

National Bank of the Republic of Kazakhstan

**Inflation Survey
for the Fourth Quarter of 2005**

Contents

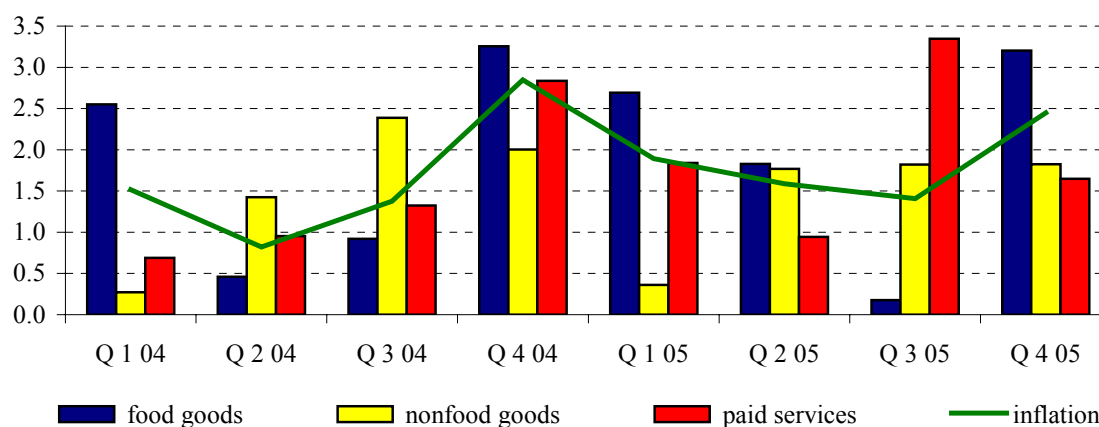
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1. Inflation

a. Consumer Prices

Seasonal acceleration of growth of prices on the consumer market compared to the preceding quarter was observed in the fourth quarter of 2005, although compared to the same period of the past year, inflation decreased negligibly. Thus, according to the results for the fourth quarter of 2005, growth of consumer prices reached 2.4 percent (Figure 1).

**Figure 1. Dynamics of Inflation and Its Components
(Percent of Preceding Period)**



Source: Republic of Kazakhstan Statistical Agency

Growth of prices of food goods in the fourth quarter of 2005 came to 3.2 percent. Characteristically for this period, prices increased for eggs, meat and dairy products, fruit and vegetable products, fish, and seafood.

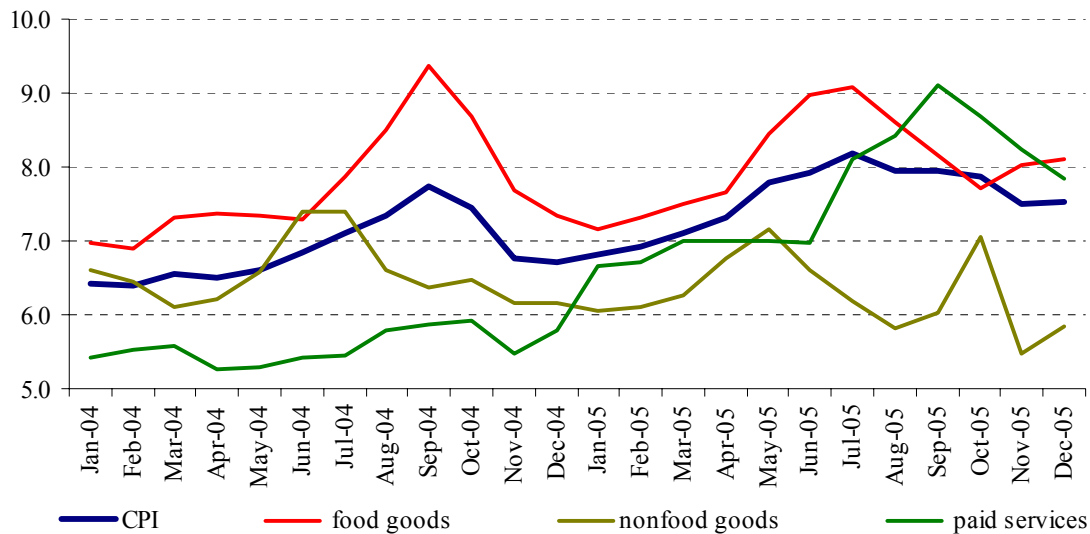
Nonfood goods grew 1.8 percent more expensive in the period of analysis. A decrease in gasoline prices was a typical feature, at the same time that price increases were recorded for clothing and footwear, personal hygiene products, fabrics, furniture, and household goods.

Growth of prices and tariffs for paid services to the public reached 1.6 percent in the fourth quarter of 2005. The dynamics of the prices of housing and municipal services were governed by increases in the cost of housing maintenance and gas supply services, while the prices of all other services remained unchanged during the quarter. Besides that, the services of cultural, educational, transportation, and health care services grew more expensive.

Inflation in 2005 as a whole established itself in annual terms (December 2005 compared to December 2004) at 7.5 percent (6.7 percent in 2004). Growth of consumer prices was brought about mainly by an increase in cost of food goods and paid services to the

public -- 8.1 percent and 8.0 percent respectively, while nonfood goods grew 5.9 percent more expensive (Figure 2). The greatest price increases in 2005 were recorded for fruits and vegetables (23.1 percent), gas supply services (34.5 percent), educational services (19.5 percent), rice (18.3 percent), meat products (12.5 percent), and sugar (11.9 percent).

**Figure 2. Dynamics of Inflation and Its Components
(Percent of Same Month of Preceding Year)**



Source: Republic of Kazakhstan Statistical Agency

The dynamics of consumer prices in the fourth quarter of 2005, and those of the entire year as well, were the product of the influence of a number of micro- and macroeconomic factors. Many are long-term factors -- that is, they impact the consumer market over the course of several years. Besides that, these factors have a dual nature: on one hand they reflect the positive dynamics of Kazakhstan's economic development, although on the other hand they make it more difficult to pursue effective inflation control policy.

One of the main factors that has already been putting pressure on the dynamics of consumer prices for several years is the more significant rate of increase of aggregate demand compared to the rate of expansion of aggregate supply. This is because public income has been increasing, growth of wages has outpaced growth of labor productivity, banks have expanded their lending, the state's budget expenditures have increased, and there has been a sizable inflow of foreign exchange.

In the fourth quarter of 2005 compared to the fourth quarter of 2004, growth of real monetary income of the population was estimated at 17.2 percent, while in 2005 it increased 12.0 percent. Inasmuch as the public spends a sizable fraction of its income on consumption (more than 60 percent), income growth also manifests itself in the growth of consumption -- that is, retail turnover. Thus, in October-December 2005 compared to the same period of 2004, retail turnover is estimated to have increased almost 14 percent, and during all of 2005

-- by 12.4 percent. The rate of its increase, moreover, exceeds real growth of GDP, which is estimated to have increased in the fourth quarter of 2005 compared to the fourth quarter of 2004 by 10.5 percent, and during 2005 -- by 9.4 percent.

In October-December 2005 wages increased in real terms by 18.7 percent compared to the same period of 2004, significantly surpassing the increase in labor productivity, which was 8.6 percent. In 2005 as a whole, growth of real wages reached 12.0 percent, while labor productivity increased 8.8 percent.

Investment demand also grew at a high rate in 2005, although by the year's end its rate decreased noticeably. In the fourth quarter of 2005, investments in fixed capital are estimated to have increased almost 5 percent compared to the same period of 2004. In 2005 as a whole, investment in fixed capital increased 22.1 percent.

Consumer and investment demand is being supported by increasing availability of credit resources from banks. Thus, according to the results of 2005 the increase in volume of credits to the economy by second-tier banks was 74.7 percent, to include 22.4 percent in the fourth quarter (in 2004 -- 51.7 percent and 11.7 percent respectively).

Expansion of lending to the economy and the significant inflow of foreign exchange were mainly the result of an increase in borrowing by second-tier banks on the external market, and of an increase in world prices, especially on oil. Thus, as of the end of 2005 the volume of loans taken out by second-tier banks with nonresidents reached US\$14.6 billion, having doubled during the year, to include a 45.4 percent increase in the fourth quarter. Although in December 2005 the world price of Brent oil fell 9.9 percent compared to September 2005, in the year as a whole it increased to \$56.8 from \$39.7 per barrel (43.1 percent).

The rate of expansion of money measures decreased significantly in 2005 in spite of an aggressive credit policy, high liquidity of banks, and a sizable inflow of foreign capital into the country. In the fourth quarter of 2005 base money expanded 3.2 percent (43.0 percent in the fourth quarter of 2005), the money supply grew by 2.5 percent (24.1 percent in the fourth quarter of 2004), and cash in circulation shrank by 0.7 percent (21.5 percent growth was observed in the fourth quarter of 2004).

In 2005 as a whole, base money increased 14.7 percent, while in 2002-2004 it grew at a rate of 51.2 percent on an annual average. The money supply expanded 25.2 percent (as opposed to 43.2 percent annually in 2002-2004), and cash in circulation expanded 8.6 percent (as opposed to 43.3 percent). Thus the decrease in rate of growth of money measures in 2005 compared to 2004 served to lower pressure on inflation on the part of monetary factors.

Aggressive budget policy, which was expansionist in nature, was a factor that had the influence of increasing inflation in 2005. While in 2004 the state budget's expenditures were 22.6 percent of GDP, in 2005 they were as much as 29.7 percent of GDP. Although this

policy is having a favorable influence on social development and economic activity in the Republic, it is helping to increase inflation pressure.

Decreases in prices of fuel and lubricants, which are atypical of this period, had a restraining influence on inflation. The drop in prices of these goods occurred as result of steps taken by the government. First, export of fuel and lubricants was banned until the end of 2005, second, a zero rate was introduced for excises on sale of gasoline on the internal market, and third, steps were taken to increase oil deliveries to the Republic's refineries. Besides that, a decision was made by the large gasoline vendors in November 2005 to decrease gasoline prices to what they were in August 2005.

And so, the prices of gasoline and other fuels and lubricants remained stable in the fourth quarter of 2005 (there was a price decrease of 5.9 percent in October-December 2005, and there was a 3.2 percent increase in the year as a whole).

b. Base Inflation¹

Growth of the overall level of food prices in the fourth quarter of 2005 compared to the preceding quarter was accompanied by an increase in base inflation calculated by all methods (Figure 3).

In the fourth quarter of 2005 in version 2 the base inflation indicator established itself at a higher level than overall inflation owing to a decrease in prices of energy resources, which are excluded from the calculation of base inflation in this version. The increase in base inflation in versions 1, 3, 4, and 5 proceeded more slowly than for the overall level of prices. This is connected with the fact that there was significant growth of the prices of goods and services excluded from the calculation of inflation by this method (vegetables and fruits, eggs, dairy products, services of educational institutions), except for gasoline prices, which decreased in the period of analysis.

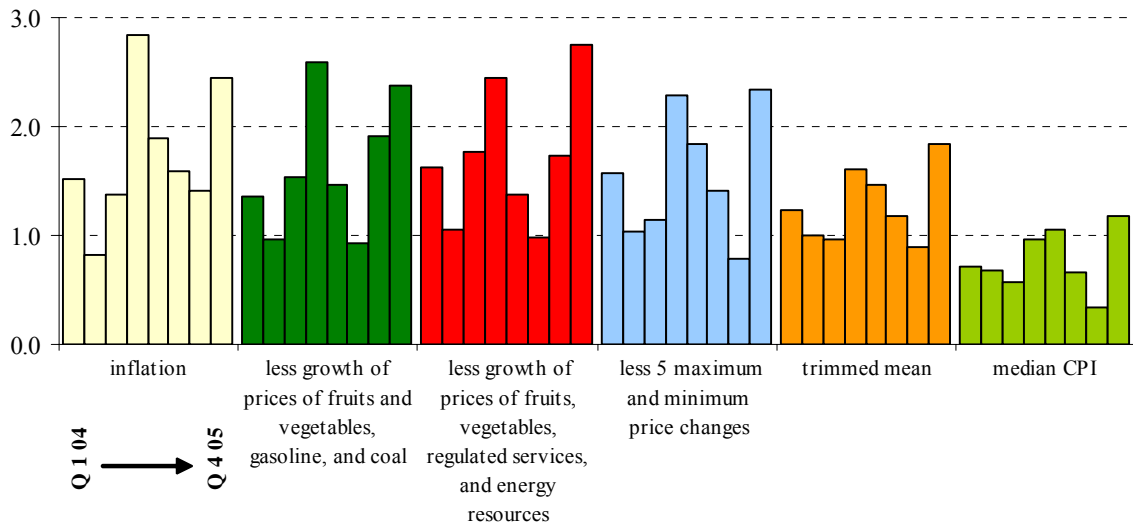
Base inflation indicators calculated in annual terms using all methods remained relatively stable in the fourth quarter of 2005, with their values not exceeding the inflation indicator. Thus, base inflation decreased in versions 1 and 3, remained unchanged in version 2, and increased negligibly in versions 4 and 5 (Figure 4).

Consequently factors limiting a more-significant decline in base inflation in 2005 were associated in larger part with the condition of individual commodity markets. Inflation growth was the result of a sizable increase in prices and tariffs for food goods and paid

¹ The National Bank orients itself in monetary policy on two main indicators of base inflation: (1) exclusion of changes in prices of fruits and vegetables, gasoline, and coal from the consumer price index (CPI); (2) exclusion from the CPI of the five components exhibiting the largest price increase and the five components showing the largest price decrease. Base inflation indicators calculated by other methods are used by the National Bank for analytical purposes.

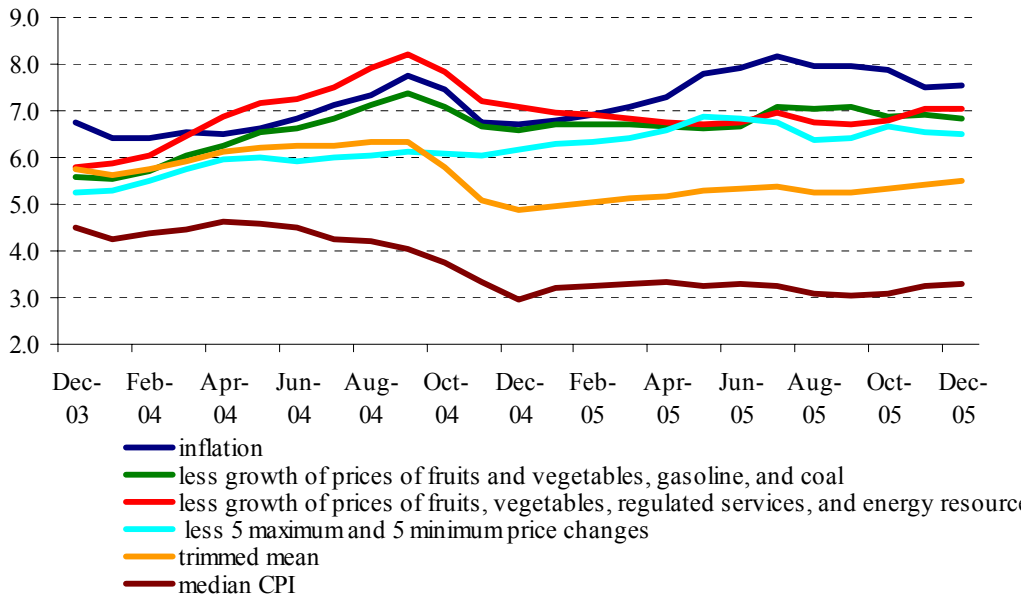
services -- that is, the dynamics of base inflation were determined by factors having a volatile and local nature on the backdrop of a decrease in pressure on the part of monetary factors.

Figure 3. Inflation and Base Inflation in 2004-2005
(Percent of Preceding Period)



Source: Republic of Kazakhstan Statistical Agency

Figure 4. Inflation and Base Inflation
(Percent, in Annual Terms)



Source: Republic of Kazakhstan Statistical Agency

c. Prices in the Real Sector of the Economy

Prices in Industrial Production

According to the Republic of Kazakhstan Statistical Agency, the prices of industrial producers decreased 4.2 percent in the fourth quarter of 2005 (they grew 2.6 percent in the fourth quarter of 2004). Products became 4.6 percent cheaper, with prices decreasing 5.4 percent for products of intermediate consumption and with prices increasing 2.7 percent for production resources and 1.5 percent for consumer goods. The prices of production services grew 1.3 percent during the quarter.

In October-December 2005 the products of mining industry enterprises grew 10.1 percent cheaper (there was a 4.4 percent price increase in the fourth quarter of 2004). The decrease in prices in industry was provoked first and foremost by decreases in the cost of oil by 12.3 percent and gas condensate by 11.1 percent. At the same time, the prices of petroleum products grew 7.3 percent, and the price of coal increased 1.6 percent. The prices of energy resources in general fell in the fourth quarter of 2005 by 9.8 percent (there was a 3.8 percent increase in the fourth quarter 2004).

In processing industry, a 4.2 percent increase in prices was noted in the fourth quarter of 2005 (0.8 percent in October-December 2004) connected, as in the preceding period, with a 6.9 percent price increase for the products of metallurgical industry. Thus, rolled ferrous metals grew 8.6 percent more expensive, and the prices of nonferrous metals increased 11.4 percent. The prices of foodstuffs produced in the Republic increased 0.9 percent in October-December 2005. Prices of livestock meat increased 1.5 percent, at the same time that prices decreased 12.8 percent for poultry meat and 9.0 percent for pasta products.

Prices and tariffs in production and distribution of electricity, gas, and water grew 0.4 percent in the fourth quarter of 2004.

In 2005 as a whole (December 2005 compared to December 2004), the increase in prices in industrial production was 20.3 percent (23.8 percent in 2004).

Prices in Agriculture

According to the Republic of Kazakhstan Statistical Agency the prices of agricultural products fell 1.0 percent in the fourth quarter of 2005 (0.1 percent in the fourth quarter of 2004). The price decrease occurred in the industry as a whole on the backdrop of a price decrease of 7.7 percent for plant farming products and a price increase of 7.6 percent for animal farming products.

The dynamics of plant farming products took shape under the influence of a 9.1 percent decrease in prices of cereal crops. A 3.8 percent seasonal increase in prices of vegetable crops was observed in October-December 2005.

The prices of animal farming products also took shape under the influence of the seasonal factor. The bulk of the price increase was recorded for eggs -- 26.1 percent, and milk -- 17.3 percent, while livestock and poultry grew 2.0 percent more expensive.

Based on the results of 2005 as a whole, agricultural products became 0.4 percent more expensive (4.0 percent in 2004). Plant farming products, meantime, grew 7.2 percent cheaper in 2005 (1.4 percent cheaper), and animal farming products grew 10.5 percent more expensive (11.1 percent more expensive).

Monitoring Enterprises

In the fourth quarter of 2005 compared to the preceding quarter, an increase in demand for finished products was reported by 35.3 percent of polled enterprises (37.8 percent in the third quarter of 2005), while the share of enterprises experiencing a decrease in product demand increased concurrently (to 15.1 percent from 12.9 percent). The share of enterprises exhibiting steady growth is anticipated to decrease in the first quarter of 2006 (to 47.8 percent), while 24.8 percent of enterprises participating in the survey anticipate an increase in demand.

The prices of finished products were observed as continuing to be steady in the fourth quarter of 2005 compared to the third quarter of 2005. This was reported by 68.9 percent of enterprises, while in the preceding quarter their share was 69.1 percent. Besides that, the share of enterprises whose products increased in price fell -- to 24.2 percent from 25.1 percent. Worsening of the price situation is anticipated in the first quarter of 2006: the share of enterprises with steady prices will drop to 54.1 percent, and the share of enterprises for which products are projected to increase in price will increase to 30.9 percent.

The price situation of raw materials and supplies also exhibited stability in the fourth quarter of 2005 (compared to the third quarter). The share of enterprises noting price increases fell to 54.1 percent from 57.7 percent, and 40.6 percent of polled enterprises reported steady prices, while in the preceding quarter their share was 40.0 percent. Price stability is anticipated in the first quarter by 28.5 percent of enterprises, while 51.1 percent of enterprises taking part in the survey anticipate price growth.

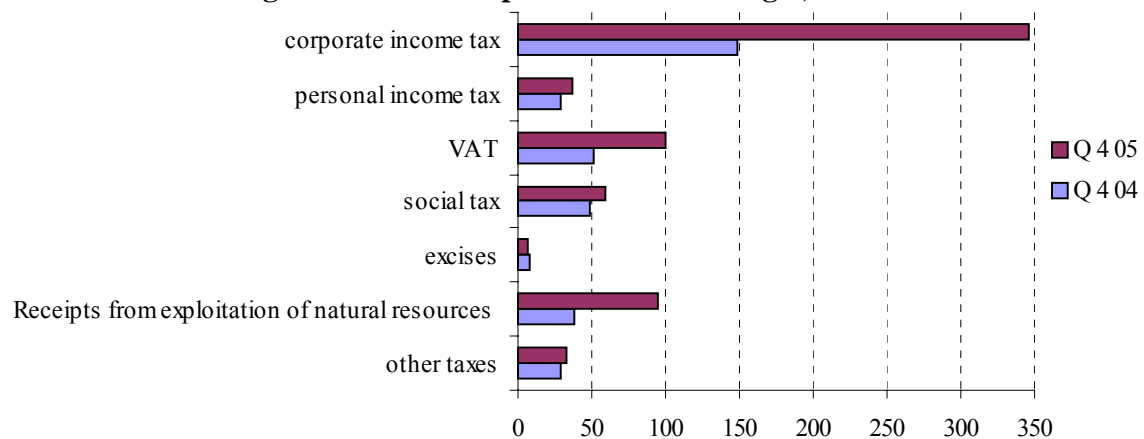
2. Fiscal Policy

According to the Republic of Kazakhstan Ministry of Finance state budget revenues were T 715.2 billion in the fourth quarter of 2005, which is historically a quarterly maximum. Compared to indicators for the same period of the preceding year, they increased 92.4 percent.

Tax receipts, which represent 94.7 percent of state budget revenues, grew 92.5 percent. Such significant growth is associated in many ways with the fact that both planned and excess receipts from organizations of the raw material sector began to be accounted for in the budget in 2005, while in preceding years only planned receipts were shown in the budget. As result receipts of corporate income tax climbed by a factor of 2.3, and those from exploitation of natural resources grew by a factor of 2.5.

VAT receipts increased in the fourth quarter of 2005 by 92.8 percent compared to the fourth quarter of 2004 due to growth of collections, both on products of domestic manufacturers and on imported goods. Receipts were 31.2 percent greater for personal income tax and 21.2 percent greater for social tax. Collections of excises shrank 10.0 percent, one of the reasons being introduction of a zero rate for the sale of gasoline on the internal market (Figure 5).

Figure 5. Tax Receipts of the State Budget, T billion

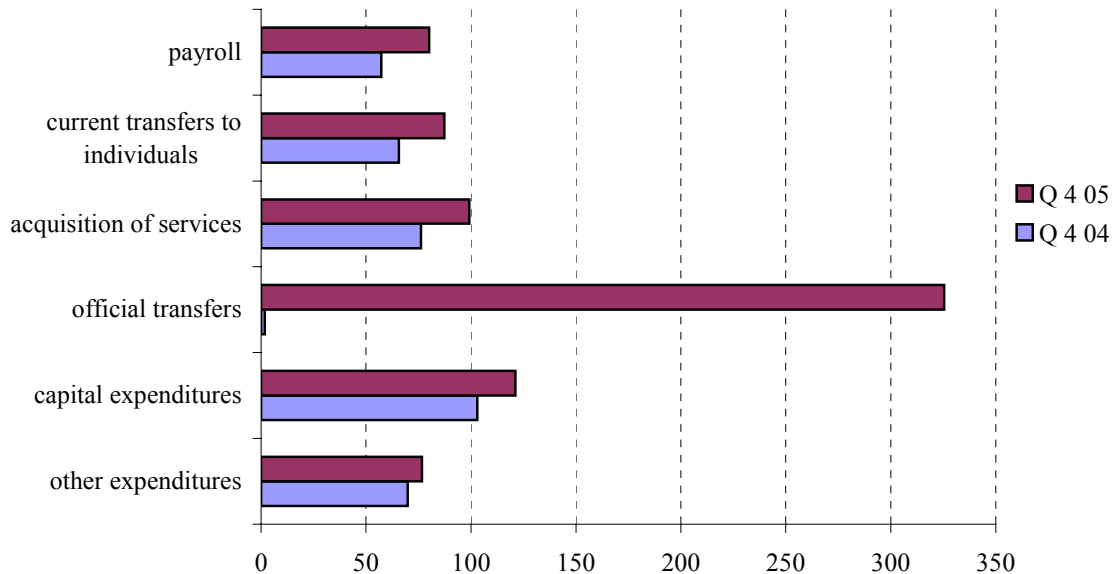


Source: Republic of Kazakhstan Ministry of Finance

Nontax receipts and receipts from sale of fixed capital, which in their aggregate represent 5.3 percent of budget revenues, increased respectively by 69.7 percent and by a factor of 2.4. Growth of nontax receipts (by T 9.7 billion) was owing mainly to an increase in revenues from state property, especially dividends (T 8 billion). Proceeds from sale of fixed capital increased owing to growth of revenues from the sale of goods out of the state material reserve, including grain, and from sale of land parcels.

State budget expenditures were financed in an amount of T 792.8 billion in the fourth quarter of 2005. Compared to the indicators for the same period of the preceding year, expenditures increased by a factor of 2.2. Current expenditures increased in the fourth quarter of 2005 by a factor of 2.5 compared to the same period of 2004, while capital expenditures increased 17.6 percent (Figure 6).

Figure 6. Structure of Expenditures of the State Budget, T billion



Source: Republic of Kazakhstan Ministry of Finance

As in the case of revenues, the dramatic increase in expenditures was fueled by operations with the National Fund. Excess receipts from the petroleum sector, as well as other receipts passing to the National Fund, have been shown since 2005 on the revenue side of the budget, and the counterpart (official transfers) has been shown on the expenditure side.

In the fourth quarter of 2005 compared to the same period of the preceding year, an increase occurred in expenditures paid in cash (current transfers to individuals and payroll expenditures), which had a significant impact on the dynamics of cash in circulation. Payroll expenditures increased 39.9 percent, and transfers to individuals increased 33.0 percent.

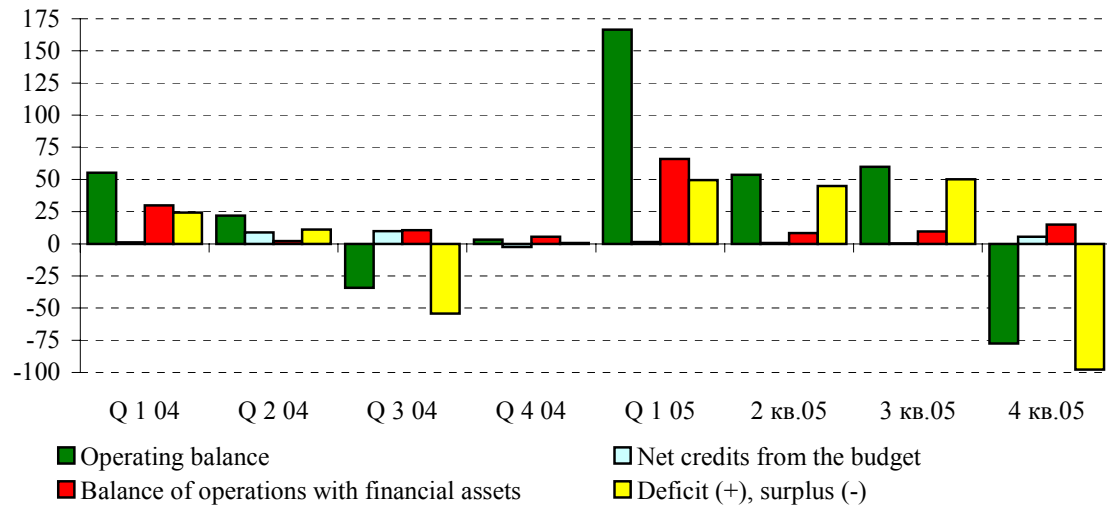
As result of revenues exceeding expenditures, the operating balance of the state budget ended up a negative T 77.6 billion in the fourth quarter of 2005, while in the same period of 2004 it was a positive T 3.3 billion.

Net budget lending (budget credits minus their repayment) was T 5.4 billion in the fourth quarter of 2005, while in the same period of 2004 it ended up as a negative value (T 2.5 billion). Growth was made possible both by a 60.9 percent increase in issued credits and by a 2.1-time decrease in repayment of credits issued earlier.

The balance of operations with financial assets came to T 14.9 billion, having increased by a factor of 2.8 compared to the same period of the preceding year.

As a result the state budget ended up with a maximum quarterly deficit of T 97.9 billion in the fourth quarter of 2005, while in the same period of 2004 a surplus of T 0.5 billion was observed (Figure 7).

Figure 7. Execution of the State Budget in Terms of the 2005 Structure



Source: Republic of Kazakhstan Ministry of Finance

The state budget deficit was financed by internal sources (T 165.3 billion), while external financing came to a negative value (T 67.4 billion). While T 184.5 billion were attracted, T 86.6 billion were repaid.

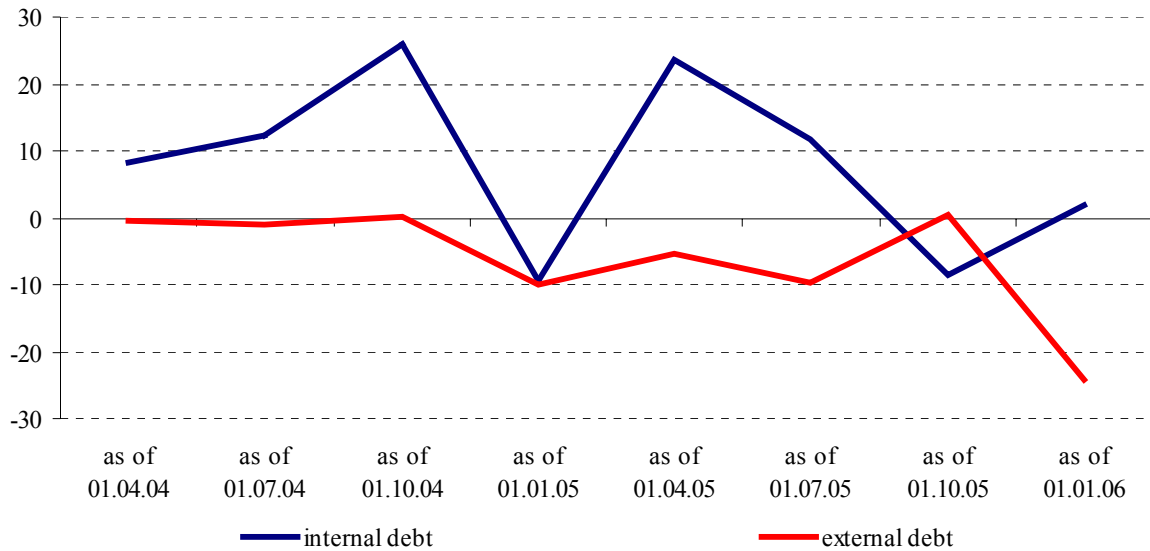
An issuance of government securities in late December 2005 amounting to T 17.8 billion and money saved in preceding periods in government accounts, amounting to almost T 160 billion, served as the internal financing sources of the state budget deficit in the fourth quarter of 2005.

Government internal debt increased 2.0 percent in the fourth quarter of 2005 compared to the preceding quarter, to T 297.9 billion, which is connected with issuance of 4-year medium-term treasury obligations (MYeOKAM).

Four-year medium-term indexed treasury obligations (MOIKAM) and special compensating treasury bonds were taken out of circulation in the fourth quarter of 2005.

Government external debt shrank 24.1 percent in the fourth quarter of 2005 compared to the preceding quarter, to a figure of US\$1.8 billion (Figure 8).

**Figure 8. Dynamics of Government Debt
(Percent of Preceding Period)**



Source: Republic of Kazakhstan Ministry of Finance

If we look at execution of the state budget in 2005 as a whole, we find that for the first time, it ended up with a surplus of T 46.7 billion, or 0.6 percent of GDP.

We can assert in this connection that the Ministry of Finance possesses significant "extra" financial resources, over and above the funding needs of the relevant budget programs. All the more so because the surplus is made possible to a negligible degree by high oil prices, inasmuch as with the world price of oil being in excess of \$19 per barrel, budget receipts in excess of the plan from certain oil companies are credited to the National Fund. In 2005 the National Fund increased by more than 56 percent (or by almost US\$2.9 billion).

All of this is evidence of significant fiscal expansion, which is a significant obstacle to effective regulation of inflationary processes in Kazakhstan.

3. Monetary Policy

a. The Supply of Money

Monetary Base

As of the end of December the monetary base was T 663.0 billion. It expanded 3.2 percent during the fourth quarter of 2005. Growth of the monetary base was brought about by an increase in the National Bank's net internal assets.

The National Bank's net international reserves fell 14.9 percent during the fourth quarter of 2005, to \$7,065.9 million, as a result of servicing external debt of the Ministry of Finance and replenishing assets of the National Fund. Net foreign exchange reserves decreased 17.8 percent to \$6,080.3 million. Assets held in gold grew \$84.1 million as result of the National Bank's operations and 8.4 percent growth of the price of gold on the world's markets.

The increase in net internal assets in the fourth quarter of 2005 was brought about mainly by a 78.7 percent increase in claims against the government as a result of a significant decrease in the balances of the government's accounts with the National Bank. Claims against financial institutions grew 17.6 percent as a result of a decrease in the volume of short-term notes in circulation, the face value of which shrank 17.4 percent. Besides that, a 12.2 percent increase occurred in claims against the rest of the economy. Other net internal assets decreased 8.6 percent (Table 1).

**Table 1. Dynamics of Changes in Assets and Liabilities of the National Bank
(Percent of Preceding Quarter)**

	Q 1 05	Q 2 05	Q 3 05	Q 4 05
Net external assets	1.9	-11.9	2.7	-14.8
Net internal assets	-16.0	12.9	11.3	40.8
Net internal credit	-18.8	16.0	13.6	50.8
net claims against government	-98.4	-24.8	-13.6	78.7
claims against financial institutions	-3.3	30.7	28.7	17.6
claims against the rest of the economy	-15.7	66.3	204.2	12.2
Other net internal assets	1.9	-11.4	-1.7	-8.6
Monetary base	-5.5	0.8	16.7	3.2

Source: Republic of Kazakhstan National Bank

The monetary base increased 14.7 percent in all of 2005. There was a 21.5 percent decrease in net external assets due to a decrease in the National Bank's international reserves. Net internal assets grew 46.9 percent as a result of growth of claims against the government, financial institutions, and the rest of the economy.

Monetary Survey of Second-Tier Banks

The fourth quarter of 2005 was characterized by further growth of the resource base of second-tier banks. During this period the volume of the obligations of second-tier banks to nonresidents determined in accordance with the monetary survey exceeded the volume of internal obligations for the first time.

The net external assets of banks shrank 75.7 percent in the fourth quarter of 2005 owing to faster growth of external obligations compared to external obligations [*sic*].

Obligations of second-tier banks to nonresidents climbed 47.3 percent in connection with growth of attracted deposits (by 49.2 percent) and credits (by 46.4 percent), and of placed securities other than shares (by 26.4 percent). Banks actively placed attracted external resources in external assets. Thus, claims against nonresidents grew 32.4 percent in the fourth quarter of 2005, and they were allocated mainly for placement in deposits (33.1 percent of the amount of claims), for lending (29.9 percent), and for securities acquisition (29.5 percent).

Internal assets of second-tier banks increased in the fourth quarter of 2005 by 18.7 percent, which was made possible by growth of internal credit. An increase continued in the credit expansion of banks, as a result of which claims against the economy increased 21.7 percent (the maximum quarterly level since 2002). Net claims against the government grew 0.9 percent, mainly due to a reduction in obligations of banks thereto by 19.2 percent.

Claims against the National Bank within the structure of the internal assets of second-tier banks fell 3.4 percent in December compared to September 2005. This is explained by reduction of the volume of notes in circulation, and consequently in bank portfolios. Cash domestic currency held in bank cash departments increased 25.1 percent, and that in deposits of banks with the National Bank increased 1.1 percent.

Other net internal assets of second-tier banks shrank 13.9 percent.

**Table 2. Monetary Survey of Second-Tier Banks
(Percent of Preceding Quarter)**

	Q 1 05	Q 2 05	Q 3 05	Q 4 05
Net external assets	-3.1	-3.8	6.3	-75.7
claims against nonresidents	26.9	21.6	16.0	32.4
obligations to nonresidents	15.4	13.9	7.2	47.3
Internal assets	7.3	10.5	7.2	18.7
Claims against National Bank	0.1	-16.1	-2.4	-3.4
Internal credit	9.2	16.4	9.7	20.6
net claims against the government	11.2	1.6	-9.0	0.9
claims against economy	9.1	17.6	10.9	21.7
Other net internal assets	-8.8	-12.7	-12.7	-13.9
Liabilities	8.8	12.8	11.4	3.9
deposits	11.4	10.8	11.0	3.2
other	-9.5	30.6	13.9	8.7

Source: Republic of Kazakhstan National Bank

Financing of the assets of second-tier banks out of internal sources was accomplished by increasing attracted deposits by 3.2 percent, and by 8.7 percent out of other sources (Table 2).

During 2005 as a whole, net external assets of second-tier banks shrank 76.0 percent, while internal assets grew 50.9 percent. As a result, the liabilities of banks determined in accordance with the monetary survey increased 42.0 percent.

Money Supply

The increase in the money supply during the fourth quarter of 2005 was 2.5 percent, to a figure of T 2,065.3 billion, which is far below the rate of its growth in the same period of the past year (24.1 percent). The net external assets of deposit institutions decreased 81.6 percent, and internal assets increased 41.6 percent.

The decrease in net external assets of deposit institutions during the period in question was brought about by shrinking of net external assets, both of the National Bank and of second-tier banks.

Growth of the internal assets of deposit institutions was provided for by continuing rapid growth of lending to the economy; as a result these claims of deposit institutions increased 21.6 percent in the fourth quarter of 2005, and net claims against the government grew by a factor of 2.2. Other net internal assets of deposit institutions shrank 11.0 percent (Table 3).

**Table 3. Dynamics of Changes in the Money Supply
(Percent of Preceding Quarter)**

	Q 1 05	Q 2 05	Q 3 05	Q 4 05
Money supply	5.8	5.0	10.0	2.5
Net external assets	1.2	-22.1	10.5	-81.6
Internal assets	9.5	25.1	9.7	41.6
net claims against government	-107.6	-834.0	-99.2	216.5
claims against economy	8.9	17.9	11.6	21.6
other net internal assets	-0.3	-4.6	-10.4	-11.0

Source: Republic of Kazakhstan National Bank

The higher rate of expansion of the monetary base in the period in question compared to the rate of growth of the money supply led to a decrease in the value of the money multiplier to 3.12 from 3.14.

Analysis of the dynamics of the main constituents of the money supply in the fourth quarter of 2004 shows that cash in circulation (M0) decreased 0.7 percent to a figure of T 411.8 billion, while deposits with deposit institutions increased 3.3 percent to a figure of T

1653.5 billion. As a result the proportion of deposits in the structure of the money supply increased to 80.1 percent from 79.4 percent (Table 4).

**Table 4. Dynamics of Changes in Components of the Money Supply
(Percent of Preceding Quarter)**

	Q 1 05	Q 2 05	Q 3 05	Q 4 05
Money supply	5.8	5.0	10.0	2.5
cash in circulation	-3.8	6.7	6.5	-0.7
deposits of residents	8.7	4.5	10.9	3.3

Source: Republic of Kazakhstan National Bank

In annual terms (December 2005 compared to December 2004) the money supply increased 25.2 percent. The decrease in net external assets was 84.0 percent, and internal assets grew by a factor of 2.1.

- Cash in Circulation

Cash in circulation decreased 0.7 percent in the fourth quarter of 2005 compared to the preceding quarter, to T 411.8 billion. Data on turnover of cash in second-tier banks and institutions engaging in certain kinds of banking operations permit identification of the factors responsible for the slowing of the rate of its growth (Table 5).

The volume of cash in circulation was acted upon in the fourth quarter of 2005 by factors that promoted both their increase and their decrease.

Issuances of cash from bank cash departments for payroll increased 19.3 percent compared to the preceding quarter. Such growth is explained in many ways by supplemental holiday and New Year's payments to employees by employers.

Growth of seasonal activity in agriculture helped to increase issuances of cash from bank cash departments in payment of agricultural products -- by 87.8 percent compared to the third quarter of 2005.

Net issuances of cash from bank cash departments in payment of goods, services, and completed work in the fourth quarter of 2005 exceeded their volume in the third quarter of 2005 by 4.1 percent.

Operations with foreign currency, growth of receipts in deposits with banks, and other receipts of the bank cash departments were factors that promoted a decrease in cash in circulation in the fourth quarter of 2005

In the fourth quarter of 2005 the volume of receipts of cash domestic currency by the cash departments of second-tier banks as a result of sale of foreign currency increased 29.8 percent, while issuance of domestic currency by banks as a result of purchases of

foreign currency shrank 14.5 percent compared to the third quarter of 2005. As a consequence the net receipts of cash currency by bank cash departments came to T 251.3 billion, which is 54.7 percent more than in the third quarter of 2005.

**Table 5. Balance of Payments and Receipts of Cash through Bank Cash Departments
(Percent of Preceding Quarter)**

	Q 1 05	Q 2 05	Q 3 05	Q 3 05
Goods, services, and completed work payments	-39.1	35.1	-68.1	4.1
sales receipts	-26.5	48.2	5.7	15.6
	-15.0	24.4	15.0	11.3
Payroll (accounting for money in automatic teller machines, demand deposits, and current accounts of individuals)	-17.9	28.3	10.5	19.3
Agricultural products	-62.1	32.4	34.4	87.8
Operations with foreign currency issuance for purchase of currency	-5.9	-64.4	-3.4	-54.7
receipts from sales of currency	-15.3	3.0	8.9	-14.5
	-5.0	36.1	5.3	29.8
Time deposits of individuals	75.9	81.1	94.5	-5746.4
deposit withdrawals	36.5	13.3	-0.1	6.9
deposit receipts	-8.5	3.3	-1.9	13.2
Pensions and benefits	6.4	9.6	14.7	-1.1
Other items	-31.3	15.0	-7.1	-16.1
Overall balance of cash payments and receipts	-95.6	1139.6	0.4	-66.9

Source: Republic of Kazakhstan National Bank

Growth of deposits with second-tier banks continued in the period in question, expressing itself as an increase in the cash tenge receipts of banks.

Overall, the final balance between issuances and receipts of cash by second-tier banks in the fourth quarter of 2005 came to T 16.2 billion, having decreased 66.9 percent compared to the third quarter of 2005.

- Deposits of Residents

The fourth quarter of 2005 was characterized by further growth of the volume of attracted deposits. As of the end of December 2005 the deposits of residents reached T 1,653.5 billion, and during the fourth quarter of 2005 they grew 3.3 percent. Private deposits, moreover, increased 12.1 percent, while deposits of nonbank legal entities fell 1.0 percent (Table 6).

**Table 6. Dynamics of Changes in Deposits of Residents
(Percent of Preceding Period)**

	Q 1 05	Q 2 05	Q 3 05	Q 4 05	Share % ²
Deposits of residents	8.7	4.5	10.9	3.3	100.0
Transferred tenge deposits of individuals	7.0	11.9	2.9	4.4	23.4
of nonbank legal entities	-2.9	12.0	9.1	10.4	3.5
Other tenge deposits of individuals	8.7	11.9	1.9	3.4	19.9
of nonbank legal entities	6.9	8.3	9.3	7.8	34.7
Transferred foreign currency deposits of individuals	8.8	0.1	2.8	7.5	15.4
of nonbank legal entities	5.1	17.0	15.1	8.1	19.3
Other foreign currency deposits of individuals	70.2	-0.5	4.8	8.0	8.7
of nonbank legal entities	0.6	23.3	3.0	24.3	1.4
Other foreign currency deposits of individuals	86.8	-3.5	5.2	5.4	7.3
of nonbank legal entities	1.6	-2.6	20.4	-2.8	33.2
Other foreign currency deposits of individuals	5.5	14.2	4.9	16.6	15.2
of nonbank legal entities	-0.5	-12.6	32.4	-14.9	18.0

Source: Republic of Kazakhstan National Bank

Persistence of a large proportion of other deposits of residents in the structure of the deposits of residents with deposit institutions is seen as a positive thing because they are one of the main sources of lending to the real sector. Thus, at the end of the fourth quarter of 2005 this proportion was 67.9 percent, with the remaining 32.1 percent represented by transferable deposits. Mention should be made here of the unfavorable decreasing trend in the proportion of other deposits within their total volume, observed this year: upon reaching a maximum in December 2004 (70.4 percent), by the end of December 2005 they fell to 67.9 percent.

An increase in the proportion of deposits in domestic currency to 58.1 percent should be singled out among the trends of the fourth quarter of 2005 (the proportion was 56.4 percent in the third quarter of 2005). This is connected with shrinking of other foreign currency deposits of nonbank legal entities.

b. Instruments and Operations of Monetary Policy

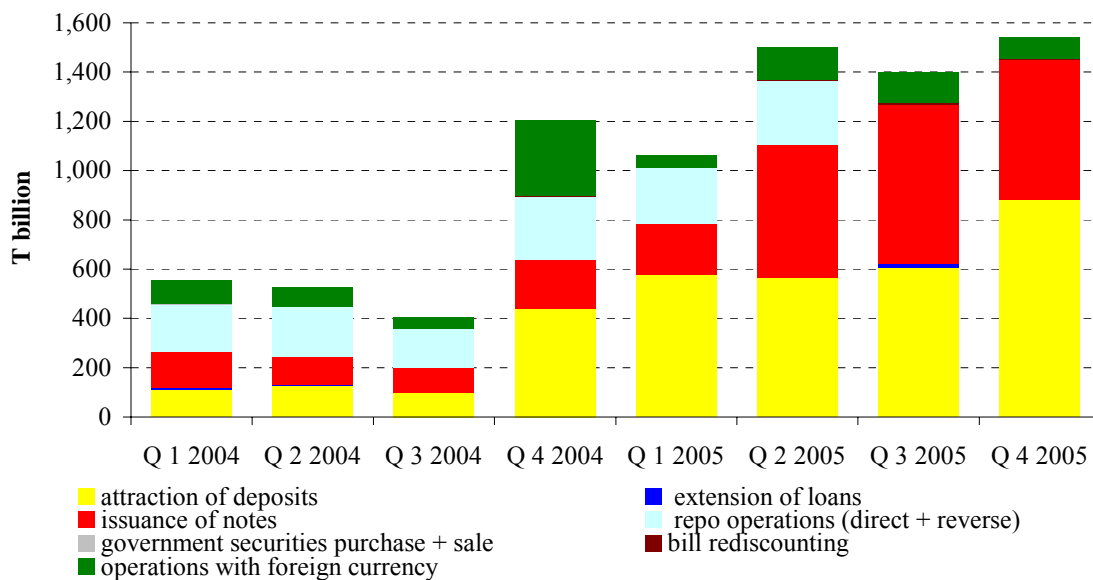
The National Bank's monetary policy was pursued in the fourth quarter of 2005 in the conditions of continuing growth of liquidity on the financial market of Kazakhstan, and in particular, in second-tier banks. Average daily balances of correspondent tenge accounts of banks with the National Bank increased 20.9 percent in the fourth quarter compared to the preceding quarter, well compared to the fourth quarter of 2004 they increased 59.8 percent.

² As of April 1, 2006.

Their volume peaked in December, when they were in excess of T 95 billion on a daily average.

During the fourth quarter of 2005 as a whole the gross volume of National Bank operations on the financial market, including issuance of short-term notes, attraction of deposits, rediscounting of commercial bills, and sale and purchase of foreign exchange, came to T 1,541.6 billion, having increased 10.1 percent compared to the preceding quarter. The volume of operations on the money market grew 14.0 percent, while in contrast on the currency exchange it fell 29.8 percent (Figure 9).

Figure 9. Operations of the National Bank on the Internal Financial Market



Source: Republic of Kazakhstan National Bank

In the fourth quarter the volume of the National Bank's operations on the money market reached 94.3 percent of the volume of the National Bank's operations on the internal financial market. The National Bank attracted deposits from second-tier banks, issued short-term notes, and rediscounted bills only. The National Bank did not carry out other kinds of operations on the money market, such as operations with government securities and lending.

Operations with foreign currency (purchase and sale) constituted 5.7 percent of the volume of the National Bank's operations on the internal financial market.

Changes in the Mechanism of Monetary Policy

The mechanism of formation of minimum required reserves was changed as of October 1, 2005 for second-tier banks. The adopted resolution expands the basis for calculation of minimum required reserves insofar as concerns external obligations of banks, and improves the procedure for forming reserve assets. Expansion of the calculation basis in

terms of external obligations of banks was accomplished by including the following kinds of obligations to nonresidents in the calculations, regardless of their maturity:

- obligations to international financial organizations;
- special-purpose deposits by subsidiary organizations;
- obligations under debt securities;
- subordinated debt.

At the same time, according to the new procedure obligations to nonresidents are decreased by the amount of particular external assets of the bank:

- cash foreign currency of states having a sovereign rating not below the sovereign rating of the Republic of Kazakhstan;
- money in accounts with central banks of states having a sovereign rating not below the sovereign rating of the Republic of Kazakhstan;
- money in accounts with foreign banks and deposits with nonresident organizations having a long-term credit rating not below the sovereign rating of the Republic of Kazakhstan;
- investments in foreign government securities cleared for dealer activities by second-tier banks, at balance-sheet value;
- investments in securities of international financial organizations having a rating not below the sovereign rating of the Republic of Kazakhstan.

As a result, reserve obligations are calculated as the positive difference between the sum of external obligations and external reserve assets of a bank, and internal obligations. A bank's internal obligations are calculated as the amount of obligations to resident customers maturing (entirely or in part) during the current month and subsequent month.

Besides that, the resolution changed the list of reserve assets into which bank assets must be placed for the purposes of fulfilling minimum reserve requirements. In particular, previously allowed deposits with the National Bank, overnight loans extended to the National Bank, and refined gold were eliminated from reserve assets. As a consequence the list of reserve assets contains only cash and cash in correspondent accounts with the National Bank.

Thus besides decreasing the volume of external borrowing by banks, introduction of the new rules will also make it possible to decrease excess liquidity in the banking sector.

The minimum required reserve ratio, meantime, was kept at 6 percent.

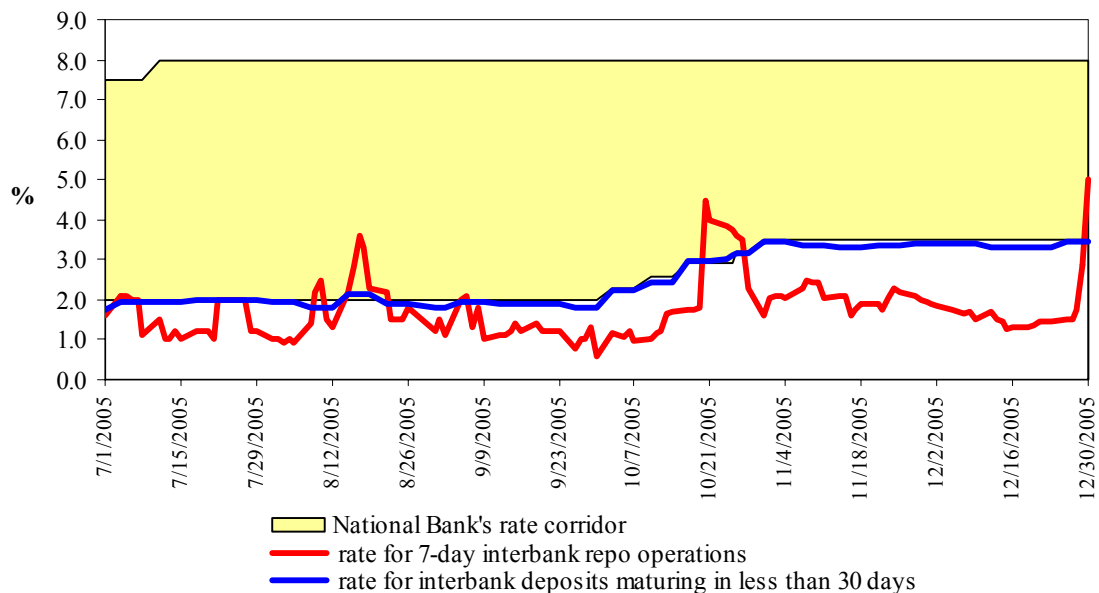
Rates of the National Bank

The practice of quarterly review and establishment of the official refinancing rate was introduced at the start of 2005. In the fourth quarter of 2005 the rate was kept at 8.0 percent.

The rate for deposits attracted by the National Bank from second-tier banks was increased gradually to 3.5 percent from 2.0 percent during October 2005.

Consequently the boundaries of the National Bank's rate corridor, which was introduced July 1, 2005, grew closer together in the fourth quarter of 2005, to 450 basis points from 600 basis points (Figure 10).

Figure 10. Boundaries of the National Bank's Rate Corridor



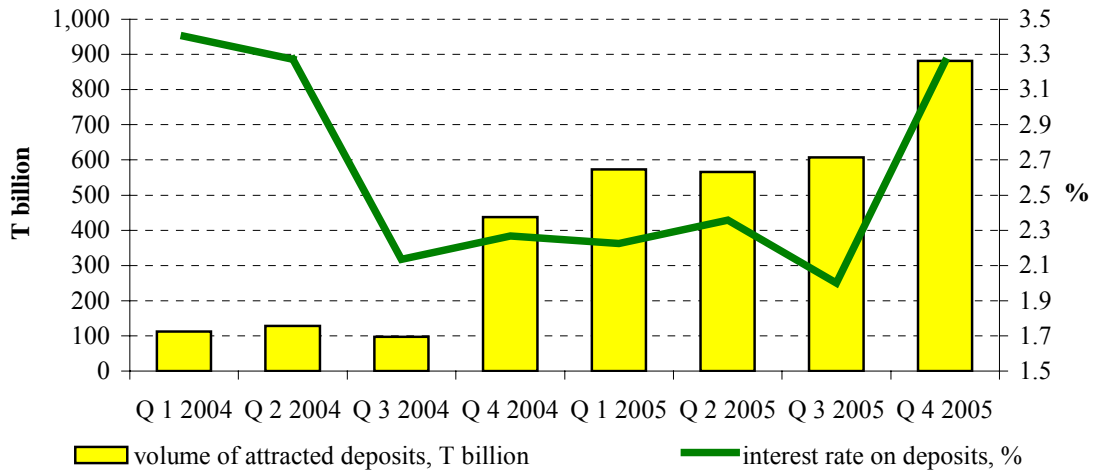
Source: Republic of Kazakhstan National Bank

The rates for operations on the interbank market, which are comparable in duration with rates defining the National Bank's corridor (7 days) were with rare exception below the lower boundary of the rate corridor in the fourth quarter of 2005.

Attraction of Deposits

In the fourth quarter of 2005 the National Bank attracted tenge deposits from second-tier banks amounting to T 881.6 billion, which is historically the maximum volume. Compared to the preceding quarter the volume of attracted deposits increased 45.1 percent. The maturities of attracted deposits were exclusively 7 days. The weighted average interest rate on attracted deposits climbed in the fourth quarter of 2005 to 3.26 percent (2.00 percent in the third quarter of 2005) (Figure 11).

Figure 11. Volume and Interest Rates on Deposits Attracted by the National Bank



Source: Republic of Kazakhstan National Bank

The volume of unsettled obligations of the National Bank under deposits attracted from second-tier banks increased 7.3 percent at the end of 2005 compared to the volume at the end of the third quarter of 2005, to a figure of T 86.9 billion (Figure 12).

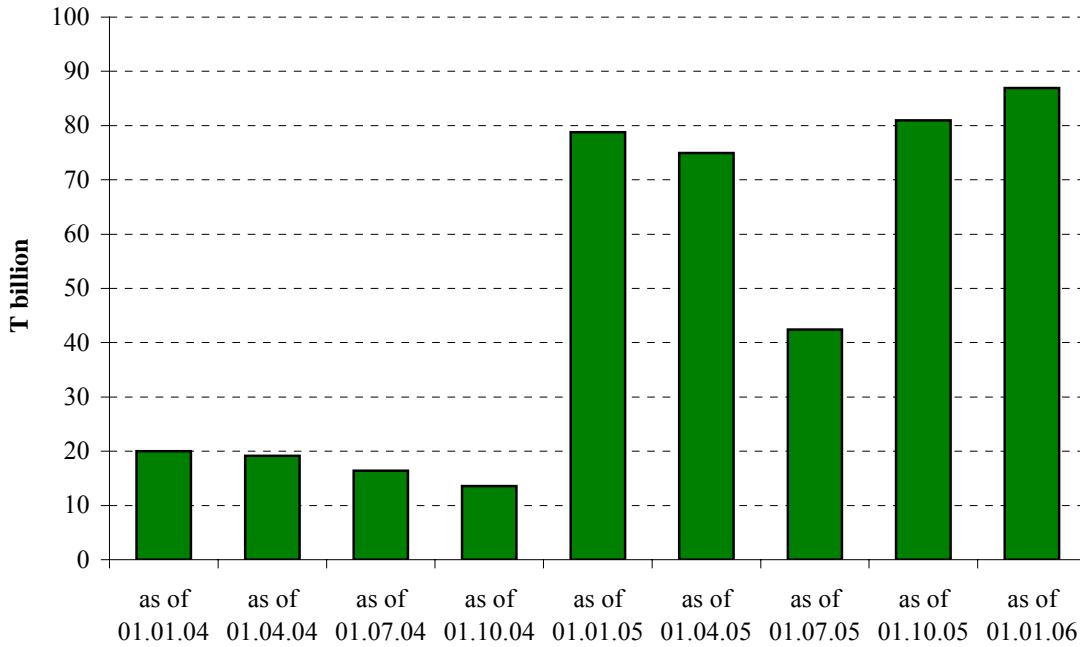
Issuance of Short-Term Notes

Placement of short-term notes of the National Bank in the fourth quarter of 2005 came to T 569.3 billion, which is 11.7 percent less than the volume of the preceding quarter. Notes were issued with a circulation period of 28 days.

In the period in question, the decreasing trend in the yield of notes observed since 2003 was replaced by an insignificant increase. The weighted average effective yield established itself at 2.22 percent based on the results of the fourth quarter of 2005, while in the third quarter of 2005 it was 2.17 percent (Figure 13).

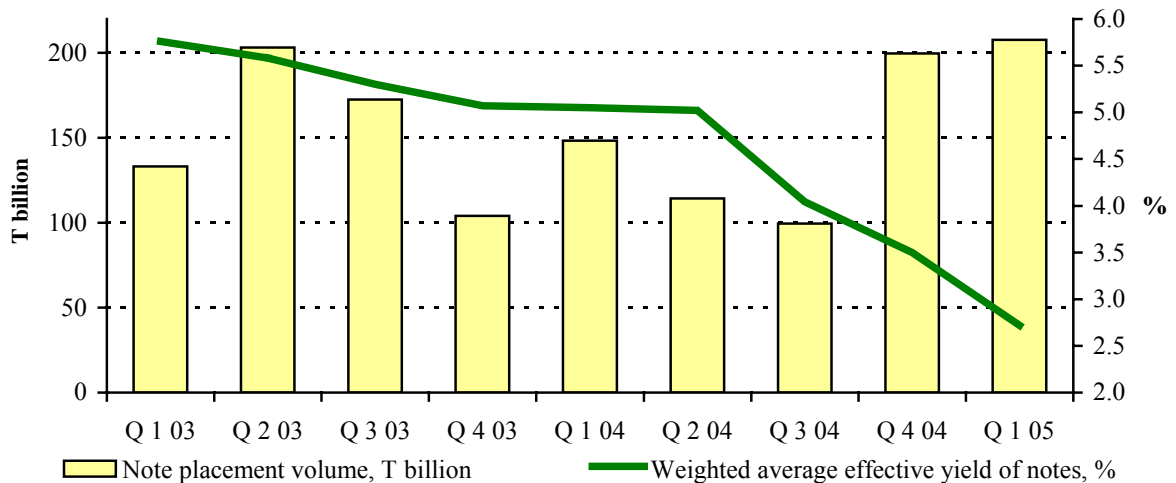
A decrease in issuance of short-term notes was accompanied by an associated decrease in their volume in circulation. During the fourth quarter of 2005 the volume of short-term notes in circulation shrank a by 17.4 percent, and at the end of 2005 it was T 161.0 billion. The duration of notes in circulation decreased at the end of 2005 to 15.2 days (Figure 14).

Figure 12. Volume of Unsettled Obligations of the National Bank under Deposits Attracted from Second-Tier Banks



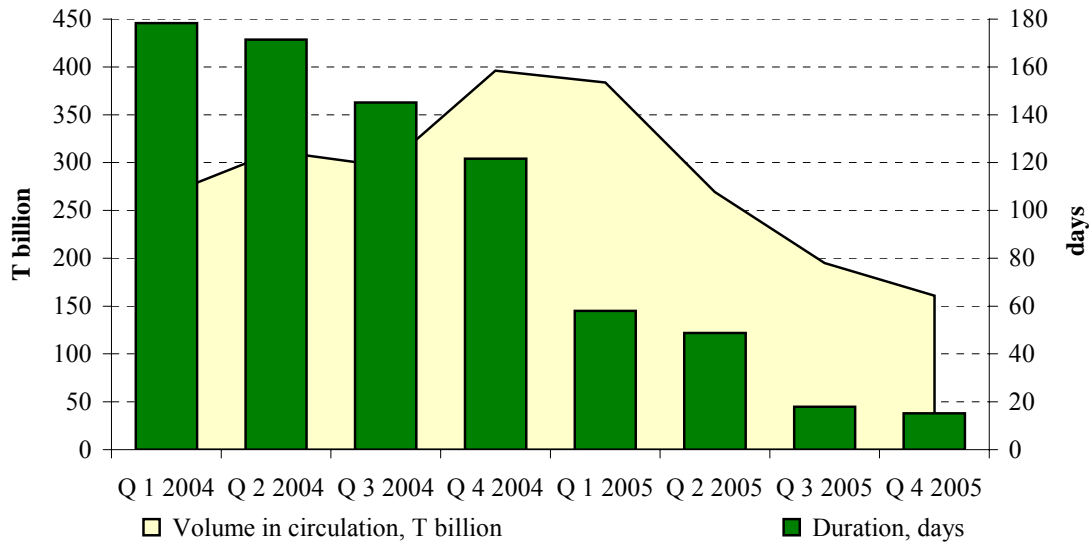
Source: Republic of Kazakhstan National Bank

Figure 13. Placement of Short-Term Notes by the National Bank and the Weighted Average Yield Thereon (during the Period)



Source: Republic of Kazakhstan National Bank

**Figure 14. Short-Term Notes in Circulation
(As of Period's End)**



Source: Republic of Kazakhstan National Bank

Provision of Loans

New regulations on bank loans granted by the National Bank went into effect in the third quarter of 2005. According to these regulations the National Bank may grant (1) refinancing loans to banks and/or organizations engaging in certain kinds of banking operations, (2) special-purpose loans to banks and/or legal entities, including loans granted as a lender of last resort.

Refinancing loans could be granted for a period of not more than 1 month, both in the domestic currency through reverse repo operations and in foreign currency (swap operations).

The National Bank did not grant refinancing loans or special-purpose loans in the fourth quarter of 2005.

Foreign Exchange Rate

In the fourth quarter of 2005 the situation on the internal exchange market was characterized by relative stability. On the whole, based on the quarter's results the tenge's exchange rate against the U.S. dollar strengthened by 0.04 percent -- to T 133.77/US\$ from T 133.83/US\$.

As before, changes in the tenge's exchange rates against American and European currencies continue to be main factor governing fluctuations of the rates of these currencies on the international currency exchanges.

Publication of data in October 2005 according to which the rates of inflation and economic growth in the USA and euro zone countries were increasing impacted the dynamics of the world's main currencies. As result expectations of another increase in the base rate of the Federal Reserve System, and as a consequence of growth of the U.S. dollar's exchange rate against most of the world's currencies, intensified among market participants.

On this backdrop the tenge's exchange rate against the U.S. dollar on the internal exchange market underwent devaluation in nominal terms by 0.28 percent in October 2005 (to T 134.21/US\$ from T 133.83/US\$).

According to the results for November 2005, the exchange rate of the U.S. dollar strengthened 2.2 percent against the euro. Thus, the U.S. Federal Reserve raised the key rate for federal financing to 4 percent per annum from 3.75 percent. At the same time, the European Central Bank decided on November 3 to keep the European rate at its former level (2 percent). As result the exchange rate of the U.S. dollar against the euro reached a 2-year maximum of €01.164/US\$ on November 15, 2005 during trading on the world exchange market. By as early as November 18, however, the exchange rate of the American currency underwent an adjustment on the backdrop of announcements by the head of the European Central Bank of plans to raise the rate before the end of 2005.

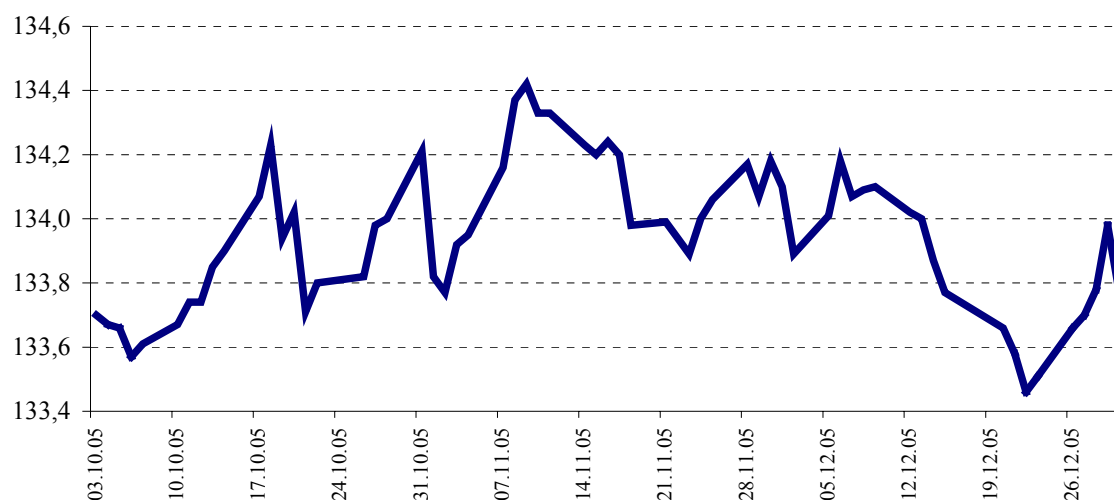
On the internal exchange market the dynamics of the tenge's exchange rate against the U.S. dollar were characterized by opposing trends. Thus, according to the results of November 2005 the tenge's exchange rate against the U.S. dollar strengthened 0.02 percent, to a figure of T 134.18/US\$.

Decisions to change interest rates were made in December 2005 both by the European Central Bank and by the U.S. Federal Reserve. An increase in the rate of the European Central Bank on December 1, 2005 (to 2.25 percent from 2 percent) did not have a significant influence on the dynamics of the exchange rate of the U.S. dollar against the euro, inasmuch as the head of the European Central Bank announced concurrently that this was a one-time increase. The market reacted to an increase in the rate of the U.S. Federal Reserve by 0.25 percent on December 13, 2005 to a figure of 4.25 percent by decreasing the U.S. dollar's exchange rate against the euro, since Federal Reserve representatives had warned investors that tight monetary policy would soon come to an end. As result the U.S. dollar's exchange rate against the euro fell to a 1 1/2 month minimum -- \$1.2061 to the euro.

Opposing trends dominated on the internal exchange market in December 2005 in connection with the situation on global currency exchanges, the presidential elections in the Republic of Kazakhstan, and seasonal factors. Based on the month's results the tenge was found to have strengthened against the U.S. dollar by 0.31 percent to a rate of T 133.77/US\$.

The weighted average exchange rate of the tenge was T 133.89 against the U.S. dollar in the fourth quarter of 2005. During the quarter the tenge varied against the U.S. dollar within a narrow band of T 133.46 to T 134.42 against \$1 (Figure 15).

Figure 15. Dynamics of the Nominal Exchange Rate of the Tenge against the U.S. Dollar



Source: Republic of Kazakhstan National Bank

The position of the single European currency on the international financial market impacted the dynamics of the tenge's exchange rate relative to European currency on the Kazakhstani market. In the fourth quarter of 2005 the official exchange rate of the tenge against the euro strengthened by 1.77 percent, and as of the period's end it came to T 158.54 to the euro.

The dynamics of the Russian ruble's exchange rate against the tenge were determined mainly by policy of the Central Bank of Russia concerning the exchange rate of the Russian ruble against the U.S. dollar. Thus, in the fourth quarter of 2005 the tenge's official exchange rate against the Russian ruble strengthened by 1.06 percent (Figure 16).

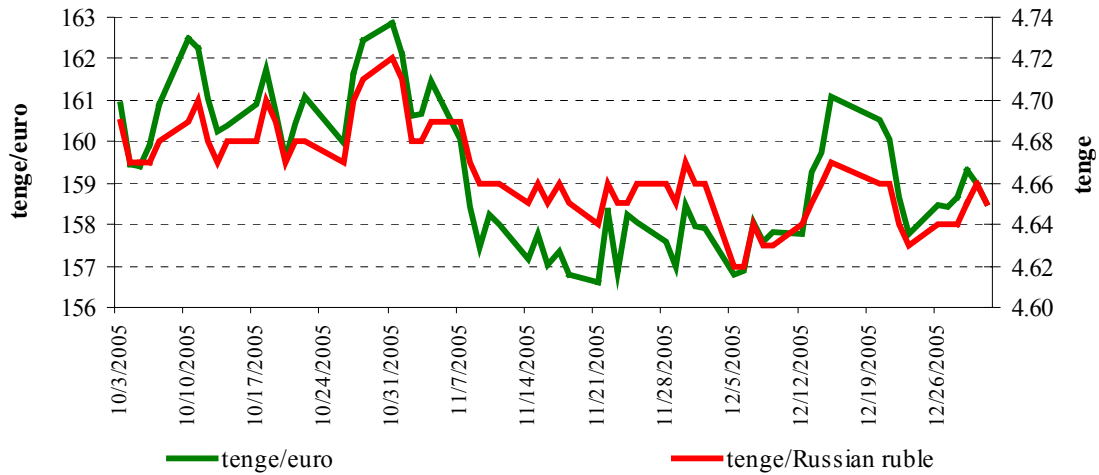
In the fourth quarter of 2005 the volume of exchange trading in the dollar position on the Kazakhstani Stock Market was US\$3.5 billion, which is 21.0 percent less than the volume in the same period of 2004.

On the over-the-counter exchange market the volume of operations in the fourth quarter of 2005 tripled compared to the same indicator for the past year, coming to a figure of US\$5.8 billion (Figure 17).

For the purposes of keeping the demand and supply of foreign currency on the internal exchange market in balance, the National Bank acted as net purchaser of foreign

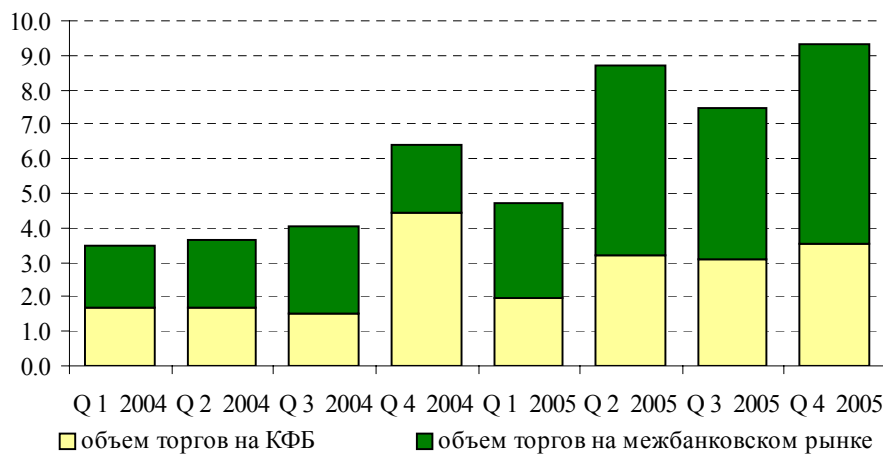
currency. The coefficient of the National Bank's participation was about 6.6 percent in the fourth quarter of 2005. Practically the entire volume of interventions occurred in this case in December 2005.

Figure 16. Dynamics of the Official Exchange Rate of the Tenge against the Euro and the Russian Ruble



Source: Republic of Kazakhstan National Bank

Figure 17. Trading Volume on the Internal Exchange Market, US\$ Billion

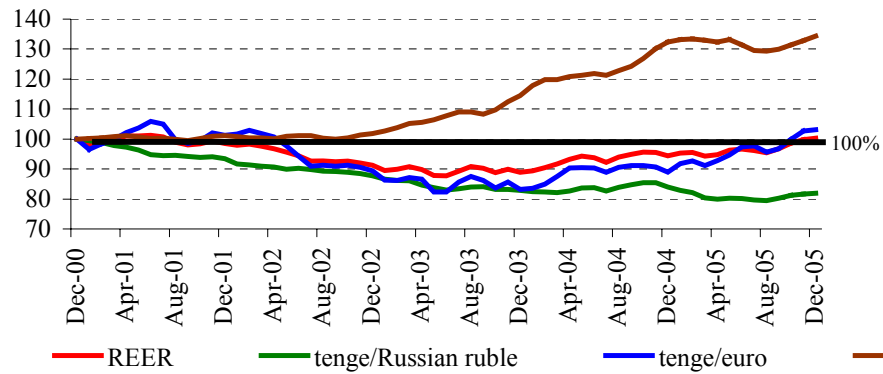


Source: Republic of Kazakhstan National Bank

[Key: left -- Trading volume on Kazakhstani Stock Market; right -- Trading volume on interbank market]

The real effective exchange rate index (REER) for the tenge grew 3.9 percent in December 2005 relative to September 2005. Real strengthening of the tenge in relation to the Russian ruble was 2.1 percent, in relation to the U.S. dollar it was 3.4 percent, and in relation to the euro it was 6.5 percent (Figure 18).

**Figure 18. Real Exchange Rate Indexes for the Tenge, Percent
(December 2000 = 100%)**



Source: Republic of Kazakhstan National Bank

Bill Rediscounting

In the fourth quarter of 2005 the National Bank accepted for rediscounting 74 bills (257 bills in the third quarter of 2005) amounting to T 3.5 billion (T 8.9 billion in the third quarter), and settled bills amounting to T 2.16 billion. As of January 1, 2006 the National Bank's portfolio contained bills amounting to T 11.9 billion (T 10.5 billion as of October 1, 2005).

Owing to their insignificant volume, bill rediscounting operations did not have an influence on the liquidity of the financial market.

4. Inflation Forecast

a. Assessment of the Inflation Forecast for the Fourth Quarter of 2005 and 2005 as a Whole

Actual inflation in the fourth quarter of 2005 (2.4 percent) was below the forecast for this period (2.5 percent) by 0.1 percentage points.

Actual inflation was recorded above forecast only in October -- 1.0 percent as opposed to 0.9 percent, while in November, inflation settled on a lower level (0.6 percent as opposed to 0.9 percent), and in December it matched the forecast exactly.

In October 2005, prices on the consumer market formed under the influence of an increase in the prices of nonfood goods, which reached 1.8 percent (the maximum in 2005).

As a result of an abrupt increase in gasoline exports, and correspondingly a decrease in the volume of gasoline deliveries to the internal market, the price of gasoline increased. Considerable growth of prices occurred in September (by 8.6 percent) and in October (by 13.0 percent). In November 2005, however, large gasoline vendors decided to lower the price to the August 2005 level. Additionally, the brakes were put on inflation at the end of the year by measures of the Republic's government to regulate the fuel and lubricant market. A ban was imposed on exports of these materials abroad until December 31, 2005, a zero rate was set for excises on sale of gasoline on internal market, and extreme measures were undertaken to increase oil deliveries to Kazakhstani refineries. As a result of these measures gasoline prices fell in November and December, and according to the results for the fourth quarter, prices of gasoline decreased by 5.9 percent.

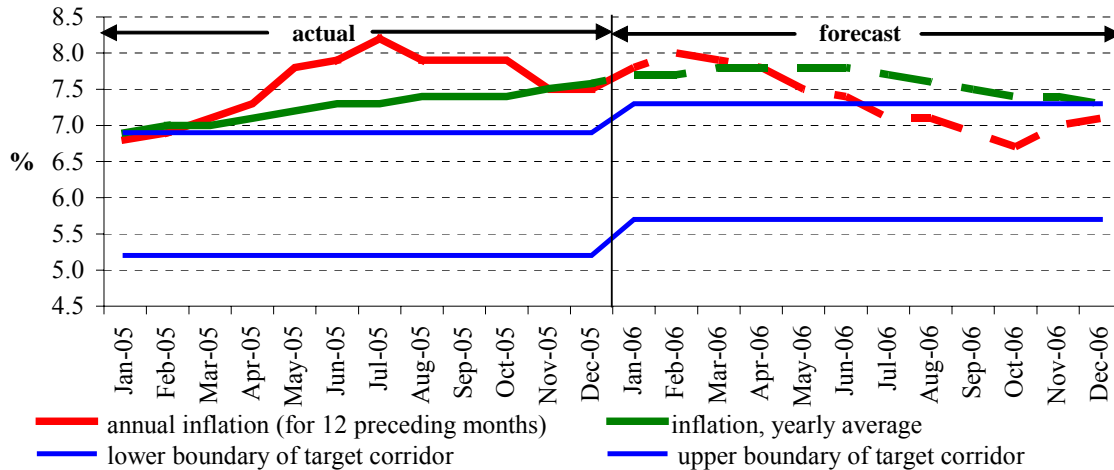
Inflation intensified in 2005 in response to objective factors, among which we can single out considerable growth of lending to the economy by banks, and consequently an increase in money measures, growth of consumer and investment demand, increase of aggregate supply and growth of wages at rates outpacing economic growth, high world oil prices, and a number of others. All of them have already been having a negative influence to a greater or lesser degree on the dynamics of inflationary processes for several years. Besides that, the dynamics of consumer prices in the country took shape also under the influence of the public's inflationary expectations, provoked by an increase in social payments from the budget (wages, pensions, benefits, scholarships).

The influence of these factors on inflation in 2005 was underestimated, as a result of which actual inflation exceeded the forecast throughout practically the entire year. While the National Bank had predicted that average annual inflation would settle within 5.2-6.9 percent in 2005, the actual level was 7.6 percent.

b. Inflation Forecast for 2006

It is anticipated in 2006 that average annual inflation will not differ significantly from the level of 2005, and will settle within 5.7-7.3 percent (Figure 19).

Figure 19. Actual and Projected Inflation in 2005



Source: Republic of Kazakhstan National Bank

This is connected with the fact that persistence of inflationary pressure is anticipated in the face of a significant inflow of foreign capital, excess liquidity in the financial sector, and growth of state budget expenditures.

Under these conditions, the National Bank will continue to implement measures to tighten monetary policy in 2006. Thus, the possibility is not excluded that the official refinancing rate and rates on attracted deposits will rise further.

Deposits by second-tier banks in the National Bank of the Republic of Kazakhstan and issuance of short-term notes will continue to be the main instruments for regulating interest rates on the financial market and sterilizing the excess liquidity of banks. The National Bank of the Republic of Kazakhstan will not limit the volume of deposits attracted, but it will specify the rates thereon.

To blunt the sharpness of the excess liquidity problem the National Bank of the Republic of Kazakhstan intends to make further improvements in the mechanism for calculating minimum reserve requirements by expanding the basis for calculating minimum required reserves and including within it all of the internal obligations of second-tier banks irrespective of maturities (at the present time, internal obligations maturing in the current month and subsequent month are included in the calculations).

Inflation Forecast for the First Quarter of 2006

It is anticipated that in the first quarter of 2006, inflation will settle within 2.3-2.5 percent. The main increment of prices at the beginning of the year will be credited to food goods, but even so, the overall level of prices will remain high.

Inflation will be restrained in the first quarter of 2006 compared to the fourth quarter of 2005 to a certain degree by measures undertaken by the Republic of Kazakhstan government to extend the ban on exports of diesel and aviation fuel and gasoline to February 7, 2006.

From January 1, 2006 the existing tariffs for services of the main rail net connected with carriage of freight by rail transport on inter-oblast and international (export-import) lines will increase by 11 percent. This increase will reflect upon growth of prices, chiefly of agricultural products.

Besides that, the high level of liquidity still persisting in the economy, the aggressive credit policy of second-tier banks, the high world prices of raw materials and energy resources, and as a consequence, significant inflow of foreign currency into the Kazakhstan will facilitate an increase in consumer prices in the first quarter of 2006.

It is anticipated that lower rates of growth of money measures in 2005, including in the fourth quarter, and measures taken in the current year by the National Bank to tighten monetary policy will have a restraining influence on inflation. This expectation is based on the fact that growth of money measures influences consumer prices with a certain delay.

Inflation Forecast for the Second Quarter of 2006

Inflation will decline in the second quarter of 2006 compared to the preceding quarter as a result of the action of seasonal factors, and it is forecast at a level of 1.4-1.6 percent (it was 1.6 percent in the second quarter of 2005). The decline in inflation will be brought about by seasonal factors, particularly slower growth of the prices of certain food goods.

Expectations that inflation will not decrease compared to the preceding year, however, can be explained by the persistence of high inflationary expectations in the economy, the influence of high world prices, especially on oil and sugar, the boom in consumer demand, and a number of other factors.

As in preceding periods, in the second quarter of 2006 average annual inflation will climb above the forecast corridor determined for 2006.