

**National Bank
of the Republic of Kazakhstan**

**Inflation Report
Q1 2007**

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Basic terms and concepts

In section 1. Inflationary processes

Inflation in the Republic of Kazakhstan is calculated based on a consumer price index (CPI) that characterizes the change in the overall level of prices for goods and services acquired by the population for personal consumption in the cities of Astana and Almaty, all the oblast centers, and a sample set of cities and rayon centers. The consumer basket for calculating inflation reflects the structure of household expenditures and comprises 508 goods and services making up the largest proportion in the population's consumption.

Core inflation consists of inflation excluding short-term irregular price changes influenced by certain factors of an administrative, one-off, or seasonal nature.

Since 2004 the Republic of Kazakhstan Statistics Agency has been calculating baseline inflation using five different methodologies:

- core inflation-1: inflation excluding price increases for vegetables, fruits, gasoline, and coal;
- core inflation-2: inflation excluding price increases for vegetables, fruits, regulated services, and energy resources;
- core inflation-3: excluding the five maximum and five minimum price increases;
- core inflation-4: trimmed mean; and
- core inflation-5: median CPI.

In the framework of the **Enterprise monitoring** carried out by the National Bank since 2002, the inflationary expectations of enterprises of the real sector are surveyed. This survey covers qualitative assessments of managers of the surveyed enterprises (“will rise,” “will fall,” and “will remain unchanged”) with regard to production activities of the enterprises, including demand for and prices of finished output and for raw and other materials used in production for the preceding and the upcoming quarters.

The diffusion index is presented as the number of “will rise” responses and half of the “unchanged” responses. This index represents a summary indicator characterizing the dynamics of change in the indicator being examined. An index figure above 50 signifies an increase in the indicator, and a figure lower than 50 represents a decline in the indicator.

In section 2. Fiscal policy

Budget receipts include revenue (tax receipts, nontax receipts, and receipts from the sale of fixed capital), the repayment of budget credits, and receipts from the sale of financial assets of the state.

Budget expenditures comprise expenses (current and capital), budget credits, and acquisition of financial assets.

In section 3. Monetary policy

Base money (reserve money) includes cash released into circulation by the National Bank including cash in cash departments of second-tier banks (cash outside the National Bank), transferable and other deposits of second-tier banks, and transferable deposits of nonbank financial and current accounts of state and nonstate nonfinancial institutions in tenge with the National Bank.

Narrow base money represents base money excluding other deposits of second-tier banks with the National Bank.

The M1 monetary aggregate is calculated as the total of cash in circulation and transferable deposits of non-bank legal entities and the population 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 population in foreign currency.

The money stock (M3) is determined based on consolidation of accounts of the balance sheets of the National Bank and second-tier banks. It consists of cash in circulation and transferable and other deposits of legal entities and households in the domestic and foreign currency.

Transferable deposits are all deposits that: 1) can at any moment be turned into money at face value without penalties or restrictions; 2) are freely transferable using a check, bill of exchange, or draft; and 3) are widely used for making payments. Transferable deposits are part of the narrow money stock.

Other deposits pertain, for the most part, to savings and time deposits that may be withdrawn only at the expiration of a defined time period or are subject to various restrictions that make them less convenient for use in common commercial operations and generally are subject to requirements set on savings mechanisms. In addition, other deposits also include nontransferable deposits denominated in foreign currency.

The ratio of participation of the National Bank in foreign exchange trading on the Kazakh Stock Market (KFB) is calculated as the ratio of net participation of the National Bank (purchases minus sales of foreign currency) to the net volume of trading on the KFB.

The balance of National Bank operations on the money market is calculated as the total of the change in volume of short-term notes in circulation, balances on deposit and correspondent accounts of banks with the National Bank, and net operations for the purchase and sale of government securities.

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1. Inflationary processes

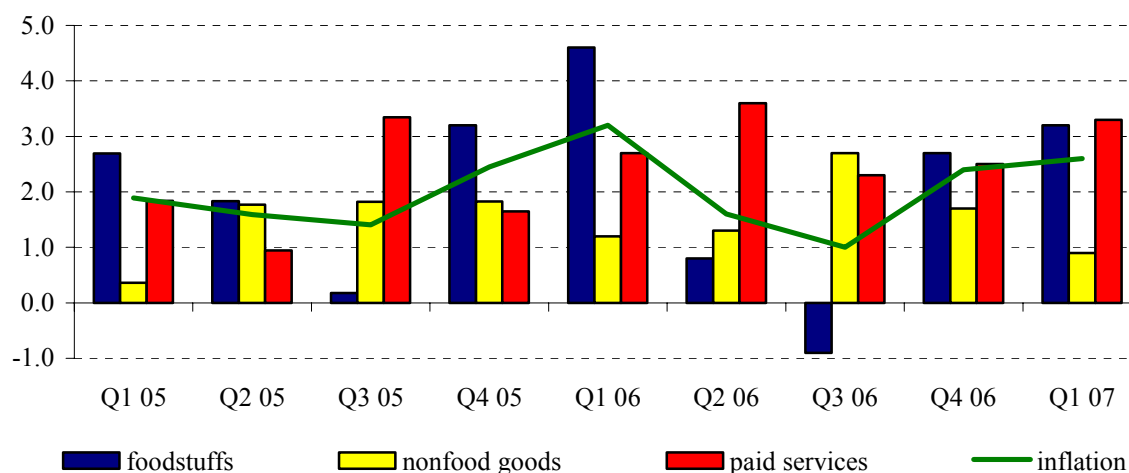
1.1. Consumer prices

In Q1 2007 there was an insignificant increase in prices on the consumer market by comparison with the preceding quarter. By comparison with the same period in 2006 inflation was lower and comprised 2.6 percent.

The main reason that inflation remained at a fairly high level is an increase in the cost of paid services and foodstuffs, which increased in cost in this period by 3.3, and 3.2 percent respectively, and prices for non-foodstuffs increased by 0.9 percent (Figure 1).

Figure 1

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



Source: Republic of Kazakhstan Statistics Agency

The increase in consumer prices in January–March 2007 was caused by increased prices for certain types of paid services and a seasonality factor.

In Q1 2007 the largest prices increases occurred for fruits and vegetables—by 11.4 percent, electricity—by 10.3 percent, medical services—by 7.2 percent, and transportation services—by 3.0 percent, including railway passenger transport—by 9.7 percent.

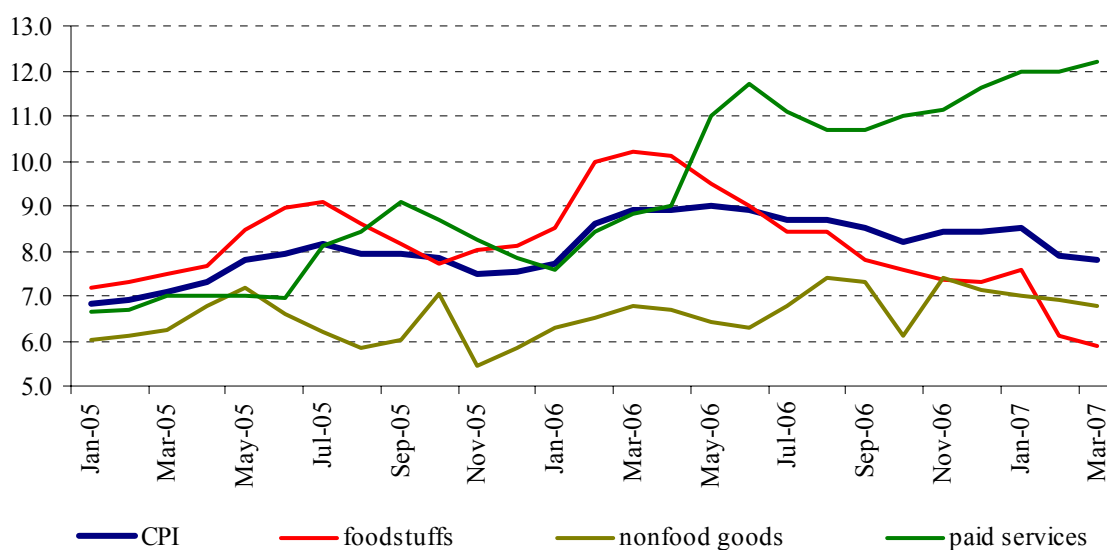
According to National Bank estimates, the contribution of these goods and services to the generation of inflation was 0.7 percent, in other words inflation would have been 1.9 percent excluding the increase in prices for the aforementioned goods and services.

The increase in fruit and vegetable prices is due to a seasonal factor that is traditional for the period. In addition, the pace of the price increase this year declined significantly by comparison with previous years (in Q1 2003–2006 the price of fruits and vegetables increased by an average of 16.5 percent).

Inflation in annual terms showed a declining trend in January–March 2007 and was at 7.8 percent at the end of March (in December 2006 it was 8.4 percent). In addition, paid services for the public also determine the dynamics of inflation in annual terms. Thus, paid services increased in price for the year by 12.2 percent, non-foodstuffs—by 6.8 percent, and foodstuffs—by 5.9 percent (Figure 2). Expressed annually, fruits and vegetables, medical and transport services, housing and communal services, and gasoline demonstrated the greatest increase in prices.

Figure 2

**Dynamics of inflation and its components
(as a percentage of the same month in the previous year)**



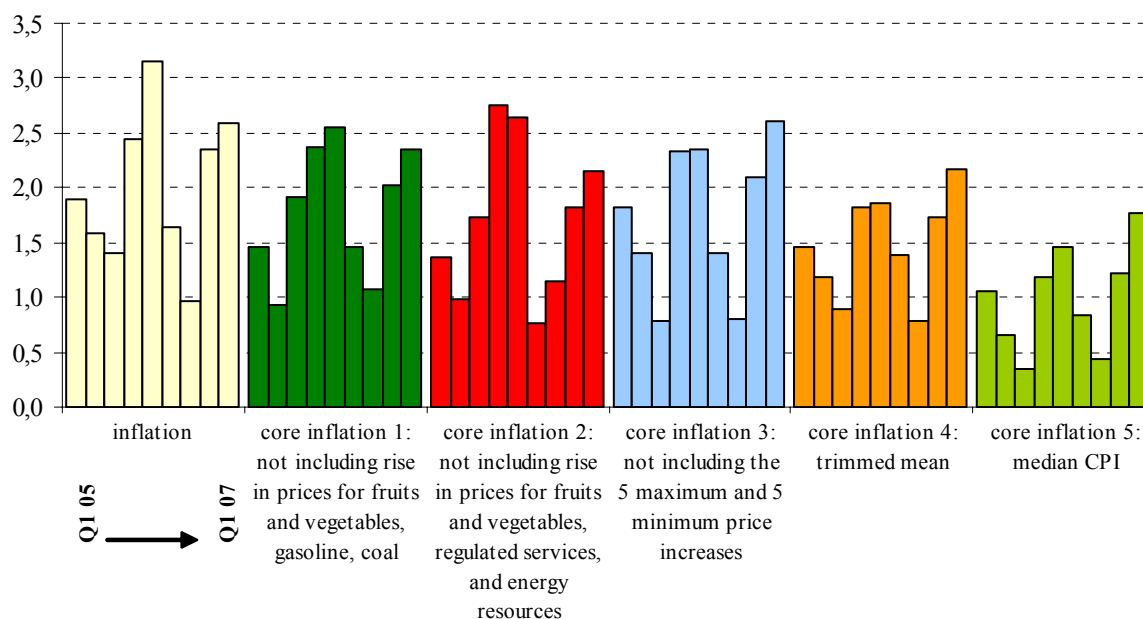
Source: Republic of Kazakhstan Statistics Agency

1.2. Core inflation

The seasonal increase in the overall level of prices in Q1 2007 was accompanied by an increase in core inflation by comparison with the preceding quarter (Figure 3).

Figure 3

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



Source: Republic of Kazakhstan Statistics Agency

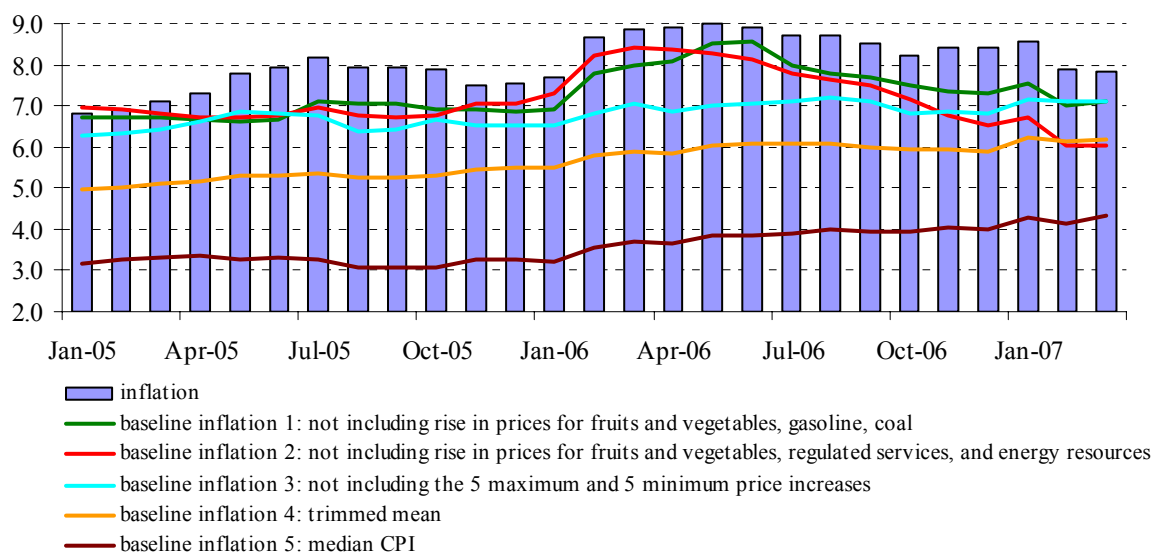
Due to the increase in prices for fruits and vegetables, transportation services, medical services, and housing and communal services in Q1 2007, baseline inflation when calculated excluding those components was at a lower level than the indicator for overall inflation.

Despite the decline in inflation in Q1 2007, the dynamics of indicators for baseline inflation do not demonstrate the observed trend toward a slowing of inflationary processes (Figure 4). Of the indicators for baseline inflation, only baseline inflation-1 and baseline inflation-2 showed a decline in their level by comparison with December 2006, whereas baseline inflation-3, baseline inflation-4, and baseline inflation-5 increased.

The slowing rate of baseline inflation-1 and baseline inflation-2 in annual terms was aided by prices for certain foodstuffs and non-foodstuffs whose increase over the last 12 months was insignificant. These products are excluded from calculation of baseline inflation-3, baseline inflation-4, and baseline inflation-5, which explain the increase in those types of baseline inflation.

Figure 4

**Dynamics of annual inflation and baseline inflation
(percentage of the same month of the preceding year)**



Source: Republic of Kazakhstan Statistics Agency

1.3. Prices in the real sector of the economy

1.3.1. Prices in industry

In Q1 2007 there was a decline in prices of enterprises that are producers of industrial output by 4.6 percent (in Q1 2006—an increase of 6.4 percent). Produced output was 4.9 percent cheaper, which was first and foremost caused by a 5.7 percent decline in the cost of products of intermediate consumption, whereas prices for production resources increased in cost by 2.3 percent and consumer goods—by 1.7 percent. Prices for services of a production nature increased by 0.8 percent.

Within the structure of economic sectors in January–March 2007 output of enterprises of the extractive industry decreased in price by 3.9 percent (in January–March 2006 they increased by 9.5 percent). The decline in prices in the industry was caused first and foremost by a decline in the cost of gas condensate by 9.8 percent, of oil—by 4.3 percent, and of petroleum products—by 3.9 percent. The main increase in prices occurred in extraction of coal and natural gas, by 4.6 percent and 3.1 percent respectively. As a whole, prices of producers for energy resources in January–March 2007 declined by 4.0 percent (in Q1 2006 they increased by 9.3 percent).

The decline in prices in the processing industry in Q1 2007 was 6.9 percent (in Q1 2006 prices increased by 2.4 percent), primarily influenced by the existing pricing situation for metals. Prices for rolled ferrous metals declined by 21.0 percent and for non-ferrous metals—by 19.5 percent.

Foodstuffs produced in the Republic increased in price during January–March 2007 by 3.4 percent (by 3.2 percent in January–March 2006). The highest increase in prices occurred

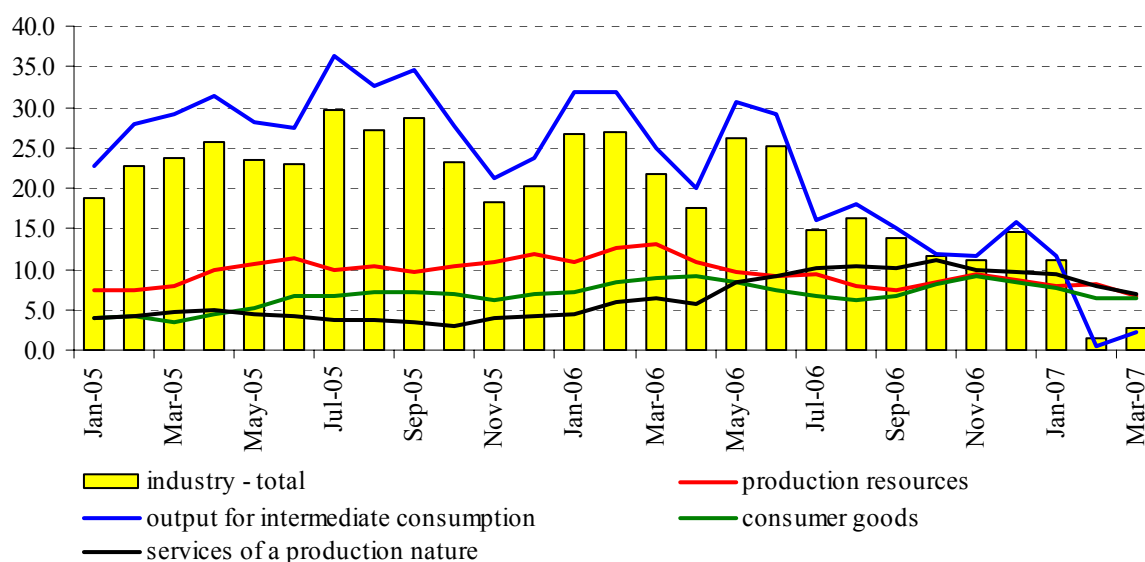
for production of flour, as a result of which prices for bread on the foodstuffs market increased by 7.7 percent.

Prices and tariffs for the production and distribution of electricity, gas, and water in Q1 2007 grew by 5.0 percent (in Q1 2006—by 2.4 percent).

In March 2007 the annual increase in prices in industrial production (March 2007 against March 2006) was 2.8 percent, which declined from 14.6 percent in December 2006. Produced output increased in price over the last 12 months by 2.6 percent, including production resources—by 6.7 percent, products of intermediate consumption—by 2.1 percent, and consumer goods—by 6.4 percent. The annual increase in prices for services of a production nature was 6.9 percent (Figure 5).

Figure 5

Dynamics of the price index for enterprises that are producers of industrial output (as a percentage against the same month of the preceding year)



Source: Republic of Kazakhstan Statistics Agency

1.3.2. Prices in agriculture

According to data of the Republic of Kazakhstan Statistics Agency, in Q1 2007 sales prices of producers of agricultural output increased by 3.6 percent (in Q1 2006—by 0.9 percent). Price dynamics in agriculture occurred against the backdrop of a 4.0 percent increase in prices for crop output and a 3.1 percent increase for livestock products.

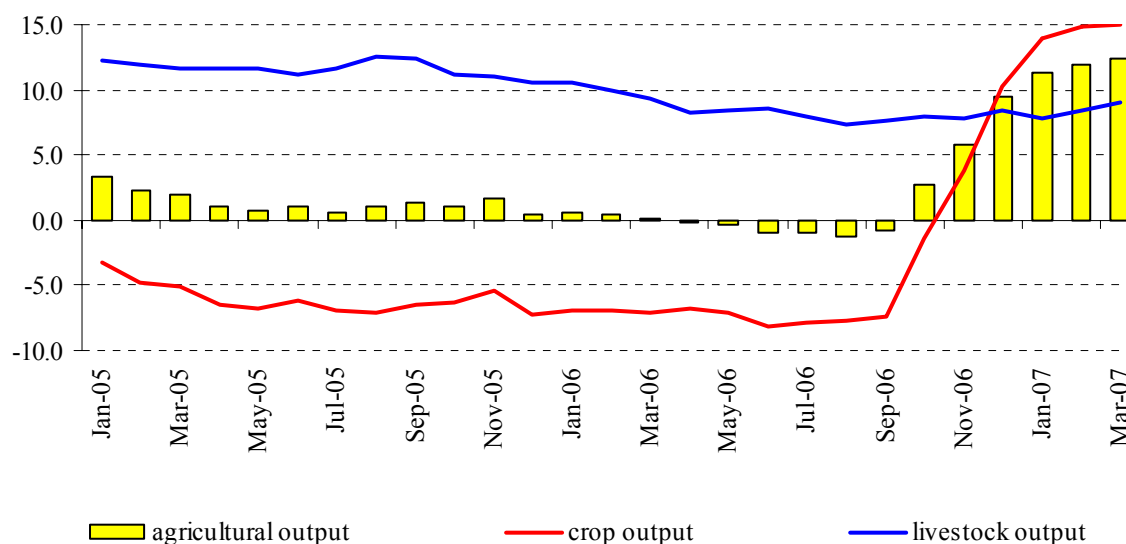
Among livestock products, prices increased the most in Q1 2007 for milk, eggs and meat. Poultry meat decreased in price.

An increase in prices for crop products during the reference period was caused by the increased cost of grain crops. At the same time there was a seasonal increase in prices for vegetable crops, including potatoes and vegetables.

Prices for agricultural output in March 2007 increased in annual terms by 12.4 percent (in December 2006—by 9.5 percent). Prices for livestock products increased by 9.0 percent (in December 2006—by 8.4 percent), and for crop output—by 15.0 percent (in December 2006—by 10.3 percent) (Figure 6).

Figure 6

**Dynamics of the price index for agricultural output
(as a percentage against the same month of the preceding year)**



Source: Republic of Kazakhstan Statistics Agency

1.3.3. Enterprise monitoring

A survey of enterprises demonstrated a further slowing of growth of demand for finished output of the polled enterprises. Thus, in Q1 2007 by comparison with the previous quarter 30 percent of polled enterprises noted an increase in demand for finished output (in Q4 2006—32.2 percent). At the same time there was an increase in the share of enterprises with stable demand (from 53.4 percent to 54.7 percent) and in the share of enterprises whose demand for output declined—from 12.7 percent to 14.4. percent. As a result the diffusion index for the change in demand for finished output continued the declining dynamic that began in Q2 2006, reaching a value of 57.8 in Q1 2007.

In Q2 2007 38.4 percent of enterprises participating in the survey anticipate an increase in demand, and only 6.6 percent of enterprises anticipate a decline in demand for finished output. As a result, we anticipate significant growth of the diffusion index for the change in demand for finished output in Q2 2007 to 65.9 (Figure 7).

The situation with prices for finished output of polled enterprises and raw materials and supplies used in the production process is characterized by the existence of inflationary trends and continued inflationary expectations. In Q1 2007 31.5 percent of enterprises noted an increase in prices for finished output (in Q4 2006—26.6. percent). There was a slight increase in the number of enterprises for whose output prices declined—5.4 percent (in Q4 2006—3.2 percent). As a consequence, there was an increase in the diffusion index for the

change in prices for finished output to 63.0 percent (in Q4 2006—61.7), which was the highest value during the time the index has been calculated (since Q2 2005).

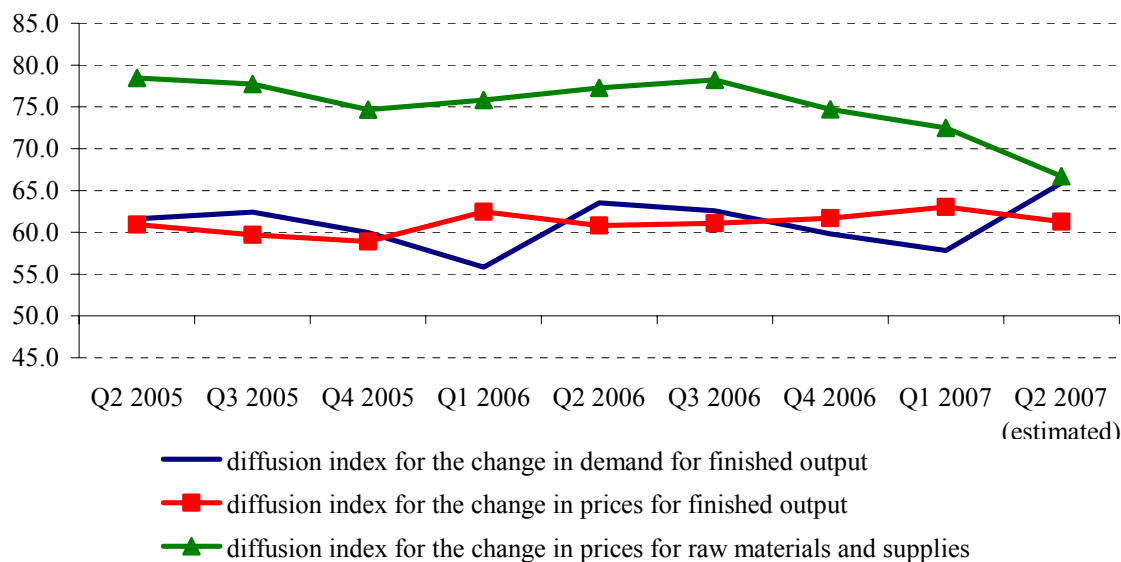
In Q2 2007 we anticipate a decline in the diffusion index for the change in prices for finished output to 61.3, which is associated with the decline to 25.7 percent of the share of enterprises for whose output a price increase is forecast, with an insignificant 3.2 percent decline in the share of enterprises anticipating a decline in prices for their own finished output (Figure 7).

Since Q4 2006 we have observed a slowing of the increase in prices for raw materials and supplies. The share of enterprises that noted a decline in prices for raw materials and supplies increased from 1.0 percent to 2.7 percent; 32.0 percent of the polled enterprises announced stable prices, whereas in the preceding quarter their proportion was 36.5 percent. The share of enterprises noting price increases rose insignificantly, from 55.3 percent to 56.2 percent. As a result, the diffusion index for the change in prices for raw materials and supplies declined to 72.5.

The share of enterprises anticipating an increase in prices for raw materials and supplies in Q2 2007 declined to 43.6 percent, and the share of enterprises anticipating a decline in prices is 1.7 percent. As a result the diffusion index continued its decline to 66.7 (Figure 7).

Figure 7

Diffusion indices for changes in demand and prices



Source: Republic of Kazakhstan National Bank

1.4. Inflationary factors

In 2007 the situation on the consumer market is being influenced by such factors as increases in prices for the service of monopolist enterprises, an active budget policy, and a growth rate for wages in excess of labor productivity growth. Moreover, the increase in

aggregate demand and inflows of foreign capital continue to have a negative influence on inflation, despite a significant decline in the action of those factors.

Inflation in Q1 2007 was largely influenced by increases in prices and tariffs for services of monopolist enterprises. Thus, in January–March electricity increased in price by 10.3 percent, provision of gas—by 3.1 percent, and transportation services—by 3.0 percent, including railway transport—by 9.7 percent.

Budget policy of Kazakhstan in Q1 2007 was fairly active. It was characterized by a significant increase in expenditures and moderate growth in budget receipts. During January–March 2007 state budget expenditures increased by 36.3 percent, while receipts increased by only 3.6 percent. As a result, the budget deficit at the end of March 2007 was T 84.7 billion or 3.3 percent of GDP, while in the same period in 2006 there was a surplus in the amount of T 75.0 billion (see 2. Fiscal Policy).

The rate of growth of wages in excess of the rate of growth in labor productivity remains an urgent problem in this year as well, contributing to an increase in inflationary pressure in the economy. Thus, in January–March 2007 the increase in real wages was 20.0 percent, while labor productivity grew by 7.5 percent.

The trend toward flows of foreign capital into the country has continued in this year. According to data from customs statistics (not incorporating non-organized trade), the volume of exports in Q1 2007 was \$10.1 billion, which is 36.6 percent more than the volume for Q1 2006, and imports grew by 60.1 percent to \$6.5 billion. The asset balance for foreign trade increased to \$3.6 billion (an 8.0 percent increase). To a certain degree this increase was offset by a decline in volumes of inflows of foreign investments in fixed capital. Thus, foreign investments in fixed capital in January–March 2007 declined by 77.6 percent by comparison with the same period in 2006.

Liabilities of second-tier banks to nonresidents increased in Q1 2007 by 14.6 percent.

Despite a decline in consumer and investment demand, credit activity of banks in Q1 2007 remained fairly high: following a seasonal decline in demand for loans in January 2007, in February–March 2007 credit activity of the banks again increased. The volume of loans given out by the banks in January–March 2007 by comparison with January–March 2006 grew by a factor of 1.9 (in October–December 2006—by a factor of 1.7). At the same time there was also an increase in interest rates on issued loans from 12.6 percent in December 2006 to 13.2 percent in March 2007.

Despite this growth, the rates of expansion of monetary aggregates slowed in 2007. The increase in the money stock in Q1 2007 was 7.0 percent (in January–February 2006—by 12.9 percent), while the expansion of base money was 5.5 percent (56.9 percent) (see 3.1. Money supply).

This year we are seeing a slowdown in growth of consumer and investment demand that began in the second half of 2006.

Monetary income of the population in Q1 2007 by comparison with the same period in 2006 increased in real terms by 19.0 percent (and in Q4 2006—by 7.4 percent). Growth of

retail trade turnover in January–March 2007 by comparison with January–March 2006 was 9.8 percent (in Q4 2006—16.1 percent).

At the end of 2006 we noted a trend toward a decline in investment demand. In the current year the slowing of investment demand has continued. Thus in January–March 2007 by comparison with the same period in 2006 investments in fixed capital increased by 7.1 percent, whereas in Q1 2006 the volume of investments grew by 19.4 percent (in Q4 2006—a decline by 23.1 percent). This slowdown was caused first and foremost by the decline in foreign investments in fixed capital; their volume in January–March 2007 was 53.7 percent of the volume in January–March 2006.

The increase in real GDP, as an indicator of aggregate supply, was 10.5 percent in Q1 2007 by comparison with Q1 2006 (in Q4 2006—10.8 percent).

Thus, the action of certain inflationary factors in Q1 2007 significantly weakened by comparison with previous quarters. As a result, these trends led to a slowdown in inflationary processes, which caused a decline in the annual inflation rate from 9.0 percent in May 2006 to 7.8 percent in March 2007.

2. Fiscal policy

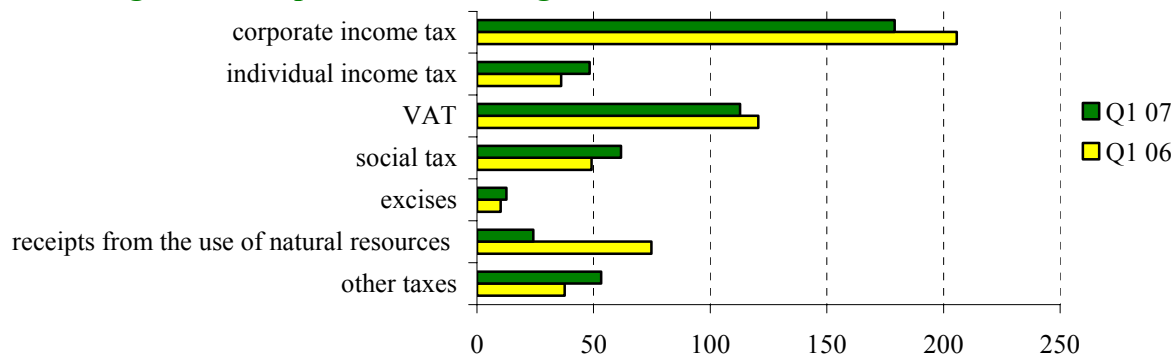
According to Republic of Kazakhstan Ministry of Finance data, state budget receipts in Q1 2007 totaled T 592.1 billion. Compared to the indicators for the same period of the previous year, this marked an increase of 3.6 percent. The increase in revenue resulted from an increase in volumes of nontax receipts and receipts from the sale of fixed capital, and also from official transfers.

A 7.0 percent decline in tax receipts occurred as a result of a drop in receipts for use of natural resources by 67.6 percent and for corporate income tax by 12.9 percent, which is associated with the change effective July 1, 2006 in the mechanism for the operation of the Republic of Kazakhstan National Fund (Box 1). There was an insignificant 6.5 percent decline in receipts for value added tax as a result of the drop in the VAT rate from 15 percent to 14 percent.

Receipts for other types of taxes increased in Q1 2007 by comparison with Q1 2006 (Figure 8).

Figure 8

State budget tax receipts, billions of tenge



Source: Republic of Kazakhstan Ministry of Finance

Within the structure of nontax receipts in Q1 2007, the fee for legalization of property represented more than 21 percent.

In Q1 2007, a guaranteed transfer was withdrawn from the National Fund to the republican budget, which happened for the first time since the change in the mechanism for its operation (Box 1). The volume of the guaranteed transfer was T 37 billion.

Repayments of budgetary credits increased by 17.1 percent, and receipts from the sale of financial assets of the state fell by a factor of 64.4.

In Q1 2007 state budget expenditures were financed in the amount of T 543.7 billion. By comparison with indicators for the same period in 2006, this represented an increase of 36.3 percent.

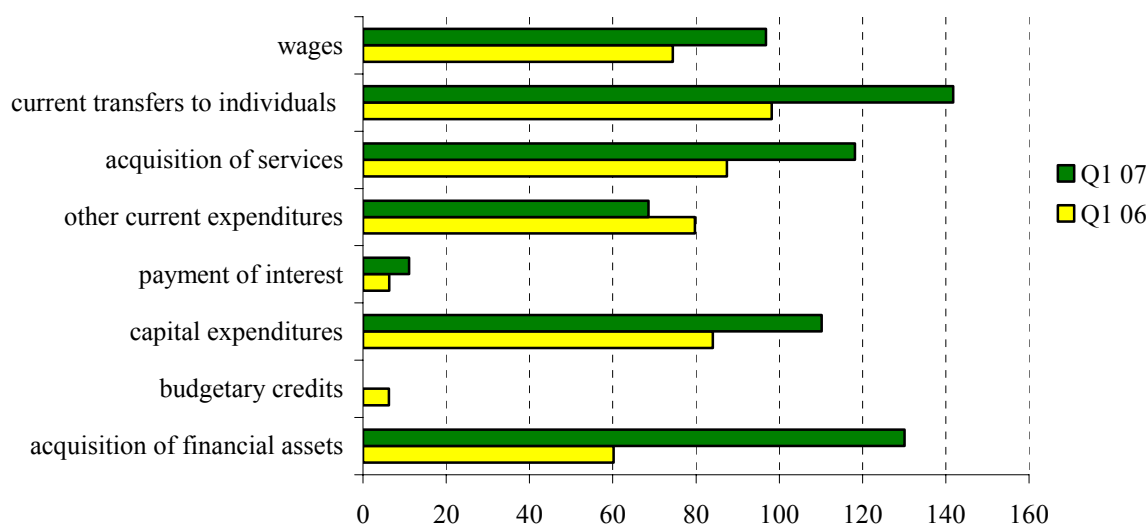
Current state budget expenditures were financed in the amount of T 436.5 billion. By comparison with indicators for the same period in 2006, they increased by 26.2 percent. Within the makeup of current expenditures from the state budget, the largest proportion was represented by current transfers to individuals, expenditures on the acquisition of services, and also for payment of wages. In Q1 2007 there was a significant increase in expenditures to service debt—by 76.4 percent by comparison with indicators for Q1 2006—especially for domestic loans. This is associated with the increase in volumes of government securities in circulation, the increase in maturities, and also the increase in yields on them.

Capital expenses of the state budget in Q1 2007 increased by 31.3 percent by comparison with the same period in 2006, which was chiefly associated with the increase in expenditures on the acquisition and creation of fixed capital.

Budget credits in Q1 2007 comprised 0.2 percent of their volume in Q1 2006. Expenditures on the acquisition of financial assets increased by a factor of 2.2 (Figure 9).

Figure 9

State budget expenditures, billions of tenge



Source: Republic of Kazakhstan Ministry of Finance

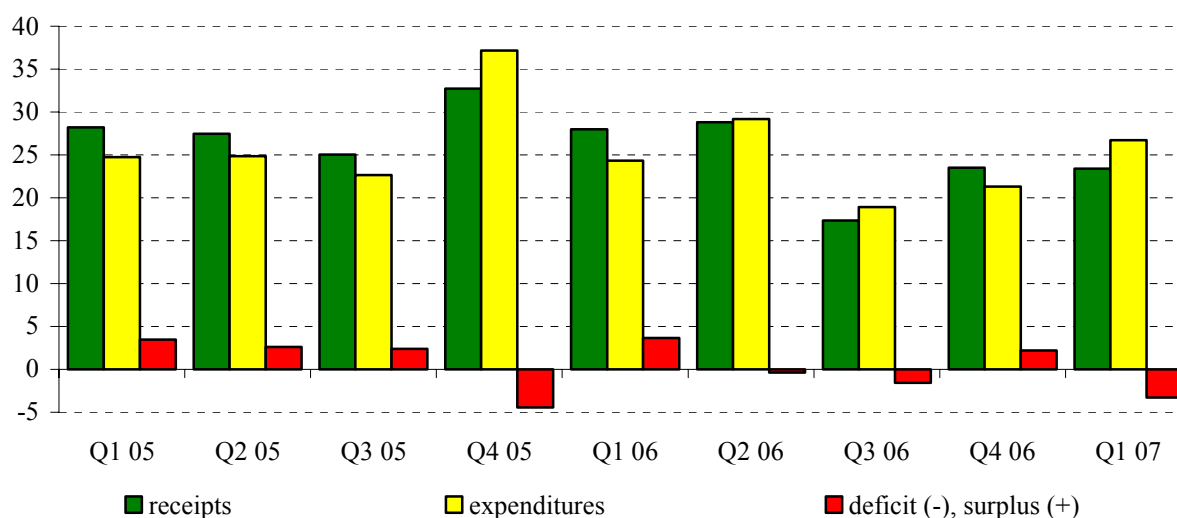
As a result the state budget showed a deficit of T 84.7 billion or 3.3 percent of GDP in Q1 2007, whereas in the same period in 2006 there was a surplus of T 75.0 billion (Figure 10).

Sources for financing the deficit were as follows: receipt of loans—T 21.0 billion, their repayment—T 15.8 billion, and use of available balances of budgetary resources—T 79.5 billion.

Government domestic debt in March 2007 by comparison with December 2006 increased by 5.2 percent to T 398.6 billion and was covered via the issuance of long-term treasury bonds.

External debt of the Government in Q1 2007 declined by 5.1 percent to \$1.7 billion.

Figure 10

Execution of the state budget, as a percentage of GDP

Source: Republic of Kazakhstan Ministry of Finance

Box 1

Change in the mechanism for the operation of the Republic of Kazakhstan National Fund

In accordance with the system previously in operation, the sources for generation of the National Fund were:

- 1) official transfers from the republican budget, as determined by actual receipts to the republican budget from organizations of the raw materials sector in excess of their annual volumes as approved in the law on the republican budget for the corresponding fiscal year. Receipts from organizations of the raw materials sector comprised budget receipts for corporate income tax, VAT, windfall profits tax, bonuses, royalties, and the Republic of Kazakhstan's portion under production sharing for contracts concluded;
- 2) official transfers from the republican budget as determined from receipts from privatization of state property under republican ownership and pertaining to the mining and processing sectors;
- 3) official transfers from the republican budget calculated in the amount of 10 percent of amounts of republican budget receipts planned in the republican budget from organizations of the raw materials sector;
- 4) official transfers from the local budget as determined from receipts from the sale of land plots for agricultural use;
- 5) investment income from management of the National Fund; and

6) other receipts and income not prohibited by legislation of the Republic of Kazakhstan.

Thus, the receipts to the National Fund cited in items 1) - 4) were reflected as both receipts and expenditures of the state budget.

The National Fund, in accordance with the previous system, could make expenditures:

- 1) to compensate losses of the republican budget, determined as the difference between approved and actual amount of receipts to the republican budget from organizations of the raw materials sector for the current fiscal year as a whole;
- 2) in the form of earmarked transfers moved from the National Fund to the republican budget for purposes defined by the President of the Republic of Kazakhstan;
- 3) to cover expenditures associated with management of the National Fund and the conduct of an annual audit.

In accordance with the new system, which went into effect on July 1, 2006, the sources for generation of the National Fund are:

1) budget receipts directed to the National Fund consisting of:

- direct taxes from enterprises of the oil sector, comprising corporate income tax, windfall profits tax, royalties, bonuses, the portion under production sharing, and rent tax on exported crude oil and gas condensate;
- receipts from the privatization of state property under republican ownership and pertaining to the mining and processing sectors; and
- receipts from the sale of land plots for agricultural use;

2) investment income from management of the National Fund; and

3) other receipts and income not prohibited by legislation of the Republic of Kazakhstan.

In addition, these types of receipts are credited directly to the National Fund without being reflected either in the revenue or expenditure portions of the state budget.

The National Fund makes expenditures on the following:

- 1) in the form of a guaranteed transfer from the National Fund to the republican budget for implementation of budgetary development programs (subprograms);
- 2) in the form of earmarked transfers that are moved from the National Fund to the republican budget for purposes defined by the President of the Republic of Kazakhstan;
- 3) to cover expenditures associated with management of the National Fund and the conduct of an annual audit.

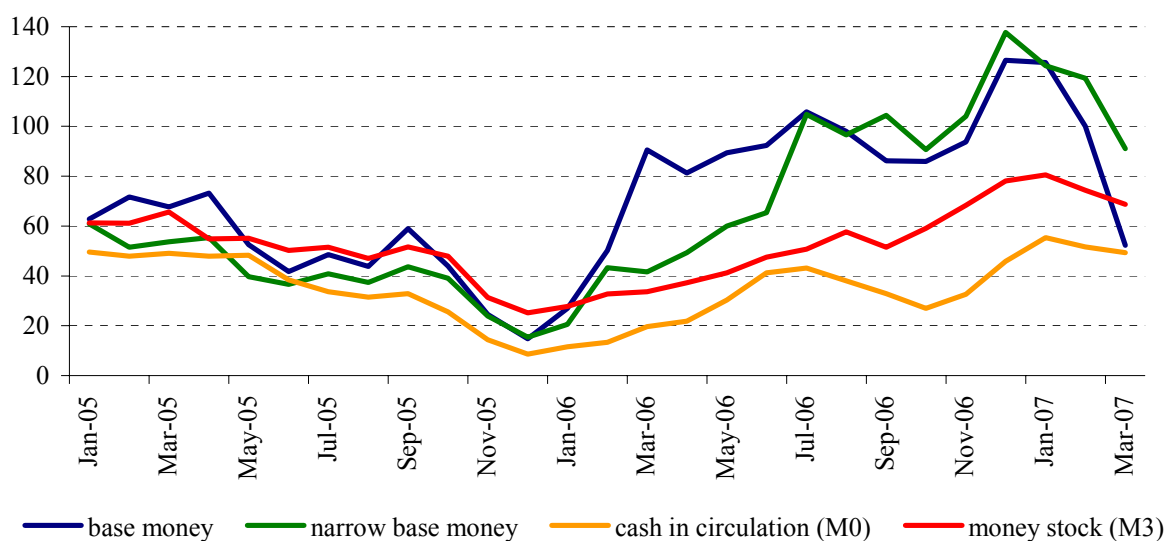
3. Monetary policy

3.1. Money supply

After practically constant growth of money supply indicators during 2006, Q1 2007 showed a trend toward a decline in rates of their growth (Figure 11).

Figure 11

**Dynamics of monetary aggregates
(as a percentage against the same month in the previous year)**



Source: Republic of Kazakhstan National Bank

The factors determining this trend vary depending on the money supply indicator.

3.1.1. Base money

Base money at the end of March 2007 comprised T 1,584.0 billion. During Q1 2007 the expansion of base money comprised 5.5 percent, while in Q1 2006 that rate was much higher—56.9 percent. Narrow base money contracted during Q1 2007 by 6.9 percent.

In March 2007 by comparison with March 2006 base money expanded by 52.2 percent. This expansion resulted from the growth of international reserves of the National Bank, which was not offset by a decline in net domestic assets.

Net international reserves of the National Bank increased in March 2007 by comparison with March 2006 by 94.6 percent to \$21.6 billion. Purchases of foreign exchange by the National Bank on the domestic currency market, despite the performance of operations to replenish assets of the National Fund and service external debt of the Ministry of Finance, led to an increase by a factor of 2.0 of net foreign exchange reserves. Assets in gold increased

by 22.8 percent as a result of operations performed and a 13.6 percent increase in its prices on world markets.

Net domestic assets of the National Bank declined due to an increase in liabilities to banks, chiefly for short-term notes (see 3.3. Monetary policy instruments and operations) and also to a decline in other domestic assets.

A tightening of the mechanism for minimum reserve requirements, which entailed an increase in balances on correspondent accounts of banks with the National Bank and cash in cash departments of banks (Box 2) resulted in an expansion of narrow base money. This expansion in March 2007 by comparison with March 2006 was 91.1 percent (Table 1).

Table 1

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

	Q2 06	Q3 06	Q4 06	Q1 07
Net international reserves	43.3	54.0	156.4	87.5
Net domestic assets	7.2	-1.1	-213.0	-184.1
Net claims on government	31.2	38.4	-357.9	-10.7
Claims on financial institutions	-47.9	-25.6	-236.7	-369.4
Claims on the rest of the economy	-62.5	-87.8	-97.4	-77.9
Other net domestic assets	147.1	-31.7	-49.6	57.0
Base money	92.3	86.2	126.5	52.2
Cash outside the National Bank	40.3	35.6	49.9	54.0
Transferable deposits of banks	207.7	410.2	502.4	200.4
Other deposits of banks	415.5	-40.3	51.5	-17.1
Narrow base money	65.3	104.5	137.8	91.1

Source: Republic of Kazakhstan National Bank

Nonetheless, by comparison with indicators for December 2006, rates of growth of base money and narrow base money in annual terms significantly slowed in March 2007 (Figure 11). The slowdown in growth rates for base money is explained by the slowdown in growth of net international reserves of the National Bank. Within the makeup of narrow base money there was a decline in growth rates for balances on correspondent accounts of banks with the National Bank.

3.1.2. Money stock

During Q1 2007 money stock expanded 7.0 percent (in Q1 2006—12.9 percent) to T 3,935.7 billion. Net external assets of the banking system declined by 48.1 percent, and domestic assets increased by 14.1 percent.

In March 2007 by comparison with March 2006 money stock growth comprised 68.7 percent (Figure 11) as a result of a significant increase in domestic assets of the banking system, while net external assets declined.

Within the structure of net external assets of the banking system, net international reserves of the National Bank increased by 87.5 percent, while net external assets of second-

tier banks declined by a factor of 2.4. The decline in external assets of banks is associated with the substantial increase in liabilities to nonresidents, especially with respect to deposits (by a factor of 3.3) and credits attracted from them (by a factor of 2.2).

The increase in domestic assets of the banking system was the result of continued high growth of volumes of credits provided to the economy (see 3.1.3. Credits to the economy). Claims of the banking system on the government increased significantly due to an increase in securities of the Ministry of Finance in circulation, as well as a decline in balances on accounts of the Ministry of Finance with the National Bank.

The dynamics of the money stock change in annual terms in the last four quarters were determined chiefly by the increase in domestic assets of the banking system at the same time as a decline in their external assets. The sole exception was Q4 2006, when there was a change in the activity of the factors (Table 2).

Table 2

**Dynamics of money stock changes
(as a percentage of the same period of the previous year)**

	Q2 06	Q3 06	Q4 06	Q1 07
Net external assets	-43.5	-80.1	324.3	-35.2
Domestic assets	89.6	115.8	66.3	91.5
Claims on government	96.0	142.0	-168.6	1397.1
Claims on the economy	63.8	80.1	84.1	93.0
Other net domestic assets	-31.1	-43.2	-97.1	-96.9
Money stock	47.6	51.5	78.1	68.7
Cash in circulation	41.2	32.8	45.8	49.3
Deposits of residents	49.2	56.3	86.1	73.2

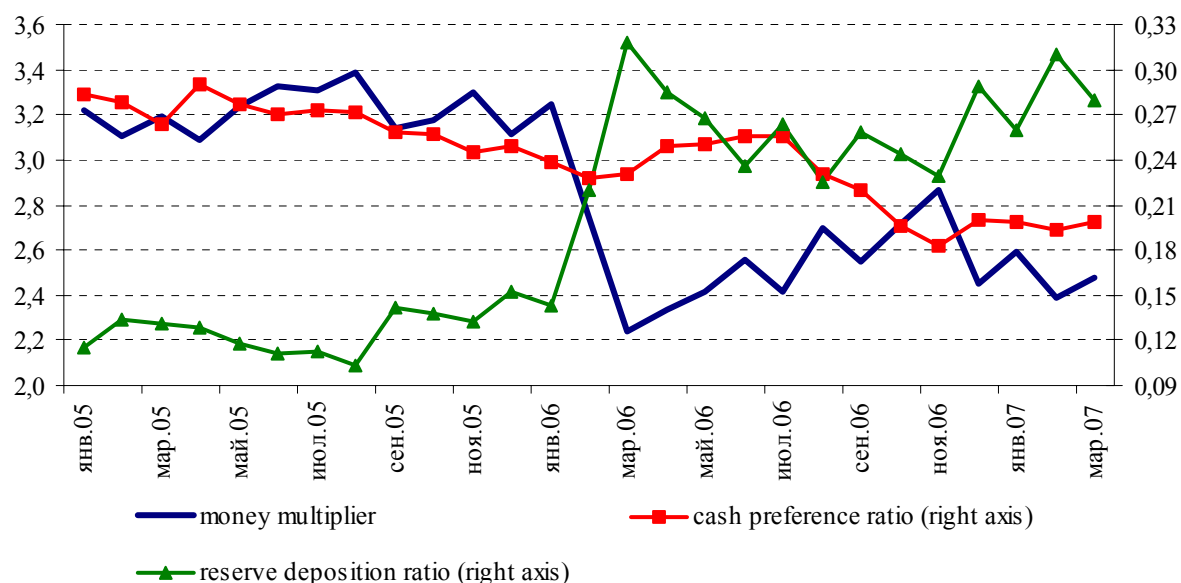
Source: Republic of Kazakhstan National Bank

An analysis of the dynamics of the main components of the money stock—cash in circulation and deposits in the banking system—shows that the prevalent role in the growth of money stock was played by the latter of the aforementioned components. As a result, according to the results for March 2007 the share of deposits of residents within the structure of the money stock increased to 83.4 percent from 81.3 percent in March 2006.

More significant rates of growth of the money stock by comparison with rates of expansion of base money caused an increase in the money multiplier from 2.24 in March 2006 to 2.48 in March 2007 (Figure 12).

Figure 12

Dynamics of the money multiplier and its components



Source: Republic of Kazakhstan National Bank

— **Cash in circulation**

Cash in circulation increased during Q1 2007 by 8.5 percent (in Q1 2006—6.0 percent) and comprised T 652.1 billion at the end of March. In March 2007 by comparison with March 2006 growth of cash in circulation reached 49.3 percent. Such trends indicate that the action of factors which contributed to their growth (increases in wages and pensions, growth of volumes of bank loans issued in cash form, the withdrawal of money from deposits, etc.) prevailed over the action of factors providing for a decrease in cash (increase in volumes of sales by exchange offices of cash foreign currency, receipts from sales of goods, work, and services, etc.)

In Q1 2007 by comparison with Q1 2006, issuances of cash from the cash departments of banks increased by 66.2 percent to T 2,081.0 billion, and receipts to cash departments of banks—by 66.1 percent to T 2,007.4 billion. As a result, the net issuance from cash departments of banks comprised T 73.6 billion (in Q1 2006—T 43.5 billion).

— **Deposits of residents**

As of the end of March 2007 deposits of residents reached T 3,283.5 billion. In Q1 2007 they grew by 6.7 percent. Deposits of legal entities increased by 2.9 percent, and of individuals—by 14.5 percent.

In annual terms deposits increased by 73.2 percent, including balances on deposits of nonbank legal entities—by 67.1 percent and of individuals—by 85.4 percent. By comparison with indicators for the preceding period there was a slowdown in growth rates (Table 3).

Transferable deposits in domestic currency that are used together with cash in circulation for calculating the M1 monetary aggregate demonstrated relatively low growth

indicators, which had a corresponding affect on indicators for growth of the M1 aggregate (Figure 13).

Table 3

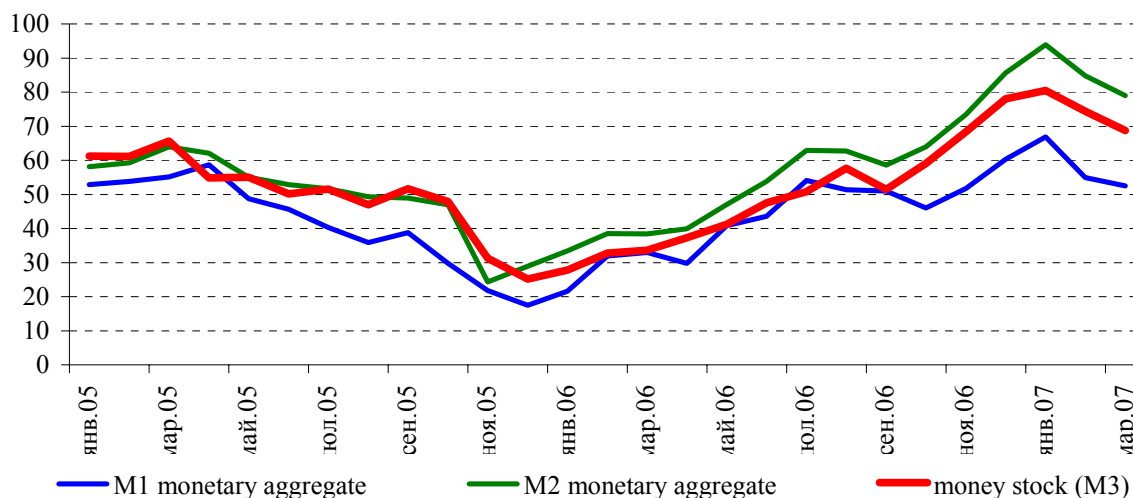
**Dynamics of changes in resident deposits
(as a percentage of the same period of the previous year)**

	Q2 06	Q3 06	Q4 06	Q1 07
Resident deposits	49.2	56.3	88.4	73.2
Transferable tenge deposits	46.1	71.2	77.1	55.4
of the population	42.5	73.5	75.4	66.9
of nonbank legal entities	69.8	57.1	77.3	53.6
Other tenge deposits	84.1	77.4	134.1	126.1
of the population	87.1	63.7	137.0	143.6
of nonbank legal entities	80.9	94.3	131.7	112.5
Transferable foreign currency deposits	-1.9	28.7	53.6	12.5
of the population	-2.5	30.7	20.5	33.7
of nonbank legal entities	1.5	16.4	59.8	9.2
Other foreign currency deposits	29.1	33.1	57.9	38.0
of the population	45.2	36.7	22.7	20.7
of nonbank legal entities	8.5	27.3	87.6	50.3

Source: Republic of Kazakhstan National Bank

Figure 13

**Dynamics of M1 and M2 monetary aggregates and the M3 money stock
(as a percentage against the same month in the previous year)**



Source: Republic of Kazakhstan National Bank

Other deposits in domestic currency, despite a decline in Q1 2007 of growth indicators in annual terms by comparison with growth indicators in Q4 2006, continue to demonstrate high growth dynamics. As a consequence, the M2 monetary aggregate is also characterized by

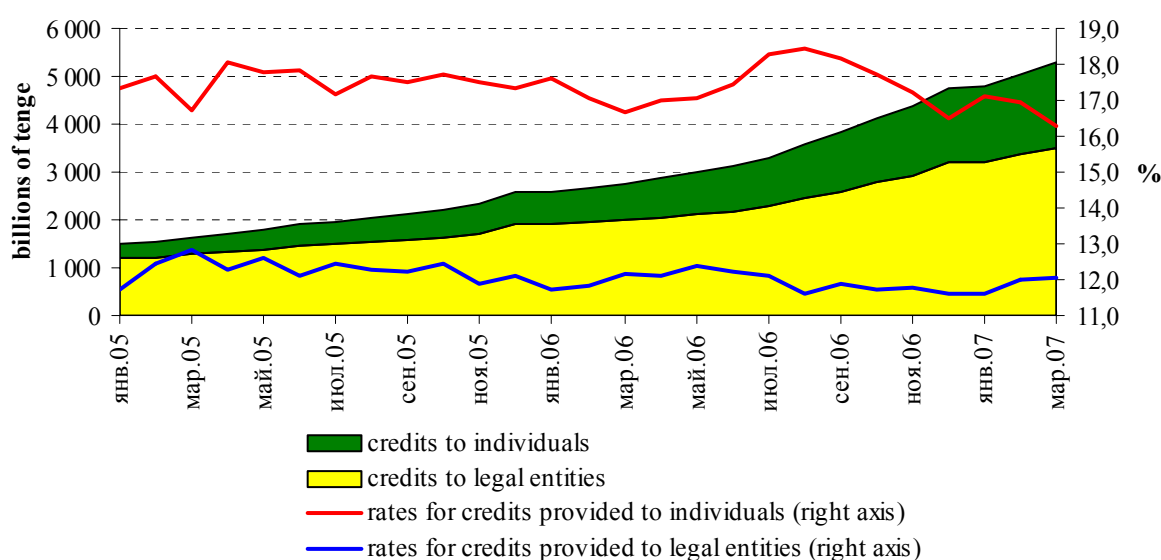
the largest growth indicators among the monetary aggregates, even despite low growth indicators for transferable deposits in foreign currency.

3.1.3. Credits to the Economy

The high rates of credit expansion of second-tier banks in the economy of Kazakhstan were maintained in Q1 2007. During this period credits to the economy increased by 12.4 percent and reached T 5,272.4 billion. Credits to the population grew by 16.3 percent, and to legal entities—by 8.9 percent. Nonetheless, in March 2007 credits to legal entities comprised 66.0 percent of the volume of credits to the economy (Figure 14).

Figure 14

Dynamics of credits to the economy and interest rates on them



Source: Republic of Kazakhstan National Bank

In March 2007 by comparison with March 2006 credits to the economy grew by 92.9 percent, including credits to legal entities—by 75.8 percent and to individuals—by a factor of 2.4.

Interest rates on credits issued in Q1 2007 demonstrated trends in varying directions. The weighted average rate for credits to legal entities increased from 11.6 percent in December 2006 to 12.1 percent in March 2007. The weighted average rate for credits to individuals fell from 16.5 percent in December 2006 to 16.3 percent in March 2007 (Figure 14).

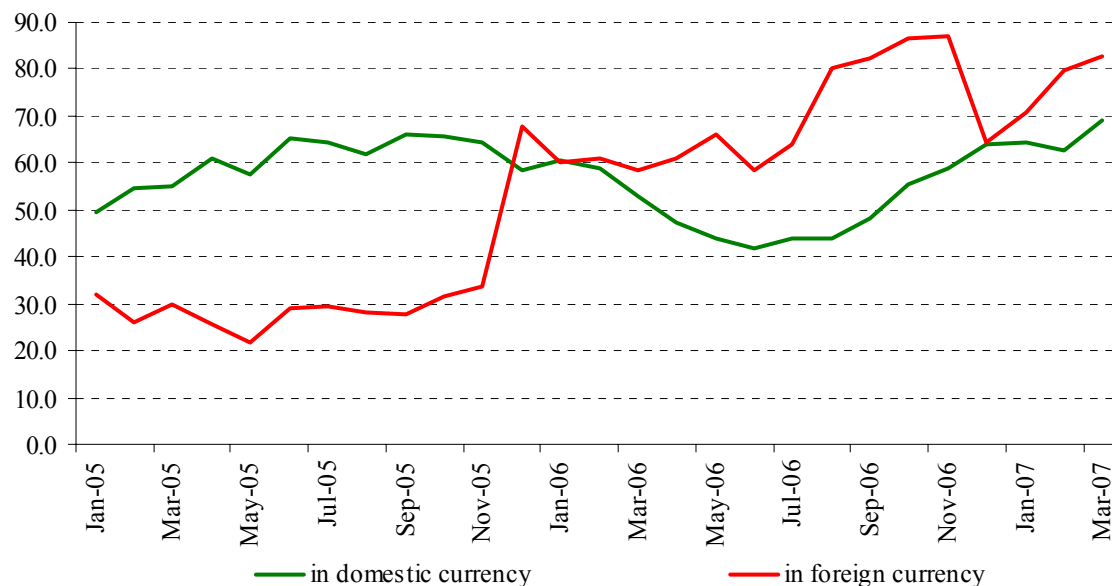
— Credits to legal entities

In March 2007 by comparison with March 2006 credits to legal entities grew by 75.8 percent.

The trend of growth rates of credits in foreign currency outpacing growth of credits in domestic currency that has been noted since the beginning of 2006 was maintained in Q1 2007 (Figure 15).

Figure 15

**Dynamics of credits to legal entities
(as a percentage of the same period in the previous year)**



Source: Republic of Kazakhstan National Bank

The proportion of medium- and long-term credits within the volume of credits to legal entities at the end of March 2007 was 66.9 percent (at the end of 2006—63.0 percent).

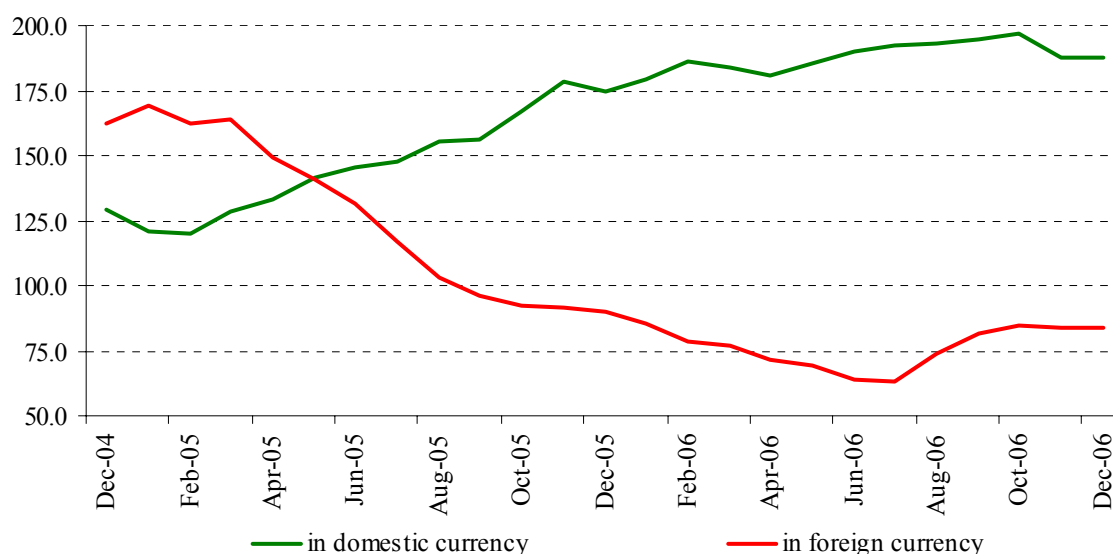
Within the structure of credits to legal entities, the largest share at the end of March 2007 consisted of credits for acquisition of working capital (47.8 percent), capital stocks (15.8 percent), and new construction and reconstruction of facilities (14.3 percent).

— **Credits to the population**

The annual increase in the dynamics of credits to the population was a factor of 2.4; within those dynamics, credits in the domestic currency are demonstrating higher rates of growth. In March 2007 by comparison with March 2006 credits to the population in the domestic currency increased by a factor of 2.9, whereas credits in foreign currency increased by 90.8 percent (Figure 16).

Figure 16

**Dynamics of credits to the population
(as a percentage of the same period in the previous year)**



Source: Republic of Kazakhstan National Bank

Within the structure of credits to the population, credits for consumer goals occupied 92.9 percent in March 2007. The proportion of credits to the population for construction and acquisition of housing was 34.4 percent in March 2007.

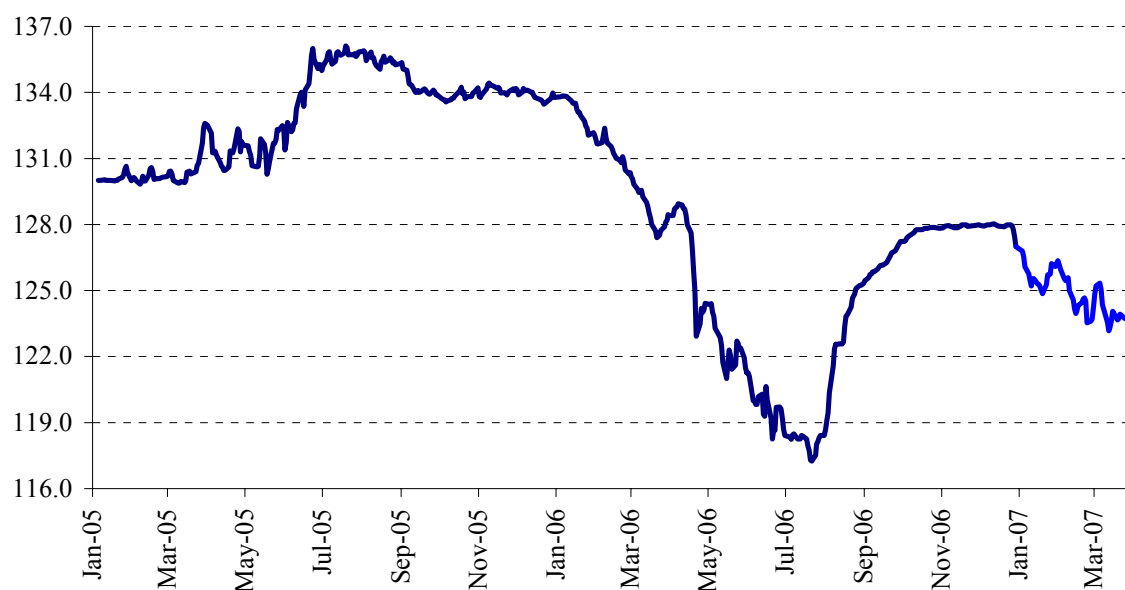
3.2. Exchange rate

In Q1 2007 the situation on the domestic currency market was characterized by a strengthening of the tenge’s exchange rate against the U.S. dollar. Altogether, based on results for the quarter, the exchange rate of the tenge appreciated against the U.S. dollar by 2.5 percent—from T 127.0 per dollar to T 123.84 per dollar.

The weighted average exchange rate of the tenge for Q1 2007 was T 124.87 per dollar, having strengthened by 2.3 percent by comparison with the indicator for Q4 2006. During the quarter the tenge changed against the dollar within a range from T 123.17 – T 126.79 per dollar (Figure 17).

Figure 17

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



Source: Republic of Kazakhstan National Bank

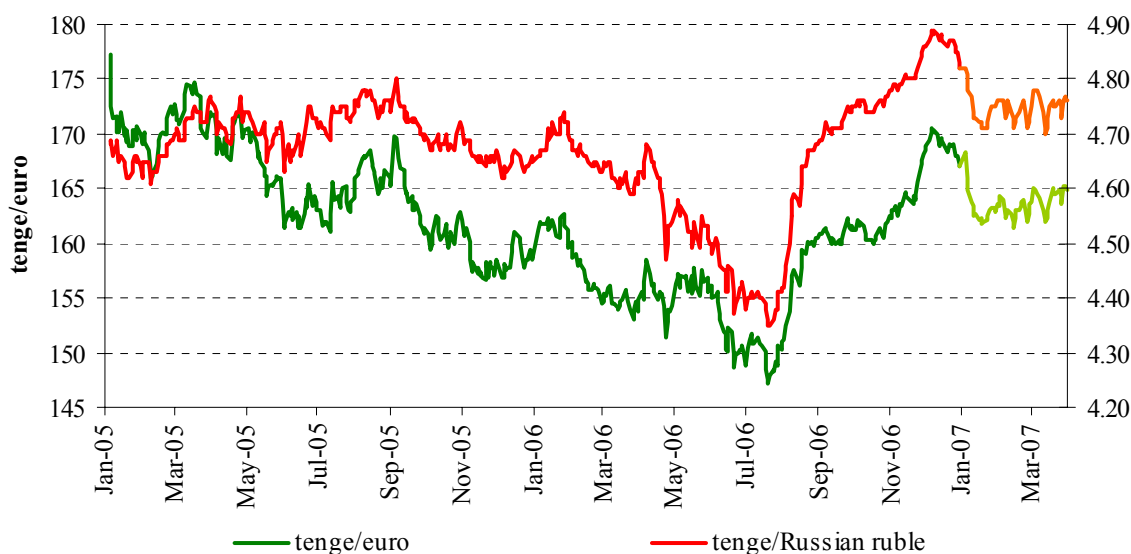
There was a significant nominal appreciation of the tenge against the U.S. dollar in February (1.7 percent), while in January and March the tenge appreciated only 0.5 percent and 0.3 percent respectively.

Given that volumes of transactions with Russian rubles on the exchange segment of the domestic currency market remains insignificant, and that no transactions were carried out with the euro at all in Q1 2007, the exchange rate of the tenge against those currencies is calculated on the basis of a cross-rate against the U.S. dollar. Correspondingly, the dynamics of the tenge exchange rate against the euro and the Russian ruble were determined by the dynamics of the tenge exchange rate against the U.S. dollar, the position of the single European currency on the international financial market, and policy of the Central Bank of Russia with respect to the exchange rate of the Russian ruble against a basket of currencies.

During Q1 2007 the official tenge exchange rate against the euro and the Russian ruble appreciated by 1.3 percent and 1.2 percent respectively (Figure 18).

Figure 18

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



Source: Republic of Kazakhstan National Bank

During Q1 2007 the situation on the internal currency market was determined by the situation on global foreign exchange markets, continued inflows of foreign exchange proceeds, and large volumes of operations on the currency sector of the stock and interbank markets, which created the prerequisites for foreign currency supply in excess of demand. In addition, despite the decline in Q1 of the participation of second-tier banks in the process of attracting external borrowings, that factor remains a significant source of supply of foreign currency on the domestic currency market. Thus, in Q1 2007 the increase in liabilities of second-tier banks to nonresidents was \$4.8 billion (during Q4 2006—\$8.6 billion).

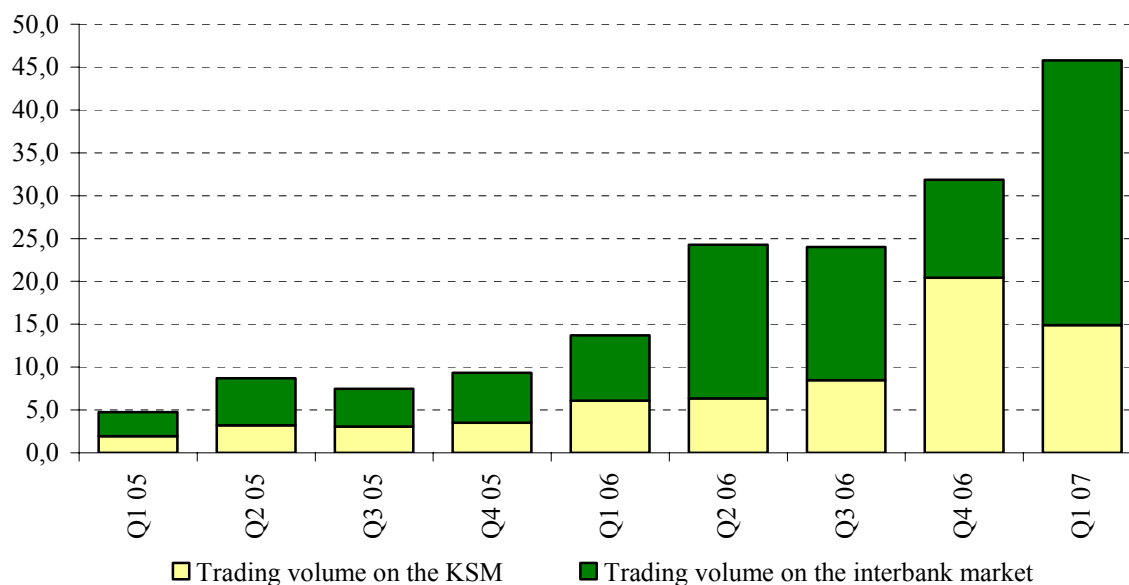
In addition, in January 2007 the domestic currency market was to a great degree influenced by internal factors. Thus, in January the situation on the global foreign exchange market, as opposed to the domestic currency market, was characterized by a strengthening of the dollar (the U.S. dollar appreciated 1.6 percent against the euro). In February and March the dynamics of the U.S. dollar on the domestic market practically corresponded to its dynamics on the global foreign exchange market (in February and March the U.S. dollar weakened against the euro by 2.0 percent and 0.8 percent respectively).

In Q1 2007 large volumes of trading took place on the currency sector of the Kazakhstan Stock Market [KSM] and on the interbank currency market, which may indicate investors' negative attitude toward the U.S. currency and a speculative mood on the part of market participants. Thus, the total volume of trading on the domestic currency market was \$45.8 billion, which was a 43.8 percent increase by comparison with Q4 2006.

The volume of exchange trading in dollar positions on the Kazakhstan Stock Market declined by 27.2 percent by comparison with Q4 2006 and comprised \$14.9 billion (the net volume of trading on the Kazakhstan Stock Market was about 70 percent of gross volume). On the over-the-counter currency market, the volume of operations in Q1 2007 increased by comparison with the previous quarter by a factor of 2.7 and comprised \$30.9 billion (Figure 19).

Figure 19

Volume of trading on the domestic currency market, billions of U.S. dollars



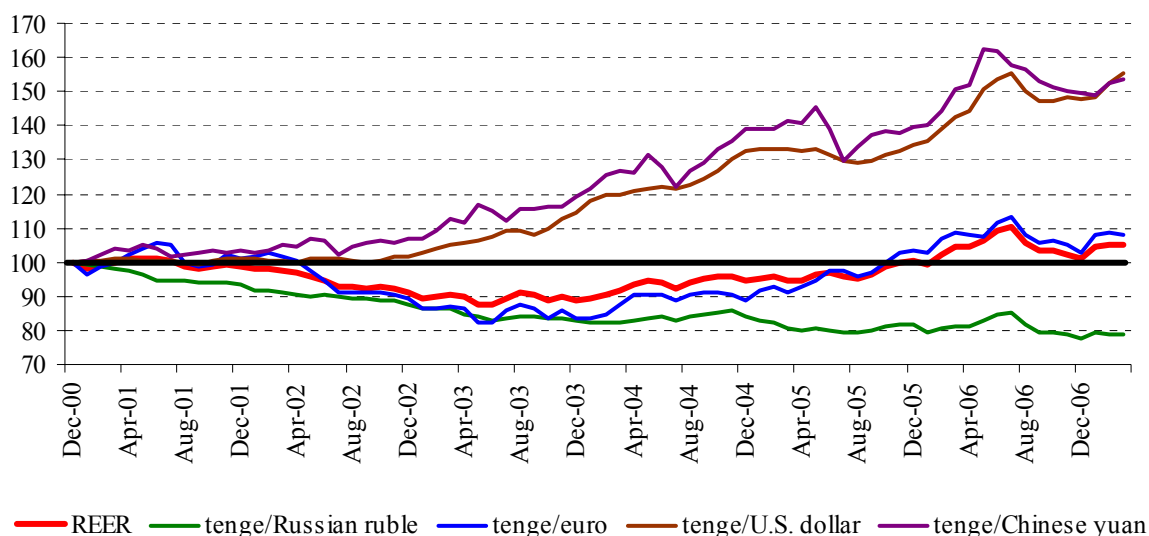
Source: Republic of Kazakhstan National Bank

Based on results for Q1 2007, the index of the real effective exchange rate (REER) for the tenge and the indices of the real exchange rate of the tenge against the main currencies increased. Thus, the REER index for the tenge increased by 4.2 percent. In addition, the tenge appreciated against a basket of CIS country currencies by 2.0 percent and against a basket of currencies of all other countries—by 5.2 percent.

During Q1 2007 the tenge appreciated in real terms by 4.6 percent against the U.S. dollar, by 4.9 percent against the euro, by 1.6 percent against the Russian ruble, and by 4.8 percent against the Chinese yuan (Figure 20).

Figure 20

**Indices of real exchange rates of the tenge
(December 2000 = 100 percent)**



Source: Republic of Kazakhstan National Bank

3.3. Monetary policy instruments and operations

In the current year the National Bank has significantly reduced its participation in the currency market. According to results for Q1 2007 the National Bank's participation ratio on the KSM was 20.4 percent. In January the National Bank was a net purchaser, and in February and March it was a net seller of foreign currency.

In addition, in Q1 2007 the National Bank purchased \$928.1 million in foreign currency for National Fund purposes.

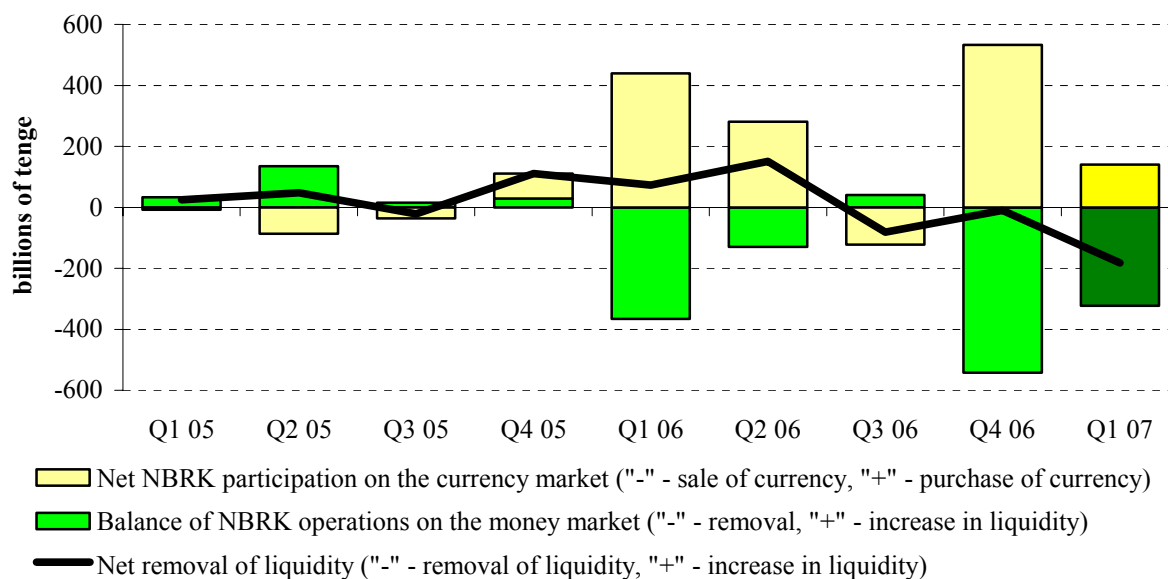
With the aim of regulating inflation, the National Bank carried out operations to sterilize excess liquidity by issuing short-term notes and attracting deposits from the banking sector (see 3.3.2. Open market operations and 3.3.3. Standing mechanisms).

Beginning from March 1, 2007, the National Bank started issuing notes with a maturity of up to 1 year (prior to March 1 notes were only issued with a maturity of 28 days). Notes will be issued with maturities of 28 days (1 month), 91 days (3 months), 182 days (6 months), and 365 days (1 year). In Q1 2007 notes were issued with maturities of 28, 91, and 182 days.

For Q1 2007 as a whole, the sum total of National Bank operations on the financial market was the removal of liquidity (Figure 21).

Figure 21

Balance of National Bank operations on the domestic market



Source: Republic of Kazakhstan National Bank

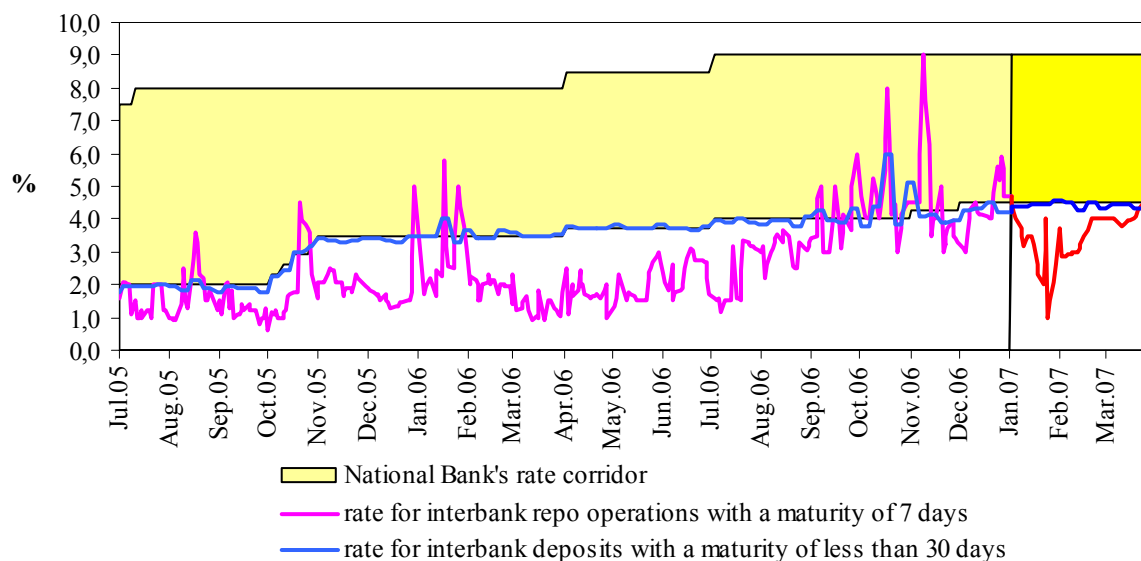
In Q1 2007 the National Bank continued its efforts to improve the effectiveness of use of monetary operations, further strengthen the influence of its measures on the status of the money market, and coordinate rates for the various types of its monetary policy tools.

Effective January 1, 2007 the rate for deposits attracted from banks was established at the level of half of the official refinancing rate. In addition, the official refinancing rate was maintained at its previous level of 9.0 percent. Thus, the National Bank's rate corridor currently comprises 4.5 percentage points (the upper limit is the official refinancing rate and the lower limit is the rate for deposits attracted from banks).

In Q1 2007 there was some decline in yield on the money market for operations that are comparable in terms of maturity. On average, their level for this period was lower than the National Bank's rate for deposits attracted from second-tier banks. The weighted average rate for interbank deposits with maturities up to 30 days in Q1 2007 was at the level of 4.4 percent (in Q4 2006—4.7 percent). The weighted average rate for interbank repo operations with a maturity of 7 days was 3.1 percent (in Q4 2006—5.34 percent). (Figure 22).

Figure 22

Limits of the National Bank's rate corridor

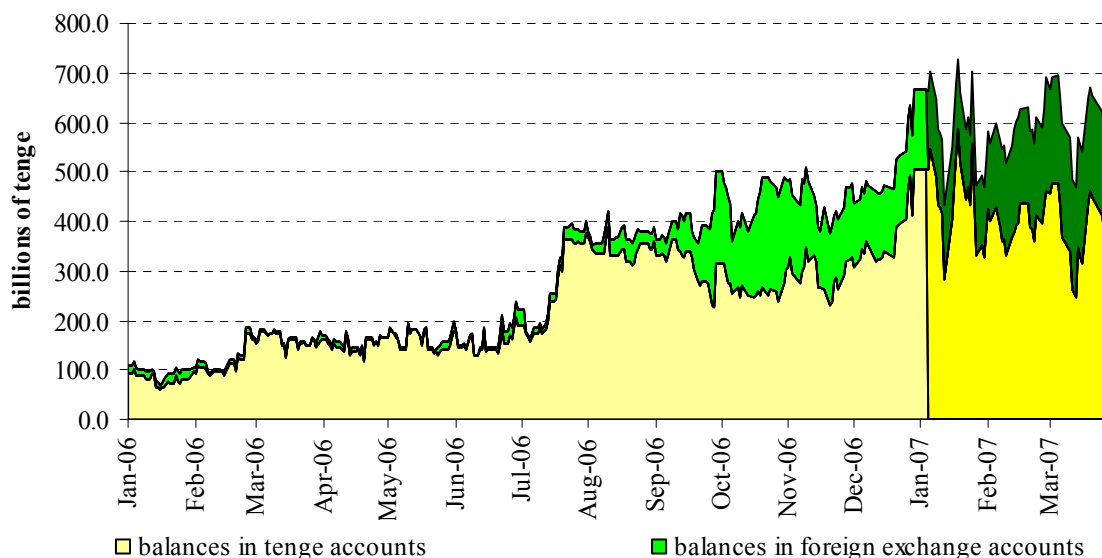


Source: Republic of Kazakhstan National Bank

In Q1 2007 there was an increase in balances on correspondent accounts of second-tier banks with the National Bank in foreign currency. Balances on correspondent accounts in domestic currency in this period demonstrated a declining trend (Figure 23).

Figure 23

Balances on correspondent accounts of banks with the National Bank



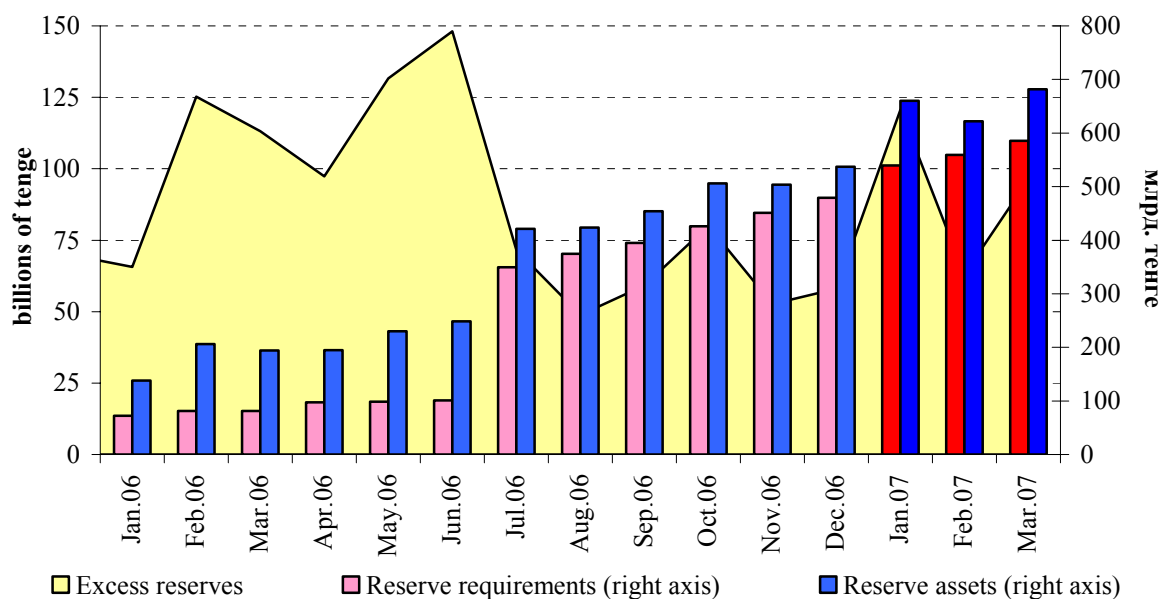
Source: Republic of Kazakhstan National Bank

3.3.1. Minimum reserve requirements

As a result of the change to the mechanism for generating and meeting minimum reserve requirements effective July 12, 2006, beginning with the second half of 2006 there was a significant reduction of excess liquidity of second-tier banks. As a whole, the situation in the banking sector is characterized by relative stabilization despite the fact that in Q1 2007 it increased slightly by comparison with Q4 2006. As an average for January–March 2007, reserve assets exceeded the necessary volume of reserve deposition by 19 percent (in Q4 2006—by 15 percent) (Figure 24).

Figure 24

Achievement of minimum reserve requirement norms



Source: Republic of Kazakhstan National Bank

Box 2

Procedure for the generation and achievement by second-tier banks of minimum reserve requirements

The structure of a bank’s liabilities that are used for calculating minimum reserve requirements shall include the amount of the bank’s domestic liabilities and the bank’s other liabilities. A bank’s domestic liabilities are defined as the amount of liabilities to residents according to a strictly defined list regardless of their maturity. A bank’s other liabilities are calculated as the amount of the bank’s liabilities to nonresidents and liabilities for debt-based securities regardless of residency designation.

When recording reserve liabilities (both for domestic and for other liabilities), the calculation shall include the amount of the bank’s liabilities with respect to principal, interest, and arrears.

The period for determination of minimum reserve requirements shall comprise 14 calendar days and begin from the first Tuesday of the week and end with the last Wednesday of the 14-day period for determination of minimum reserve requirements.

Minimum reserve requirement norms shall be met via the generation by banks of reserve assets, which shall include cash tenge in the cash department and money on correspondent accounts with the National Bank in domestic and freely convertible foreign currencies.

The bank shall place money in reserve assets in such a fashion that the average amount of the reserve assets during the period of generation of reserve assets will not be less than the average amount of the minimum reserve requirements for the period of determination of minimum reserve requirements.

The period of generation of reserve assets shall comprise 14 calendar days and shall begin from the first Thursday of the week in which a period for determination of minimum reserve requirements begins and end on the Wednesday of the week in which a period for determination of minimum reserve requirements ends.

The minimum reserve requirement norms for second-tier banks are at 6 percent for a bank's domestic liabilities and 8 percent for a bank's other liabilities.

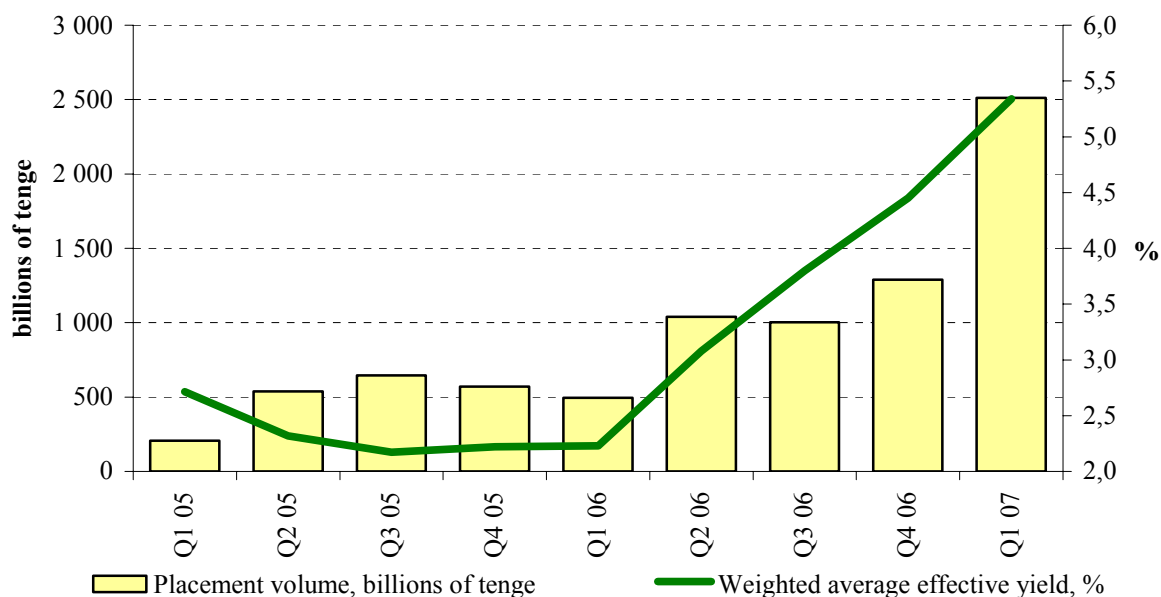
This mechanism has been in operation since July 12, 2006.

3.3.2. Open market operations

In Q1 2007 placement of short-term notes of the National Bank reached the latest historic quarterly maximum and comprised T 2,511.2 billion, or 94.7 percent more than the volume for the preceding quarter. The notes were issued with a maturity of 28, 91, and 182 days. The weighted average yield for the placed notes increased from 4.45 percent in Q4 2006 to 5.34 percent in Q1 2007 (Figure 25).

Figure 25

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

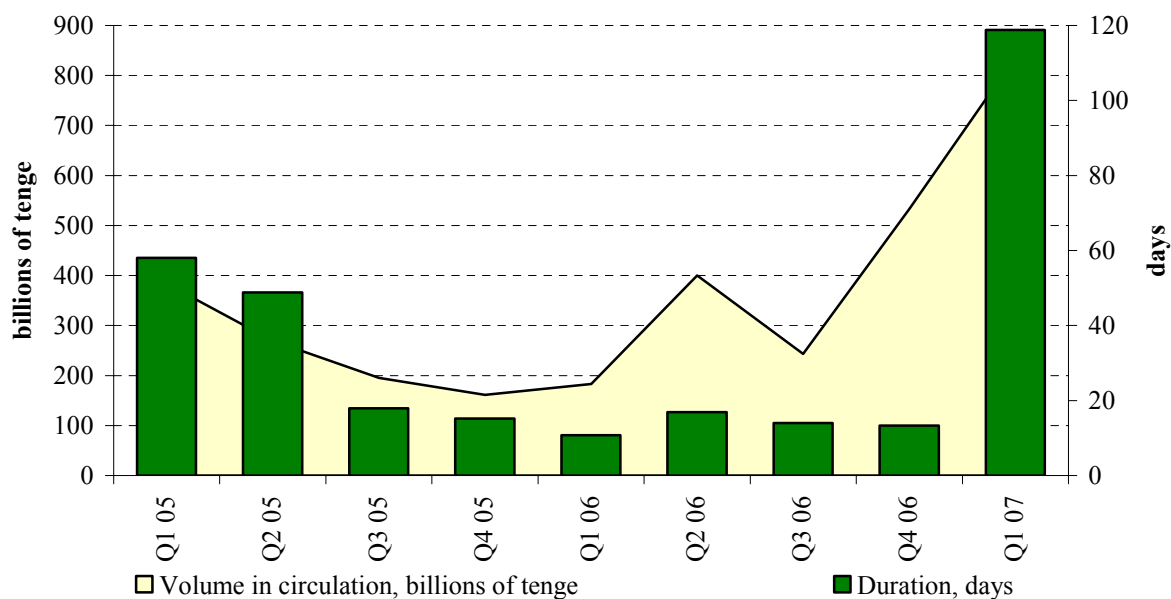


Source: Republic of Kazakhstan National Bank

At the end of March 2007 the volume of short-term notes in circulation was T 837.5 billion, which is 57.1 percent more than the volume at the end of Q4 2006. The duration of notes in circulation at the end of March 2007 increased to 119 days (Figure 26).

Figure 26

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



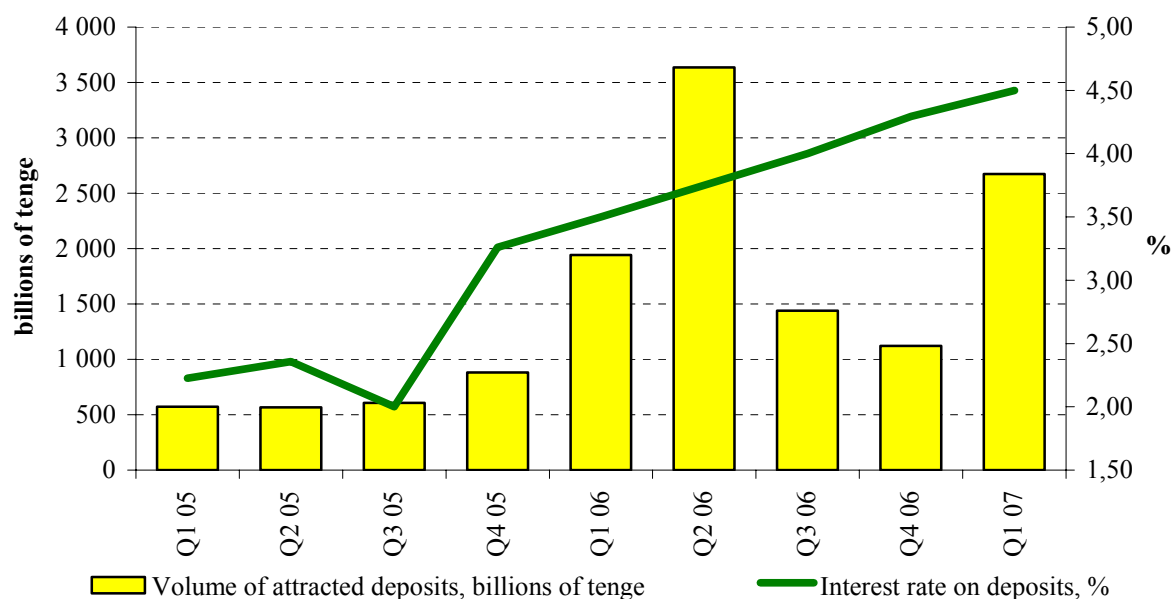
Source: Republic of Kazakhstan National Bank

3.3.3. Standing mechanisms

In Q1 2007 the National Bank attracted T 2,672.6 billion in deposits from second-tier banks, which is more by a factor of 2.4 than the volume for Q4 2006. The period of attraction of deposits was 7 days, and the weighted average rate on them was 4.5 percent (Figure 27).

Figure 27

Volume and interest rates for deposits attracted by the National Bank

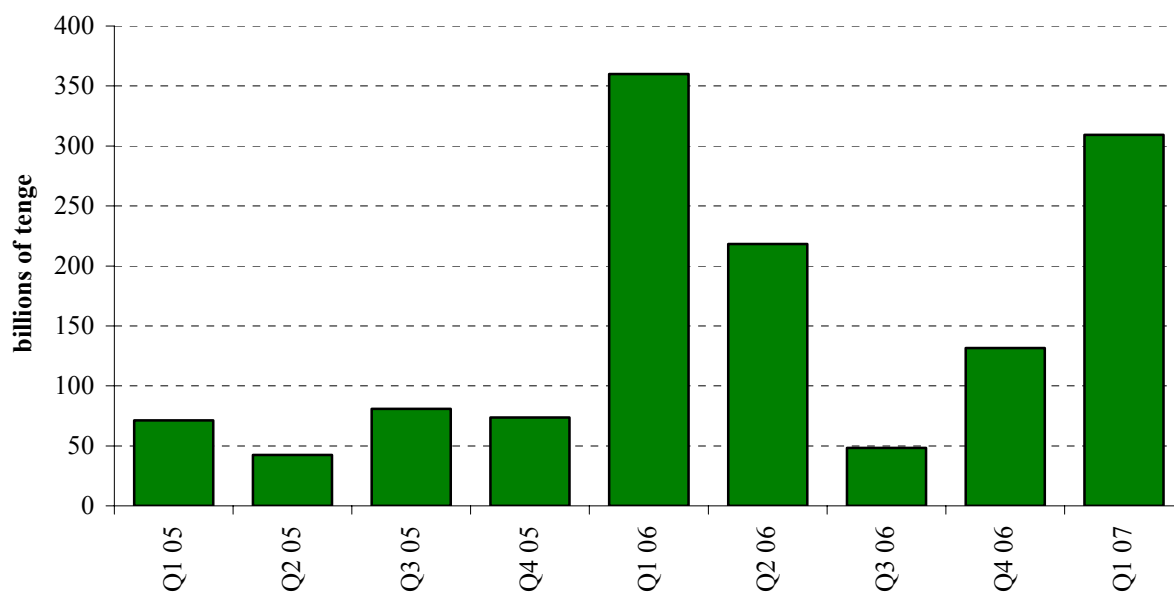


Source: Republic of Kazakhstan National Bank

As a result of the increase in volumes of attraction of deposits from second-tier banks in Q1 2007, the volume of unpaid liabilities of the National Bank with respect to them increased by a factor of 2.4 to T 309.2 billion (Figure 28).

Figure 28

**Volume of unpaid liabilities of the National Bank for deposits attracted from second-tier banks
(at the end of the period)**



Source: Republic of Kazakhstan National Bank

4. Inflation forecast

4.1. Estimated inflation forecast for Q1 2007

The actual level of inflation in Q1 2007 (2.6 percent) matches the forecast for that period (2.6–2.8 percent) published in the previous issue of the “Inflation Survey.” In January the actual level of inflation was at the forecast level, and in February and March inflation was lower than estimated.

In Q1 2007 inflation was caused by an increase in prices for foodstuffs and paid services to the population. Within their structure, the greatest increase in prices occurred for fruits and vegetables, medical services, housing and communal services, and transportation services.

Although an increase in prices for fruits and vegetables is traditional for this time of the year and was expected, the increase in prices and tariffs for services was first and foremost caused by the activities of monopolist enterprises.

In the meantime, the decline in the degree of influence of such factors as growth of aggregate demand, inflows of foreign capital, and imports on inflation contributed to a slowdown in the rate of increase of consumer prices.

The actual level of inflation in annual terms at the end of March 2007 also corresponded to the forecast for that period as indicated in the previous issue of the “Inflation Survey.” Thus, in March 2007 annual inflation was at the level of 7.8 percent compared to a forecast of 7.8–8.0 percent.

4.2. Inflation forecast for 2007

Even though in 2007 significant inflows of foreign capital to the country and also high liquidity of the domestic financial market will retain their influence on development of the country's economy, with respect to results for 2007 inflation will be at a lower level by comparison with indicators for 2006.

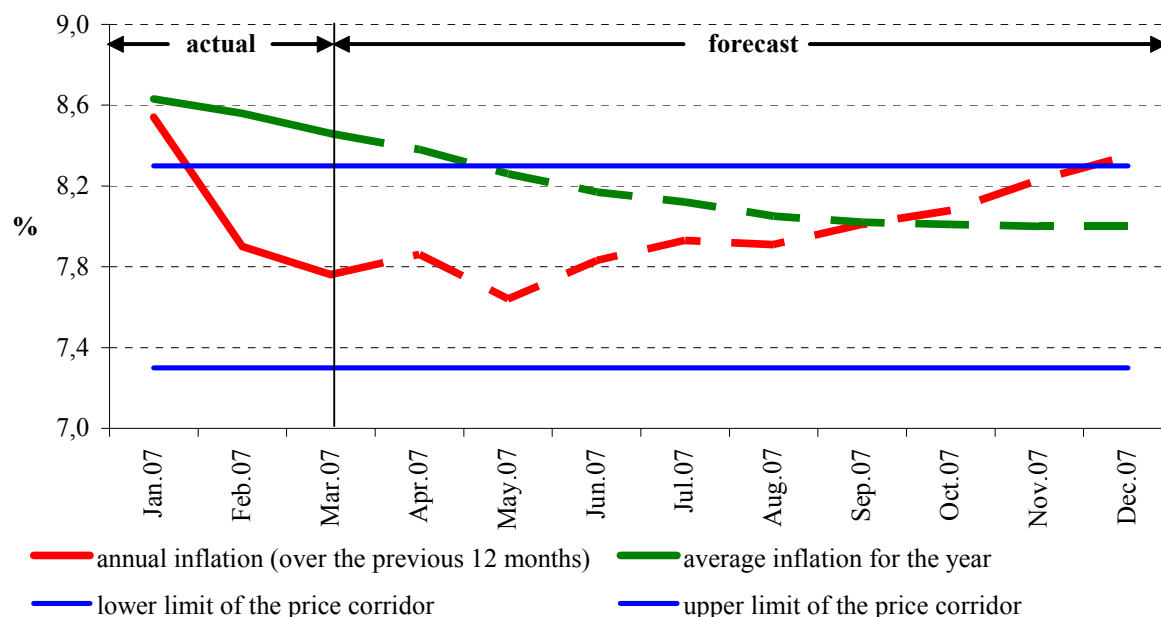
In accordance with the Guidelines for Monetary Policy of the National Bank for 2007–2009, three scenarios have been developed for economic development incorporating a high degree of dependence of the state of the economy on prices for energy resources, especially oil, and inflows into the country of capital: "moderate prices for oil and moderate capital inflows," "moderate prices for oil and high capital inflows," and "high prices for oil."

In accordance with the "moderate prices for oil and high capital inflows" scenario, the inflation forecast for 2007 has been determined in the range of 7.3–8.3 percent as an average for the year (Figure 29).

To achieve these inflation targets, the Guidelines also define monetary policy measures for 2007, including measures to tighten policy.

Figure 29

Inflation, actual and forecast in 2007



Source: Republic of Kazakhstan National Bank

The main tools for regulating interest rates on the financial market and for sterilizing excess liquidity of banks in 2007 remain short-term notes and deposits of second-tier banks with the National Bank.

To ensure stability of the banking system, improvements will be made in the mechanism for providing bank loans, repo operations, and rediscounting operations; in particular, work will be carried out to expand the list of collateral instruments. In addition, in order to strengthen the effectiveness of use of tools to provide liquidity (such as refinancing loans and rediscounting of bills of exchange), we will review opportunities for unifying their maturity.

We will continue working to monitor enterprises of the real sector for the purpose of generating estimates of development trends and directions for the sector of nonfinancial corporations, the current economic situation, and the financial state of enterprises, and also for the purpose of expanding the practical application of monitoring results in the activities of the National Bank with respect to determining interest rate and foreign exchange policy, establishing minimum reserve requirement norms, and generating financial stability reports.

In addition, in 2007 we expect to pursue a comprehensive anti-inflation policy jointly with the Government and the local executive authorities.

In particular, Directive of the Prime Minister of the Republic of Kazakhstan No. 370-r dated December 29, 2006 approved an Action Plan To Regulate Inflation Processes in the Republic of Kazakhstan for 2007–2008.

In accordance with the Plan, the government and local executive authorities will monitor price increases for goods and services of natural monopolies within the framework of

medium-term tariff schedules, monitor price-setting for goods and services of entities that dominate their market, carry out measures to halt price collusion and unfair competition, and create conditions for the development of competitive internal markets and a reduced number of intermediaries in the market.

At the local level we will continue efforts to establish a network of wholesale and retail markets, develop the trade infrastructure, and saturate the domestic market with products. We will assess the work done by local executive authorities with respect to restraining price increases at the regional level.

4.2.1. Inflation forecast for Q2 2007

In Q2 2007 the trend toward stabilization of inflationary process on the consumer market will continue. This will contribute to a decline in inflation by comparison with the previous quarter to the level of 1.6–1.8 percent (in Q2 2006—1.6 percent). Annual inflation at the end of June 2007 is forecast at 7.8–8.0 percent.

A slowdown in the inflation growth rate will occur due to a certain degree by a seasonal factor that should slow down growth in prices on certain commodity markets (fruits and vegetables, eggs, dairy products, etc.). In the meantime, in conjunction with the start of seasonal agricultural work, we expect price increases on fuels and lubricants during that period.

We expect that inflation will remain at last year's level because certain factors will have a negative influence on inflation in the future as well. Among these factors we would like to emphasize the increase in prices for services and goods of monopolist enterprises, inflows into the country of foreign capital, and high credit activity of the banking sector.

At the same time measures undertaken by the National Bank in 2006 and Q1 2007 will to a certain degree help slow inflation. In particular, the National Bank has increased volumes of its operations and also increased the maturities of short-term notes to one year.

4.2.1. Inflation forecast for Q3 2007

As a rule, the lowest inflation rate for the whole year is observed in the summer period. The situation on the consumer market in July–September is largely influenced by seasonal factors. This in turn leads to a decline in prices for certain types of foodstuffs (fruits and vegetables, meat and dairy products, etc.) At the same time one notes an increase in charges for certain services to the population (services of educational institutions).

The implementation of the National Bank's comprehensive anti-inflation policy together with central and local executive authorities will help restrain inflation to a stable level.

The inflation forecast for Q3 2007 is 1.0–1.2 percent, and based on results for September 2007 inflation in annual terms is expected at the level of 7.9–8.1 percent.