

National Bank of Kazakhstan

Inflation Report fourth quarter 2008

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Key terms and concepts

In Section 1. Inflationary processes

Inflation in the Republic of Kazakhstan is calculated on the basis of the consumer price index (CPI), which describes the change in the overall level of prices for goods and services purchased by the population for personal consumption in the cities of Astana and Almaty, in all oblast centers, and in a selected group of cities and rayon centers. The consumer goods basket used for calculating inflation reflects the structure of household spending and includes 508 goods and services that account for the bulk of the population's consumption.

Core inflation – 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, fruits, gasoline, and coal;
- core inflation-2: inflation that does not take into account the rise in prices for vegetables, fruits, 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 describes the dynamics of changes in the indicator in question. An index value above 50 means a positive change in the indicator, while a value below 50 means a negative change.

In Section 2. Fiscal policy

Budget **revenue** includes income (tax receipts, nontax revenue, proceeds from the sale of fixed capital), repayment of budget credits, and proceeds from the sale of government financial assets.

Budget **spending** refers to expenditures (current and capital), budget credits, and the acquisition of financial assets.

In Section 3. Monetary aggregates

Base money (reserve money) includes cash issued by the National Bank, with the exception of cash in vault at the National Bank (currency outside the National Bank), transferable and other bank deposits, transferable deposits of nonbank financial institutions, and current accounts of public and private nonfinancial institutions in tenge at the National Bank.

Narrow base money refers to base money not including other bank deposits at the National Bank.

The **M1 monetary aggregate** is calculated as the sum of currency in circulation and transferable deposits held by nonbank 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 held by nonbank legal entities and the public in tenge.

The **money supply (M3)** is defined on the basis of the consolidation of account balances of the National Bank and banks. It consists of currency in circulation and transferable and other deposits of resident legal entities and households in domestic and foreign currency.

Transferable deposits are all deposits which: 1) can be converted into cash at face value at any time without penalties and restrictions; 2) are freely transferable with the aid of a check, draft, or endorsement orders; 3) are widely used for the performance of payments. Transferable deposits are part of narrow money.

Other deposits include primarily savings and time deposits that may be withdrawn only upon expiration of a certain time period, or that have various restrictions which make them less convenient for use in ordinary commercial transactions and, for the most part, meet requirements established for savings mechanisms. In addition, other deposits also include nontransferable deposits and deposits denominated in foreign currency.

The **KazPrime** index is the weighted average interest rate on interbank deposits at banks that are parties to the Agreement on the Formation of the KazPrime Kazakhstan Interbank Deposits Index. Each quotation includes the rate for the attraction and placement of funds for deposit for one of the parties to the Agreement, as well as the volume of funds attracted and placed. The minimum quotation amount is 150 million tenge. The maximum spread between quotations is 100 basis points (1.00 percent per annum). The standard term for an interbank deposit at the time the project was launched was three months.

In Section 5. 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 the sum of the change in the volume of short-term notes in circulation, balances on banks' deposit and correspondent accounts with the National Bank, and net transactions involving the purchase and sale of government securities.

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1. Introduction

Kazakhstan's macroeconomic development in 2008 was a reflection of the realization of risks that had accumulated over previous years. The risks were seen in both the financial sector and the real sector. The situation in 2008 was aggravated by the slowdown in the global economy, a significant rise in prices in global commodity markets in the first half of the year and an unprecedented drop in these prices in the second half of the year, as well as a devaluation of currencies in a number of countries. And although economic growth continued in the country in spite of this, the pace of growth fell off significantly.

According to the estimate, real growth in GDP was equal to 2.5 percent. At the same time, there was a contraction in sectors such as the manufacturing industry (by 2.6 percent in 2008) and agriculture (by 5.6 percent). The rest of the sectors of the economy reported a slowdown in growth in production output. For example, production in the mining and extraction industry grew by 5.3 percent in 2008, output in construction rose by 1.8 percent, the retail trade turnover expanded by 3.6 percent, and freight turnover by 5.5 percent.

The slowdown in real economic growth, the stagnation of credit activity in the banking sector, and falling prices for Kazakhstan's major export goods in light of the conditions in world commodity markets contributed to a decline in business activity in Kazakhstan. Among the main indicators of enterprises' business activity, special mention should be made of the growth in unemployment in the second half of 2008, shrinking personal income, and a slowdown in growth in prices for industrial products of Kazakhstani enterprises.

The emergence of these trends in Kazakhstan's economy helped to curb inflation. Based on the results for 2008, annual inflation was equal to 9.5 percent.

In this connection, in 2008 the National Bank pursued a moderately tight monetary policy aimed at ensuring financial stability and price stability.

With the aim of ensuring financial stability, the National Bank provided short-term liquidity to the banking sector. Access by banks to lending from the National Bank was gradually expanded in 2008.

In July 2008 the National Bank lowered the rates on its own operations: the official refinancing rate was lowered from 11.0 percent to 10.5 percent, and the rate on deposits attracted from banks by the National Bank was cut from 5.5 percent to 5.25 percent.

In 2008 the minimum reserve requirements for banks were reduced twice: from 6 percent to 5 percent for a bank's domestic liabilities and from 8 percent to 7 percent for a bank's other liabilities in July 2008, and to 2 percent and 3 percent, respectively, in November 2008.

In addition, a stable exchange rate, which remained in the range of 119–121 tenge to the U.S. dollar with minimum participation by the National Bank in the domestic exchange market, also contributed to maintaining the stability of the financial system.

2. Inflation processes

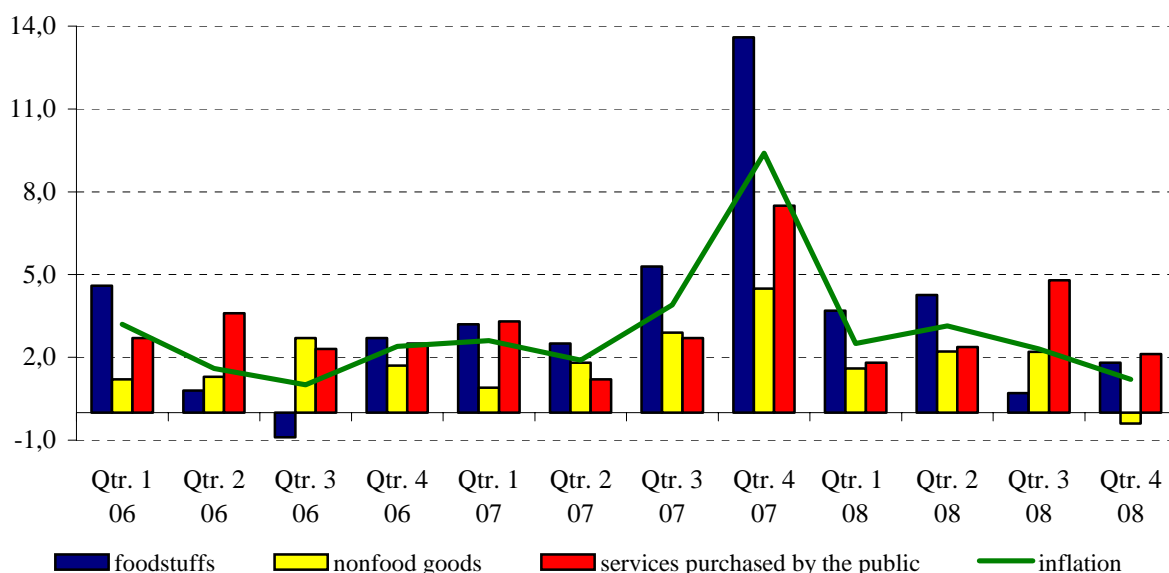
2.1. Consumer prices

The downward trend in inflationary pressure in the economy continued in the fourth quarter of 2008. Inflation during this period was lower compared to both the previous quarter and the corresponding quarter of the previous year. The inflation rate reported in the fourth quarter was the lowest figure seen in the past nine years. In October–December 2008 the inflation rate was 1.2 percent.

The rise in prices in the fourth quarter of 2008 was due to an increase in the cost of services purchased by the public by 2.1 percent and an increase in the cost of food by 1.8 percent. Prices for nonfood goods fell by 0.4 percent (Figure 1).

Figure 1

Dynamics of quarterly inflation and its components (as a percentage of the previous period)



Source: Statistical Agency of the Republic of Kazakhstan

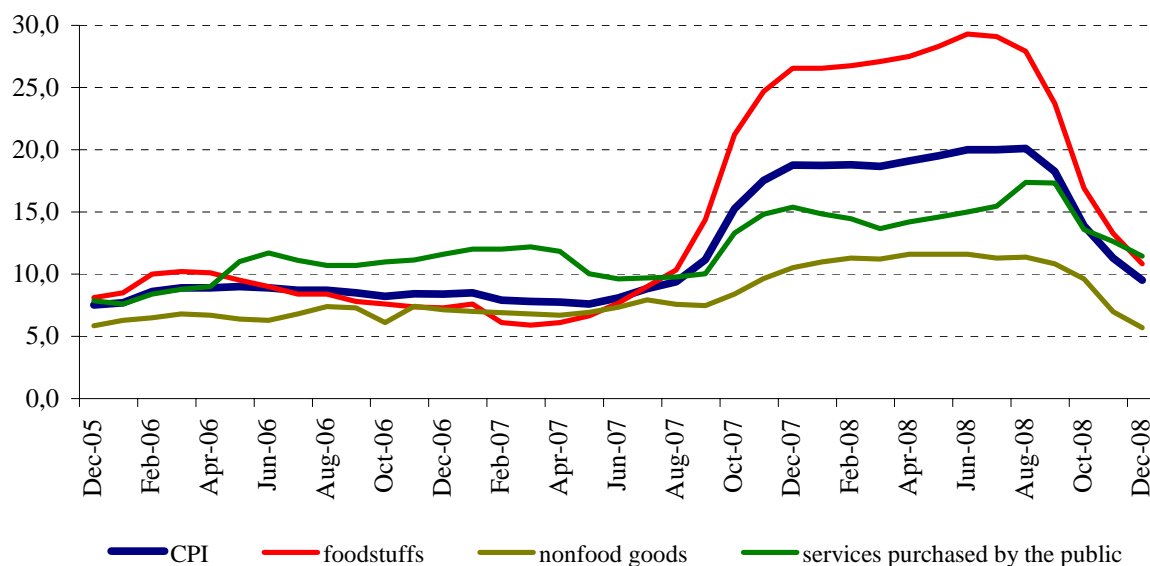
In the fourth quarter of 2008 most of the increase in prices was due to goods and services, such as eggs, which posted an increase of 11.7 percent, dairy products, which rose by 7.1 percent, fruits and vegetables, which increased by 4.4 percent, educational services, which increased by 4.1 percent, and medical services, which showed an increase of 2.5 percent.

Based on the results for 2008, annual inflation reached 9.5 percent (compared to 18.8 percent in December 2007).

Prices for foodstuffs rose by 10.8 percent, prices for nonfood goods increased by 5.7 percent, and the cost of services purchased by the public grew by 11.4 percent (Figure 2). In annual terms, the largest price gain was seen among bread and bakery goods, dairy products, fruits and vegetables, sugar, transportation services, medical services, services provided by educational institutions, and housing and municipal services. At the same time, there was a drop in prices for fuel and lubricants.

Figure 2

Dynamics of annual inflation and its components
(as a percentage of the corresponding month of the previous year)



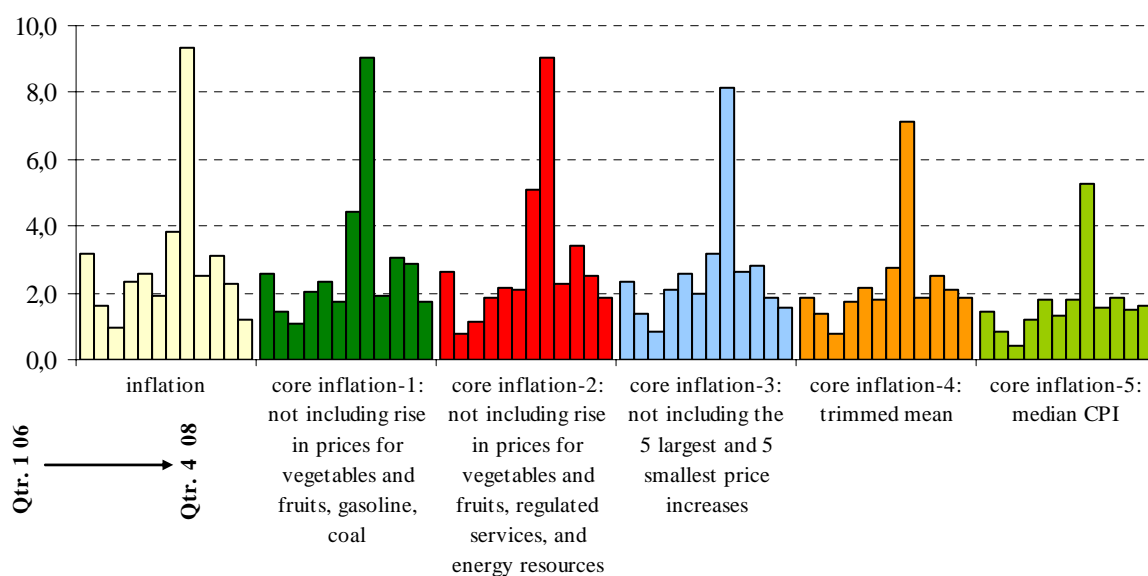
Source of information: Statistical Agency of the Republic of Kazakhstan

2.2. Core inflation

Core inflation indicators also point to a decline in inflationary pressure in the economy. In the fourth quarter of 2008 core inflation slowed compared to the previous quarter (with the exception of core inflation-5), and also compared to the fourth quarter of 2007 (Figure 3).

Figure 3

Dynamics of quarterly inflation and core inflation
(as a percentage of the previous period)



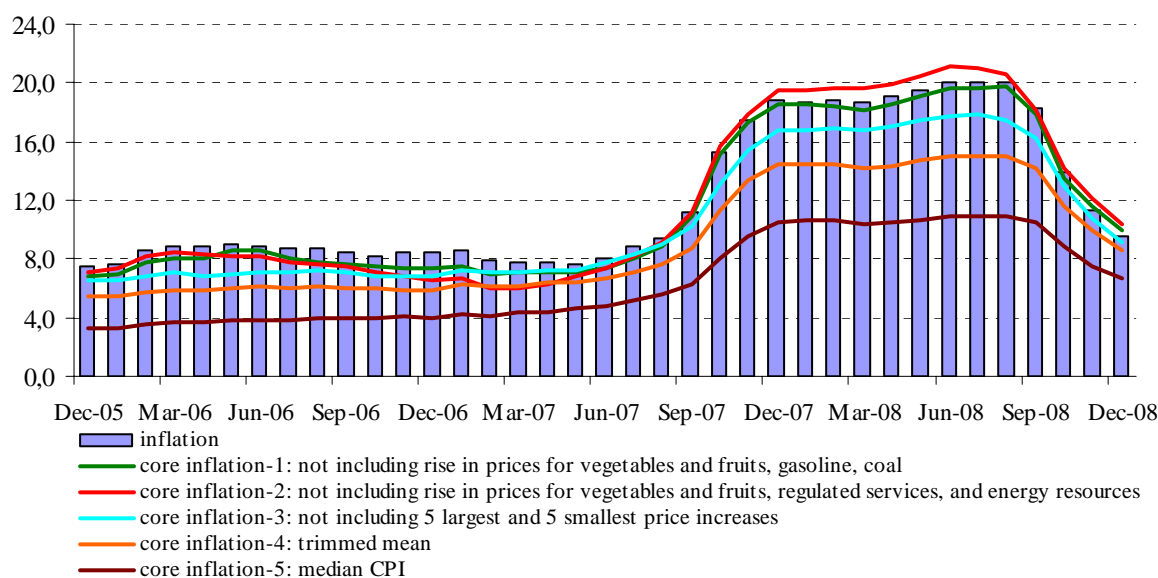
Source: Statistical Agency of the Republic of Kazakhstan

In October–December 2008 the core inflation rate, calculated using all methods, was higher than the overall inflation figure. This was due to a decline in prices for certain types of goods and services (fuel and lubricants, oils and fats, transportation services), and also to a moderate rise in prices for fruits and vegetables, meat products, and bread and bakery goods, the change in prices for which was excluded in the calculation of the given indicators.

In annual terms, the core inflation indicators, like the overall inflation indicator, are slowing down. All of the core inflation indicators in December 2008 were lower than the figures reported for December 2007. At the same time, one should mention that based on the results for December 2008, the core inflation-1 and core inflation-2 indicators in annual terms were higher than the overall inflation indicators, which was due primarily to a significant drop in prices for fuel and lubricants (Figure 4).

Figure 4

**Dynamics of annual inflation and core inflation
(as a percentage of the corresponding month of the previous year)**



Source: Statistical Agency of the Republic of Kazakhstan

2.3. Prices in the real sector of the economy

2.3.1. Prices in the industry

In the fourth quarter of 2008 there was a drop in producer prices by 36.6 percent, while in the fourth quarter of 2007 these prices rose by 10.1 percent. Goods produced were 38.2 percent less expensive, with a 41.5 percent decline in the cost of intermediate consumption products and a 0.1 percent drop in the cost of consumer goods. The cost of producer goods and services of a production nature provided by industrial producers rose by 4.1 percent and 2.4 percent, respectively.

In October–December 2008 prices of enterprises in the mining and extraction industry fell by 48.6 percent (in the fourth quarter of 2007 this indicator rose by 14.5 percent). One of the reasons for the decline in producer prices was the drop in prices for energy and other raw materials. Oil production prices fell by 53.6 percent in the fourth quarter of 2008 (compared to an increase of 24.6 percent in the same period in 2007), gas condensate prices dropped by 53.5 percent (compared to an increase of 33.3 percent the previous year). On the whole, from

October through December 2008 the cost of energy resources declined by 47.5 percent, while their cost grew by 23.5 percent in the corresponding period in 2007.

Prices in the manufacturing industry declined by 15.8 percent, also under the influence of the energy price situation. Prices for rolled ferrous metals dropped by 45.1 percent (compared to a decline of 9.3 percent in the fourth quarter of 2007), while prices for petroleum products fell by 7.2 percent (compared to an increase of 13.3 percent).

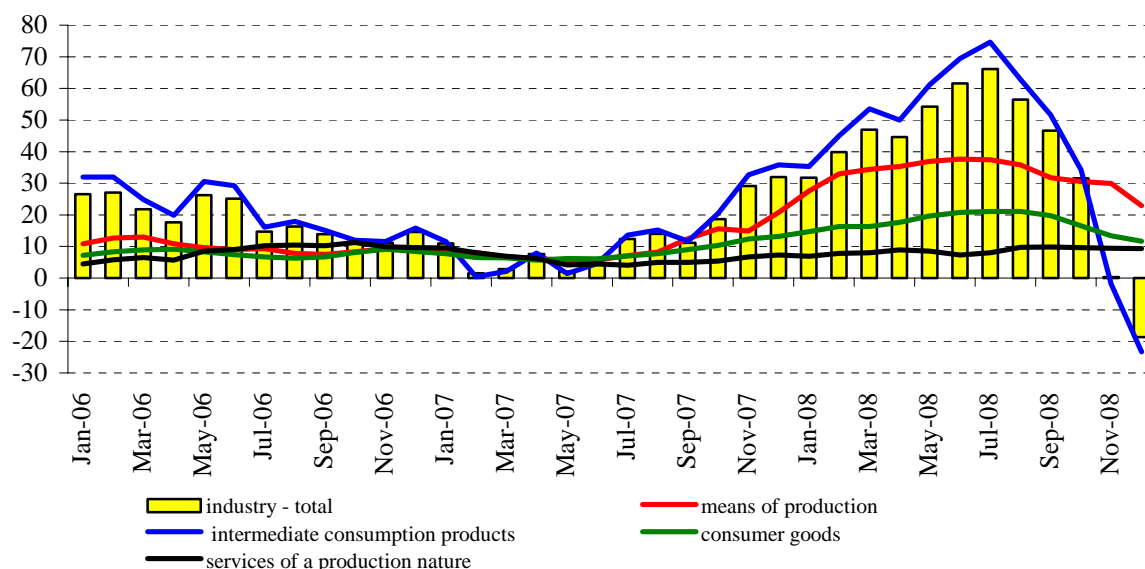
The cost of foodstuffs produced by the country's enterprises fell by 1.9 percent in the fourth quarter of 2008.

Prices and rates for the production and distribution of electricity, gas, and water grew by 2.1 percent in the fourth quarter of 2008 (compared to an increase of 5.8 percent in the fourth quarter of 2007).

In December 2008 the decline in prices in industrial production was equal to 18.6 percent in annual terms (December 2008 compared to December 2007). The cost of goods produced in 2008 fell by 20.1 percent, including a 23.3 percent decline in the cost of intermediate consumption goods. The annual rise in prices for consumer goods, producer goods, and services of a production nature was 11.7 percent, 22.9 percent, and 9.3 percent, respectively (Figure 5).

Figure 5

**Dynamics of the producer price index
(as a percentage of the corresponding month of the previous year)**



Source: Statistical Agency of the Republic of Kazakhstan

2.3.2. Prices in agriculture

In the fourth quarter of 2008 there was a decline in the rate of growth in sales prices paid to producers of agricultural goods, which rose by 4.1 percent (compared to 26.1 percent in the fourth quarter of 2007). The dynamics of prices in agriculture occurred against the backdrop of a 7.4 percent increase in prices for animal husbandry products and a 2 percent rise in prices for products of crop farming.

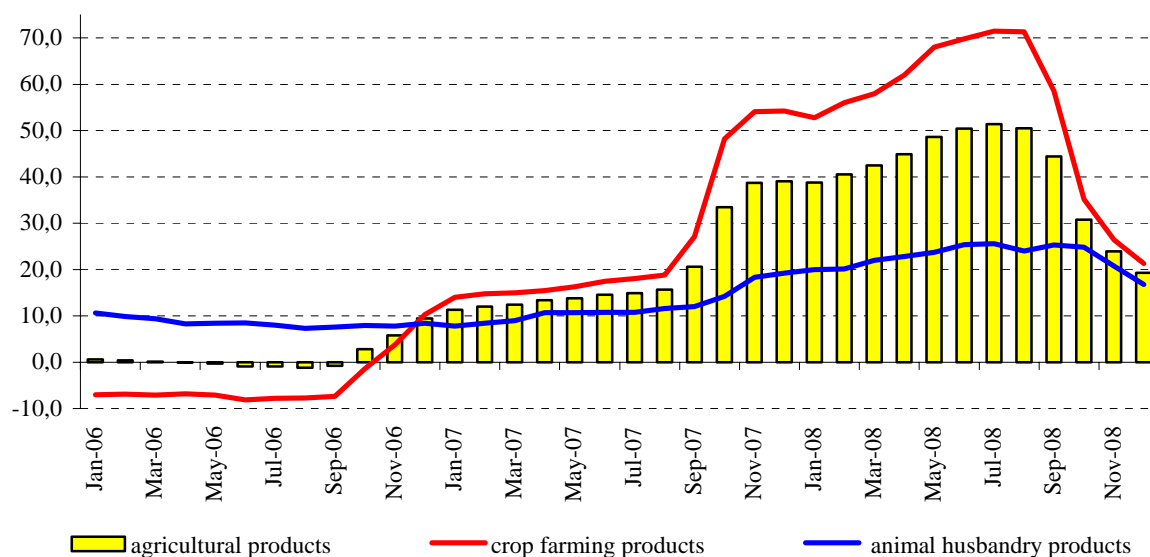
In the period October–December 2008, among animal husbandry products there was an 18.3 percent rise in egg prices, a 14.6 percent increase in milk prices, and 3.5 percent growth in prices for meat from livestock and poultry.

The rise in prices for crop farming products during the period in question was driven by higher potato prices, which rose by 8.2 percent, higher vegetable prices, which grew by 6.1 percent, and prices for grain crops, which went up 1.8 percent.

Based on the results for 2008, the annual increase in prices for agricultural products reached 19.3 percent (compared to 39.1 percent in 2007). The cost of crop farming products rose by 21.3 percent (compared to 54.2 percent), while prices for animal husbandry products grew by 16.8 percent (compared to 19.2 percent) (Figure 6).

Figure 6

**Dynamics of the agricultural price index
(as a percentage of the corresponding month of the previous year)**



Source: Statistical Agency of the Republic of Kazakhstan

2.3.3. Enterprise monitoring

In the fourth quarter of 2008 demand for finished products declined substantially compared to the preceding quarter. Some 36.4 percent of the enterprises surveyed reported a drop in this indicator (the figure was 22.4 percent in the third quarter of 2008). At the same time, there was a decline in the proportion of enterprises with stable demand (from 51.4 percent to 45 percent) and a significant drop in the proportion of enterprises that reported an increase in demand (from 25.6 percent to 17.7 percent). As a result, the diffusion index of the change in demand for the finished products of a given sector, which serves as an overall indicator, reached 40.7, falling below 50 for the first time in the period under review. This means that there was a decline in demand compared to the preceding quarter.

In the first quarter of 2009, 37.2 percent of the enterprises surveyed expect that demand for finished products will remain unchanged, while 25.5 percent of the enterprises participating in the survey expect a decline in demand. Just 12.4 percent of the enterprises expect that there will be an increase in demand for finished products. As a result, in the first quarter of 2009 the diffusion index will be 43.4, that is, it is expected that demand will continue to fall, but at a slower pace than in the fourth quarter of 2008 (Figure 7).

The situation with prices for finished products of the enterprises surveyed is characterized by a significant drop in inflationary pressure: the diffusion index of the change in prices for finished products fell to the 48.6 mark (compared to 60.9 in the third quarter of 2008), demonstrating a decline in prices throughout the economy as a whole. Meanwhile, just

17.4 percent of the enterprises reported a rise in prices for finished products in the fourth quarter of 2008 (compared to 31.1 percent in the third quarter), while the proportion of enterprises whose prices for finished products declined was 20.3 percent (compared to 9.3 percent in the preceding quarter).

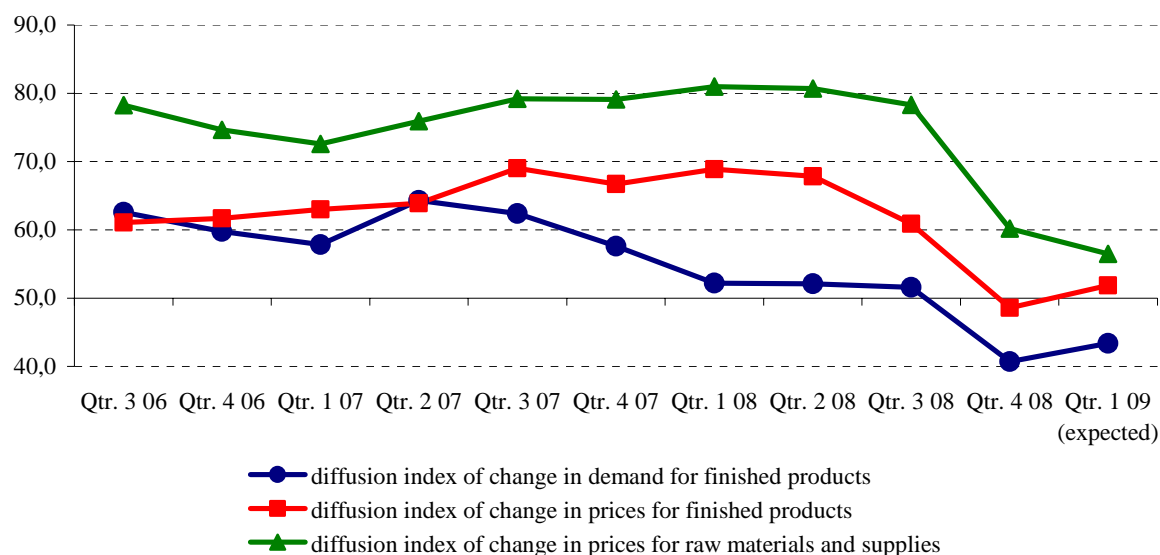
A slight increase in the diffusion index for the change in prices for finished products is expected in the first quarter of 2009 (to 51.9). This is tied to a decline to 12.7 percent in the proportion of enterprises whose products are expected to drop in price, while the proportion of enterprises that expect an increase in prices for their products will reach just 16.5 percent (Figure 7).

In the fourth quarter of 2008 there was a marked drop in the proportion of enterprises that reported a rise in prices for raw materials and supplies from 65.9 percent to 40.4 percent. Some 38.9 percent of the enterprises surveyed reported stable prices, while 24.5 percent reported the same in the third quarter of 2008. The proportion of enterprises that reported a drop in prices for raw materials and supplies grew from 2.7 percent to 12.7 percent. As a result, the diffusion index of the change in prices for raw materials and supplies fell from 78.3 to 60.2, that is, the rise in prices continued in 2008, but at a slower pace.

The proportion of enterprises expecting higher prices for raw materials and supplies in the first quarter of 2009 fell to 29.5 percent, while the proportion of enterprises expecting lower prices dropped to 9.3 percent. As a result, the diffusion index fell to 56.5 (Figure 7).

Figure 7

Diffusion indices for changes in demand and prices



Source of information: The National Bank of the Republic of Kazakhstan

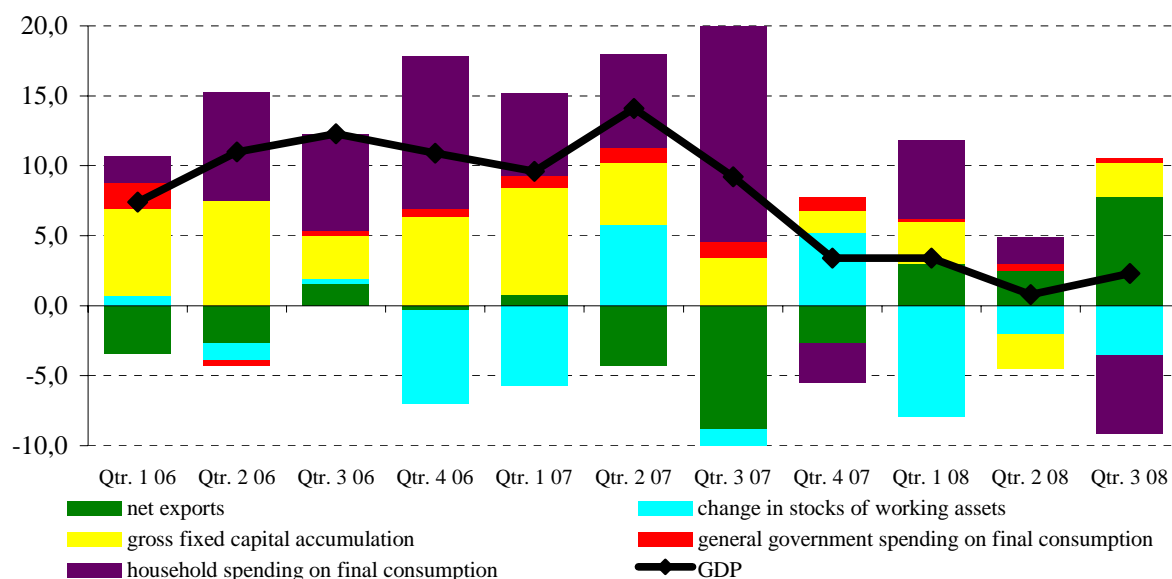
3. Factors of inflation

3.1. Aggregate demand

In the third quarter of 2008 growth in GDP consumption was estimated at 2.3 percent compared to the corresponding period of 2007, which is significantly higher than the same figure in the previous quarter (0.8 percent). The reason for this was a steep increase in growth in net exports, while there was a substantial drop in consumer demand in the household sector (Figure 8).

Figure 8

Contribution of components of aggregate demand to growth in GDP, %



Source of information: Data from Statistical Agency of the Republic of Kazakhstan, calculations of the National Bank of the Republic of Kazakhstan

3.1.1. Individual consumption and investment demand

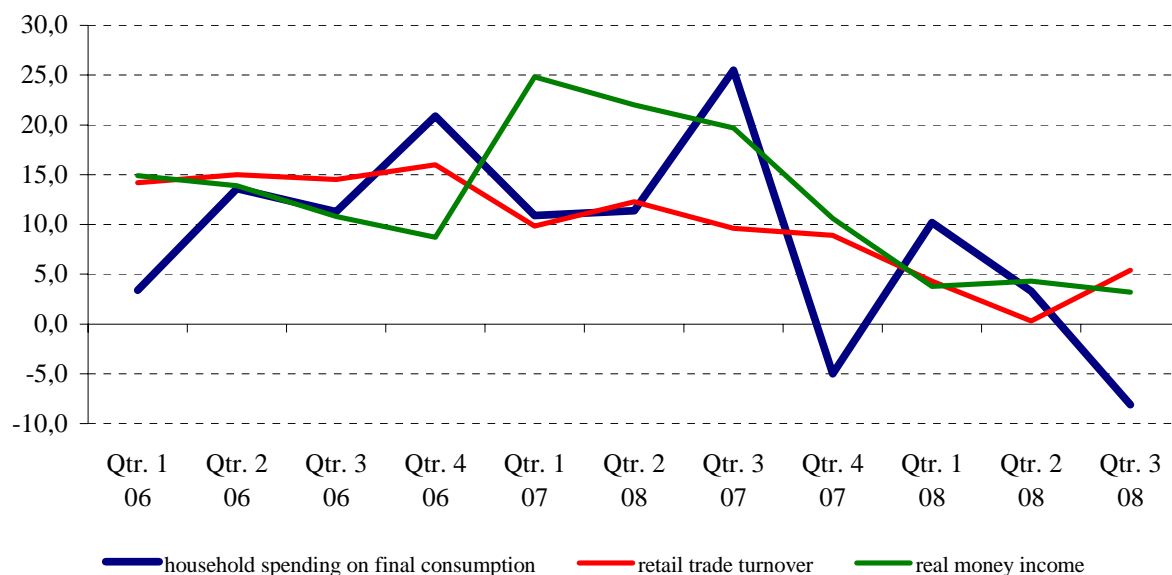
Household spending on final consumption in the third quarter of 2008 fell sharply by 5.6 percent compared to the corresponding period in 2007 (there was 1.9 percent growth in the second quarter).

Slower growth in personal income contributed to the decline in household consumption. Based on the results for the third quarter of 2008, average per capita income grew by 3.2 percent in real terms compared to the third quarter of 2007 (the figure for the second quarter of 2008 was 4.3 percent), while real wages fell by 1.6 percent (growth in this indicator in the corresponding quarter of 2007 was 18.3 percent).

The retail trade turnover grew markedly in the third quarter of 2008 compared to the corresponding period in 2007, posting a 5.4 percent increase (this figure was 0.3 percent in the second quarter of 2008) (Figure 9).

Figure 9

Dynamics of personal spending and income
(as a percentage of the corresponding period of the previous year)

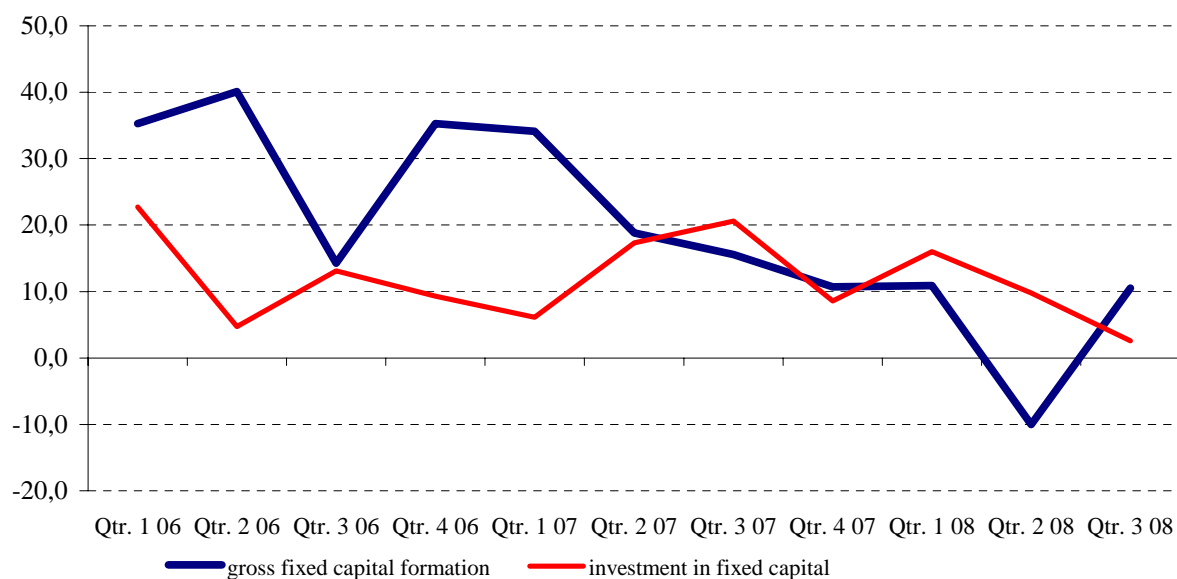


Source of information: Data from Statistical Agency of the Republic of Kazakhstan, calculations of the National Bank of the Republic of Kazakhstan

In the third quarter of 2008 spending on gross fixed capital formation as a proportion of GDP rose substantially (posting growth of 10.5 percent, according to the estimate). At the same time, the volume of investment in fixed capital in the third quarter of 2008 grew by 2.8 percent (Figure 10).

Figure 10

Dynamics of spending on investments in fixed capital
(as a percentage of the corresponding period of the previous year)



Source of information: Data from Statistical Agency of the Republic of Kazakhstan, calculations of the National Bank of the Republic of Kazakhstan

3.1.2. Government consumption

Spending on final consumption by general government in the third quarter of 2008 compared to the corresponding period of 2007 increased by 3.8 percent according to the estimate (the figure for the second quarter of 2008 was 7.4 percent).

In the third quarter of 2008 as a whole state budget spending was financed in the amount of 1045.1 billion tenge, or 22.7 percent of GDP. Compared to the indicators for the corresponding period of 2007, state budget spending increased by 35.6 percent.

Current state budget expenditures totaled 577.8 billion tenge, which is 22.5 percent more than in the corresponding period of 2007.

Capital state budget expenditures in the third quarter of 2008 increased by 21.9 percent compared to the corresponding period in 2007. Budget credits increased by a factor of 1.6 in the third quarter of 2008, while spending on the acquisition of financial assets grew by a factor of 2.8.

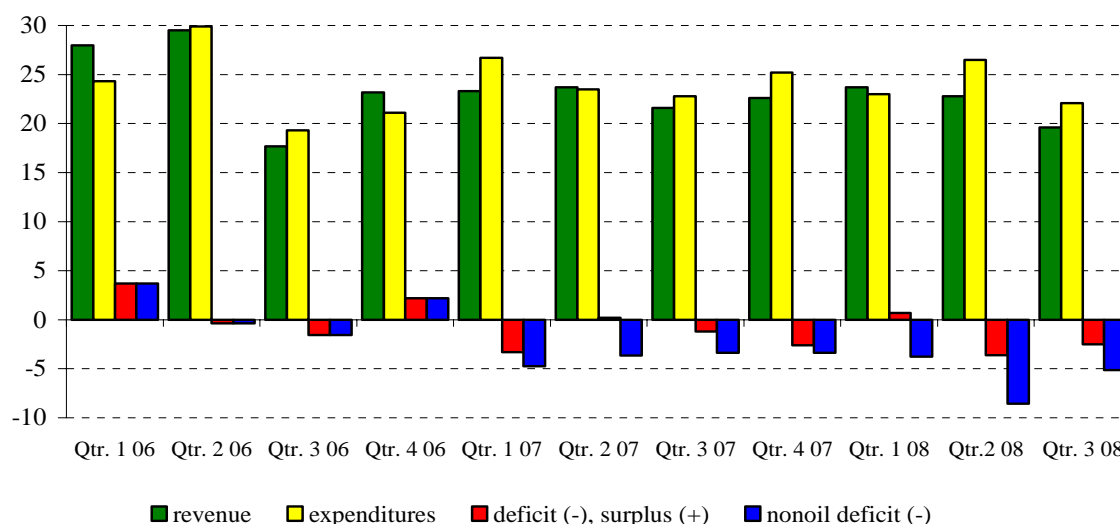
State budget revenue in the third quarter of 2008 totaled 925.3 billion tenge, or 20.1 percent of GDP. Compared to the indicators for the corresponding period of the previous year, revenue grew by 26.6 percent. Tax revenue accounted for 84 percent of state budget revenue, while official transfers represented 13 percent. Compared to the third quarter of 2007, nontax revenue fell by 79.5 percent in the third quarter of 2008, while proceeds from the sale of fixed capital also dropped, by 43.9 percent.

In the third quarter of 2008 a guaranteed transfer in the amount of 122.1 billion tenge was withdrawn from the National Fund and applied to the state budget.

As a result of state budget spending in excess of revenue, there was a deficit equal to 119.8 billion tenge (2.6 percent of GDP) in the third quarter of 2008, while in the third quarter of 2007 there was a deficit in the amount of 40.1 billion tenge. The nonoil budget deficit totaled 239.8 billion tenge, or 5.1 percent of GDP (Figure 11).

Figure 11

Execution of the state budget, as a percentage of GDP



Source of information: Ministry of Finance of the Republic of Kazakhstan

In the third quarter of 2008 external government debt grew to 731.5 billion tenge, or by 17.5 percent compared to the figure for the second quarter of 2008, and it was due to the issuing of medium- and short-term treasury bonds.

External government debt increased from US\$1469.6 million in the second quarter of 2008 to US\$1502.6 million in the third quarter of 2008, or by 2.3 percent.

3.1.3. External sector

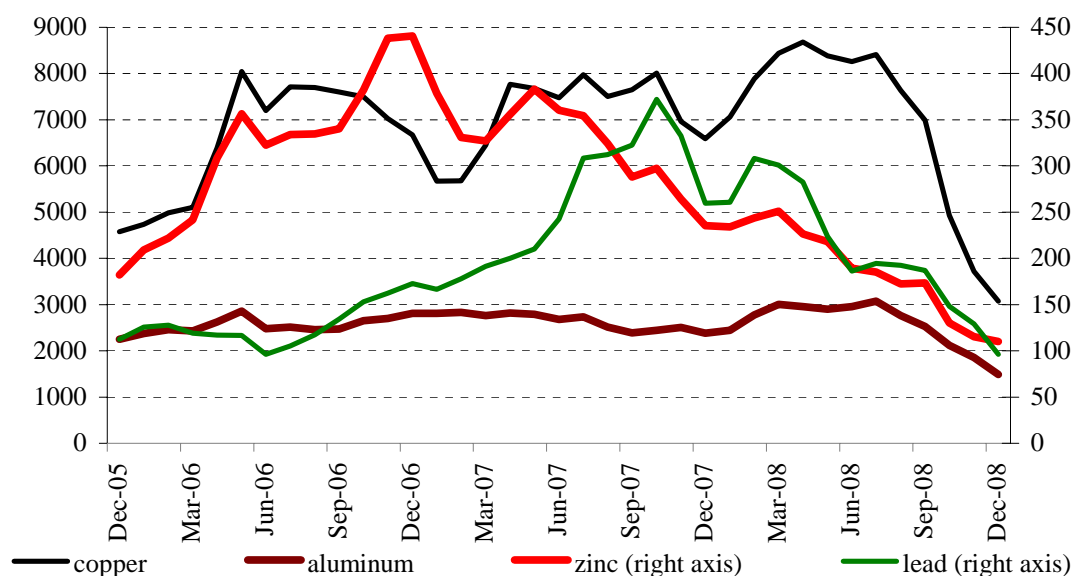
– World prices

The downward trend in prices for certain types of food and commodities in global commodity markets continued in the fourth quarter of 2008.

Metal prices continued to slide in the fourth quarter of 2008. In October–December 2008 copper prices fell by 56.1 percent and averaged US\$3905 per metric ton during this period, lead prices fell by 48.4 percent and reached US\$1.245 per kilogram, aluminum prices dropped 41.0 percent and hit US\$1821 per metric ton, and zinc prices declined 36.5 percent and reached US\$1.185 per kilogram (Figure 12).

Figure 12

Dynamics of world metal prices

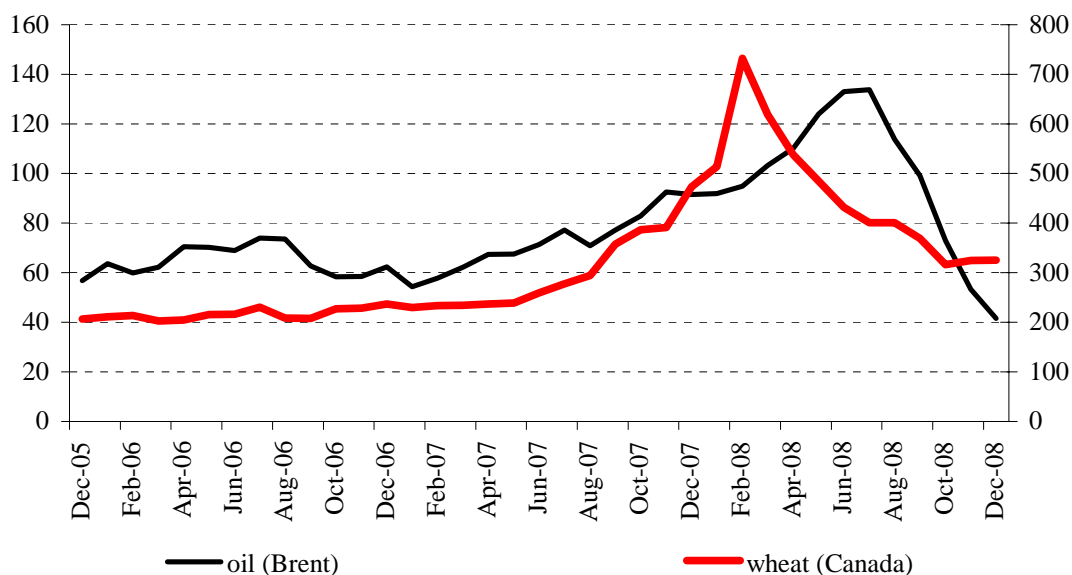


Source of information: The World Bank,

In October–December 2008 world wheat prices remained relatively stable: the average price for the period was US\$322 per metric ton. During the fourth quarter of 2008 as a whole the world price for wheat (Canada) fell by 11.9 percent (Figure 13).

There was a significant decline in oil prices in global markets in October–December 2008. According to World Bank data, the price for Brent grade oil fell by 58.0 percent in the fourth quarter of 2008 and reached US\$41.6 per barrel in December 2008 (Figure 13).

Figure 13

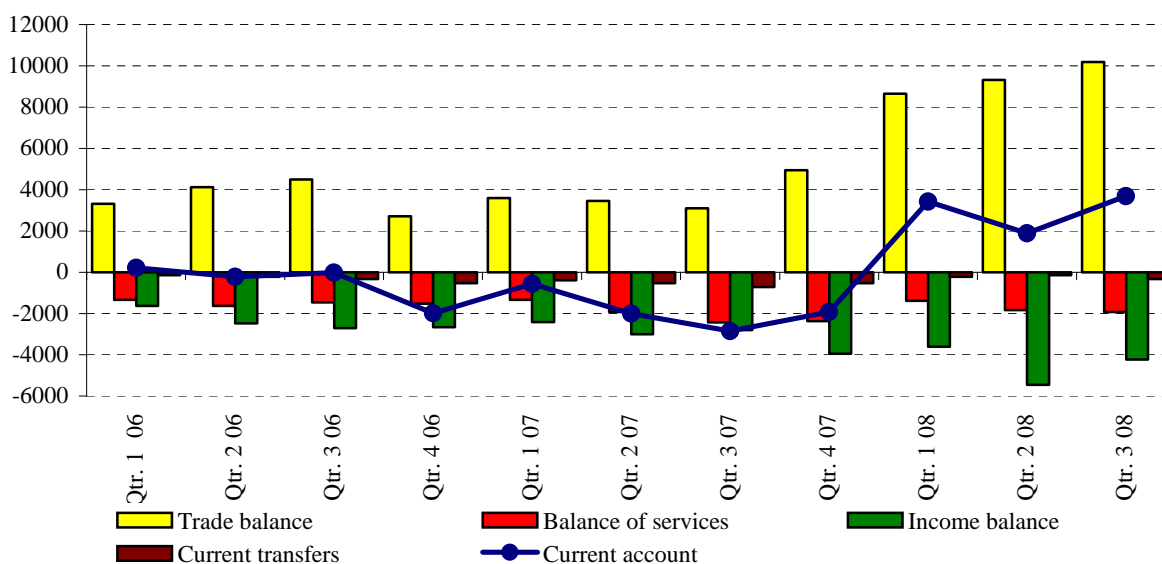
Dynamics of world oil prices (Brent) and wheat prices (Canada)

Source: The World Bank

– Balance of payments

Based on the results for the third quarter of 2008, there was a significant positive current account balance in the amount of US\$3.7 billion (Figure 14).

Figure 14

Current account balance, millions of U.S. dollars

Source of information: The National Bank of the Republic of Kazakhstan

An increase in the value of exports, due to high world prices for energy resources, made the greatest contribution to the current account surplus. Earnings from exports of goods increased by 75.2 percent compared to the third quarter of 2007, while spending on commodity imports grew by 22.8 percent. Thus, the trade balance was equal to US\$10.2 billion, which marked an increase by a factor of 3.2 compared to the corresponding period in

2007, and compensated for the net outflow of resources under other components of the current account. The deficit in the balance of services shrunk compared to the third quarter of 2007 (by 20.9 percent) and reached US\$1.9 billion, while the deficit in the income balance grew by 50.7 percent to US\$4.2 billion. Payments to nonresidents under current transfers totaled US\$332.1 million, which is equal to half of the figure reported for the third quarter of 2007.

The net outflow of resources under financial account operations was equal to US\$0.4 billion (in the third quarter of 2007 there was a net inflow of US\$0.2 billion). Residents' foreign assets grew by US\$5.6 billion in the third quarter of 2008, which is 3.2 times more than the figure reported for the corresponding period in 2007. Residents' external liabilities increased by US\$5.2 billion, or by a factor of 2.7. While there was an increase in income in the form of direct investment (US\$3.1 billion), the growth in external liabilities was due above all to operations in the nonfinancial sector. Growth in external liabilities of nonfinancial corporations to unaffiliated creditors was equal to US\$5.3 billion (compared to US\$2.2 billion in the third quarter of 2007), while external debt liabilities of the banking sector fell by US\$3.2 billion, compared to an increase of US\$0.1 billion in the third quarter of 2007.

There was a balance of payments surplus in the third quarter of 2008 in the amount of US\$1.2 billion (compared to a deficit of US\$4.4 billion in the third quarter of 2007).

– Terms of trade and the real effective exchange rate

In the third quarter of 2008 the aggregate terms of trade index was 3 percent higher than the corresponding indicator for the third quarter of 2007. The terms of trade with countries in the euro area improved by 9 percent, while with Russia they deteriorated by 9 percent (Table 1).

Table 1

Change in price indexes and terms of trade (as a percentage of the corresponding period of the previous year)

	1qtr. 07	2qtr. 07	3qtr. 07	4qtr. 07	1qtr. 08	2qtr. 08	3qtr. 08
Export prices	6	8	8	32	56	61	62
Import prices	19	18	12	18	28	45	57
Terms of trade	-10	-8	-4	12	20	12	3
of which:							
Countries in euro area							
Export prices	5	2	-1	32	54	62	64
Import prices	28	22	2	10	16	29	52
Terms of trade	-18	-17	-3	19	28	28	9
Russia							
Export prices	0	19	17	28	30	38	35
Import prices	15	14	17	17	43	49	48
Terms of trade	-13	4	0	9	-9	-8	-9

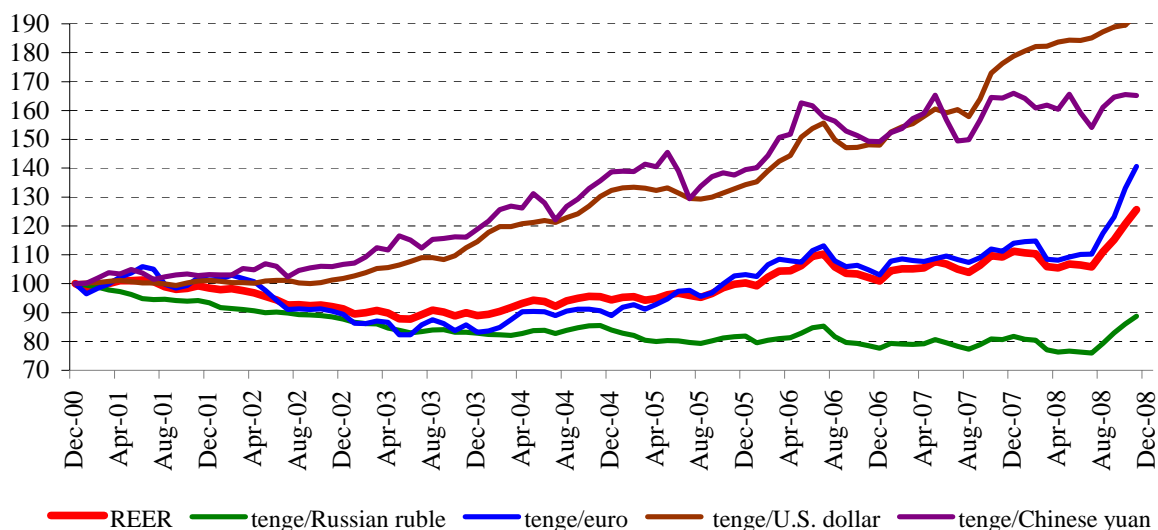
Source of information: The National Bank of the Republic of Kazakhstan

Based on the results for the third quarter of 2008, the index of the tenge's real effective exchange rate strengthened by 4.1 percent compared to the preceding period. The tenge also strengthened by 3.2 percent against a basket of currencies of CIS countries, and by 1.9 percent against a basket of currencies of other countries.

In the third quarter of 2008 the tenge strengthened against the U.S. dollar by 1.6 percent in real terms compared to the preceding period, by 7.1 percent against the euro, and by 4.0 percent against the Russian ruble (Figure 15).

Figure 15

**Indexes of real exchange rates for the tenge
(December 2000 = 100%)**



Source of information: The National Bank of the Republic of Kazakhstan

Commodities dominate Kazakhstan's foreign trade, and the dynamics of their trade turnover are determined by conditions in global commodities markets, which means that the potential for a strengthening of the tenge to have a negative impact on the results of trade operations is limited to a significant extent. Consumer goods, which are the most sensitive to a relative change in the exchange rate, account for a small share of the country's trade turnover (less than 20 percent of imports based on the results for the reporting period). At the same time, consumer imports, of which the Russian Federation is a major supplier, could receive an additional, substantial stimulus for growth from a strengthening of the trend toward a decline in the value of the Russian ruble in relation to the tenge.

– **Nominal tenge exchange rate**

In the fourth quarter of 2008 the situation in the domestic exchange market continued to remain relatively stable. On the whole, based on the results for the quarter, the tenge's exchange rate weakened in relation to the U.S. dollar by 0.79 percent – from 119.84 tenge to the dollar to 120.79 tenge to the dollar.

The weighted average exchange rate of the tenge for the fourth quarter of 2008 was 120.19 tenge to the dollar, marking a decline of 0.2 percent compared to the corresponding figure for the third quarter of 2008. During the quarter the tenge's exchange rate against the dollar fluctuated within the range of 119.27–120.83 tenge to the dollar (Figure 16).

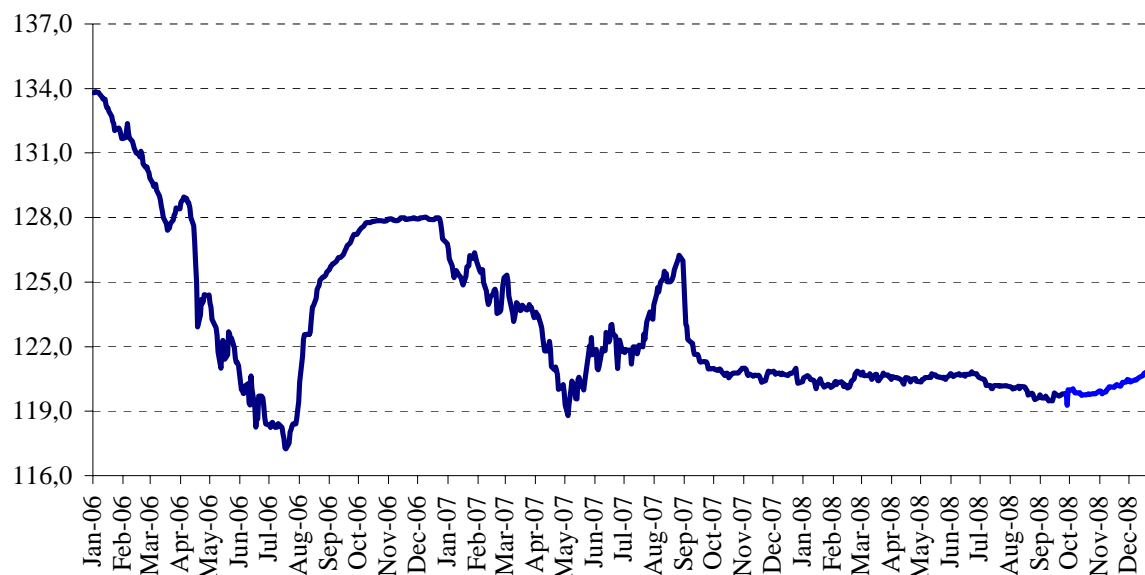
There was no change in the tenge's exchange rate in October, while in November and December it weakened in relation to the dollar by 0.4 percent per month.

Since the volume of transactions with euros and Russian rubles in the exchange segment of the domestic currency market remains negligible, the tenge's exchange rate against these currencies is calculated on the basis of a cross rate with the U.S. dollar. Accordingly, the dynamics of the tenge's exchange rate against the euro and the Russian ruble

was determined by the dynamics of the tenge's exchange rate against the U.S. dollar, by the position of the common European currency in the international financial market, and by the policy of the Central Bank of Russia regarding the exchange rate of the Russian ruble against a basket of currencies.

Figure 16

Dynamics of the nominal exchange rate of the tenge against the U.S. dollar

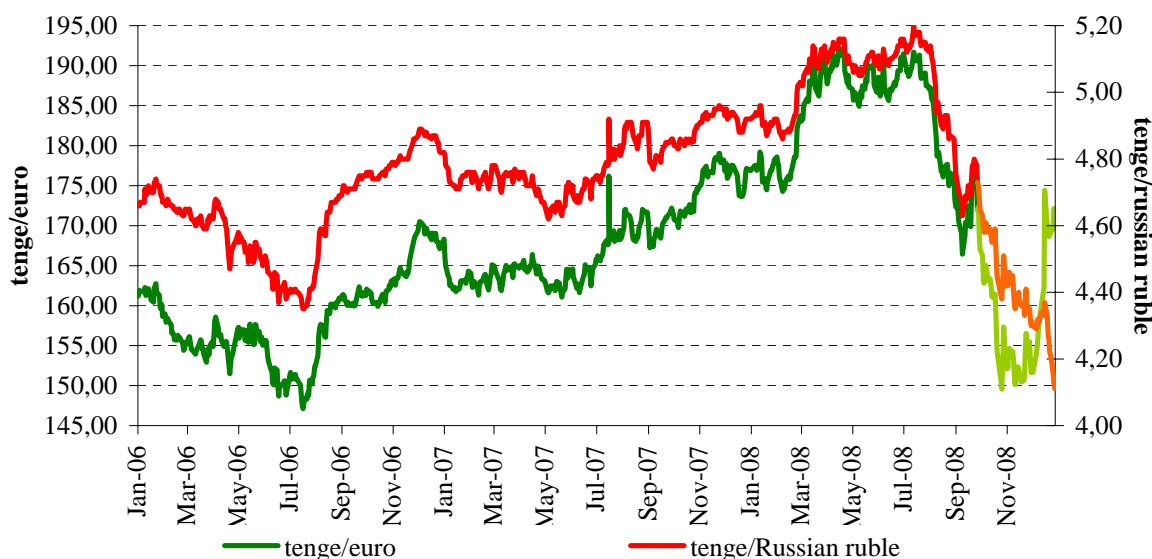


Source of information: The National Bank of the Republic of Kazakhstan

During the fourth quarter of 2008 as a whole, the official exchange rate of the tenge against the euro and the Russian ruble strengthened by 0.6 percent and 13.1 percent, respectively (Figure 17).

Figure 17

Dynamics of the official exchange rate of the tenge against the euro and Russian ruble



Source of information: The National Bank of the Republic of Kazakhstan

3.2. Production

GDP output in the third quarter of 2008 totaled 4608 billion tenge in current prices. Growth in real GDP slowed markedly compared to the corresponding period in 2007 and is estimated at 0.8 percent, which was due primarily to a decline in the contribution of sectors such as industry and real estate transactions to GDP growth, and also to a decline in production output in construction and agriculture (Figure 18).

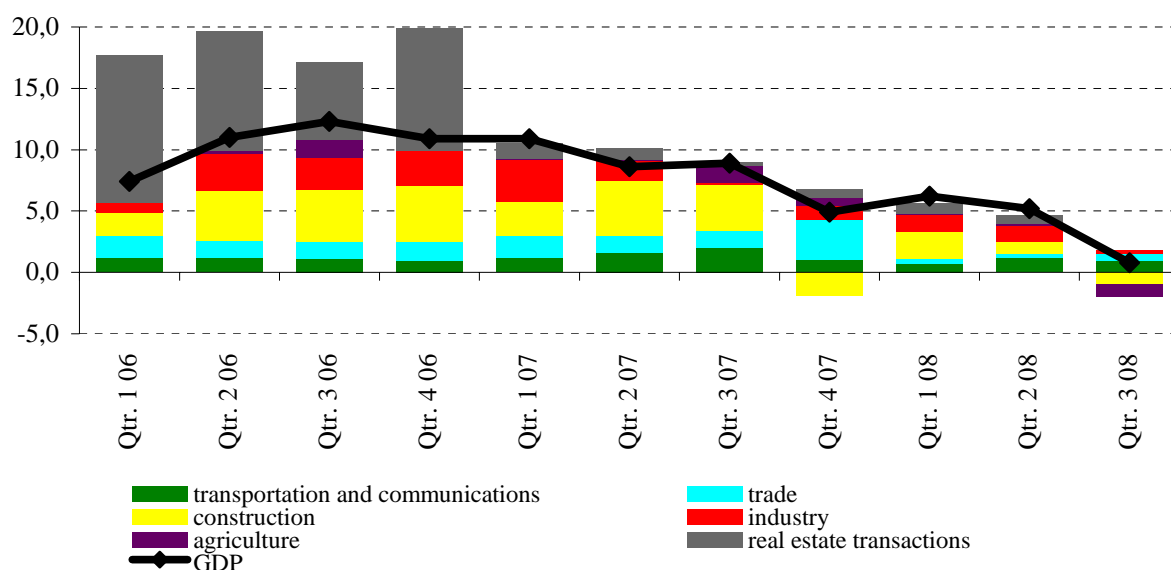
In the third quarter of 2008 the index of physical output in construction in real prices declined by 5.7 percent compared to the corresponding period in 2007, while the index for agriculture fell by 7 percent. The contribution of these sectors to growth in GDP was negative at (-)1 percent.

There was a substantial slowdown in growth in sectors such as real estate transactions, leasing, and services to enterprises, as well as industry, whose indexes were equal to 100.4 percent and 101.1 percent, respectively, and whose contributions to GDP growth were 0.02 percent and 0.3 percent.

At the same time, there was stronger growth in the volume of trade, whose index reached 103.4 percent, in transportation services, with 110.5 percent, and hotels and restaurants, with 110.2 percent. The contributions of these sectors to GDP growth reached values of 0.5 percent, 1 percent, and 0.1 percent, respectively.

Figure 18

Contribution of key sectors of the economy to growth in real GDP (as a percentage of the corresponding period of the previous year)



Source of information: Data from Statistical Agency of the Republic of Kazakhstan, calculations of the National Bank of the Republic of Kazakhstan

3.3. Labor market

3.3.1. Employment and unemployment

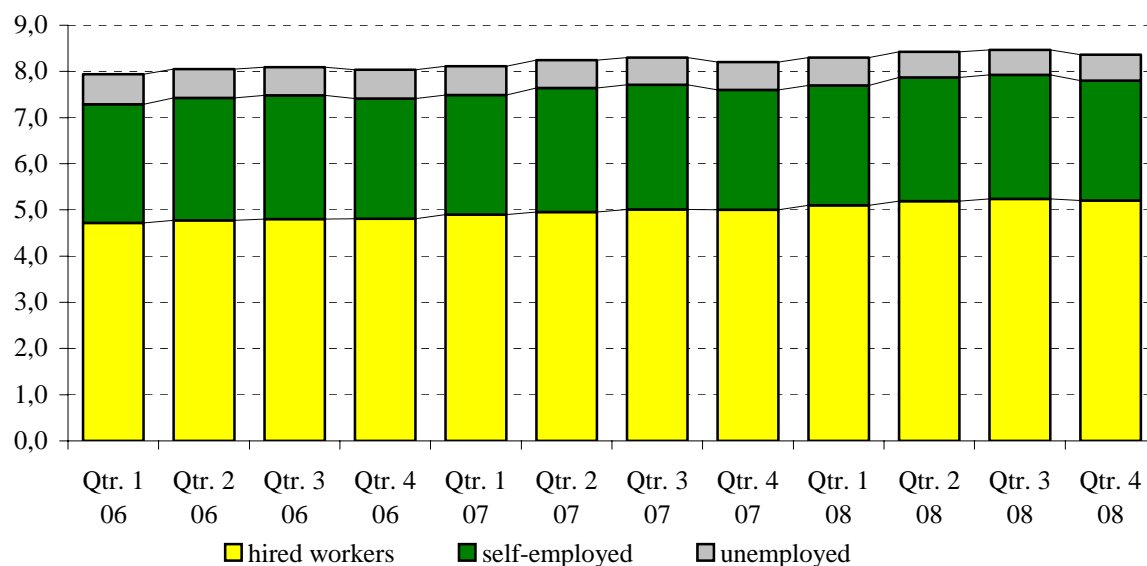
In the fourth quarter of 2008 there was a negligible change in the number of people employed in the economy. The figure was equal to 7.9 million people, which is 0.8 percent fewer than in the preceding quarter. The number of hired workers declined by 0.1 percent, reaching 5.2 million, while the number of self-employed people fell by 2.1 percent to 2.6 million.

In terms of the structure of hired workers, there were 4.2 million people employed by public and private organizations (80.7 percent of the total number of hired workers), 0.6 million people were employed by individuals (11.8 percent), and 0.4 million people (7.5 percent) were employed at peasant (owner-operated) farmers.

In the fourth quarter of 2008 the number of people unemployed reached 559,300, which represents an increase of 3.5 percent compared to the preceding period, and a 3.4 percent decline from the fourth quarter of 2007 (Figure 19).

Figure 19

Structure of the economically active population, million people

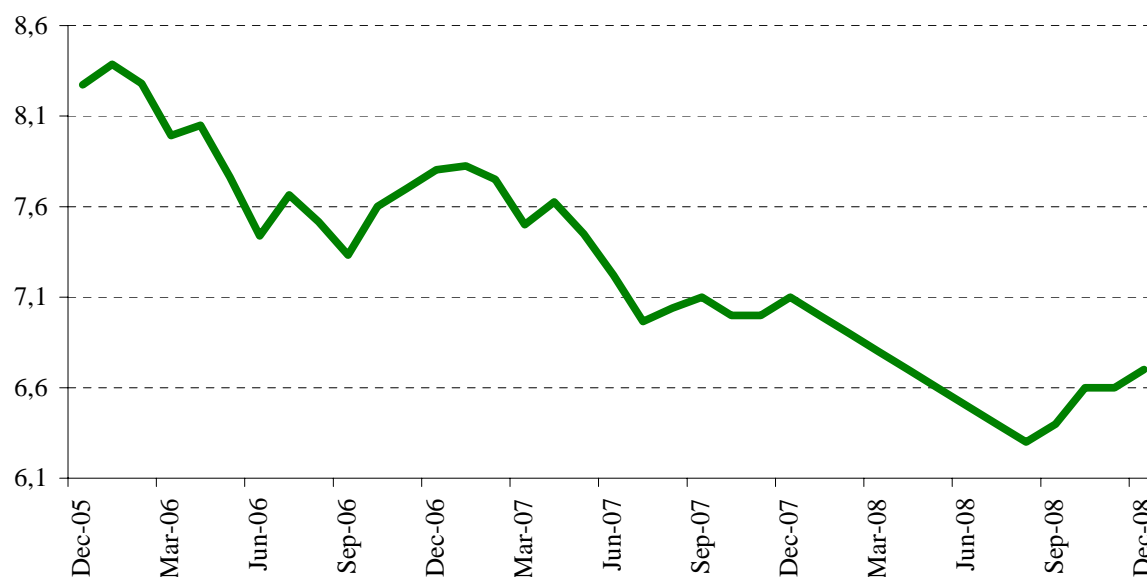


Source of information: Statistical Agency of the Republic of Kazakhstan

In the fourth quarter of 2008 the unemployment rate rose from 6.4 percent to 6.6 percent (Figure 20).

Figure 20

Actual unemployment rate, %



Source of information: Statistical Agency of the Republic of Kazakhstan

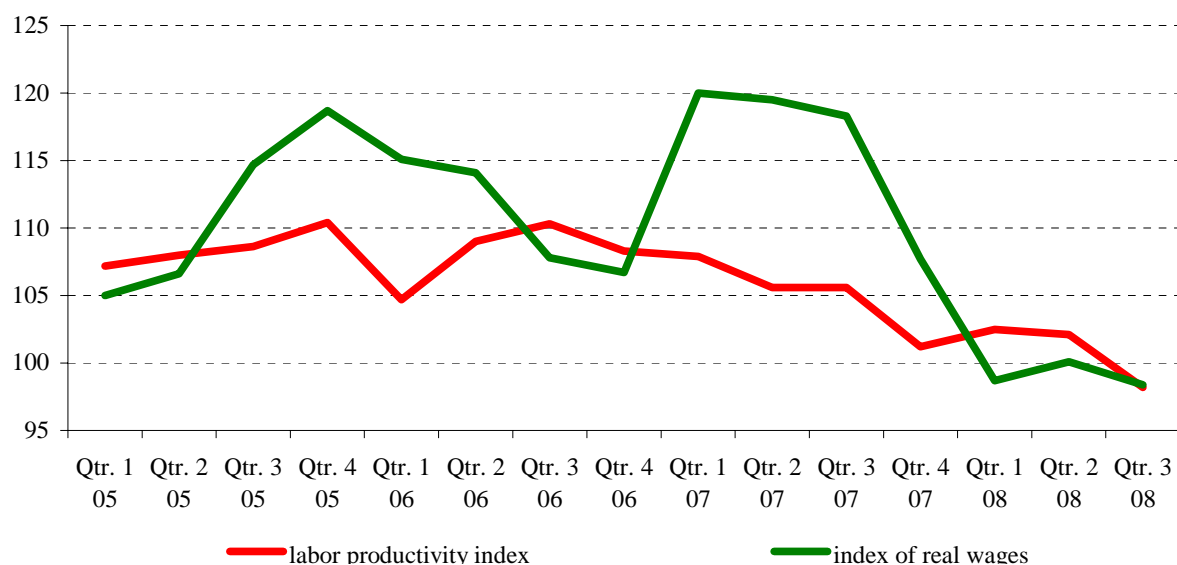
3.3.2. Wages and productivity

Nominal wages rose by 17.5 percent in the third quarter of 2008. At the same time, growth in consumer prices led to a decline in the purchasing power of wages, which fell in real terms by 1.6 percent (compared to the corresponding quarter in 2007).

A sharper slowdown in growth in GDP against the backdrop of a slight decline in employment growth led to a decrease in labor productivity estimated at 1.8 percent (Figure 21).

Figure 21

Dynamics of labor productivity and real wages (as a percentage of the corresponding period of the previous year)



Source of information: Statistical Agency of the Republic of Kazakhstan

4. Monetary aggregates

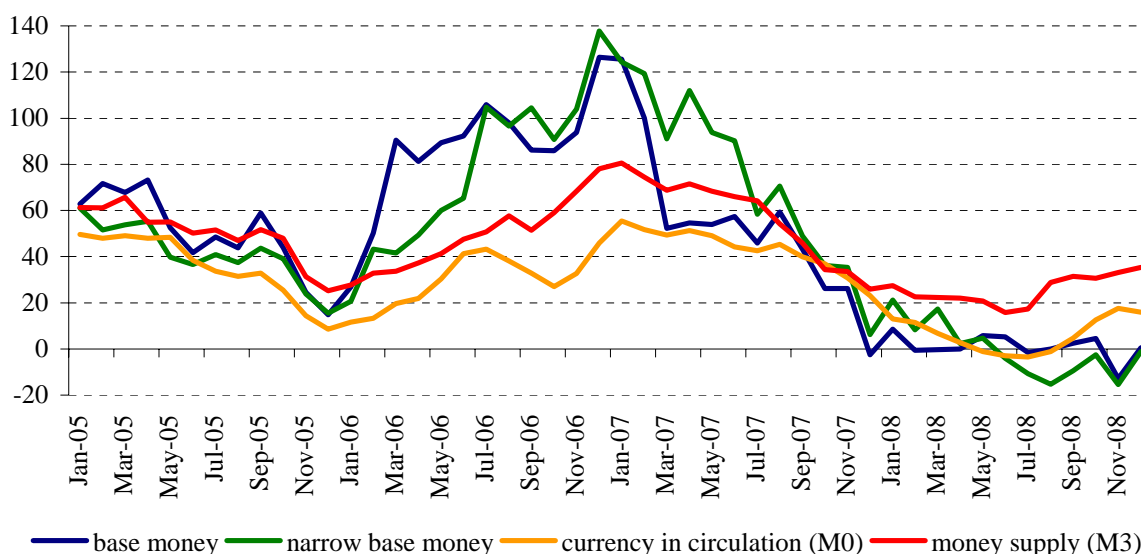
4.1. Monetary aggregates

The dynamics of money supply indicators showed a slight upward trend in the fourth quarter of 2008, while narrow base money posted negative growth indicators. Mention should be made of slightly more active growth in the money supply and currency in circulation in the fourth quarter of 2008 (Figure 22).

Figure 22

Dynamics of monetary aggregates

(as a percentage of the corresponding period of the previous year)



Source of information: The National Bank of the Republic of Kazakhstan

4.1.1. Reserve money

At the end of December 2008 base money totaled 1471.4 billion tenge. In the fourth quarter of 2008 base money contracted by 16.2 percent. In the fourth quarter of 2008 narrow base money contracted by 7.0 percent to 1438.3 billion tenge.

In December 2008 base money expanded slightly, by 0.5 percent, compared to December 2007, due to growth in the National Bank's international reserves and in its net domestic assets.

In December 2008 net foreign exchange reserves (NFER) increased by 10.3 percent compared to December 2007, as a result of purchases of foreign currency in the domestic exchange market, reconversion of National Fund assets into National Bank foreign exchange assets, as well as foreign exchange posted to government accounts at the National Bank. At the same time, there was a decline in balances on banks' correspondent accounts in foreign currency at the National Bank, and operations were also performed to service external government debt. Assets in gold grew by 8.0 percent as a result of transactions performed and an increase in its price in world markets by 4.4 percent. Net domestic assets of the National Bank grew as a result of an increase in net claims on central government and a reduction in liabilities to banks, primarily on short-term notes (see Section 5. Monetary policy instruments and operations).

Narrow base money contracted by 1.1 percent in December 2008 compared to December 2007 (Table 2).

Table 2

Dynamics of changes in National Bank assets and liabilities
(as a percentage of the corresponding period of the previous year)

	1 qtr. 08	2 qtr. 08	3 qtr. 08	4 qtr. 08
Net international reserves	-10.7	-5.5	19.1	10.0
Net domestic assets	42.5	40.9	-51.7	42.3
Net claims on government	-13.7	57.5	63.3	133.3
Claims on financial corporations	77.0	66.5	-172.5	53.4
Claims on the rest of the economy	13.8	16.7	3.0	1.6
Other net domestic assets	-199.4	-579.8	-26.5	14.7
Base money	-0.3	5.2	2.4	0.5
Narrow base money	17.2	-4.1	-9.5	-1.1

Source of information: The National Bank of the Republic of Kazakhstan

4.1.2. Money supply

In the fourth quarter of 2008 the money supply grew by 6.5 percent to 6266.4 billion tenge. Net external assets of the banking system fell by 6.6 percent, while domestic assets grew by 4.3 percent.

In December 2008 the money supply grew by 35.3 percent compared to December 2007, as a result of a significant increase in net external assets of the banking system (Table 3).

In terms of the structure of net external assets of the banking system, in December 2008 net international reserves of the National Bank increased by 10.0 percent compared to December 2007 and net external assets of banks increased by 40.9 percent. The increase in banks' external assets was tied to a reduction in liabilities to nonresidents (by 15.0 percent).

An analysis of the dynamics of the main components of the money supply shows that resident deposits in the banking system grew at a faster pace than currency in circulation. As a result, based on the figures for December 2008 resident deposits as a proportion of the money supply grew to 86.3 percent from 84.0 percent in December 2007.

Table 3

Dynamics of changes in the money supply
(as a percentage of the corresponding period of the previous year)

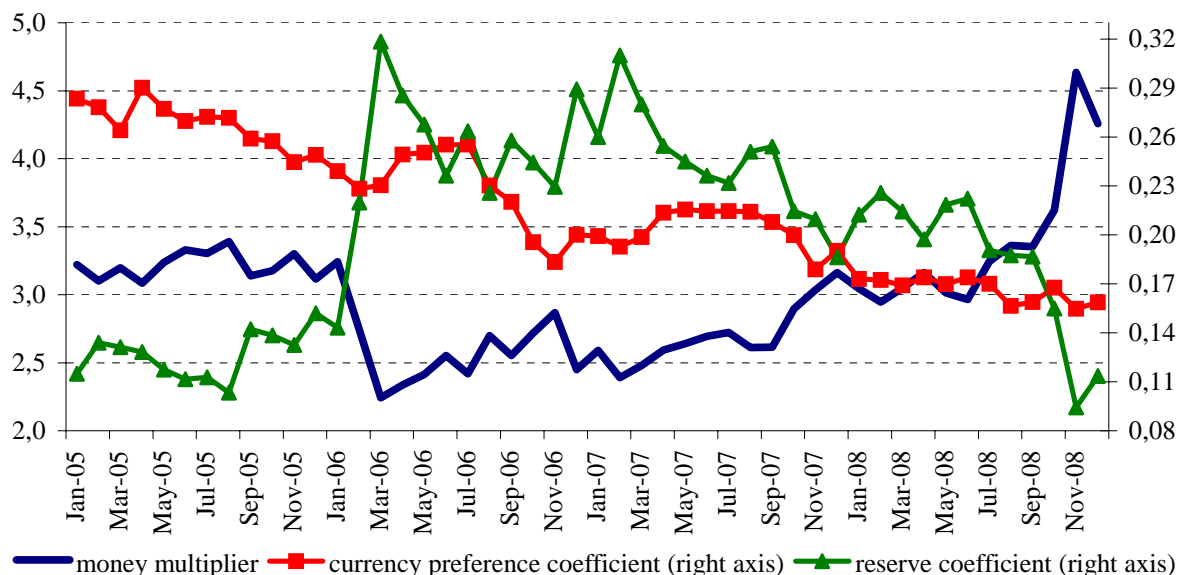
	1 qtr. 08	2 qtr. 08	3 qtr. 08	4 qtr. 08
Net external assets	-198.6	167.3	212.6	233.2
Domestic assets	40.5	14.0	0.2	1.9
Claims on government	391.0	689.5	2563.3	159.2
Claims on the economy	37.5	11.7	5.9	7.1
Other net domestic assets	-34.9	-14.2	-26.8	-23.1
Money supply	22.3	15.7	31.4	35.3
Currency in circulation	6.8	-3.0	4.7	16.0
Resident deposits	25.4	19.7	37.0	39.0

Source of information: The National Bank of the Republic of Kazakhstan

The money multiplier increased from 3.16 in December 2007 to 4.26 in December 2008 as a result of growth in the money supply that exceeded expansion of base money (Figure 23). The rise in the money multiplier was due to a decline in the reserve ratio, which in turn was influenced by lower minimum reserve requirements (see 5.2. Minimum reserve requirements).

Figure 23

Dynamics of monetary multiplier and its components



Source of information: The National Bank of the Republic of Kazakhstan

– Cash in circulation

Currency in circulation in the fourth quarter of 2008 increased by 6.3 percent and totaled 857.8 billion tenge at the end of December.

In December 2008 currency in circulation grew by 16.0 percent compared to December 2007. This indicates that the impact of factors promoting growth in currency (an increase in wages and pensions) prevailed over the impact of factors that contribute to a decline in currency (higher sales of foreign exchange cash at bureaux de change, growth in balances on deposits, proceeds from the sale of goods, work, and services, etc.).

Currency disbursed by bank cash departments grew by 8.7 percent to 2837.6 billion tenge in the fourth quarter of 2008 compared to the fourth quarter of 2007, while currency received by bank cash departments increased by 4.8 percent to 2711.1 billion tenge. As a result, net disbursements from bank cash departments totaled 126.6 billion tenge.

– Deposits of the residents

At the end of December 2008 resident deposits reached 5408.6 billion tenge. They grew by 6.5 percent in the fourth quarter of 2008. Deposits held by legal entities rose by 10.7 percent, while deposits held by individuals fell by 3.2 percent.

The total volume of resident deposits at deposit institutions grew by 39.0 percent in 2008. Deposits held by legal entities grew more rapidly than those held by individuals (Table 4).

In terms of the structure of deposits held by individuals, there was a shift away from domestic currency to foreign currency. This can be explained to a large extent by devaluation expectations on the part of the public, which increased in the fourth quarter of 2008. Another

negative factor continues to be a significant slowdown in the inflow of other personal deposits, which are an important source for the financing of banks' activities.

Deposits held by legal entities grew against the backdrop of a slowdown in economic activity. The source of deposits was money allocated by the government within the framework of economic support programs and programs to minimize crisis phenomena.

In December 2008 the weighted average interest rate on tenge time deposits of nonbank corporations was 5.7 percent (in December 2007 it was 6.1 percent), and the rate for personal deposits was 11.3 percent (11.5 percent).

Table 4

Dynamics of changes in resident deposits
(as a percentage of the corresponding period of the previous year)

	1 qtr. 08	2 qtr. 08	3 qtr. 08	4 qtr.08
Resident deposits	25.4	19.7	37.0	39.0
<i>Personal deposits</i>	<i>26.7</i>	<i>7.2</i>	<i>9.3</i>	<i>2.8</i>
Transferable deposits	14.4	0.1	8.8	7.7
<i>in domestic currency</i>	19.9	3.4	13.1	10.1
<i>in foreign currency</i>	-9.7	-17.5	-13.3	-5.5
Other deposits	28.3	8.2	9.3	2.2
<i>in domestic currency</i>	8.3	-11.2	7.0	-6.9
<i>in foreign currency</i>	79.3	64.1	13.5	16.1
<i>Deposits of nonbank corporations</i>	<i>24.7</i>	<i>27.0</i>	<i>53.7</i>	<i>60.1</i>
Transferable deposits	23.9	22.2	32.4	48.1
<i>in domestic currency</i>	18.6	9.9	30.2	42.9
<i>in foreign currency</i>	50.1	122.2	41.1	72.0
Other deposits	25.2	29.9	68.2	66.0
<i>in domestic currency</i>	20.2	11.7	39.0	55.7
<i>in foreign currency</i>	33.4	69.5	122.2	85.5

Source of information: The National Bank of the Republic of Kazakhstan

4.2. Financial market

4.2.1. Credits to the economy

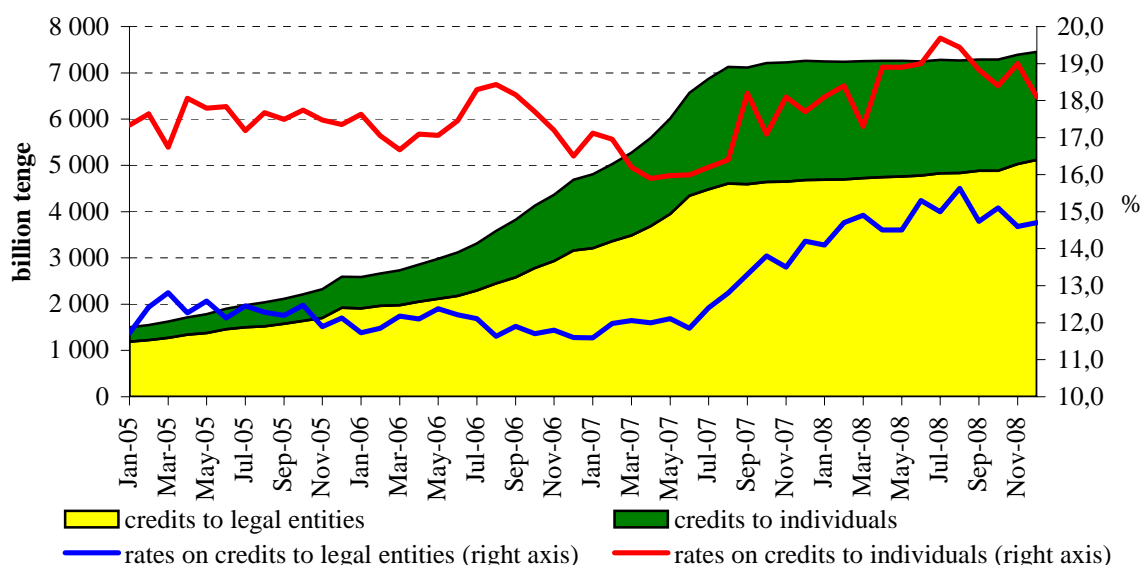
In the fourth quarter of 2008 credits to the economy increased by 2.3 percent and reached 7454.1 billion tenge. Credits to the population fell by 2.9 percent, while credits to legal entities grew by 4.8 percent.

In December 2008 credits to the economy exceeded the figure reported for December 2007 by 2.7 percent; credits to legal entities were 9.3 percent higher, while credits to individuals declined by 9.3 percent.

The weighted average rate on credits to legal entities in December 2008 compared to December 2007 rose from 14.2 percent to 14.7 percent; rates on short-term credits in domestic currency showed the only decline, while rates were higher for other types of credits.

Rates on credits to individuals rose in 2008 from 17.7 percent to 18.1 percent (Figure 24).

Figure 24

Dynamics of credits to the economy and interest rates

Source of information: The National Bank of the Republic of Kazakhstan

In terms of the structure of credits, most of the growth in 2008 was due to credits granted for the acquisition of working assets, for new construction and reconstruction, and also for other purposes, primarily for the refinancing of credits provided previously. There was a marked decline in credits for consumer purposes, and also for the construction and reconstruction of housing by individuals.

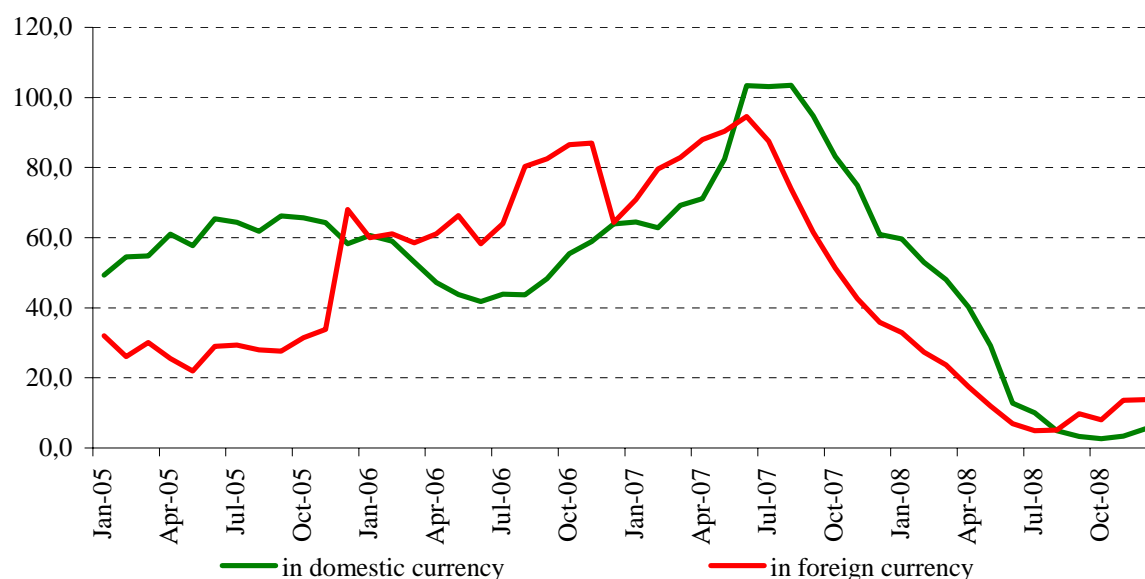
– Credits to legal entities

Credits to legal entities grew by 9.3 percent in December 2008 compared to December 2007.

In the fourth quarter of 2008 annual growth in credits in foreign currency exceeded growth in credits in domestic currency (Figure 25). Medium- and long-term credits accounted for 71.9 percent of total credits to legal entities at the end of December 2008 (compared to 71.1 percent in December 2007).

Figure 25

Dynamics of credits to legal entities
(as a percentage of the corresponding period of the previous year)



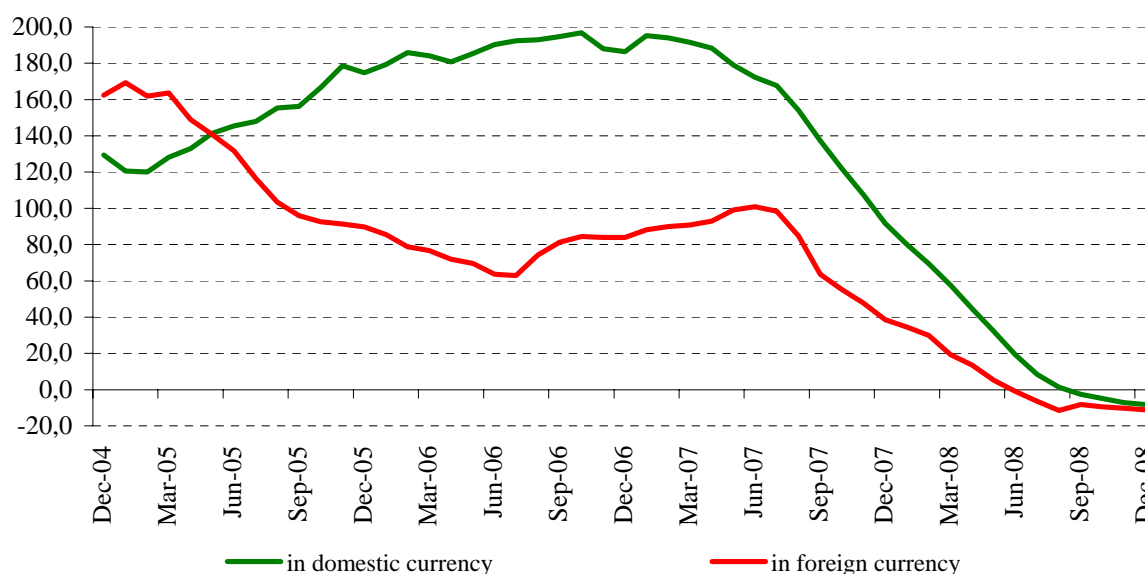
Source of information: The National Bank of the Republic of Kazakhstan

– **Credits to the population**

In terms of the dynamics of credits to the population, which declined over the year by 9.3 percent, credits in foreign currency fell at a faster pace. In December 2008 credits to the population in domestic currency decreased by 8.2 percent, while credits in foreign currency dropped by 11.1 percent (Figure 26).

Figure 26

Dynamics of credits to the population
(as a percentage of the corresponding period of the previous year)



Source of information: The National Bank of the Republic of Kazakhstan

4.2.2. Bank assets and liabilities

– Assets

In the fourth quarter of 2008 bank assets calculated in accordance with the monetary survey declined by 2.9 percent to 12.5 trillion tenge. In annual terms (December 2008 compared to December 2007) bank assets grew by 5.7 percent (Figure 27).

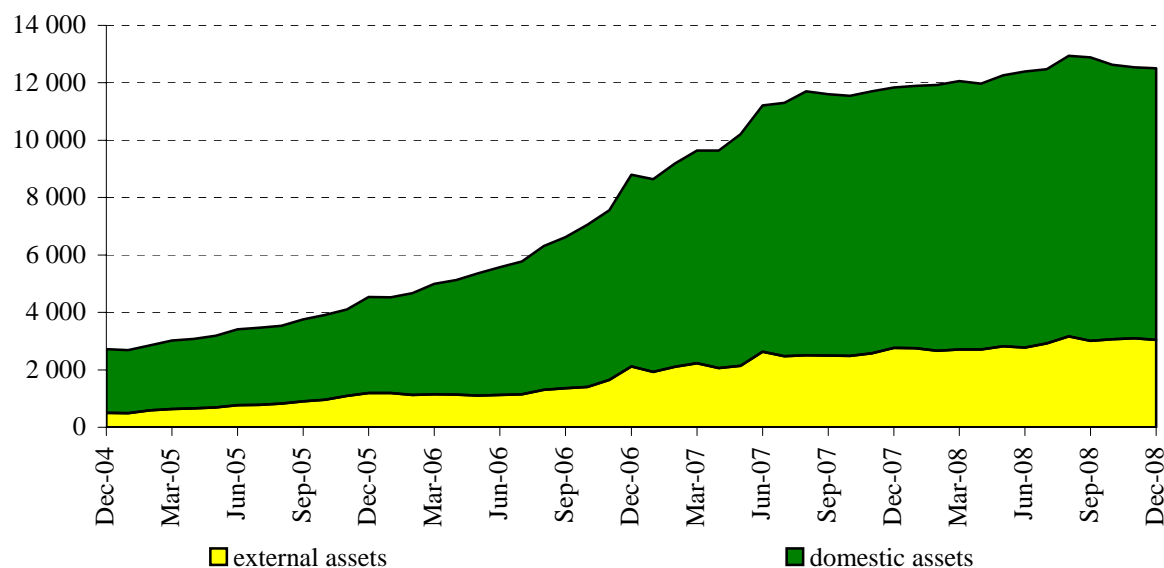
At the end of December 2008 banks' external assets accounted for 24.4 percent of total assets, or US\$25.2 billion. These assets grew by 1.3 percent compared to September 2008, and by 10.3 percent compared to December 2007.

The growth in banks' external assets in 2008 was due to lending to nonresidents, the placement of deposits, and also the acquisition of shares and other forms of equity. At the same time, there was a significant increase in banks' transferable deposits placed with nonresidents in the fourth quarter of 2008. A decline in the minimum reserve requirements (see 5.2. Minimum reserve requirements) allowed banks to free up liquidity that was in correspondent accounts at the National Bank and to transfer it to foreign banks.

In December 2008 domestic assets accounted for 75.6 percent, or 9.5 trillion tenge; domestic assets in domestic currency represented 46.3 percent, or 5.8 trillion tenge, and those in foreign currency were equal to 29.3 percent, or 3.7 trillion tenge (Figure 28). Domestic assets grew by 4.2 percent in 2008 due to growth in assets in domestic currency, while assets in foreign currency declined.

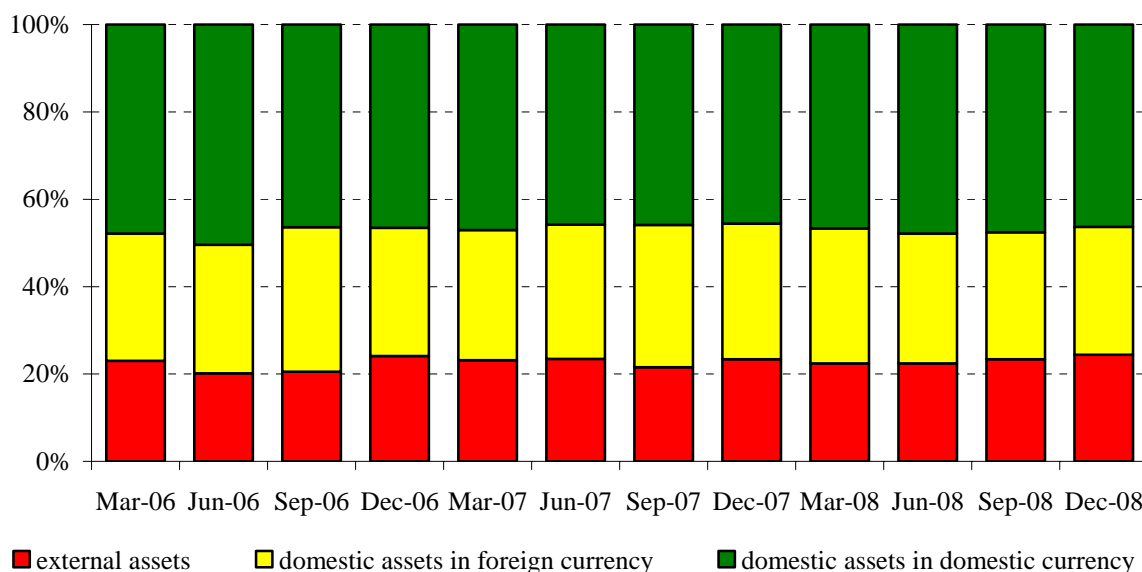
Figure 27

Dynamics of bank assets, billion tenge



Source of information: The National Bank of the Republic of Kazakhstan

Figure 28

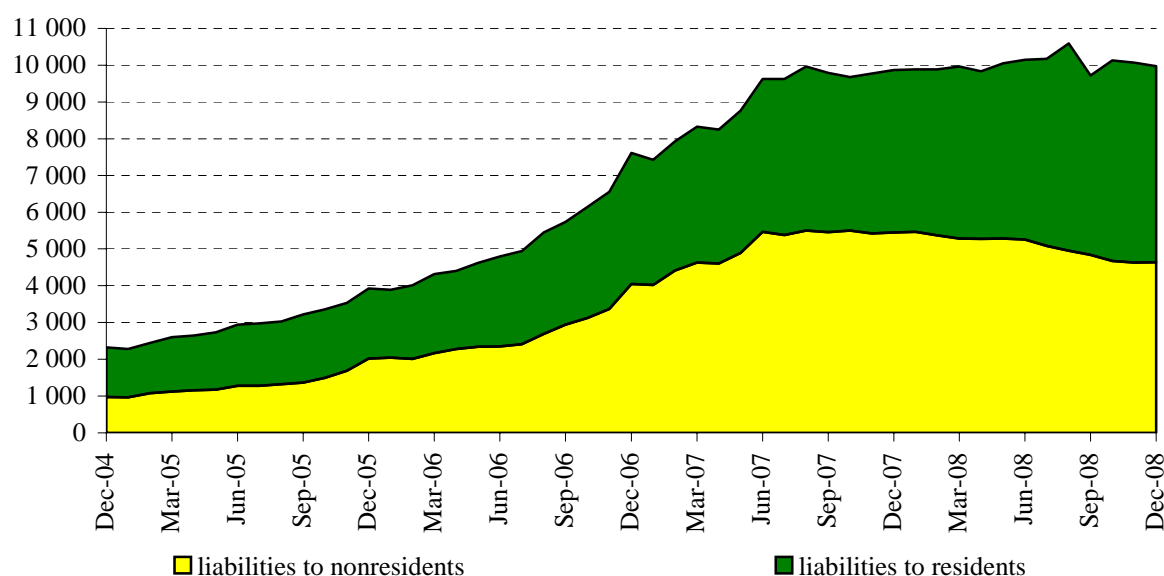
Structure of bank assets, %

Source of information: The National Bank of the Republic of Kazakhstan

– Liabilities

In the fourth quarter of 2008 the total amount of bank liabilities, calculated in accordance with the monetary survey, declined by 5.0 percent and at the end of December totaled 9.9 trillion tenge. In annual terms (December 2008 compared to December 2007), bank liabilities grew by 1.1 percent (Figure 29).

Figure 29

Dynamics of bank liabilities, billion tenge

Source of information: The National Bank of the Republic of Kazakhstan

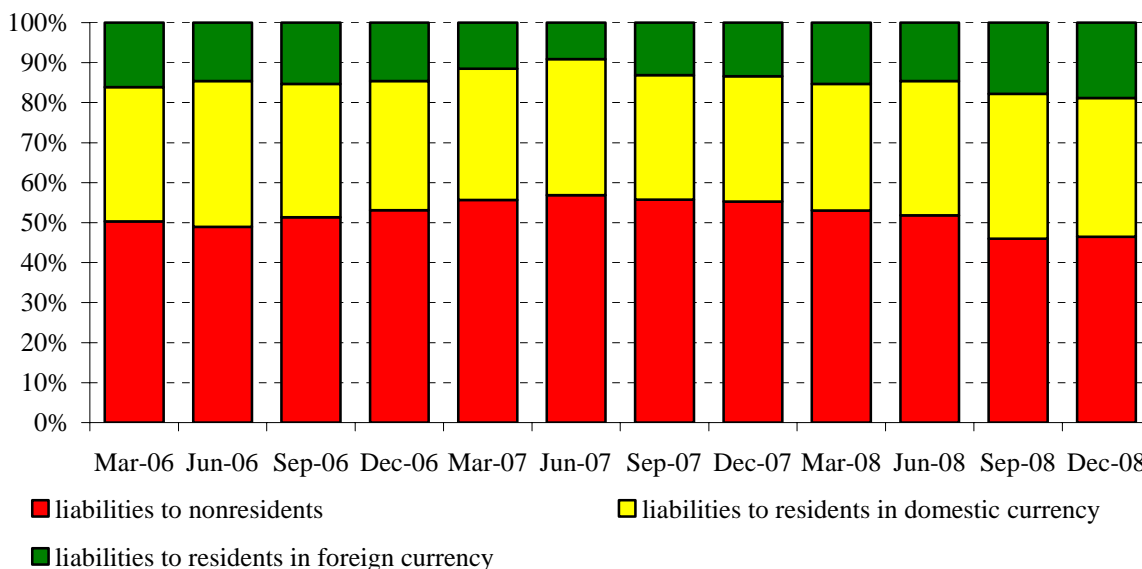
In December 2008 bank liabilities to nonresidents declined to 4.6 trillion tenge, or by 4.1 percent compared to September 2008, and by 15.0 percent compared to December 2007. At the end of December 2008 they represented 46.5 percent of total bank liabilities.

The decline in bank liabilities to nonresidents in 2008 was tied to repayments of credits previously attracted.

Bank liabilities to residents grew by 21.1 percent in 2008 (including a decline of 5.8 percent in the fourth quarter) to 5.3 trillion tenge, based on liabilities in both domestic and foreign currency (Figure 30).

Figure 30

Structure of bank liabilities, %



Source of information: The National Bank of the Republic of Kazakhstan

4.2.3. Rates in the financial market

Rates in the interbank market rose in the fourth quarter of 2008.

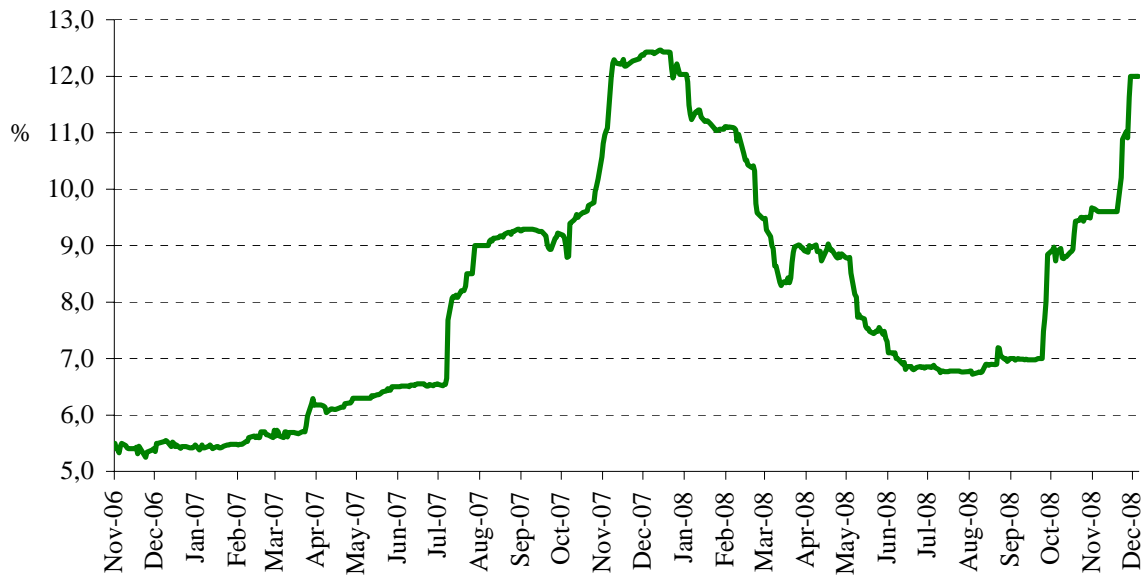
The KazPrime index grew from an average of 6.86 percent in the third quarter of 2008 to an average of 9.05 percent in the fourth quarter of 2008. At the end of September 2008 this index was equal to 6.97 percent, and at the end of December 2008 it had risen to 12.00 percent (Figure 31).

The steep rise in the index in October 2008 was due to an improvement in the methodology and a refinement of the procedure for calculating it. During the fourth quarter of 2008 as a whole the dynamics of the KazPrime index reflect accumulated and anticipated risks that are influencing the situation in Kazakhstan's money market: a low level of liquidity, lack of confidence among market participants, and accordingly, a lowering of limits for one another (even to the point of closure). The National Bank is practically the only player that is providing tenge liquidity. In addition, devaluation expectations are growing not only among participants in the financial market, but also throughout the entire economy given the devaluation of domestic currencies of neighboring countries, trading partners, and commodity-exporting countries.

Rates on repo operations are rising also.

The weighted average rate on 1-day operations in the automatic repo sector rose in the fourth quarter of 2008 and reached 5.03 percent (compared to 3.05 percent in the third quarter of 2008). The maximum rate was 11.40 percent and minimum was 1.81 percent.

Figure 31

Dynamics of the KazPrime index

Source of information: The National Bank of the Republic of Kazakhstan

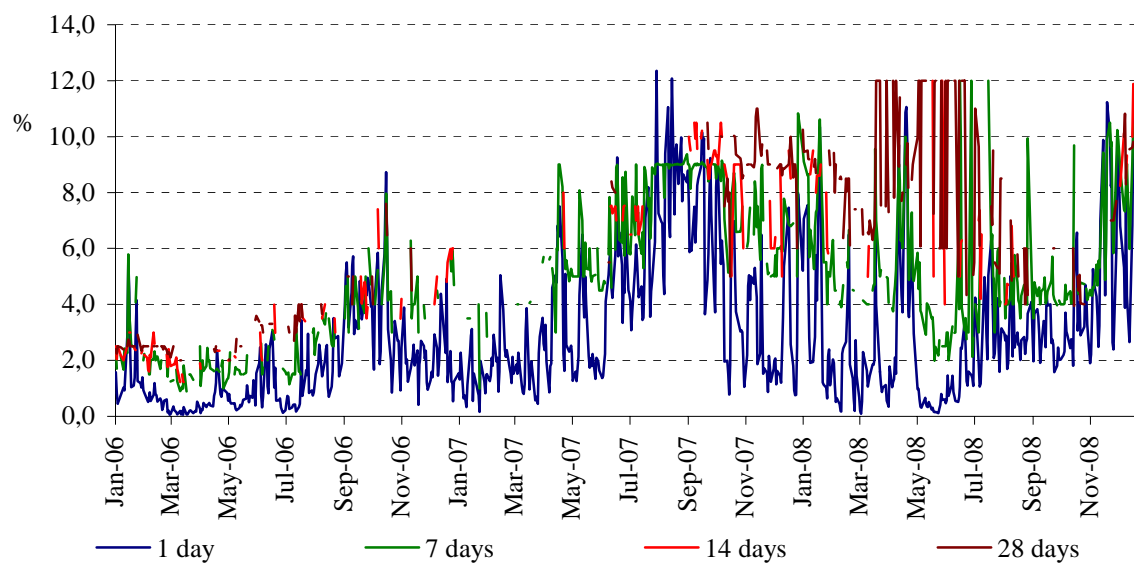
In the fourth quarter of 2008 the rates on 7-day repo operations fluctuated between 4.00 percent and 10.52 percent (the weighted average on the day of the operations), the rates for 14-day repo operations ranged between 4.25 percent and 11.88 percent, and the rates for 28-day repo operations were between 3.95 percent and 11.14 percent (Figure 32).

The volatility of money market rates remains high, which is tied to the small size of the market, little depth, and the lack of a sufficient quantity of collateral instruments. In addition, market rates fairly frequently fall outside the National Bank rate corridor, which means that they cannot be considered an effective instrument for the stabilization of rates in the money market.

The volume of transactions in the automatic repo sector in the fourth quarter of 2008 grew by 8.5 percent compared to the preceding quarter and by 35.2 percent compared to the fourth quarter of 2007. At the same time, the volume of 1-day repo operations fell compared to the third quarter of 2008, and the volume of 14-day and 28-day operations fell compared to the fourth quarter of 2007.

Mention should be made of the significant growth in the volume of 7-day repo operations, from 5.3 percent in the third quarter of 2008 to 16.1 percent in the fourth quarter of 2008 (by a factor of 3.3 and 2.0 compared to the third quarter of 2008 and to the fourth quarter of 2007, respectively). The main reason for this is the increase in the volume of liquidity provided by the National Bank (the National Bank performs only 7-day repo operations).

Figure 32

Dynamics of rates on repo operations

Source of information: Kazakhstan Stock Exchange

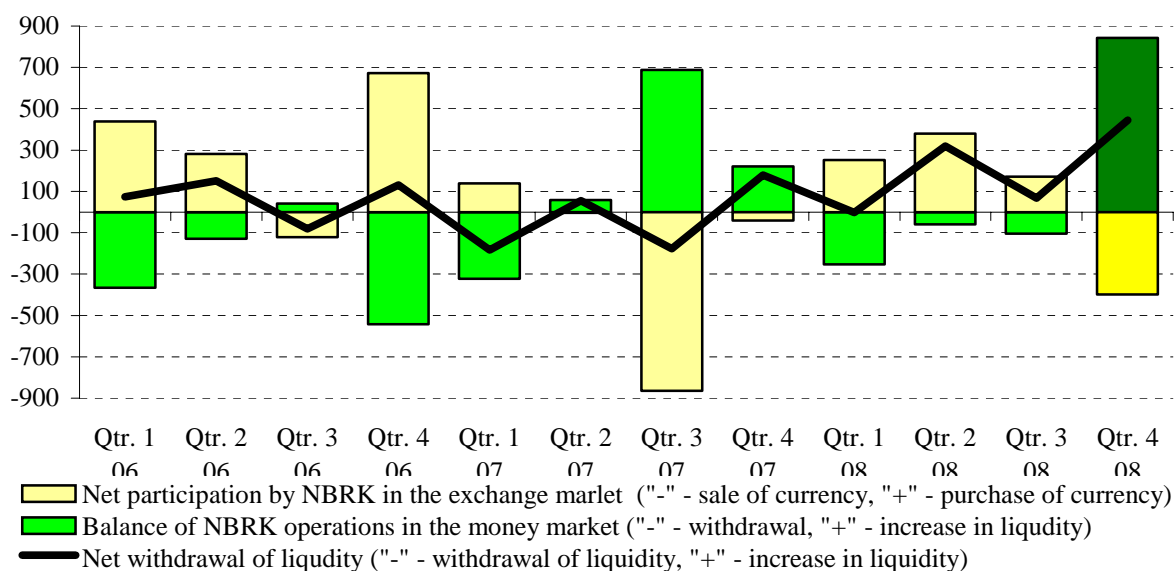
5. Instruments and operations of monetary policy

Given a shortage of short-term liquidity among banks in the fourth quarter of 2008, the National Bank increased the volume of refinancing operations, and reverse repo and swap operations in particular.

In the fourth quarter of 2008 the result of the National Bank's operations in the financial market was increased liquidity (Figure 33).

Figure 33

Balance of the National Bank's operations in the domestic market

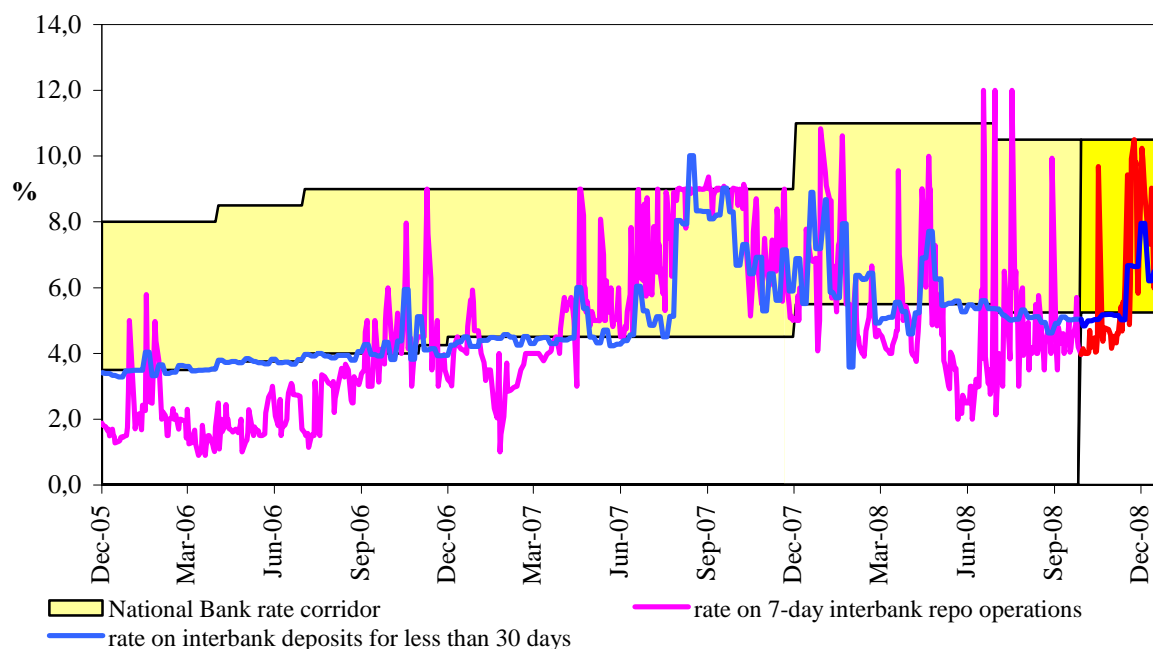


Source of information: The National Bank of the Republic of Kazakhstan

The National Bank's interest rates remained unchanged in the fourth quarter of 2008: the official refinancing rate was 10.5 percent, and the rate on deposits attracted from banks was 5.25 percent. There was some increase in the yield in the money market on operations with comparable maturities. On average the rates remained in the middle of the National Bank's rate corridor during the quarter. The weighted average rate on interbank deposits for up to 30 days was 5.80 percent in the fourth quarter. The weighted average rate on interbank 7-day repo operations was 8.06 percent (Figure 34).

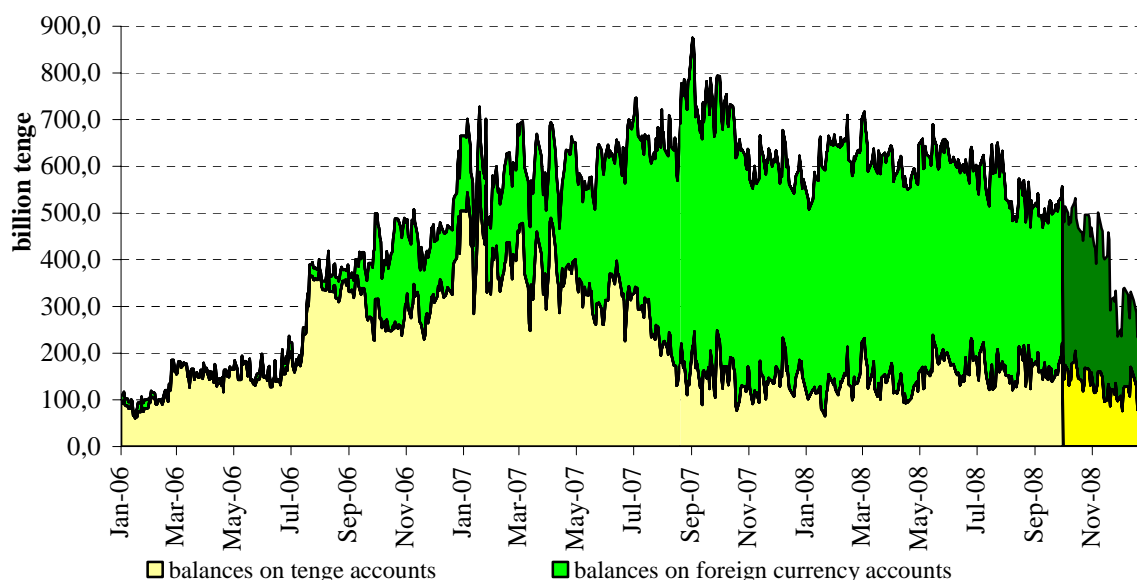
In the fourth quarter of 2008 there was a decline in balances on banks' correspondent accounts at the National Bank. During the period in question balances on accounts in foreign currency fell significantly, while balances on accounts in domestic currency remained relatively stable (Figure 35). The reduction in balances was tied to a lowering of the minimum reserve requirements and, accordingly, to a decline in the need to create significant reserve assets (see 5.2. Minimum reserve requirements). Banks transferred the funds that were freed up to correspondent accounts at foreign banks (see 4.2.2. Bank assets and liabilities).

Figure 34

Boundaries of the National Bank's rate corridor

Source of information: The National Bank of the Republic of Kazakhstan

Figure 35

Balances on banks' correspondent accounts at the National Bank

Source of information: The National Bank of the Republic of Kazakhstan

5.1. Interventions in the domestic foreign exchange market

The situation in the domestic exchange market developed in an environment in which the demand for foreign currency exceeded its supply. One of the reasons for demand in excess of supply was a decline in the export earnings of oil companies as a consequence of falling world oil prices. In addition, this was linked to an increase in the demand for foreign currency

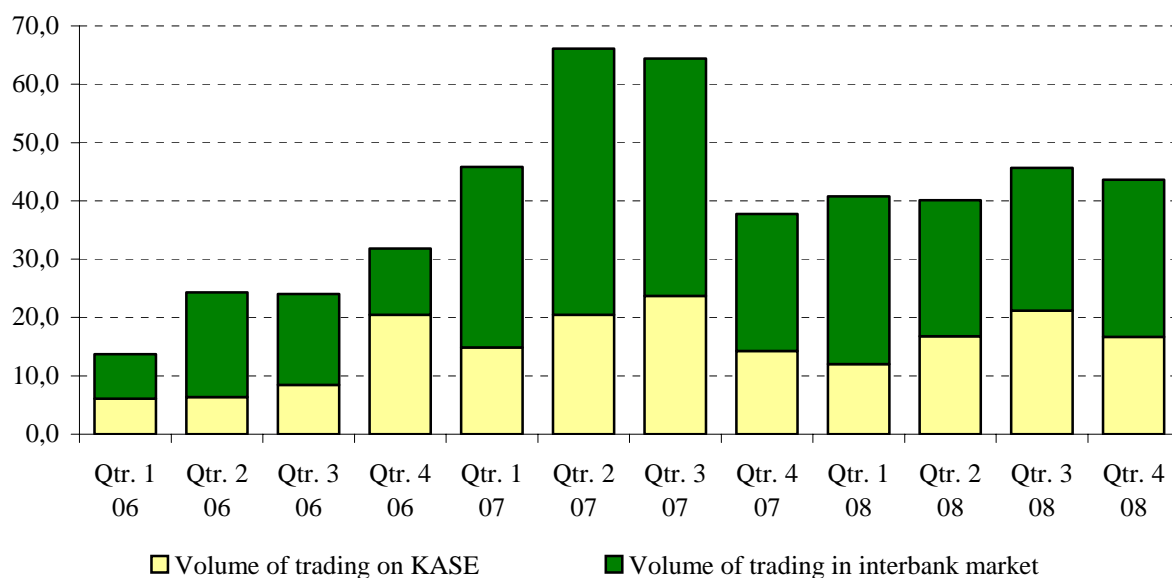
on the part of banks. Given limited access by the banking sector to borrowed resources in international capital markets, in the fourth quarter of 2008, as in the preceding quarter, there was a net outflow of resources in terms of banks' external borrowing. Thus, according to monetary survey data, banks' liabilities to nonresidents fell by US\$1.9 billion in the fourth quarter of 2008 (compared to a decline of US\$3.2 billion in the third quarter of 2008).

In the fourth quarter of 2008 the total volume of trading in the currency segment of the Kazakhstan Stock Exchange and in the interbank currency market reached US\$43.6 billion, which was a decline (by 4.6 percent) from the third quarter of 2008.

The volume of dollar position exchange trading on the Kazakhstan Stock Exchange fell by 21.4 percent compared to the third quarter of 2008 and totaled US\$16.7 billion (the net volume of trading on the Kazakhstan Stock Exchange represented 72 percent of the gross volume). The volume of operations in the over-the-counter market increased by 9.9 percent in the fourth quarter of 2008 compared to the preceding quarter and totaled US\$26.9 billion (Figure 36).

Figure 36

Volume of trading in the domestic exchange market, billion U.S. dollars



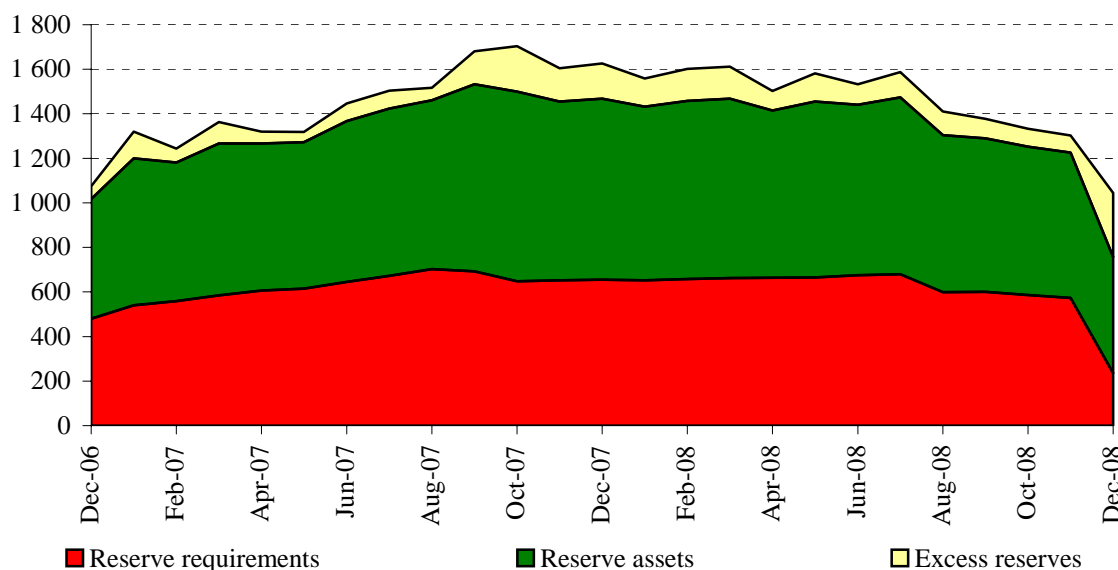
Source of information: The National Bank of the Republic of Kazakhstan

Based on the results for the fourth quarter of 2008, the coefficient of the National Bank's net participation in the Kazakhstan Stock Exchange became negative and was equal to (-)20.4 percent (in the first, second, and third quarters of 2008 it was 21.3 percent, 28.6 percent, and 0.4 percent, respectively). Thus, in the fourth quarter of 2008 the National Bank was predominantly a seller of foreign currency in the domestic exchange market.

5.2. Minimum reserve requirements

In October–December 2008 reserve assets were on average 56 percent higher than the required reserve levels (in the third quarter of 2008 they were 15 percent higher) (Figure 37).

Figure 37

Compliance with minimum reserve requirements

Source of information: The National Bank of the Republic of Kazakhstan

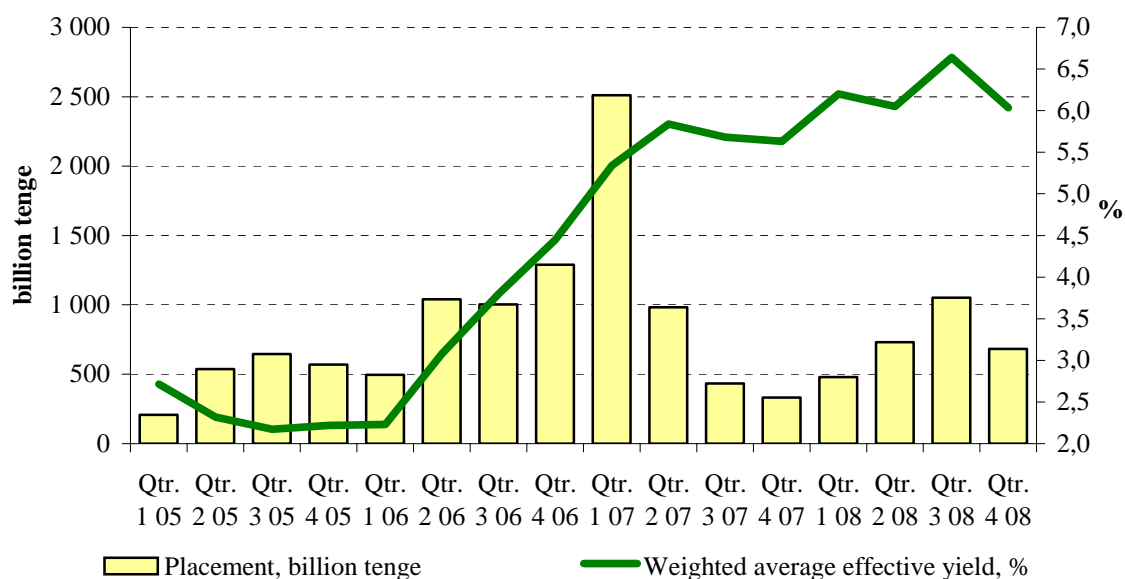
With a view to regulating the short-term liquidity of banks, as of November 18, 2008 the requirements for a bank's domestic liabilities were lowered from 5 percent to 2 percent, and for other liabilities they were reduced from 7 percent to 3 percent. The setting of new requirements enabled banks to free up some 350 billion tenge in additional liquidity.

5.3. Open market operations

In the fourth quarter of 2008 there was some decline in demand on the part of banks for short-term National Bank notes, which was tied to a worsening of the short-term liquidity crunch among banks. Thus, the volume of short-term notes issued in October–December 2008 declined by 35.2 percent and was equal to 682.3 billion tenge. Notes were issued with maturities of 28, 91, and 182 days, and there was no early redemption of the notes. The weighted average yield on notes placed fell from 6.64 percent in the third quarter of 2008 to 6.04 percent in the fourth quarter of 2008 (Figure 38).

Figure 38

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

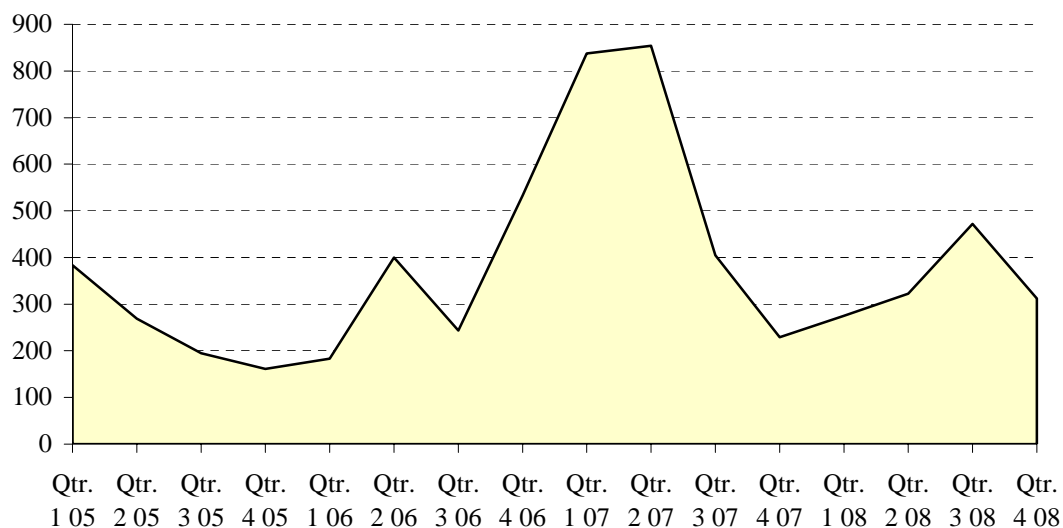


Source of information: The National Bank of the Republic of Kazakhstan

At the end of December 2008 the volume of short-term notes in circulation was equal to 312.3 billion tenge, which is 36.4 percent more than at the end of December 2007 (Figure 39).

Figure 39

Short-term notes in circulation (at the end of the period)



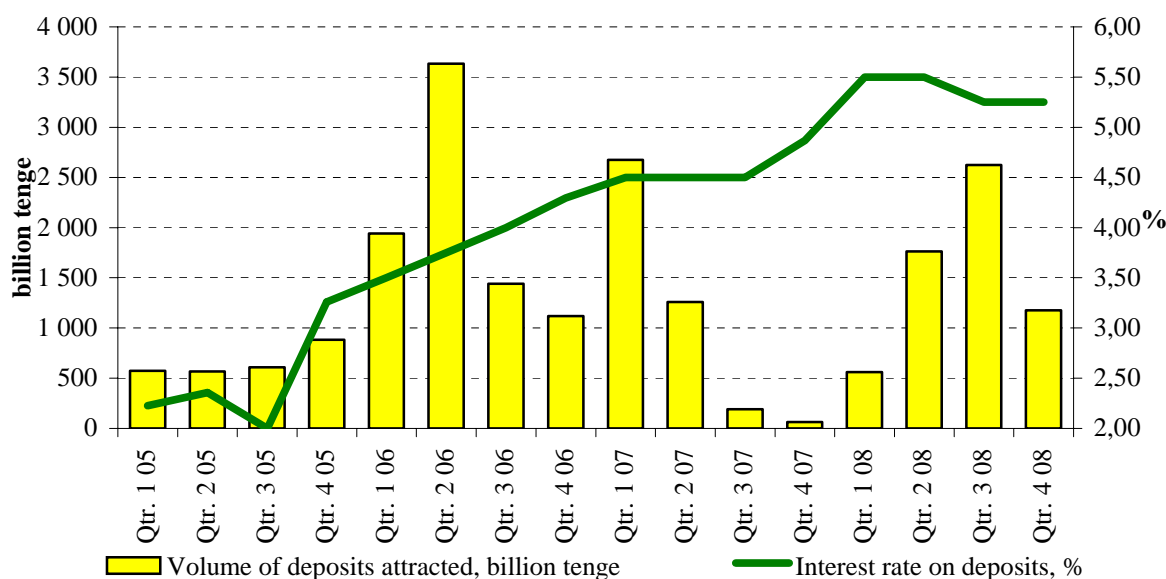
Source of information: The National Bank of the Republic of Kazakhstan

5.4. Standing facilities

There was a decline in the volume of banks' deposits at the National Bank in the fourth quarter of 2008 compared to the preceding period, although there was an increase compared to the indicator for the corresponding period in 2007. The peak attraction occurred in October. On the whole, deposits totaling 1177.4 billion tenge were attracted in October–December 2008, which is 2.2 times less than the figure reported in the third quarter of 2008 and 18.5 times more than in the fourth quarter of 2007. Deposits were attracted for seven days at a rate of 5.25 percent (Figure 40).

Figure 40

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



Source of information: The National Bank of the Republic of Kazakhstan

The decline in deposits attracted from banks in the fourth quarter of 2008 was accompanied by a decline in the volume of outstanding liabilities of the National Bank on these deposits by a factor of 6.3 to 33.0 billion tenge compared to the preceding quarter (Figure 41).

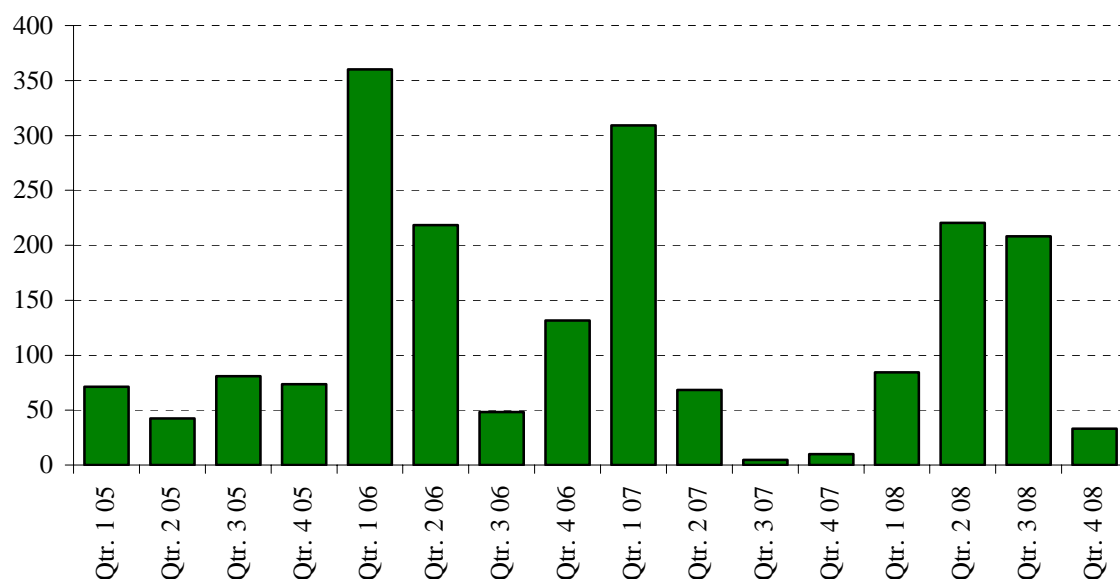
In the fourth quarter of 2008 there was a worsening of the short-term liquidity situation in the banking sector. In addition to a decline in the volume of sterilization operations by the National Bank, this was accompanied by growth in demand for National Bank refinancing operations on the part of banks.

In the fourth quarter of 2008 the National Bank provided refinancing loans to banks through reverse repo and swap operations. The total volume of reverse repo operations was 682.7 billion tenge, while swap operations totaled 1675.1 billion tenge/

In addition, in November 2008 the National Bank placed a total of 15.0 billion tenge on deposit with banks to maintain short-term liquidity. (Figure 42).

Figure 41

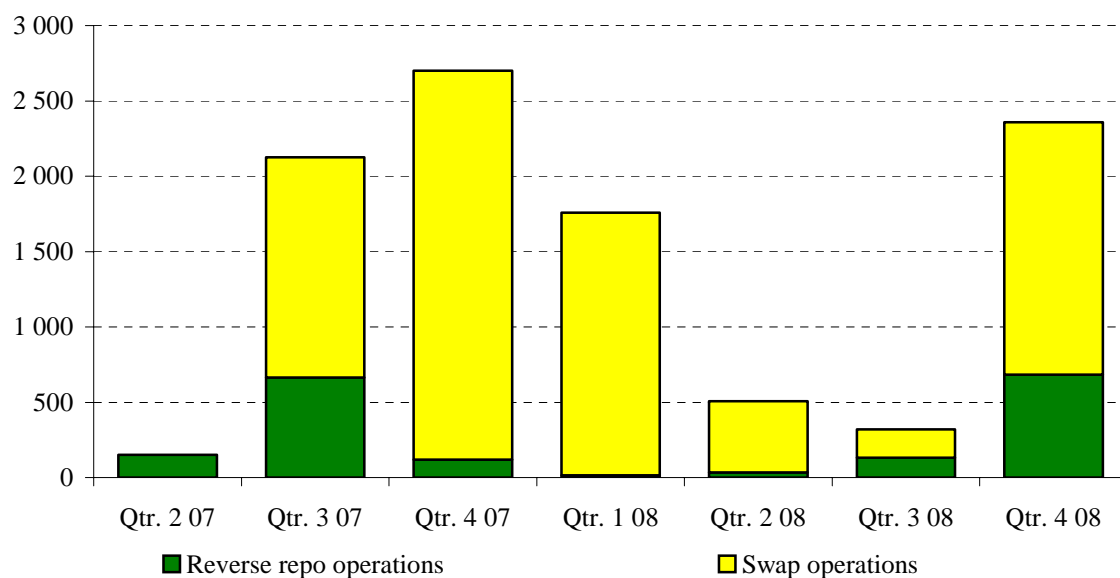
**Volume of outstanding liabilities of the National Bank on deposits attracted from banks
(at the end of the period)**



Source of information: The National Bank of the Republic of Kazakhstan

Figure 42

**Volume of National Bank refinancing operations
(for the period)**

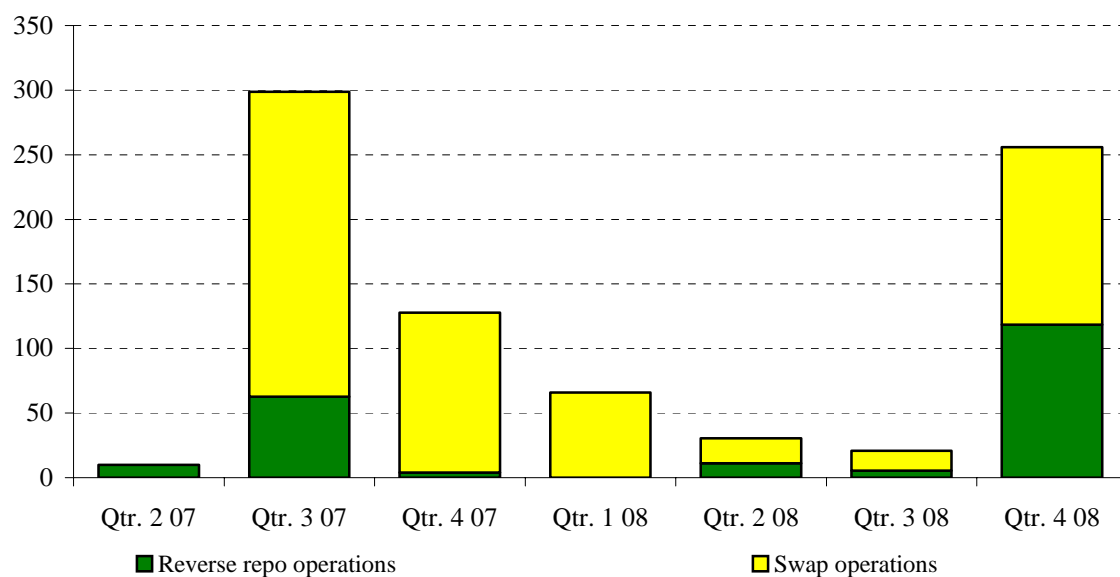


Source of information: The National Bank of the Republic of Kazakhstan

At the end of December outstanding debt on reverse repo operations totaled 118.5 billion tenge, while debt on swap operations was equal to 137.4 billion tenge (Figure 43).

Figure 43

**Volume of outstanding liabilities on refinancing operations of the National Bank
(at the end of the period)**



Source of information: The National Bank of the Republic of Kazakhstan

6. Inflation forecast

6.1. Evaluation of the inflation forecast for the fourth quarter of 2008 and for 2008 as a whole

The actual inflation rate in the fourth quarter of 2008 (1.2 percent) was considerably lower than the forecast for the period (between 2.9 and 3.1 percent), which was published in the previous issue of the Inflation Survey.

The inflation rate reported in the fourth quarter was the lowest seen for the year, while this period, as a rule, is marked by higher inflationary pressure resulting from the seasonality factor.

Inflation in October–December 2008 developed against a backdrop of higher prices for services purchased by the public and foodstuffs. At the same time, there was a decline in prices for nonfood goods.

Goods and services such as eggs, dairy products, fruits and vegetables, housing and municipal services, services provided by cultural and educational institutions, and medical services accounted for most of the growth in prices.

The cost of oils and fats, fuel and lubricants, and transportation services fell, which was due to a decline in world prices for certain types of food and commodities (see Section 3.1.3. External sector).

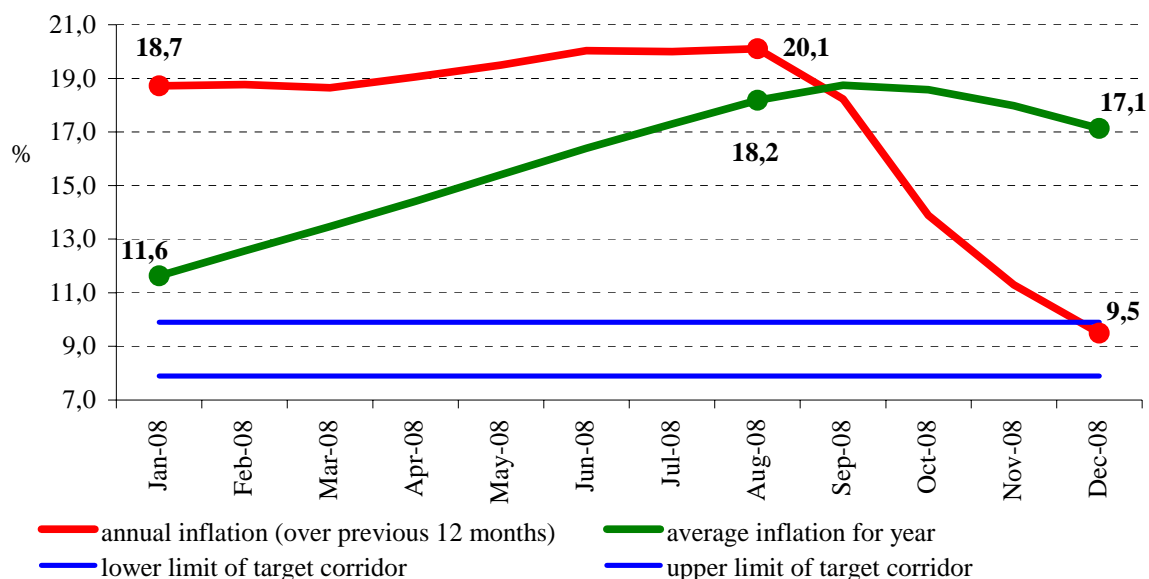
The rise in prices for fruits and vegetables, dairy products, and eggs was due primarily to the seasonality factor. At the same time, the increase in prices for these products in 2008 was smaller than in previous years. For example, in the fourth quarters of 2003–2007 the average rise in prices for fruits and vegetables was 10.3 percent, the figure for eggs was 27.1 percent, and for dairy products it was 13.4 percent, while in 2008 these figures were 4.4 percent, 11.7 percent, and 7.1 percent, respectively.

The actual inflation rate in annual terms at the end of December 2008 was 9.5 percent, which is entirely consistent with the National Bank forecasts contained in the Key Elements of the National Bank's Monetary Policy for 2008–2009 (7.9–9.9 percent).

In 2008 inflationary processes moved in different directions. In January–August the situation in the consumer market was characterized by a high degree of inflationary pressure, the principal factor in which was the influence of external factors.

Starting in September 2008 inflation began to slow down. This was due to a decline in prices in world commodity markets, a slowdown in economic growth, limited consumer demand, stagnation of credit activity in the banking sector, and slow growth in the money supply in the economy. As a consequence, annual inflation fell by a factor of more than 2 from August through December 2008 (Figure 44).

Figure 44

Actual inflation in 2008

Source of information: The National Bank of the Republic of Kazakhstan

6.2. Inflation forecast for 2009

The slowdown in the global economy, falling world prices in commodity markets, including prices for goods that are among Kazakhstan's principal exports, and continuing uncertainty in the global financial market will be the main factors determining economic development trends in Kazakhstan in 2009.

This, in turn, will contribute to a slowdown in economic growth.

At the same time, there are no signs pointing to a risk of a significant increase in inflation. In 2009 the situation in Kazakhstan's consumer market will remain stable. The trend toward slower inflation that was seen in the second half of 2008 will continue in 2009. All of these factors allow one to forecast inflation in the range of 9.0 percent at the end of 2009.

Measures taken by the National Bank in 2009 will be suited to the situation that is emerging. Since there is no expectation of an increase in inflationary pressure in the near future, there is no need to take additional measures in this direction. The top priority is to ensure the stability of the country's financial sector, which will entail an easing of monetary policy.

6.2.1. Inflation forecast for the first quarter of 2009

The inflation forecast for the first quarter of 2009 is in the range of 2.2–2.4 percent. On the whole, this rate is consistent with first-quarter inflationary trends that have been typical in previous years.

These expectations are linked primarily to the fact that inflation will be driven in the near term by the seasonality factor. A decline is expected in prices for certain types of goods and services (meat and dairy products, fuel and lubricants, certain types of housing and municipal services, transportation services).

Furthermore, in 2009 consumer demand will most likely remain limited, no sharp increase in credit activity in the banking sector is expected, and as a result, economic growth will remain at the current level.

Based on the results for March 2009, the annual inflation rate is expected to be in the range of 9.1–9.3 percent.

6.2.2. Inflation forecast for the second quarter of 2009

In the second quarter of 2009 it is expected that inflation will be in the range of 1.7–1.9 percent (in the second quarter of 2008 it was 3.1 percent), which corresponds to an annual rate of 7.7–7.9 percent at the end of June 2009.

The situation in the consumer market during this period is being influenced to a large extent by the seasonality factor, which in turn is leading to a decline in prices for certain types of foodstuffs (eggs, dairy products, fruits and vegetables, meat products, and education services).