivity in Q1 2009 by 3.7% (Figure 22).

Figure 22

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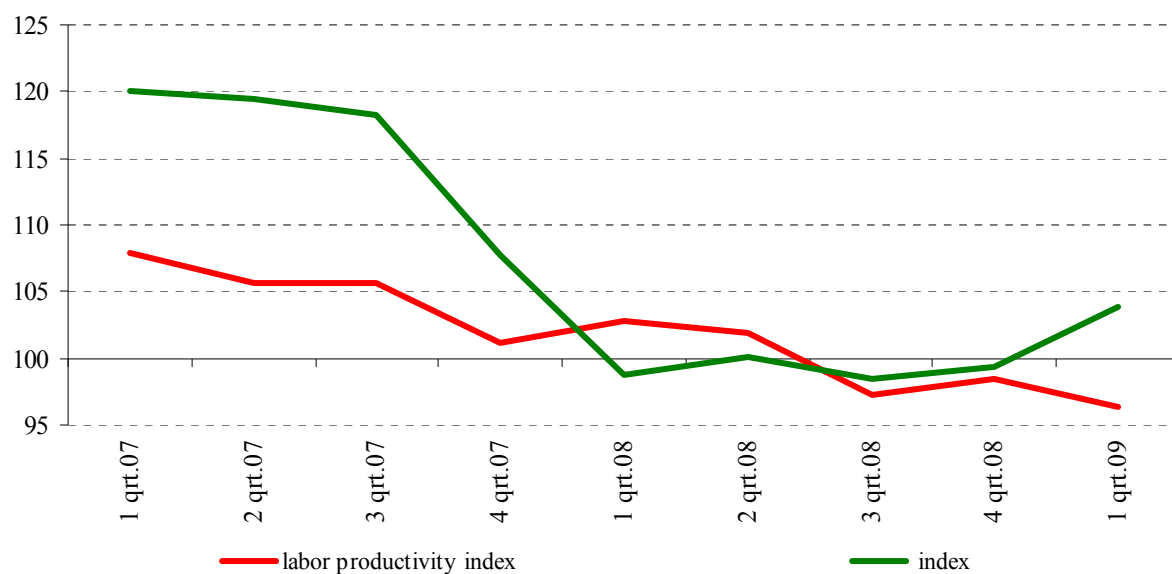
Source: The Statistics Agency of the Republic of Kazakhstan, estimates by the National Bank of the Republic of Kazakhstan
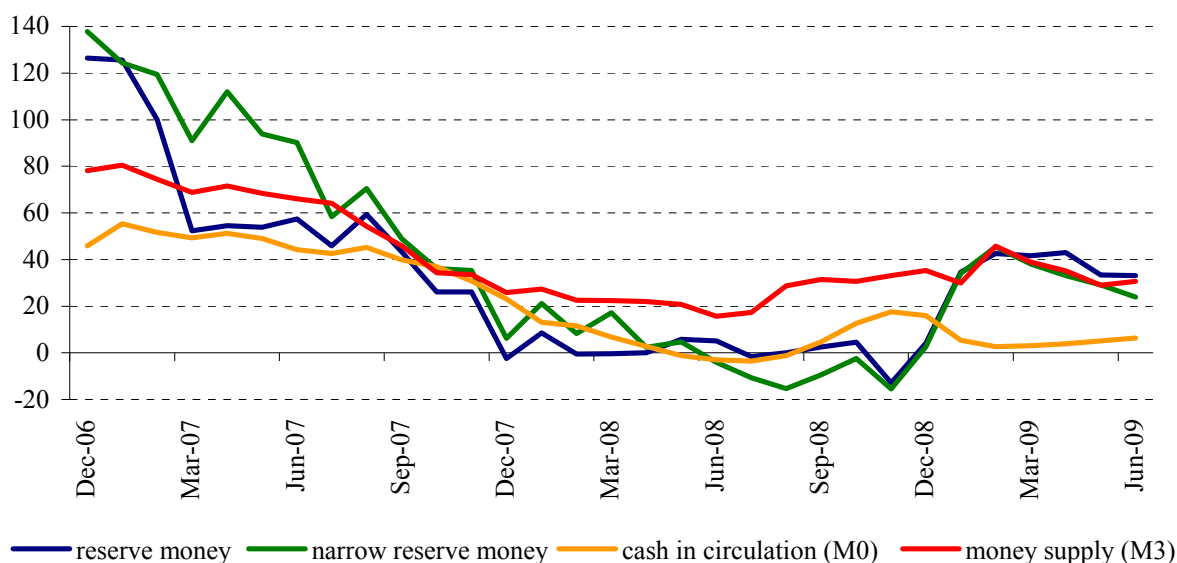
3. Money Supply

3.1. Monetary Aggregates

In Q2 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

Reserve money at the end of June 2009 amounted to KZT 2333.8 bln. In Q2 2009 the expansion of reserve money was 4.3%. Narrow reserve money for Q2 2009 contracted by 7.9% to KZT 1900.0 bln.

In June 2009 as compared to June 2008 the reserve money expanded by 33.1%. Such 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 June 2009 as compared to June 2008 decreased by 12.3% to US$ 18.5 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 June 2009 as compared to June 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 by 24.0% in June 2009 compared to June 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)

	Q3 08	Q4 08	Q1 09	Q2 09
Net international reserves	**19,1**	**12,6**	**-2,2**	**-12,3**
Net domestic assets	**-51,7**	**38,2**	**108,2**	**143,6**
Net claims on the Government	63,3	133,5	-45,6	-108,1
Claims on financial institutions	-172,5	53,7	203,8	231,8
Claims on the rest of the economy	3,0	1,6	4,1	-4,1
Other net domestic assets	-26,5	7,1	-99,1	-122,9
Reserve money	**2,4**	**4,2**	**41,7**	**33,1**
Narrow reserve money	**-9,5**	**2,6**	**38,0**	**24,0**

Source: National Bank of the Republic of Kazakhstan

3.1.1. Money Supply

Over Q2 2009 money supply grew by 1.5% to KZT 6786.3 bln. In June 2009 as compared to June 2008 its growth accounted for 30.6% 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)

	Q3 08	Q4 08	Q1 09	Q2 09
Net foreign assets	**212,6**	**233,2**	**599,2**	**1439,7**
Domestic assets	**0,2**	**1,9**	**10,6**	**9,5**
Claims on the Government	2563,3	159,2	-117,3	-80,9
Claims on the economy	5,9	7,1	18,2	17,7
Other net domestic assets	-26,8	-24,0	-49,3	-48,9
Money supply	**31,4**	**35,4**	**38,9**	**30,6**
Cash in circulation	4,7	16,0	3,1	6,4
Deposits of residents	37,0	39,1	45,0	34,8

Source: National Bank of the Republic of Kazakhstan

In the structure of net foreign assets of the banking system in June 2009 as compared to June 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 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 reduced.

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 85.2% in June 2008 to 87.9% based on June 2009.

Money multiplier decreased from 2.96 in June 2008 to 2.91 in June 2009 as a result of outstripping expansion rates of reserve money as compared to growth rates of money supply. The reason for that was 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 (**Ошибка! Источник ссылки не найден.**).

Figure 24

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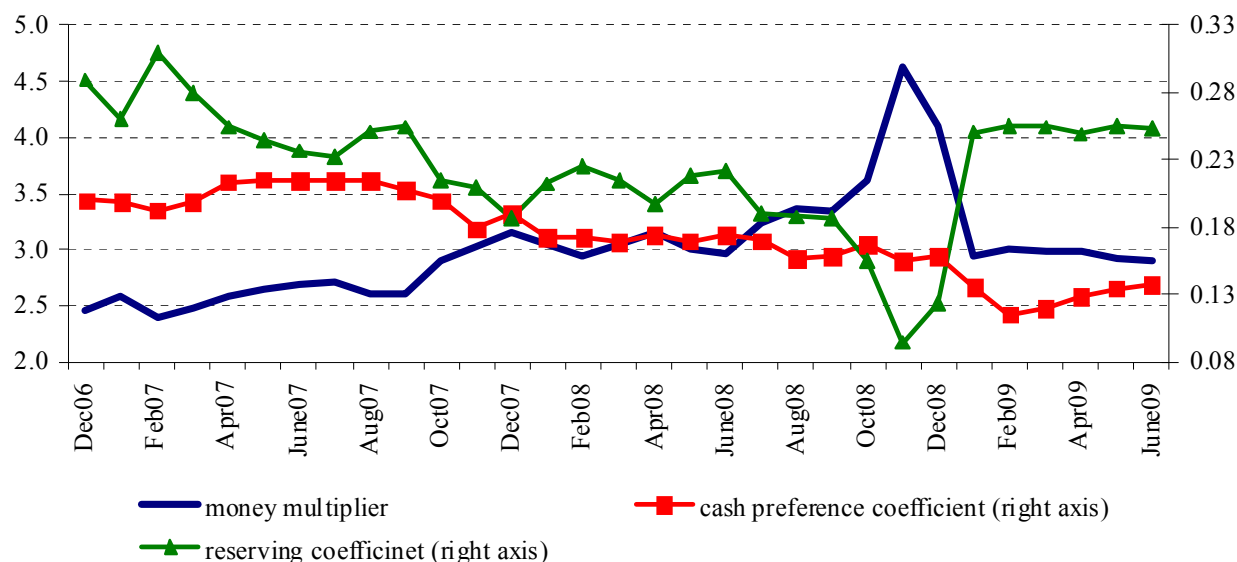
Source: National Bank of the Republic of Kazakhstan

3.1.2. Cash in Circulation

Volume of cash in circulation in Q2 2009 increased by 14.1% to KZT 818.7 bln. The main reason for the growth was the growth of net payouts of salaries and wages, net disbursements of loans to legal entities and natural persons. The growth of net proceeds from foreign exchange sale partially neutralized the growth of cash in circulation.

In June 2009 as compared to June 2008 cash in circulation increased by 6.4%. This shows that the effect of factors ensuring growth of cash (increase of wages and pensions) prevailed over 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 Q2 2009 as compared to Q2 2008 pay outs of cash from the bank cash departments reduced by 5.7% to KZT 2433.9 bln., receipts to the bank cash departments – by 8.3% to KZT 2257.4 bln. As a result, net payouts from the bank cash departments amounted to KZT 176.5 bln.

3.2. Financial Market

3.2.1. Deposits of Residents

Deposits of resident at the end of June 2009 amounted to KZT 5967.5 bln, having reduced over Q2 by 0.1%. Deposits of legal entities reduced by 0.5%, deposits of natural persons grew up by 1.2%.

The total volume of deposits of residents with depository institutions in June 2009 increased by 34.8% as compared to the respective month of the previous year. 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 (**Ошибка! Источник ссылки не найден.**).

Table 4

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

	Q3 08	Q4 08	Q1 09	Q2 09
Residents' deposits	**37,0**	**39,1**	**45,0**	**34,8**
Deposits of the population	*9,3*	*2,8*	*7,3*	*10,6*
Transferable deposits	8,8	7,7	1,6	5,4
In the domestic currency	*13,1*	*10,1*	*-1,2*	*3,7*
In foreign currency	*-13,3*	*-5,5*	*17,7*	*17,2*
Other deposits	9,3	2,2	7,9	11,3
In the domestic currency	*7,0*	*-6,9*	*-38,9*	*-30,0*
In foreign currency	*13,5*	*16,1*	*80,0*	*75,7*
Deposits of non-bank legal entities	*53,7*	*60,2*	*66,1*	*46,7*
Transferable deposits	32,4	48,2	110,6	95,4
In the domestic currency	*30,2*	*43,0*	*90,7*	*70,7*
In foreign currency	*41,1*	*71,9*	*189,4*	*195,3*
Other deposits	68,2	66,0	41,4	18,9
In the domestic currency	*39,0*	*55,7*	*5,8*	*-2,5*
In foreign currency	*122,2*	*85,5*	*94,1*	*49,7*

Source: National Bank of the Republic of Kazakhstan

Lower rates of the increase in deposits of natural persons can be explained by the slow down in the cash income of the population, conversion of funds into foreign cash. In addition, significant support from the Government provided to legal entities resulted in the growth in volumes of their transferable deposits.

Besides, in the environment of devaluation expectations the overflow of the population deposits from the domestic currency into foreign currency deposits occurred.

As part of the overall measures undertaken by the National Bank of the Republic of Kazakhstan for the support of the domestic currency, the Kazakhstan Deposit Insurance Fund from February 2009 decreased its interest rate on foreign currency deposits from 10% to 8%, and established the interest rate on deposits in the domestic currency at 13.5%.

From Q2 2009 this measure started to exert direct impact on the deposit market causing the growth in the domestic currency deposits and their reduction in foreign currency. Over Q2 2009 deposits of natural persons in the domestic currency have increased by 12.7% and have reduced in the foreign currency by 6.1%.

In June 2009 the average weighted interest rate on the Tenge time deposits of non-bank legal entities amounted to 4.1% (in June 2008 – 5.1%), and on deposits of natural persons – 10.6% (11.7%).

3.2.2. Credits to the Economy

In Q2 2009 credits to the economy reduced by 0.4% to KZT 8109.2 bln. Alongside with that credits to the population decreased by 3.2%, and credits to legal entities increased by 0.8%.

In June 2009 credits to the economy exceeded their volume as of June 2008 by 11.9%.

The average weighted rate on credits provided to legal entities in June 2009 as compared to June 2008 decreased from 15.3% to 12.8%. 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 lending, both through providing new loans and through the refinancing of the existing debt.

The average weighted rate on credits to natural persons decreased in June 2009 as compared to June 2008 from 19.0% to 17.9%, with the growth in rates (c 22.9% to 30.4%) being observed only on short-term credits provided in the domestic currency (**Ошибка! Источник ссылки не найден.**).

Figure 25

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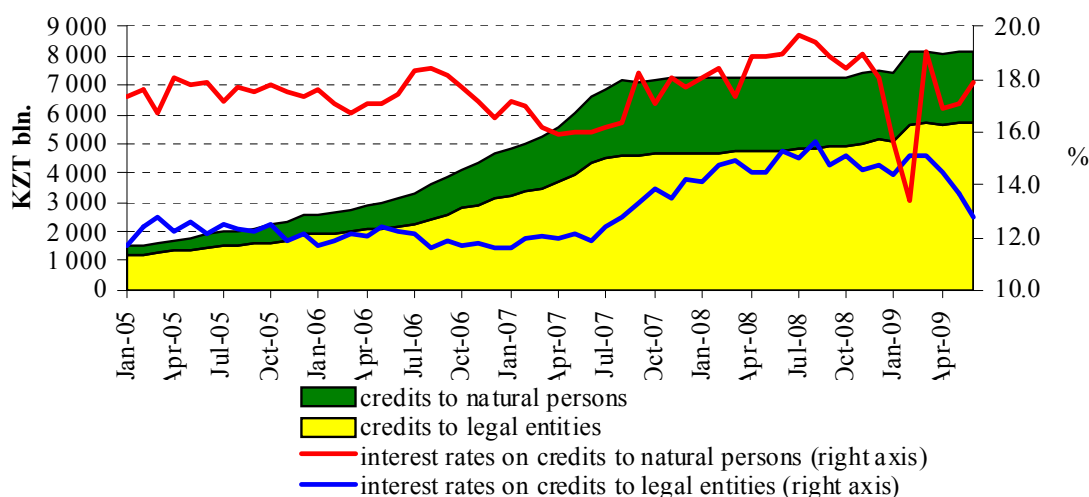
Source: National Bank of the Republic of Kazakhstan

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 notable 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 trade, construction, non-production sphere and individual entrepreneurship.
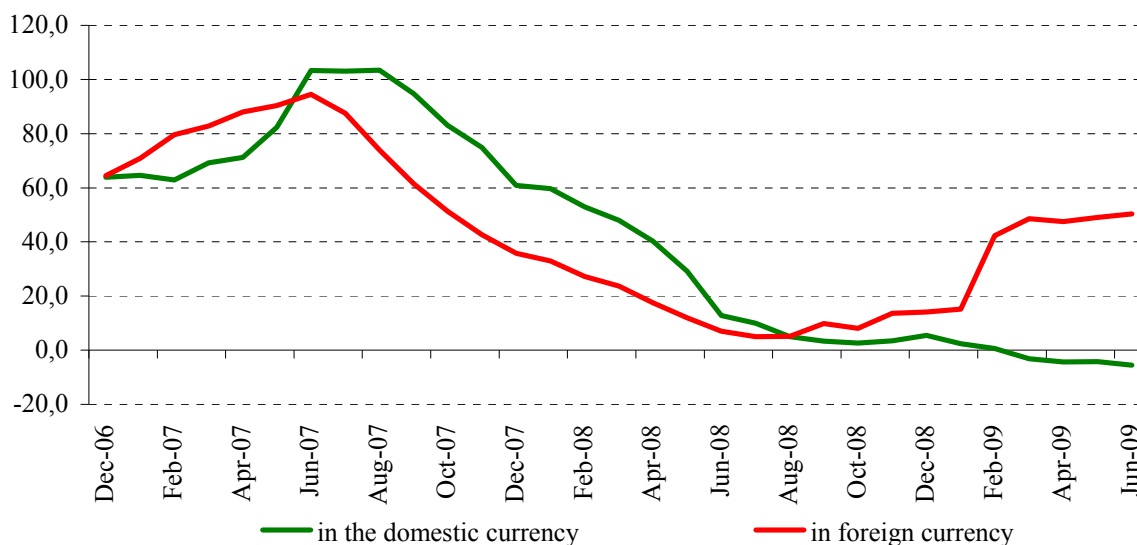
− **Credits to Legal Entities**

The volume of credits to legal entities in June 2009 as compared to June 2008 increased by 20.3%. The growth would have accounted for 7.9%, if the devaluation effect was excluded.

In Q2 2009 the annual growth in foreign currency credits exceeded that of credits in the domestic currency, being caused to a large extent by the revaluation of the loan debt as a result of the Tenge devaluation (**Ошибка! Источник ссылки не найден.**).

Figure 26

Dynamics of Credits to Legal Entities
(as % of the respective period of the previous year)

The percentage of medium- and long-term credits in the total volume of crediting of legal entities at end-June 2009 was 76.4% (in June 2008 – 72.3%).

− **Credits to the Population**

The volume of credits to the population in June 2009 as compared to June 2008 decreased by 4.3%. The decrease would have accounted for 11.6%, if the devaluation effect was excluded.

In the structure of credits to the population credits in the domestic currency have demonstrated a decrease while foreign currency credits have demonstrated an increase. In June 2009 as compared to June 2008 credits to the population in the domestic currency decreased by 9.9% whereas foreign currency credits increased by 5.7% as a result of the Tenge devaluation (**Ошибка! Источник ссылки не найден.**).

Figure 27

**Dynamics of credits to the population
as % of the respective period of the previous year)**
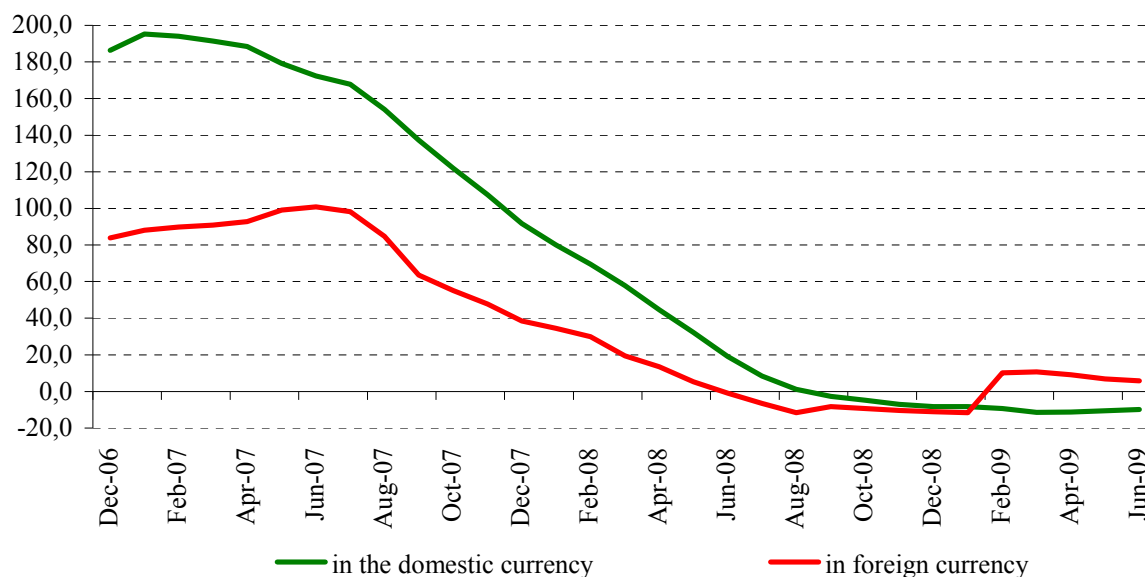
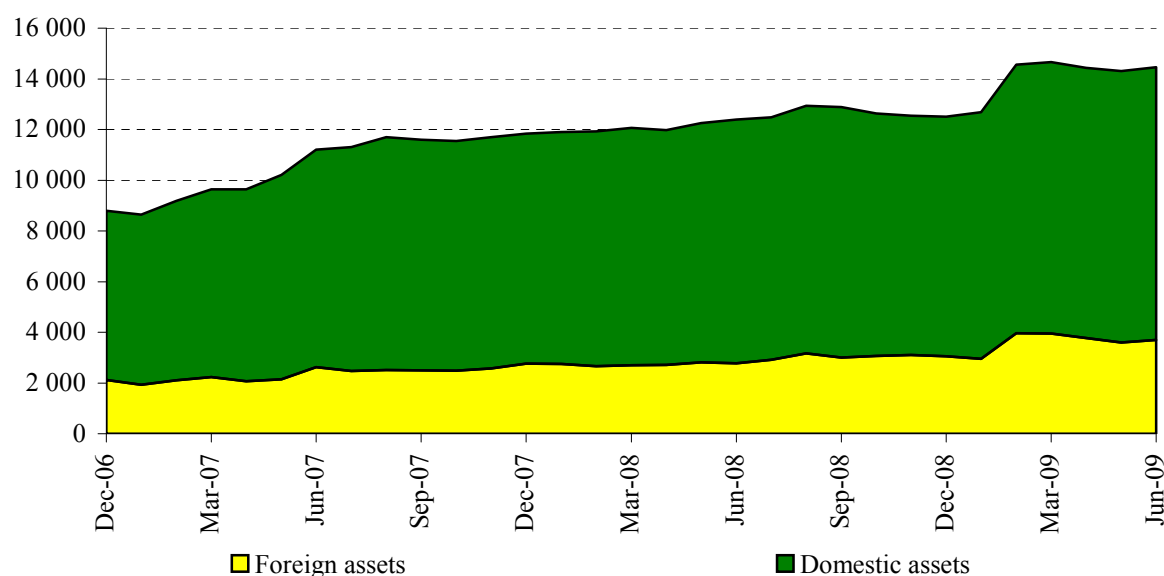Source: National Bank of the Republic of Kazakhstan

3.2.3. Bank Assets and Liabilities

− **Assets**

In Q2 2009 the size of banks' assets calculated according to the Monetary Survey decreased by 1.4% to KZT 14.5 tln. In annual terms (in June 2009 as compared to June 2008) banks' assets increased by 16.6%, and excluding the devaluation effect – by 3.5% (**Ошибка! Источник ссылки не найден.**).

Figure 28

Dynamics of bank assets, KZT bln.
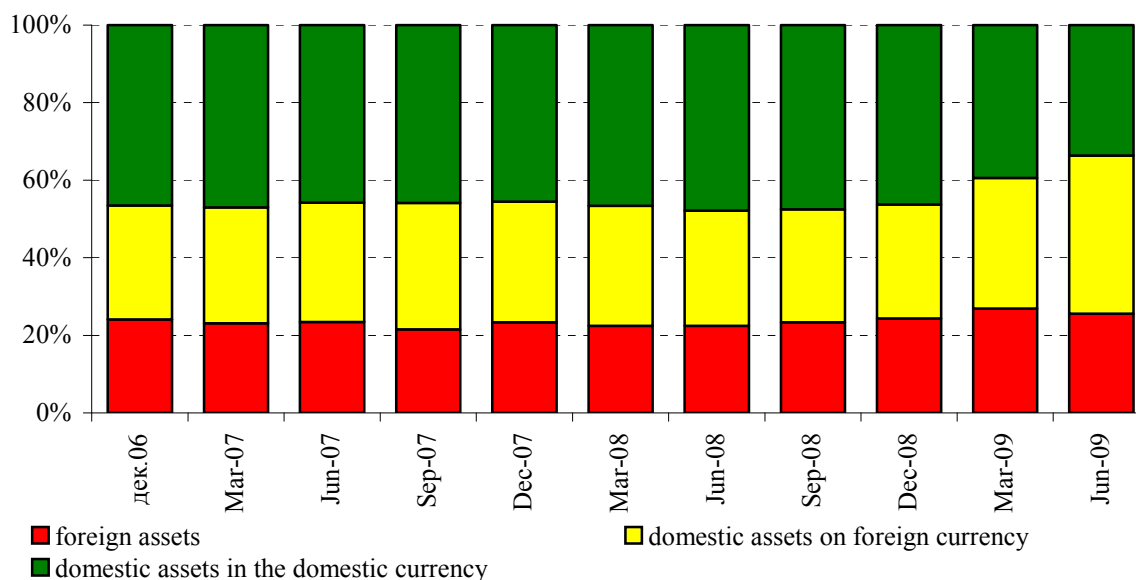

Source: National Bank of the Republic of Kazakhstan

Foreign assets of banks at end-June 2009 comprised 25.5% of the total assets or US$ 24.5 bln. As compared to March 2009 they reduced by 6.4% and increased by 32.9% as compared to June 2008.

In the structure of foreign assets in June 2009 credits provided to non-residents amounted to 55.3% (in June 2008 – 53.1%), deposits placed with non-residents – 23.4% (in June 2008 – 21.0%), securities of non-residents – 6.4% (in June 2008 – 11.1%).

Domestic assets in June 2009 comprised 74.5% or KZT 10.8 tln., including domestic assets in the domestic currency amounted to 54.8% or KZT 5.9 tln., in foreign currency – 45.2% or KZT 4.9 tln. (**Ошибка! Источник ссылки не найден.**). Over March-June 2009 domestic assets increased by 0.5%, including assets in the domestic currency increased by 2.0%, assets in foreign currency reduced by 1.3%. In annual terms the growth of these indicators reached 11.9%, (-)0.5% and 32.0%, and excluding the devaluation effect – 2.3%, (-)0.5% and 6.8%, respectively.

Figure 29

**Structure of bank assets, %**

Source: National Bank of the Republic of Kazakhstan

In June 2009 as compared to June 2008 the quality of banks' assets deteriorated significantly. The percentage of bad loans increased from 1.7% to 16.5% while the percentage of standard loans reduced (from 60.0% to 53.8%) and doubtful loans (from 38.3% to 29.8%). 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 1.2% to 6.1%) with concurrent reduction in the percentage of the 1st category (from 25.9% to 13.6%). This shows the remaining threat of a further reduction in the quality of the banks' assets.

– **Liabilities**

In Q2 2009 total liabilities of banks calculated in line with the Monetary Survey reduced by 2.6% and amounted to KZT 11.3 tln. at end-June. In annual terms (in June 2009 as compared to June 2008) liabilities of banks increased by 11.2%, and they would have decreased by3.0% without the devaluation effect (**Ошибка! Источник ссылки не найден.**).

Figure 30

Dynamics of bank liabilities
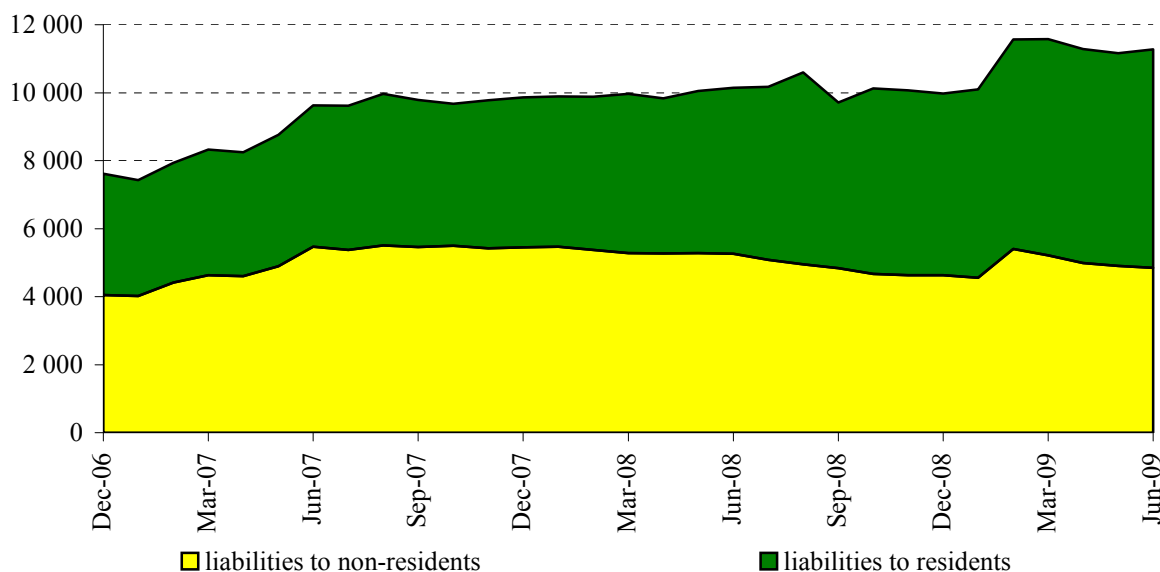
Source: National Bank of the Republic of Kazakhstan

Banks' liabilities to non-residents in June 2009 as compared to June 2008 decreased by 6.4% to US$ 32.2 bln. In annual terms, banks' liabilities to non-residents reduced by 26.0%. At end-June 2009 they comprised 43.0% of the volume of banks' liabilities.

In the structure of banks' liabilities to non-residents in June 2009 credits from non-residents decreased to 82.1% from 84.4% in June 2008, liabilities on deposits of non-residents – to 2.5% (from 4.6% in June 2008). Liabilities on securities, on the contrary, grew from 3.9% to 9.1%.
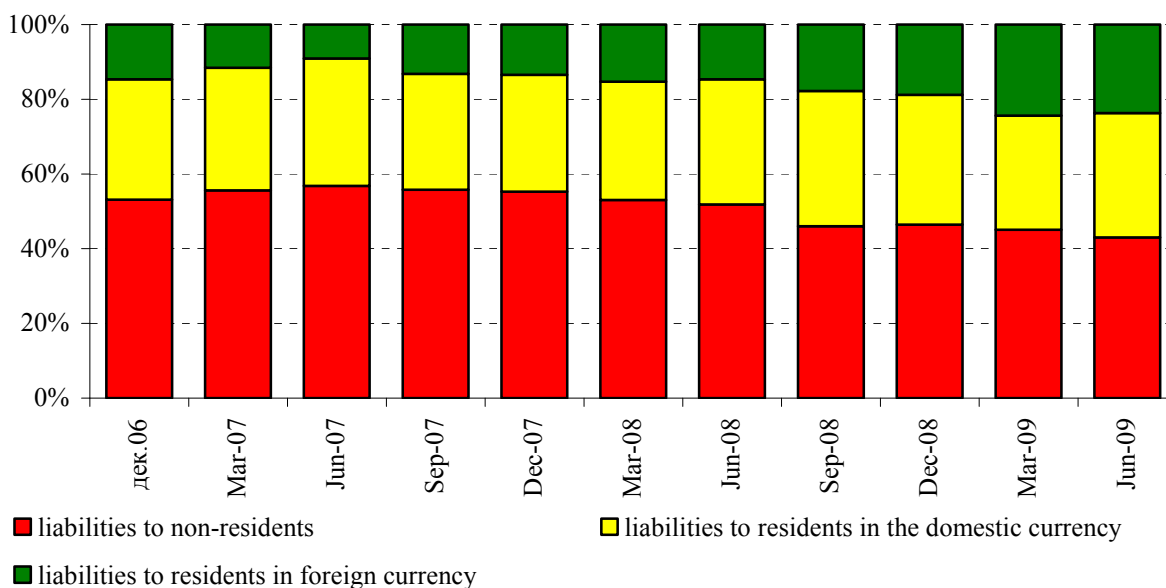
Over March-June 2009 liabilities to non-residents increased by 1% to KZT 6.4 tln., including liabilities in the domestic currency – by 6.1% to KZT 3.8 tln., foreign currency liabilities reduced by 5.3% to KZT 2.7 bln. In annual terms, the growth of these indicators comprised 31.6%, 10.6% and 79.8%, and excluding the devaluation effect – by 21.2%, 10.6% and 45.5%, respectively (**Ошибка! Источник ссылки не найден.**).

At end-June 2009 in the structure of liabilities to non-residents the percentage of transferable and other deposits of government non-financial organizations grew up – to 23.6% (in June 2008 – 16.5%). This growth was associated with the placement of resources of NWF "Samruk-Kazyna" as part of implementation of the government anti-crisis program. The percentage of deposits of non-government non-financial organizations has reduced over the period from 33.4% to 27.8%, and of households' deposits – from 29.7% to 25.0%.

The second quarter of 2009 appeared to be rather difficult for the banking system of Kazakhstan. First, two Kazakh banks have defaulted on their commitments. Second, despite the fact that the size of bank assets calculated in line with the Monetary Survey exceeds the size of their liabilities, risk adjusted assets in Q2 appeared to be less than liabilities of the banks. As a result, equity calculated in line with the Rules on Prudential Normatives happened to be negative. Third, BTA Bank and Alliance Bank are in the process of restructuring their foreign liabilities which are quite significant on the banks' balance sheets. To a large extent, a further development of the banking system in Kazakhstan will depend on how successful their plans and their implementation will be.

Figure 31

Structure of bank liabilities, %

- liabilities to non-residents
- liabilities to residents in the domestic currency
- liabilities to residents in foreign currency

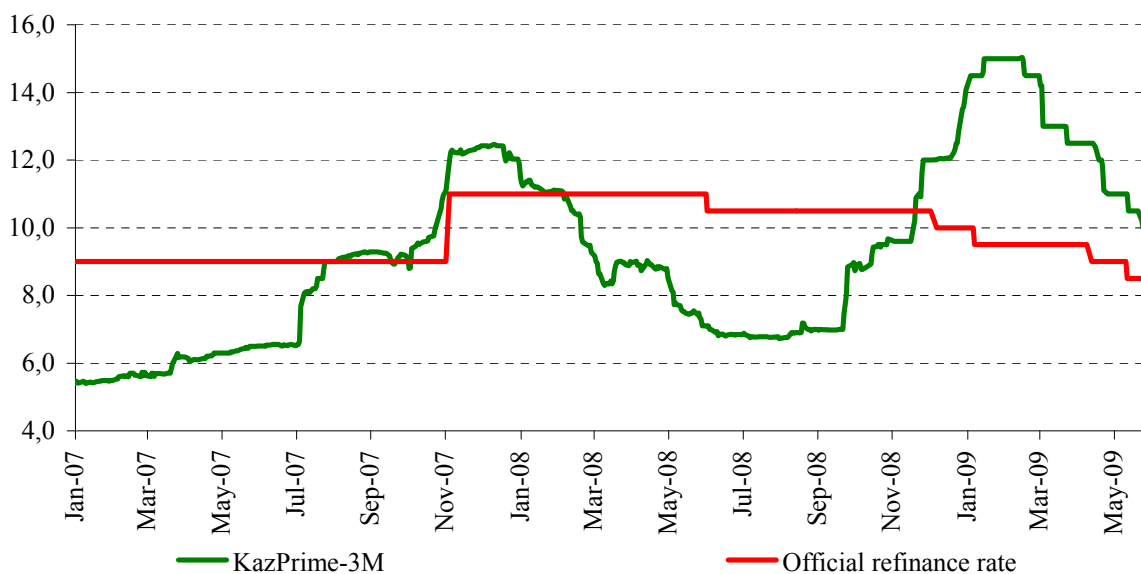Source: National Bank of the Republic of Kazakhstan

3.2.4. Financial Market Rates

In Q2 2009 interest rates in the interbank market lowered.

The KazPrime indicator decreased from 14.08% on average for Q12009 to 11.79% on average for Q2. At end-March 2009 the indicator was 14.20%, and at end-June − 10.00% (Figure 32).

Figure 32

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

KazPrime-3M   Official refinance rate

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

One of the factors for the decrease of the KazPrime rate is that in 2009 the National Bank concurrently reduced the official refinancing rate.

Rates on the REPO operations are also reduced.

The average-weighted rate on one-day automatic REPO operations reduced in Q2 2009 and amounted to 1.00% (in Q1 – 6.12%). Its maximum level was 2.64%, and minimum – 0.28%.

Fluctuations of the rate on 7-day REPO operations in Q2 2009 were within the range of 2.00% to 5.48%. The average weighted rate on 7 day REPO operations in Q2 2009 was 3.65%, whereas in Q1 it was 9.15%.

The average-weighted rate on 14-day REPO operations in Q2 2009 amounted to 5.64% (in Q1 – 9.59%). The rates fluctuated within the range of 3.00% - 10.00%.

As for 28-day REPO operations the average weighted rate reduced from 9.20% in Q1 to 5.67% in Q2 2009. Its maximum level was 10%, minimum – 4% (Figure 33).

Figure 33

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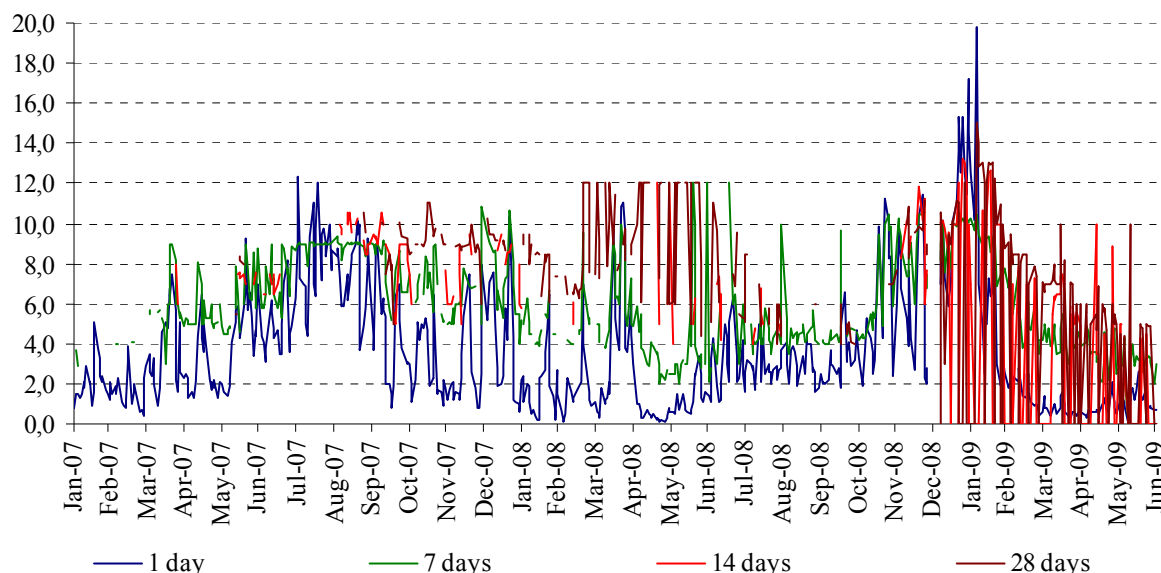
Source: Kazakhstan Stock Exchange

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.

Volumes of transactions in the automatic REPO sector in Q2 2009 decreased by 29.4% as compared to the previous quarter.

4. Monetary Policy Instruments and Operations

In Q2 2009 the situation with short-term bank liquidity has stabilized.

In Q2 2009 the National Bank's financial market operations have resulted in the increase of liquidity mainly due to refinancing operations conducted by the National Bank (Figure 34). It should be noted here that the increased liquidity was recorded in April only while in May-June the result of the National Bank's operations was the withdrawal of liquidity.

Figure 34

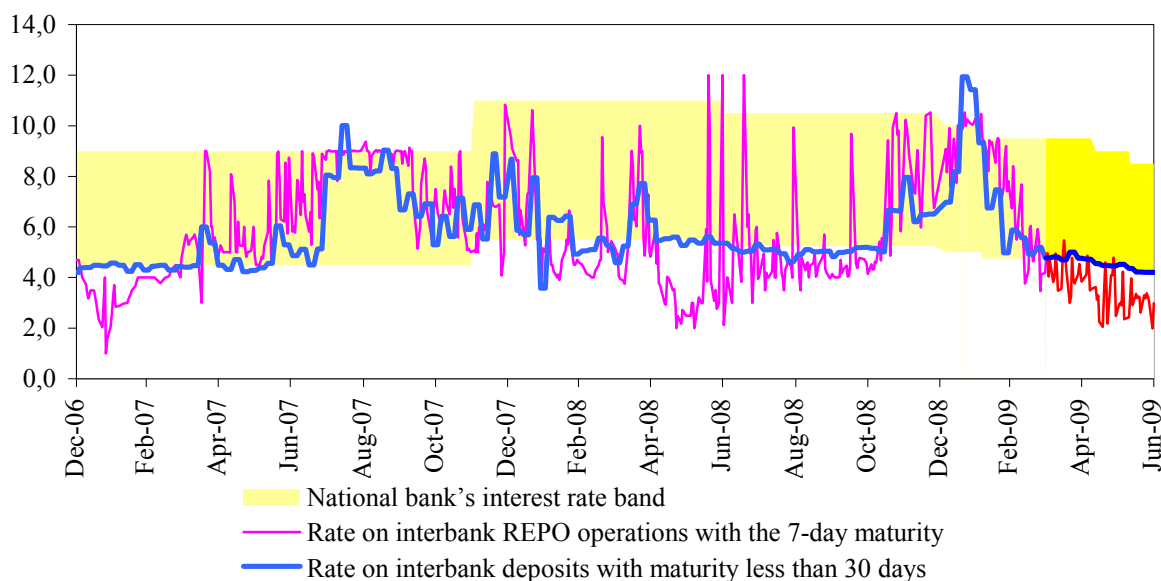**Balance of the National Bank's operations in the domestic market, KZT bln.**
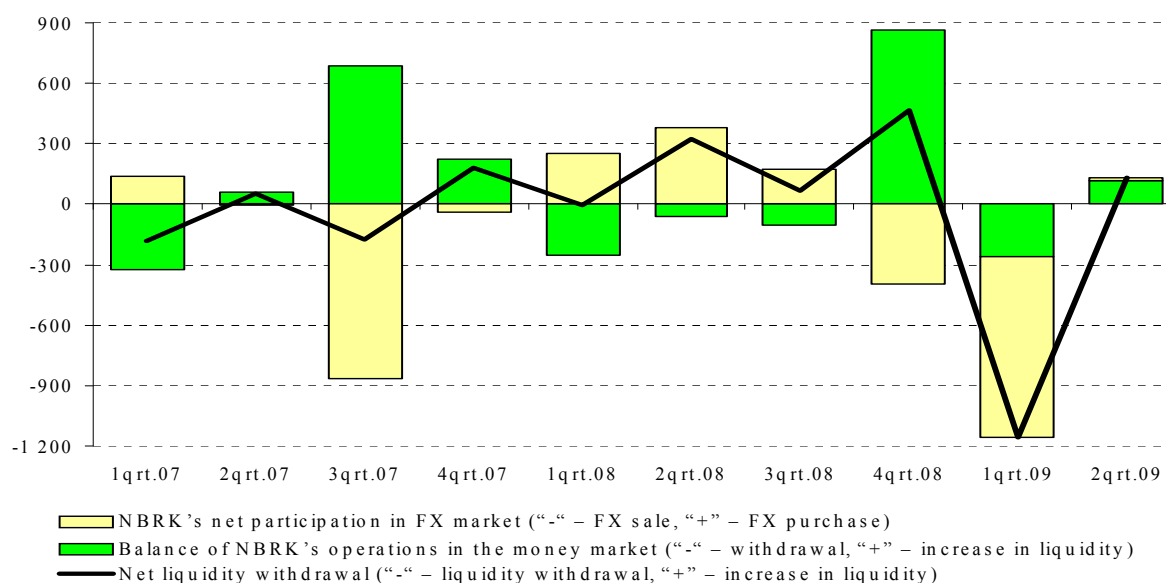
Source: National Bank of the Republic of Kazakhstan

As part of the measures for ensuring the financial sector stability, the National Bank in Q2 2009 continued to gradually reduce interest rates on its own operations. From May 12 2009 the official refinancing rate was reduced from 9.5% to 9.0%, from June 10 2009 – to 8.5%. The rate on deposits taken from banks was lowered from 4.75% to 4.5% and 4.25%, respectively.

The stabilized situation with liquidity in the financial market was accompanied by a gradual reduction of rates in the money market. On average, in April-June 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 4.56% in Q2 2009. The average-weighted rate on interbank REPO operations with the 7-day maturity was 3.65% (Figure 35).

Figure 35

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

Source: National Bank of the Republic of Kazakhstan

In Q2 2009 there was a decrease of banks' correspondent account balances with the National Bank, both in the domestic and foreign currency (Figure 36). In April-May 2009 correspondent account balances in foreign currency increased to some extent, however, their volume began to gradually decrease in June. Correspondent account balances in the domestic currency tended to gradually decrease during the entire period, which was also caused by activation of the interbank market (reduced return, growth in the transaction volumes).

Figure 36

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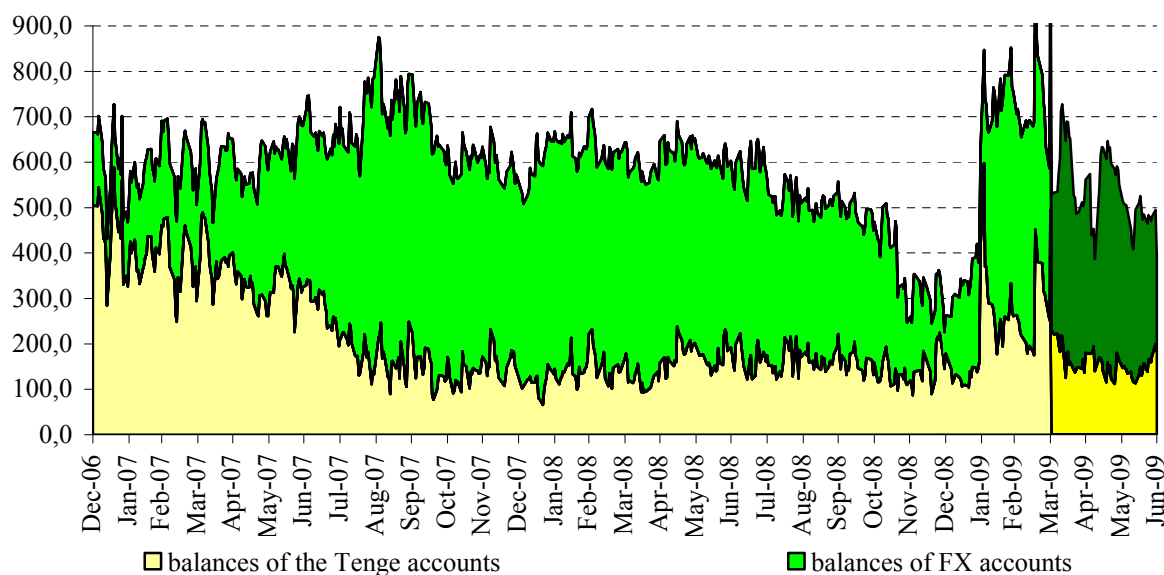
Source: National Bank of the Republic of Kazakhstan

4.1. Interventions in the Domestic Foreign Exchange Market
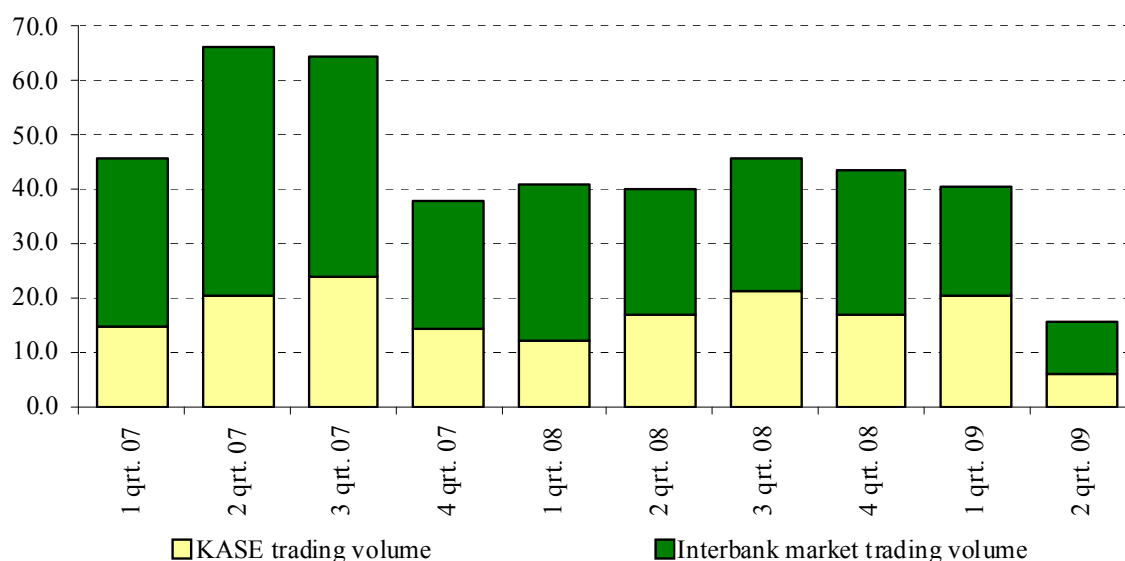
The situation in the domestic foreign exchange market was characterized by a relative stability and overall reduction in the trading volumes.

In Q2 2009 the total trading volume in the FX segment of the Kazakhstan Stock Exchange and in the interbank FX market amounted to US$ 15.5 bln., having reduced by 2.6 times as compared to Q1 2008 (US$ 40,5 bln.).

The volume of trades in Dollar position at the Kazakhstan Stock Exchange decreased by 3.3 times as compared to Q1 2009 and amounted to US$ 6.2 bln. (net trades at the Kazakhstan Stock Exchange made up 82% of gross trades). In the off-exchange foreign currency market the volume of transactions in the second quarter of 2009 decreased by 2.2 times as compared to the previous quarter and amounted to US$ 9.3 bln. (Figure 37).

Figure 37

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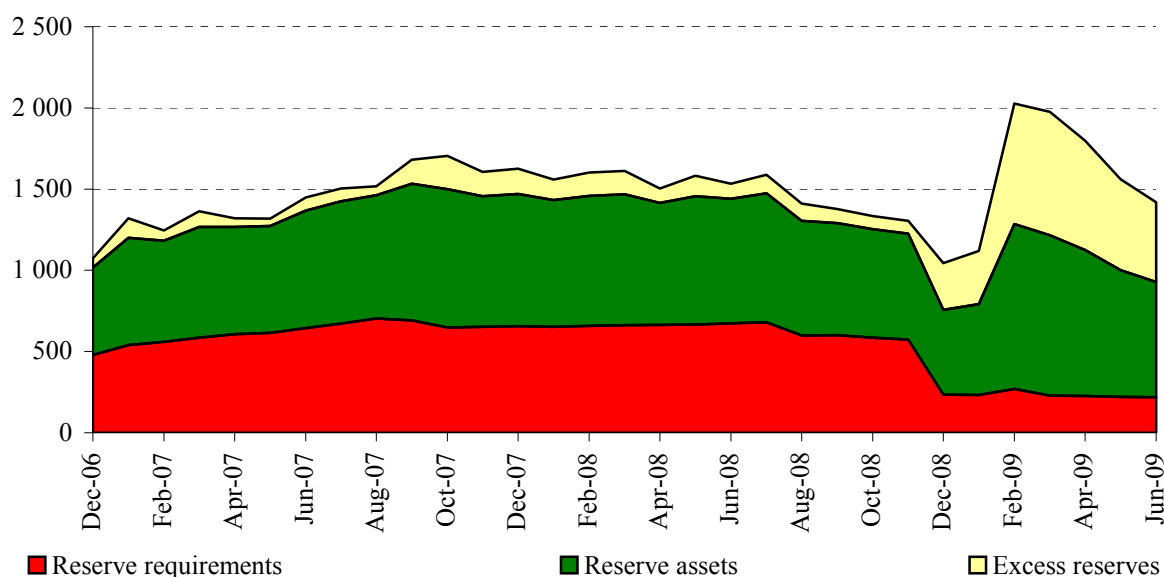

Источник: National Bank Republic of Kazakhstan

Based on the second quarter of 2009 the National Bank was primarily a buyer of foreign exchange in the domestic exchange market. The National Bank's net participation in the Kazakhstan Stock Exchange was minimal, with the participation coefficient being (-)0,1% (in Q1 2009 it equaled to (-)37,5%). In general, in Q2 2009 the National Bank was primarily a buyer of foreign exchange in the domestic exchange market.

4.2. Minimum Reserve Requirements

The lowering of the norms of minimum reserve requirements implemented in Q1 2009 resulted in building up of a significant volume of excessive reserves by banks. On average for April-June 2009 reserve assets exceeded the required reserving volume by 3.6 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 Q2 2009 demand for short-term notes of the National Bank on the part of banks increased. However, the National Bank met the demand not to the full extent. This was related to the National Bank's initiative for re-direction of participants of the short-term government securities market to Treasury obligations of the Ministry of Finance. Nonetheless, the Ministry of Finance didn't support the National Bank's initiative, in which connection medium- and long-term obligations of the Ministry of Finance remained as prevailing.

In the end, although in April-June 2009 the issued short-term notes exceeded by 14.9% the number of notes issued in Q1 2009 – for KZT 350 bln, this comprised 25.5% of the overall demand of the market participants for these types of government securities.

Notes were issued with maturities of 28 days. The average weighted yield on placed notes reduced from 6.06% in Q1 2009 to 5.24% in Q2 2009 (Figure 39).

At end-June 2009 the volume of short-term notes in circulation was KZT 145.0 bln. which is by 24.2% less than the volume of the end of March 2009 and by 55.1% less than the volume at end-June 2008 (Figure 40).

Figure 39

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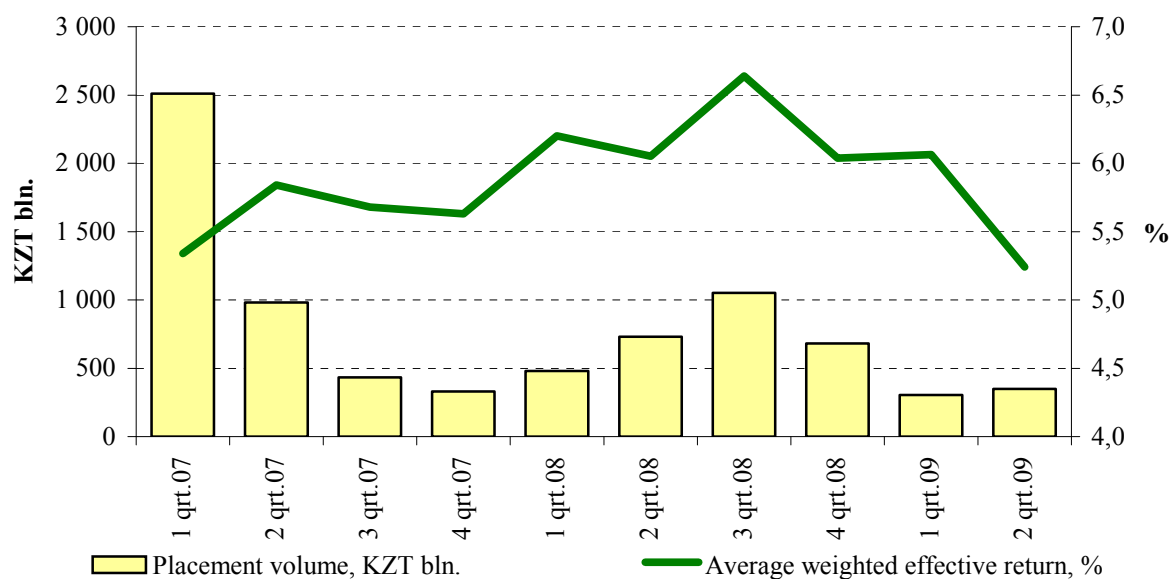
Source: National Bank of the Republic of Kazakhstan

Figure 40

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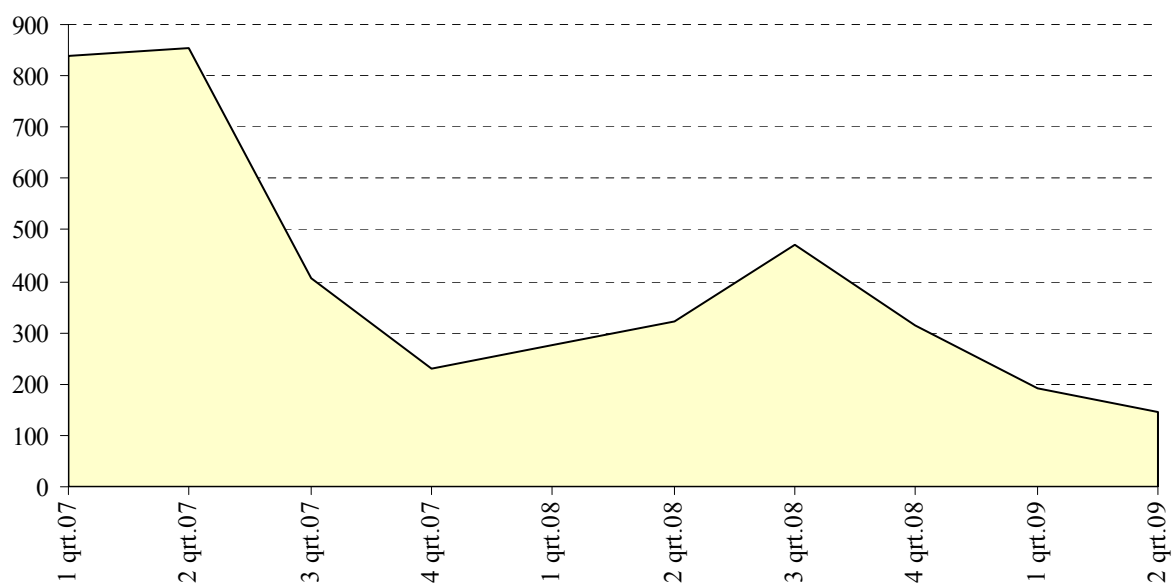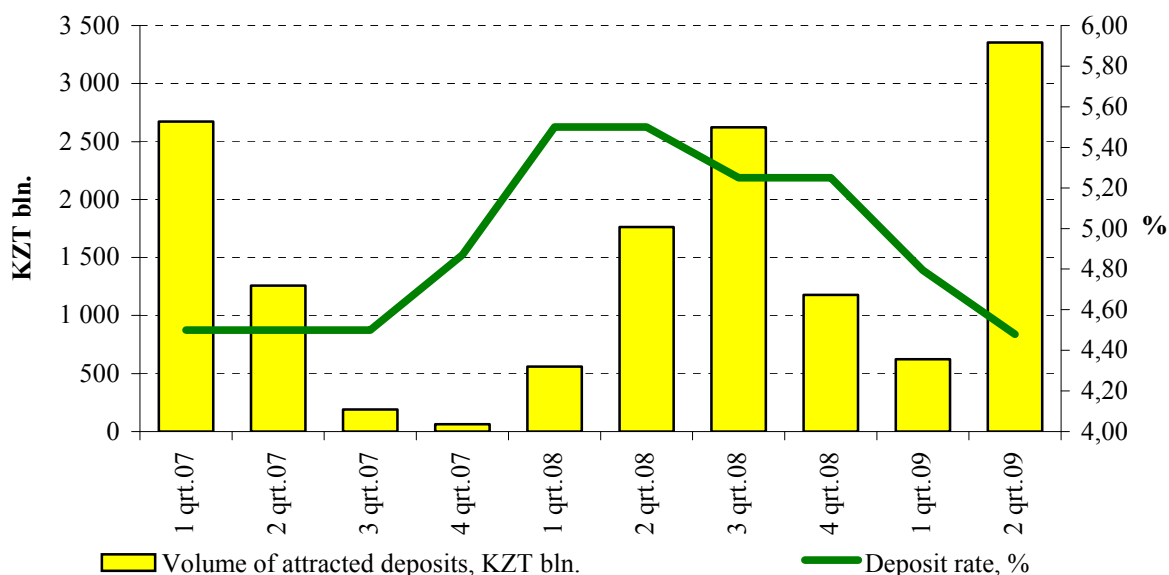

Source: National Bank of the Republic of Kazakhstan

4.4. Standing Facilities

In Q2 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. The attractions peaked in May-June. In general, over April-June 2009 deposits worth KZT 3352.8 bln. have been attracted which is by 5.4 times more than the volume for Q1 2009 and by 1.9 times more than the volume of Q2 2008. Maturity of attracted deposits was 7 days; average interest rate was at 4.48% (Figure 41).

Figure 41

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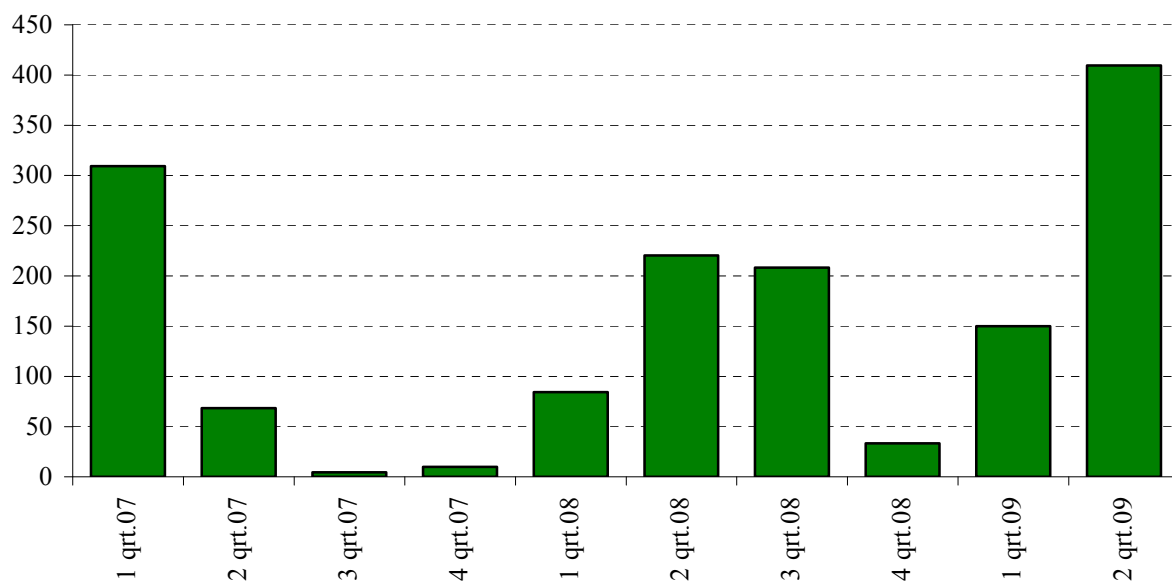

Источник: National Bank Republic of Kazakhstan

Growth in volumes of deposits attracted from banks was accompanied by the 2.7 times growth in the amount of the National Bank's outstanding liabilities on these deposits to KZT 409.5 bln. in June 2009 as compared to March 2009 and by 1.9 times as compared to June 2008 (Figure 42).

Figure 42

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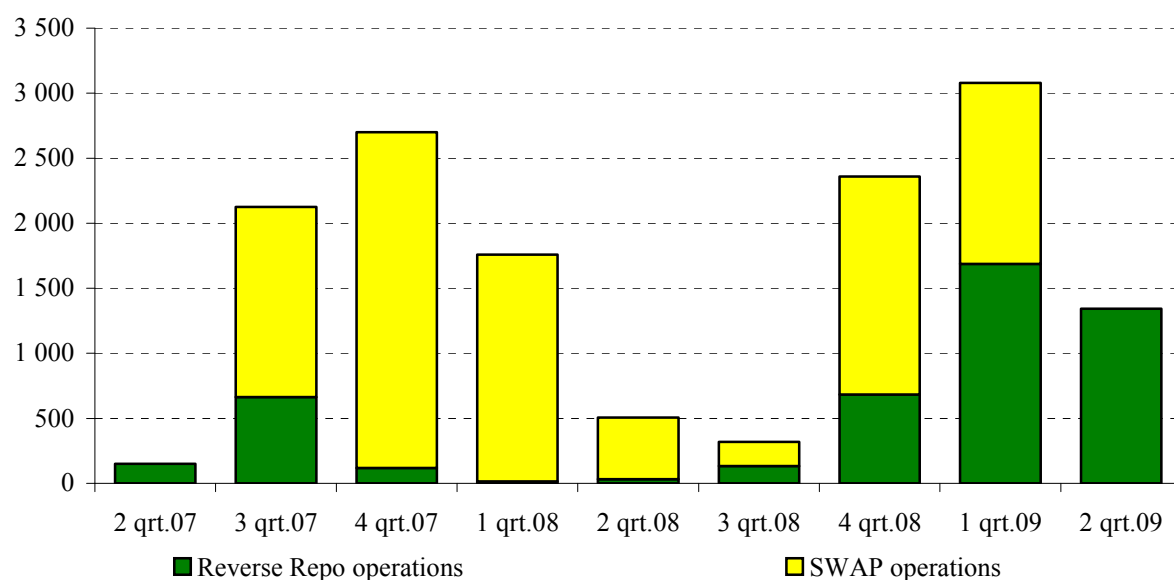

Source: National Bank of the Republic of Kazakhstan

In addition to sterilization operations, the National Bank in Q2 2009 continued providing refinancing loans to the banking sector through reverse REPO operations. The total

volume of reverse REPO operations in April-June 2009 amounted to KZT 1343.4 bln. (Figure 43).

Figure 43

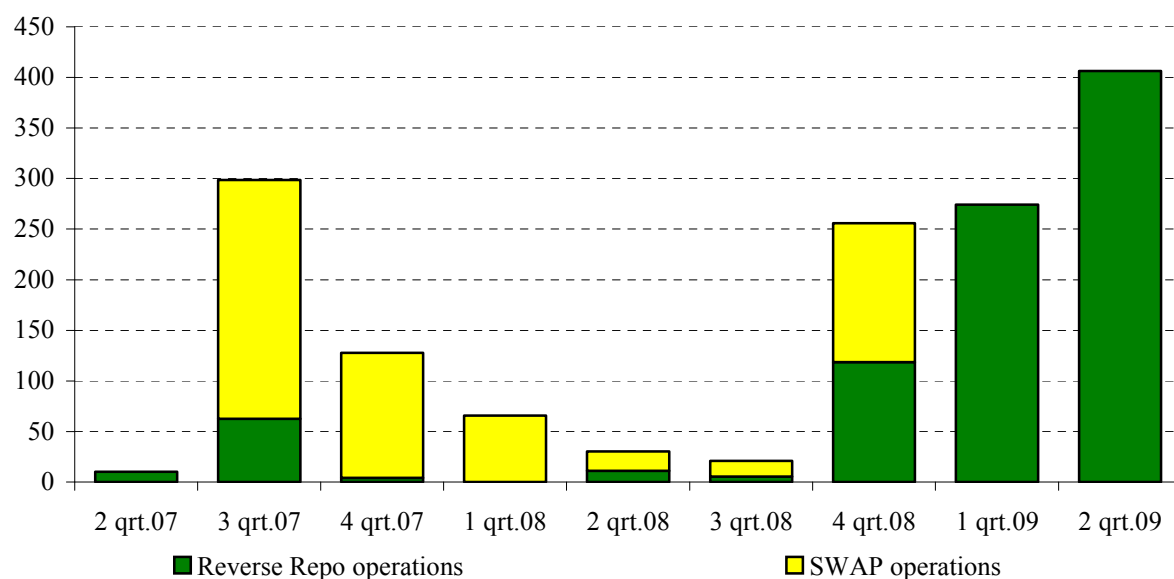**Volume of the National Bank's refinancing operations, KZT bln. (for the period)**

Source: National Bank of the Republic of Kazakhstan

At end-June 2009 the outstanding debt on reverse REPO operations amounted to KZT 406.3 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