

Republic of Kazakhstan
National Bank

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National Bank

Inflation Report

2 Qtr 2005

Contents

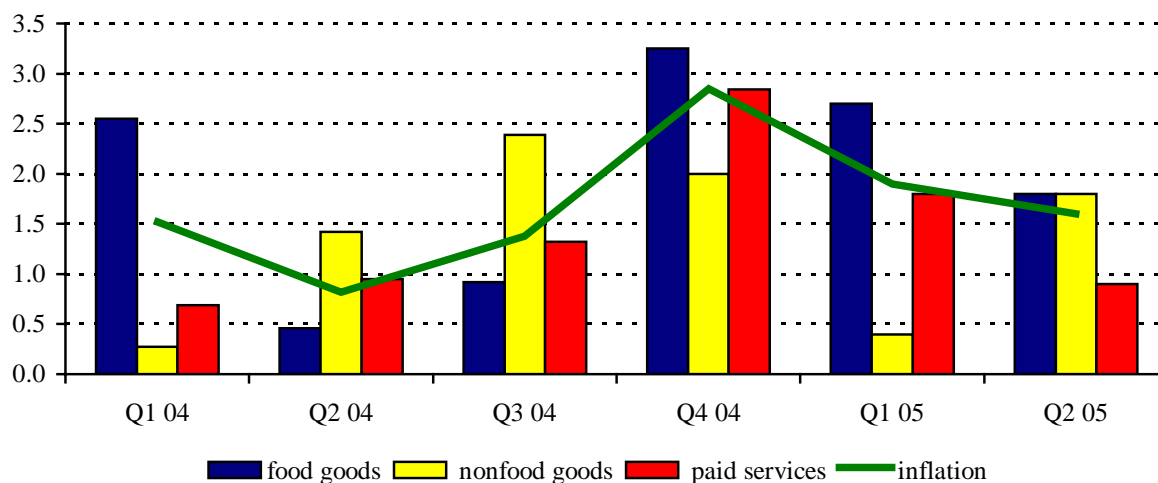
Contents	1
Contents	2
1. Inflation.....	3
a. Consumer Prices.....	3
b. Core Inflation	8
c. Prices in the Real Sector of the Economy	9
Prices in Industrial Production.....	9
Prices in Agriculture	10
Enterprise Monitoring.....	10
2. Fiscal Policy.....	12
3. Monetary Policy.....	17
a. The Supply of Money.....	17
Money base	17
Monetary Survey of Second-Tier Banks.....	19
Money Supply	20
b. Instruments and Operations of Monetary Policy	23
Exchange Rate	25
Official Rates of the National Bank.....	28
Minimum Required Reserve Ratio	29
Issuance of Short-Term Notes	30
Repo and Reverse Repo Operations	31
Attraction of Deposits	32
Granting of Loans	33
Bill Rediscounting	33
Changes in the Mechanism of Monetary Policy	33
4. Inflation Forecast	35
a. Assessment of the Inflation Forecast for the Second Quarter of 2005	35
b. Inflation Forecast for 2005.....	35
Inflation Forecast for the Third Quarter of 2005	35
Inflation Forecast for the Fourth Quarter of 2005	36

1. Inflation¹

a. Consumer Prices

Seasonal slowing of price increases on the consumer market in the second quarter of 2005 compared to the preceding quarter was observed, as is usual for this period. Compared to the second quarter of the preceding year, however, the dynamics of inflation exhibited a higher growth rate. Thus, according to the results of the second quarter of 2005, consumer price growth reached 1.6 percent, while in the same period of 2004 inflation was 0.8 percent (Figure 1).

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



Source: Republic of Kazakhstan Statistical Agency

Growth of food prices in this period, which was brought about by significant increases in the prices of vegetables and fruits, as well as meat and meat products against the backdrop of a decrease in prices of eggs, milk, dairy products, oil, and fats, was 1.8 percent.

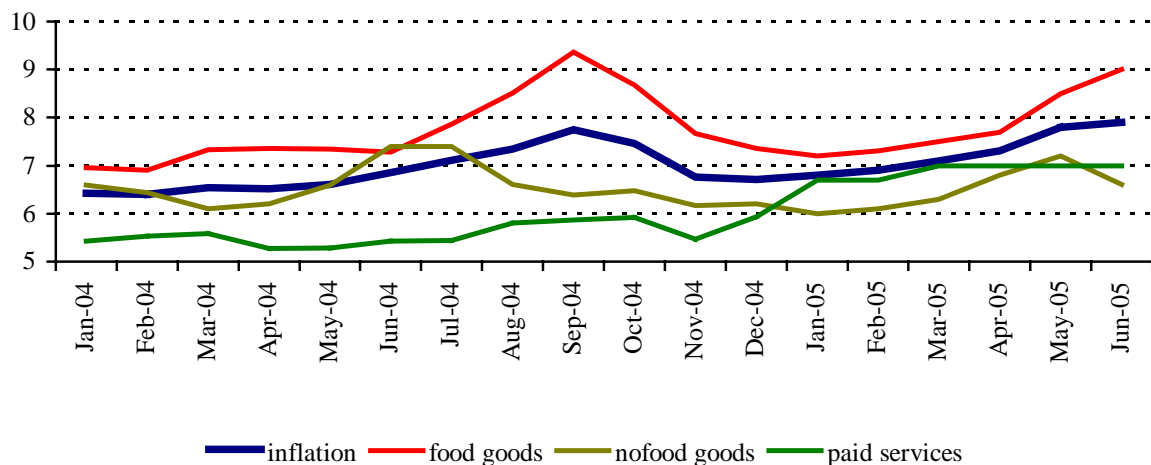
Nonfood goods grew 1.8 percent more expensive in the second quarter of this year. The price increment is credited mainly to gasoline (a 10.7 percent increase), whereas at the year's start it had grown cheaper (by 2.5 percent). Besides that, printed matter, clothing and footwear, and personal hygiene goods grew more expensive.

In the structure of paid services, which climbed by 0.9 percent in the second quarter of 2005, growth of prices was observed for both regulated and unregulated services. Growth of prices for housing maintenance, gas supply, electricity, and water supply was responsible

¹ Based on data of the Republic of Kazakhstan Statistical Agency.

for growth of the prices of housing and municipal services. Health care and transport services and the services of cultural and educational institutions grew more expensive as well.

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



Source: Republic of Kazakhstan Statistical Agency

Based on the results for the first half of 2005 (June 2005 compared to December 2004) inflation was 3.5 percent overall, and in annual terms it was 7.9 percent at the end of June 2005 (6.7 percent at the end of December 2004). Prices increased 9.0 percent for food goods, 6.6 percent for nonfood goods, and 7.1 percent for paid services. In annual terms the price increment was credited mainly to gasoline, to fruits and vegetables, to meat and meat products, and to transportation and communication services (Figure 2).

The dynamics of prices on the consumer market were governed by many factors in 2005, and specifically by factors having to do with demand, with costs, and with "import" of inflation.

- factors responsible for inflation of demand

Aggregate demand is increasing in Kazakhstan through several channels: growth of the public's consumer demand, growth of the investment demand of enterprises and organizations, and growth of demand on the part of the state. All of this is bringing about further growth of consumer prices, inasmuch as the rate of expansion of demand is outstripping the rate of expansion of aggregate supply.

In general, in the long-term aspect the increase in real monetary income of the public over the last 5 years (about 50 percent) was brought about by greater economic growth (about 64 percent). In 2004, however, the increase in the public's real monetary income outpaced economic growth: 13.2 percent as opposed to 9.4 percent. Thus, an increase in the public's standard of living provoked a consumer "boom". As a consequence retail turnover grew in 2003-2004 at a rate exceeding 10 percent.

Increase of the income of the public and enterprises is also reflected as growth of the demand for money, including for bank products. As result of this, the pace of bank lending to the economy is growing, resulting in an increase in money measures. Besides that, growth of money measures was promoted by a sizable influx of foreign exchange into the country from exports and borrowing. Considering that the impact of monetary factors on inflation processes occurs with a certain delay (with a lag) estimated at 4-6 months, the fact that inflation did not decrease in the first half of this year is explained by the significant growth of money measures observed in the second half of 2004. In the second half of 2004 the Money base increased by 48.7 percent, the money supply increased by 35.2 percent, and cash in circulation increased by 34.8 percent.

Although the government's budgetary expansion of recent years is stimulating economic activity, and serving as one of the factors of economic growth, it also is one of the causes of the increase in consumer prices. Thus, accounting for repayment of budget credits and for receipts from sale of financial assets, the revenue side of the budget increased from 21.7 percent of GDP in 2002 to 24.1 percent of GDP (as planned for 2005). Expense items (expenditures, budget credits, and acquisition of financial assets) grew from 22.1 percent of GDP in 2001 to 26.5 percent of GDP (as planned for 2005). This means that growth of the budget's expenditure side is outpacing the increase of its revenue side.

Budget expenditures on social payments will be increasing significantly in the current and subsequent years -- that is, the public's standard of living is clearly rising at a forced pace, at one that will be significantly greater than expansion of aggregate supply. Considering that the increase will impact the poorest segments of the population, in all probability it will be channeled into consumption -- that is, there will be an increase in aggregate demand, and not savings.

Mention needs to be made of the role of inflationary expectations in the formation of inflation. Considering that the increase in budget expenditures on social payments will impact the poorest segments of the population, in all probability this will be channeled into consumption -- that is, there will be an increase in aggregate demand, and not savings. Prices on the consumer market are rising in anticipation of the increase in demand.

- cost inflation factors

Among the factors of inflation that promote growth product cost, we should single out rising wages, which are surpassing economic growth, and increase in the cost of fuel and energy resources.

In the last 3 years the rate of growth of wages has steadily exceeded the rate of growth of the economy (in real terms, 10.7 percent as opposed to 9.5 percent on the average for 2002-2004). This has been happening, moreover, against the backdrop of an increase in employment in the economy. All of this says that growth of labor productivity is lagging behind the increase in wages, bringing about an increase in inflationary potential.

And although according to the results of the first half of 2005 wages grew more slowly than GDP (6.6 percent as opposed to 9.1 percent respectively), an aggressive budget policy oriented on significant increase of wages in the state sector will bring about their increase in the nonstate sector indirectly in the future as well.

The increase in prices in the economy's real sector is having a significant influence on formation of the prices of consumer goods and services (their increase or their decrease). This is connected with the fact that these industries put out a sizable quantity of consumer goods, as well as goods and services used in production and in the sale of consumer goods.

In industrial production, prices increased 5.6 percent in April-June 2005 (23.0 percent in June 2005 compared to June 2004). We should highlight within their structure an 8.1 percent increase in the price of energy resources and a 1.6 percent increase in the prices of food products produced by domestic enterprises.

Fruits and vegetables grew more expensive due to growth of the prices charged by agricultural producers (a 4.7 percent increase). In similar fashion, an increase in the prices of the meat of poultry and livestock sold by agricultural producers led to an increase in the prices of meat and meat products on the consumer market.

A drop in the prices at which producers sell milk (by 13.9 percent) and eggs (by 15.2 percent) led to an associated decrease in the prices of both these goods and their processing products at places of final sale.

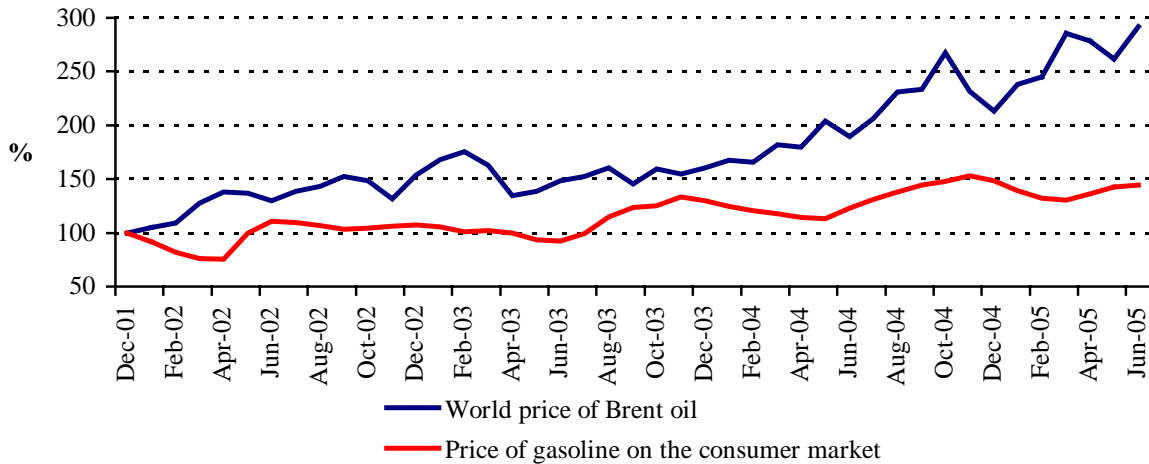
- "import" of inflation

Imported inflation is a product of an increase in the prices of imported goods on the internal market.

Given that Kazakhstan's economy is highly dependent upon the oil sector, price dynamics within it significantly impact the consumer market. According to the IMF the world prices of Brent crude grew 36.9 percent based on the results of the first half of 2005.

The increase in oil prices on the world market is causing, with a certain delay, an increase in the prices of petroleum products on the internal consumer market (Figure 3).

Figure 3. Change in World Prices of Brent Crude and of Internal Gasoline Prices (December 2001 = 100 Percent)



Source: Republic of Kazakhstan Statistical Agency

Mention should also be made of a certain negative impact of "import" of inflation that manifests itself through world meat prices and through the system of quotas on meat imports into the Russian Federation. According to the IMF, from the start of 2003 through June 2005 prices increased on the world market by 54.4 percent for pork, including by 48.3 percent in 2004 (December 2004 relative to December 2003), and by 43.3 percent (by 10.8 percent) for beef. Despite the fact that imports of meat and meat products are negligible, the correlation between world and domestic meat prices is significant. Besides that, introduction of quotas on meat imports by the Russian government led to growth of meat prices in Russia. A subsequent increase in the quota in 2005 created a situation in which deliveries of meat to Russia became more profitable, which in turn brought about an increase in the prices of meat in Kazakhstan.

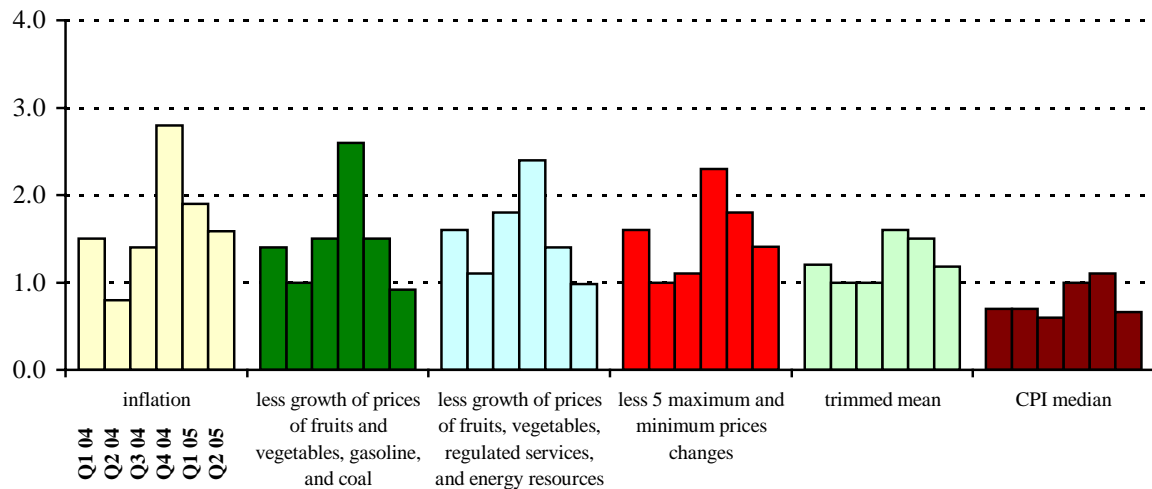
On the other hand negligible increase of the prices of ready-to-eat food products imported into Kazakhstan and cheapening of imported textile products have been observed this year. High competition in these segments of the market is keeping domestic commodity producers from raising their own prices, which is ultimately helping to hold back inflation.

This year, moreover, in the period from May 15 to December 31 an interim reduction factor was established for shipments of meat products, vegetables, and fruits by the services of the main rail net on Republican and international lines (for imports), which will also help to keep the prices of these food products relatively stable.

b. Core Inflation²

A decrease in the indicators of core inflation calculated by all methods was observed in the second quarter of 2005 compared to the preceding quarter (Figure 4).

**Figure 4. Inflation and Core Inflation in 2004-2005
(Percent of Preceding Period)**



Source: Republic of Kazakhstan Statistical Agency

Despite slowing of the rate of growth of the prices of fruit and vegetable products, on the whole the increase in prices of these goods was significant based on the results for the period in question. An increase in gasoline prices also had a negative impact on the overall dynamics of consumer prices in this period. As result, the decrease in versions 1 and 2 core inflation occurred faster than overall inflation.

Considerable scatter of values is observed in data on prices in Kazakhstan: both large increases of prices, and their abrupt decreases. Use of version 3 core inflation makes it possible to filter out seasonality and bumps in prices, which makes this measure more reliable in assessments of economic policy. In the second quarter of 2005, version 3 core inflation reached a level close to overall inflation, which was the result both of a large increase in prices of fruit and vegetable products and gasoline, and seasonal decrease of the prices of dairy products and eggs.

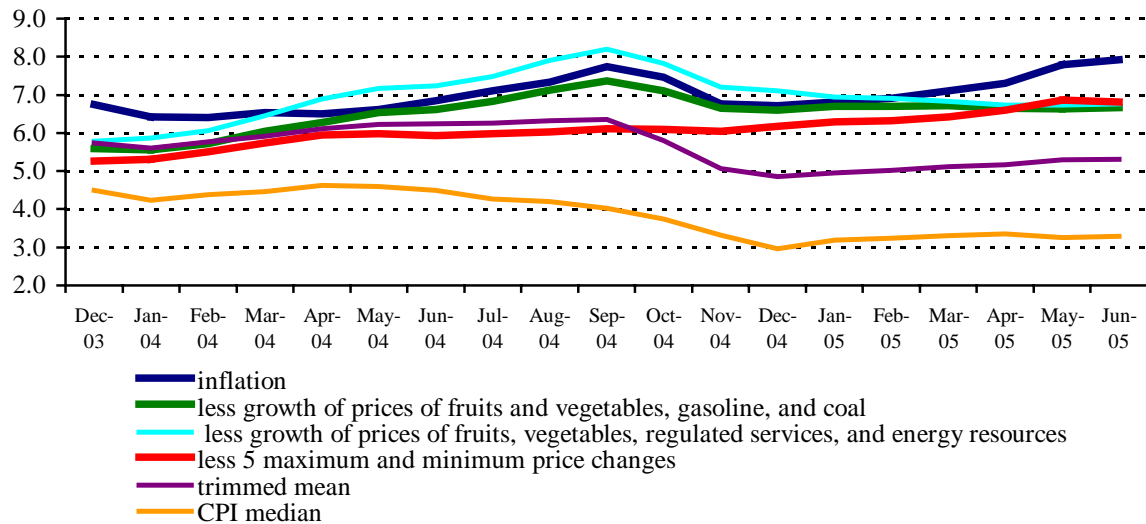
This year the dynamics of the annualized indicators of core inflation determined by all methods were similar. Versions 1 and 5 core inflation exhibited steady growth throughout

² In its monetary policy the National Bank orients itself 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 of the five components from the CPI showing the biggest price increase, and five components with the biggest price decrease. Indicators of base inflation calculated by other methods are used by the national bank for analytical purposes.

the entire year, there was a decrease in the rate of growth in version 2, and the rate of growth accelerated insignificantly in versions 3 and 4 (Figure 5).

All of this is evidence that the influence of monetary factors on inflationary processes, and specifically the significant growth of money measures that was observed in the second half of 2004, is still having the impact of increasing prices in the country. Nonetheless it is anticipated that pressure on the part of monetary factors will decrease in the second half of this year owing to negligible growth of money supply in the first half of 2005, which should manifest itself as a decrease in the annualized indicators of core inflation.

**Figure 5. Inflation and Core Inflation
(Percent, in Annual Terms)**



Source: Republic of Kazakhstan Statistical Agency

c. Prices in the Real Sector of the Economy

Prices in Industrial Production

Industrial producer prices rose 5.6 percent in April-June 2005 (6.2 percent in the second quarter of 2004). Manufactured products grew 6.0 percent more expensive, chiefly due to a 6.4 percent increase for products of intermediate consumption, while production resources grew 4.6 percent and consumer goods grew 2.3 percent more expensive. The increase in prices of services related to production was 1.8 percent.

The increase in prices in mining industry was 8.5 percent in the second quarter of 2005 (8.2 percent in the same period of 2004). Price dynamics took shape in these industries

under the influence of changes in the prices of fuel and energy resources: price increases were 10.1 percent for oil, 8.5 percent for gas condensate, 2.2 percent for coal, and 2.1 percent for natural gas. An increase in the prices of energy and other raw material goods on the world markets was one of the causes of their rather high growth.

The rate of increase of prices in processing industry was 2.7 percent, having decreased below the indicator for the same period of 2004 (5.2 percent). Producing enterprises raised their prices 4.1 percent for nonferrous metals and 1.4 percent for rolled ferrous metals.

The increase of prices in the production and distribution of electricity, gas, and water in the second quarter of 2005 was 2.5 percent (1.5 percent in the second quarter of 2004).

In annual terms the increase in prices in industrial production was 23.0 percent.

Prices in Agriculture

The agricultural product selling price index fell 0.3 percent in the second quarter of 2005 (it grew 0.6 percent in the second quarter of 2004). The price decrease was made possible by the cheapening of livestock products in general by 2.8 percent, at the same time that the prices of plant farming products climbed 1.7 percent.

Seasonal decreases in the prices of milk (13.9 percent) and eggs (15.2 percent) were noted in the structure of the prices of livestock products. The prices of livestock and poultry meat increased 3.4 percent.

Plant farming products grew more expensive owing to growth of the prices of vegetables (4.7 percent) and cereal crops (1.7 percent).

In annual terms the prices in agriculture increased 1.1 percent.

Enterprise Monitoring³

Since 2002 the Republic of Kazakhstan National Bank has been gathering information on inflationary expectations as part of its monitoring of enterprises in the real sector. This information takes the form of qualitative assessments made by the directors of surveyed enterprises regarding the prices of finished products used in the production of raw materials and supplies in the upcoming quarter.

³ According to data of the Republic of Kazakhstan National Bank.

According to this survey, compared to the preceding quarter there was an overall increase in the demand for finished products among surveyed enterprises in the second quarter of 2005. Thus, 36.2 percent of the enterprises reported an increase in demand (26.7 percent did so in the first quarter), while concurrently the share of enterprises experiencing a decrease in product demand decreased (from 20.4 percent to 13.0 percent). In the third quarter of this year the current situation is anticipated to remain the same in connection with a decrease in the share of enterprises (to 30.6 percent) expecting an increase in demand and a significant increase in the share of enterprises (to 62.3 percent) with stable demand.

The situation with the prices of finished products remained stable in the second quarter compared to the first quarter of this year. Stable prices were reported by 67.1 percent of enterprises (72.2 percent in the first quarter), while 27.4 percent (20.8 percent) reported price increases. Further stabilization of prices is projected in the third quarter: the share of enterprises with stable prices will increase to 73.1 percent, and the share of enterprises for which an increase in prices is projected for their products will decrease to 22.8 percent.

In April-June 2005 compared to the preceding period, however, the situation with the prices of raw materials and supplies worsened. Thus, 59.8 percent of the enterprises reported an increase in prices, while only 54.2 percent of the surveyed enterprises noted an increase in prices in January-March 2005. Price stability was noted by 39.1 percent, as opposed to 44.4 percent in the first quarter of 2005. Even so, enterprises anticipate an improvement in the situation in the third quarter: 50 percent of enterprises predict that prices will stabilize, and 47.3 percent of the enterprises predict that prices will increase.

2. Fiscal Policy⁴

Planned indicators have been surpassed significantly in the course of execution of the budget's revenue side in recent years. As a result, an upward adjustment of revenues over the course of the financial year continues to be a characteristic trait of budget execution. This can be explained by a higher rate of economic growth, one surpassing the anticipated indicators and, consequently, by understatement of budget revenues during the initial forecasting.

All of this is causing growth of taxpayer income collected by the state. Thus, taking account of the repayment of budget credits, and of receipts from the sale of financial assets, the budget's revenue side increased from 21.7 percent of GDP in 2002 to 24.1 percent of GDP (as planned for 2005).

A similar situation is observed this year as well. Because the plan was exceeded in the first months of the year, changes could be made in the plan for the revenue side of the Republican and local budgets. Thus, the plan for revenues of the 2005 state budget increased by T129.5 billion, or by 9.0 percent of the initially approved indicators.

Revenues of the state budget in the second quarter of 2005 were T465.7 billion, which is an unprecedented quarterly maximum. Compared to indicators for the same period of the preceding year, they increased 41.7 percent. Tax receipts, which constitute 94.6 percent of state budget revenues, grew 55.6 percent. Growth of receipts is occurring from both raw material and non-raw material sectors.

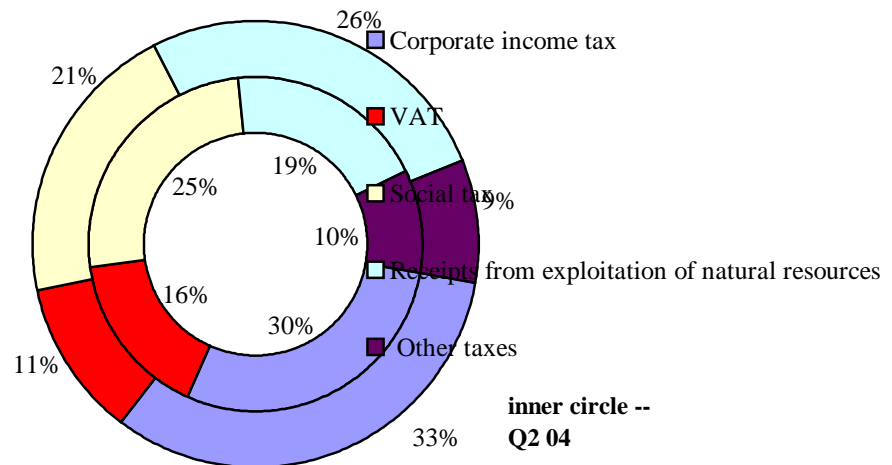
In the period in question compared to the second quarter of 2004, receipts from exploitation of natural and other resources grew by a factor of 2.1, mainly due to increases in collections of windfall tax (a 6.3-time increase), which is something that would obviously occur in the face of high oil prices, and royalties (an 80.7 percent increase). As a result, this type of receipts has become the second-largest type of tax receipts, "overtaking" VAT receipts. Corporate income tax is showing a significantly increasing trend. Receipts of this tax grew 79.8 percent in the second quarter of 2005 compared to the same period of 2004. Inasmuch as the increase in receipts of VAT, and of social and other taxes, occurred at a slower rate, their share within the structure of tax receipts decreased (Figure 6).

Continual growth of the revenue side of the state budget is having the associated impact of increasing its expenditures. Thus, expense items (expenditures, budget credits, and acquisition of financial assets) grew from 22.1 percent of GDP in 2001 to 26.5 percent of GDP (as planned for 2005). The expenditure plan for this year's budget, moreover, was increased by T259.2 billion, or by 19.1 percent.

⁴ Based on data of the Republic of Kazakhstan Ministry of Finance.

Funding of state budget expenditures in the second quarter of 2005 totaled T412.1 billion. Compared to the indicators for the same period of the preceding year, expenditures increased 34.4 percent. Current expenditures increased in the second quarter of 2005 by 26.2 percent compared to the same period of 2004, while capital expenditures increased by 64.6 percent.

Figure 6. Structure of Tax Receipts of the State Budget



Source: Republic of Kazakhstan Ministry of Finance

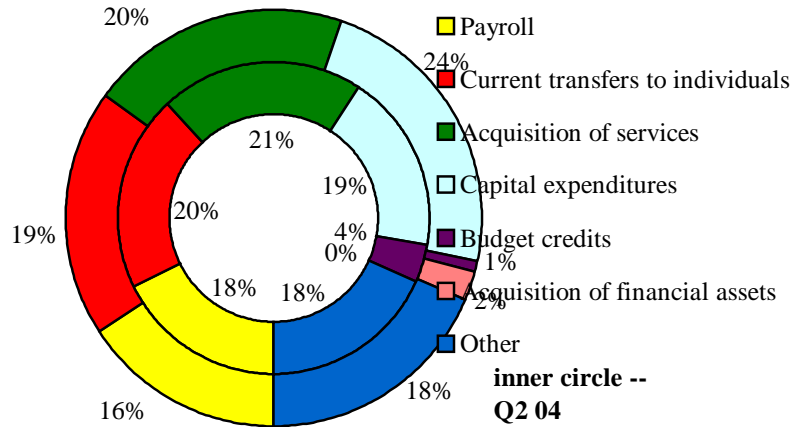
Cash expenses (current transfers to individuals and payroll expenses), which have a significant influence on the dynamics of cash in circulation, constitute a sizable share of the budget's expenditure structure. A tendency for all of these expenditures together to decrease in the second quarter of 2005 compared to the same quarter of 2004, moreover, is clearly evident in their dynamics (Figure 7).

The higher rate of growth of budget revenues compared to expenditures helped to increase the state budget's operating balance, which grew by a factor of 2.4 compared to the second quarter of 2004, coming to a figure of T53.6 billion.

Net budget credits in the second quarter of 2005 (T0.5 billion) shrank by a factor of 19.4 compared to the same period of 2004. In this case credits granted shrank by 72.7 percent, while credits repaid decreased by 12.8 percent. Acquisition of financial assets grew by a factor of 4.0 due to growth of expenditures on creation of state developmental institutions and increase of their capitalization.

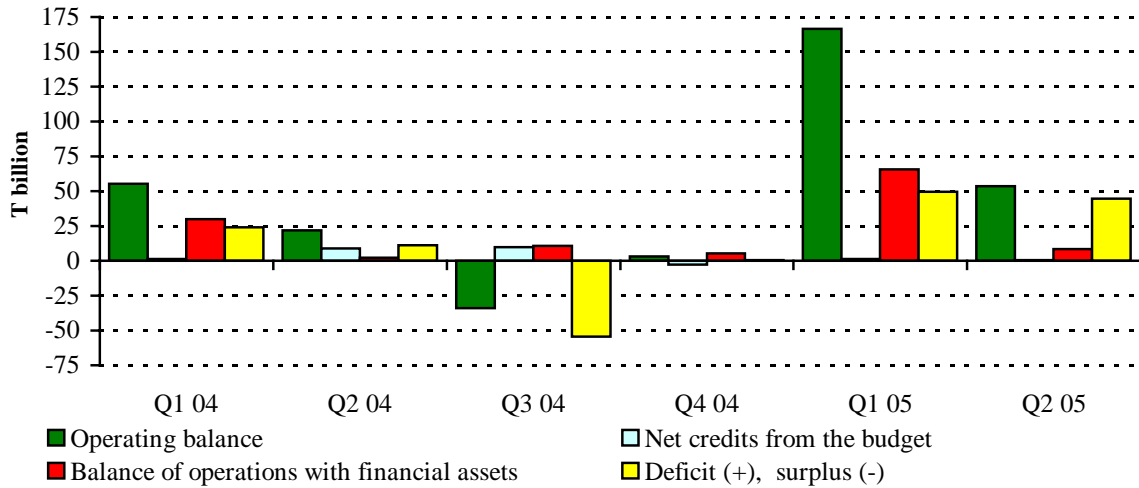
As a result the state budget ended up with a surplus of T44.8 million in the second quarter of 2005, having increased by a factor of 4.1 compared to the same period of 2004 (Figure 8).

Figure 7. Structure of Expenditures of the State Budget, Including Budget Credits and Acquisition of Financial Assets



Source: Republic of Kazakhstan Ministry of Finance

Figure 8. Execution of the State Budget in Terms of the 2005 Structure



Source: Republic of Kazakhstan Ministry of Finance

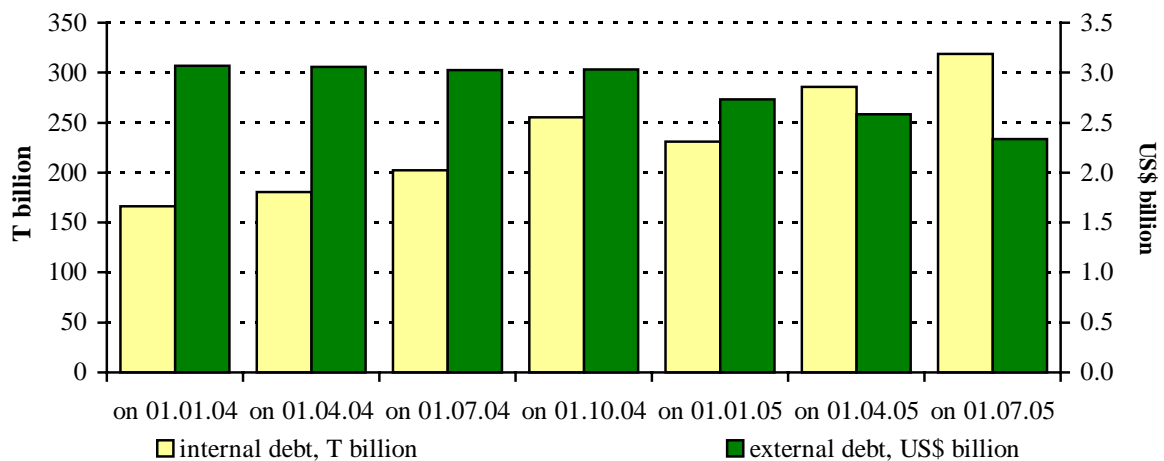
The funding sources for the possible deficit shaped up as follows: receipts of loans – T51.2 billion, and their repayment -- T28.1 billion. As a result the amount of the government's temporarily uncommitted money increased during the second quarter of 2005 to T67.9 billion.

In the second quarter of 2005 the Ministry of Finance decreased the volume of its placements of government securities by 15.8 percent compared to the preceding quarter -- to T48.0 billion. Net issuance of obligations of the Ministry of Finance (placement minus redemption) was T33.4 billion, which is 39.0 percent less than the preceding quarter's volume. As result government internal debt increased 38.1 percent in the second quarter of 2005 compared to the first quarter of 2005, reaching T319.2 billion.

This year the Ministry of Finance changed its approach to placing its securities: the number of auctions was reduced to one a month (in the last week), coupled with an increase in their volume. The Ministry of Finance, moreover, now announces the auction schedule a quarter in advance, and the auction volume.

The government's external debt shrank 14.6 percent in the second quarter of 2005, to a figure of US\$2.3 billion (Figure 9).

Figure 9. Dynamics of Government Debt



Source: Republic of Kazakhstan Ministry of Finance

Considering the above, it should be noted that the state's more-active participation in the redistribution of revenues, expenditures, and other monetary flows in the economy is a characteristic trait of budget execution. On one hand there is a continual increase in the amount of added value, collected to the budget in the form of taxes. It is occurring, moreover, despite the reductions made in some of the tax rates in recent years. On the other hand, the state is increasing investments in the economy and enlarging the volume of state property with increasing vigor. While in past years the state funded certain expenditures on a lending basis, this year the volume of granted credits decreased due to growth of expenditures -- that is, unrequited funding.

We can thus assert the fact that the Ministry of Finance possesses sizable "surplus" financial resources, over and above what is needed to fund budget programs currently in place.

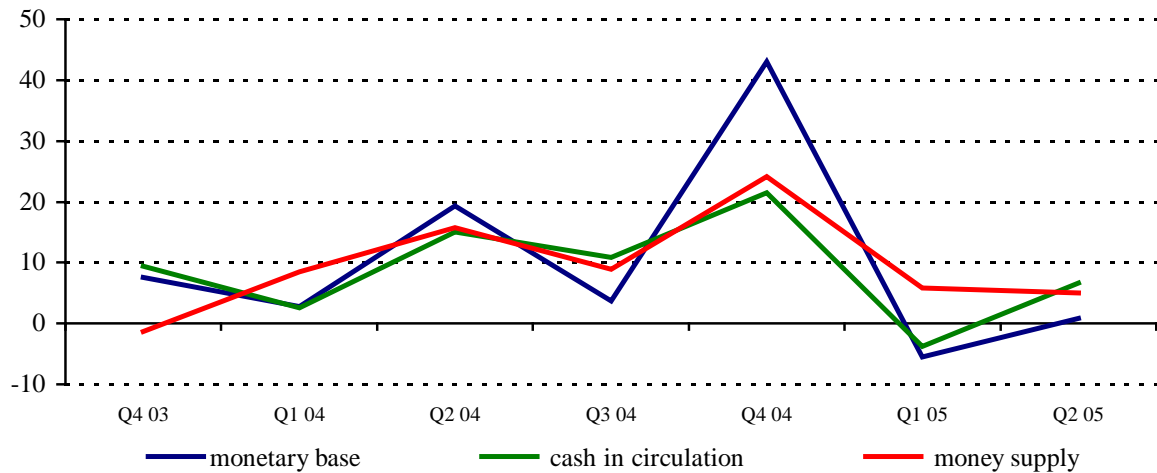
All of this is evidence of significant fiscal expansion, which is a significant obstacle to effective regulation of inflationary processes in Kazakhstan.

3. Monetary Policy

a. The Supply of Money

The dynamics of money supply indicators in the second quarter were typical of this period: growth was observed for all money measures. Even so, this year the rate of expansion of the money supply has been exhibiting noticeably lower indicators. Thus, according to the results for June 2005, the Money base did not attain the indicators of December 2004 (a 4.7 percent decrease), while in the first half of 2004 its growth was 22.6 percent. The rate of growth of the money supply fell to 11.1 percent (it was 25.6 percent in the first half of 2004). Cash in circulation increased 2.7 percent in January-June 2005, as opposed to 18.0 percent in January-June 2004. Besides that, mention should be made of a slowing in the rate of growth of the money supply in the second quarter of 2005 (5.0 percent) compared to the preceding quarter (5.8 percent) (Figure 10).

**Figure 10. Dynamics of Money Measures
(Percent of Preceding Period)**



Source: Republic of Kazakhstan National Bank

Money Base

At the end of June the Money base was T550.6 billion. During the second quarter of 2005 it expanded 0.8 percent, which is a rather low indicator for this period. In 2000-2004, the average rate of its expansion during the second quarter was estimated at more than 16 percent.

Negligible growth of the Money base against the backdrop of a significant increase in internal assets is explained by a decrease in the National Bank's net external assets.

This decrease, which was 11.9 percent, occurred due to a drop in the volume of the National Bank's net international reserves by 13.6 percent (or by US\$1.3 billion), to a figure of US\$8.0 billion.

Within the structure of net international reserves, moreover, foreign exchange assets decreased 15.2 percent. Operations of the National Bank, both within the framework of monetary policy and with government accounts, were the causes of this. In the second quarter the National Bank acted as a net seller of foreign exchange on the internal currency exchange. Operations with government accounts were connected with service and repayment of external debt, which shrank 14.6 percent, and with sale of foreign exchange with the goal of replenishing the assets of the National Fund, which increased 1.1 percent. Gold assets increased 3.4 percent as a result of the operations and a 2.2 percent increase in the price of gold on the world markets.

Table 1. Dynamics of Changes in the National Bank's Assets and Liabilities

	Q1 05		Q2 05	
	T billion	% of preceding quarter	T billion	% of preceding quarter
Net external assets	1912,7	1,9	1788,3	-11,9
Net internal assets	-1281,5	-16,0	-1225,9	12,9
Net internal credit	-528,9	-18,8	-444,1	16,0
net claims against government	-143,2	-98,4	-178,7	-24,8
claims against financial institutions	-387,9	-3,3	-268,9	30,7
claims against the rest of the economy	2,2	-15,7	3,6	66,3
Other net internal assets	-68,7	1,9	-76,5	-11,4
Liabilities	631,2	-8,6	562,4	-10,9
Money base	546,1	-5,5	550,6	0,8
Other deposits	81,3	-27,8	7,2	-91,1
Credits (repo)	3,9	-	4,5	17,7

Source: Republic of Kazakhstan National Bank

The National Bank's net internal assets grew 12.9 percent owing to an increase in net claims upon sectors of the economy, with the exception of the government. Claims against financial institutions grew 30.7 percent, while claims against the rest of the economy grew 66.3 percent. It should be noted that growth of claims against financial institutions occurred despite a significant volume increase in National Bank operations on the money market. This is explained to a great extent by the fact that growth of the volumes of short-term note issuances (by a factor of 2.6 in the second quarter compared to the preceding quarter) was

accompanied by significant reduction of their time of circulation (by a factor of 1.7). The volume of notes in circulation decreased as result.

Net claims against the government shrank 24.8 percent as result of growth of the balances of the government's accounts with the National Bank, which in turn had the consequence of a persisting budget surplus.

Despite the fact that the Money base expanded 0.8 percent in the second quarter of 2005, the National Bank's liabilities shrank 10.9 percent owing to a 91.1 percent decrease in deposits not accounted for in the calculation of the Money base (Table 1).

Monetary Survey of Second-Tier Banks

Expansion of both net external assets (by 0.4 percent) and internal assets of second-tier banks (by 10.5 percent) was observed in the second quarter of 2005 compared to the preceding quarter, with liabilities increasing by 14.2 percent.

The period in question was characterized by further growth of the resource base of banks, supported by both external and internal sources. Obligations owed to nonresidents increased 13.2 percent in connection with growth of credits received from nonresidents (by 21.2 percent) and with insignificant increase of the deposits of nonresidents in accounts with banks in Kazakhstan (by 1.4 percent). Internal sources of banks grew owing to a 10.8 percent increase in the deposits of residents.

Growth of the resource base of banks helped keep the rate of credit expansion in Kazakhstan's economy high. Claims against the economy increased 17.6 percent during the second quarter. Consumer lending is growing at a significant pace, and in this connection, the increase in claims of banks against households was 25.6 percent. Claims against nonfinancial institutions grew 15.2 percent.

In addition, second-tier banks actively placed attracted resources in external assets, which decreased to a certain degree the pressure on the internal economy. Claims against nonresidents grew 21.6 percent during the second quarter of 2005, and were channeled mainly into lending (35.1 percent of total claims), placement in deposits (32.3 percent), and acquisition of securities (23.8 percent).

Claims of second-tier banks against the government increased negligibly -- by 1.6 percent, which is connected with the low interest banks display toward securities of the Ministry of Finance in a view of their low yield.

Within the structure of the claims of second-tier banks against the National Bank, only cash domestic currency in bank cash departments increased, while deposits and other

claims of banks decreased, causing an overall reduction of claims against the National Bank (Table 2).

Table 2. Monetary Survey of Second-Tier Banks

	Q1 05		Q2 05	
	T billion	% of preceding quarter	T billion	% of preceding quarter
Net external assets	-485,6	-3,1	-483,6	0,4
claims against nonresidents	636,9	26,9	774,4	21,6
obligations to residents	1122,5	15,4	1257,9	12,1
Internal assets	1933,8	7,3	2137,6	10,5
Claims against National Bank	392,6	0,1	329,5	-16,1
Internal credit	1917,5	9,2	2232,0	16,4
net claims against government	139,3	11,2	141,5	1,6
claims against economy	1778,2	9,1	2090,5	17,6
Other net internal assets	-376,3	-8,8	-424,0	-12,7
Liabilities	1448,2	8,8	1654,0	14,2
deposits	1298,8	11,4	1438,6	10,8
other	149,5	-9,5	215,4	44,1

Source: Republic of Kazakhstan National Bank

Broad Money

Growth of the broad money in the second quarter of 2005 was 5.0 percent, reaching a figure of T1,833.3 billion, made possible by a 23.0 percent increase in the internal assets of deposit institutions coupled with a 19.3 percent decrease in their net external assets.

Decrease of the net external assets of deposit institutions during this period was brought about by shrinkage of the National Bank's gold and foreign exchange assets against the backdrop of an insignificant increase in the external assets of banks.

Growth of the internal assets of deposit institutions in the second quarter of 2005 was made possible by continuing growth of lending to the nonfinancial sector of the economy. The increment in claims of deposit institutions against the economy during the second quarter of 2005 was 17.9 percent compared to the preceding period (Table 3).

A higher rate of expansion of the broad money compared to the rate of growth of the Money base led in the period in question to an increase in value of the money multiplier from 3.20 to 3.33.

Table 3. Dynamics of Changes in the Broad Money

	Q1 05		Q2 05	
	T billion	% of preceding quarter	T billion	% of preceding quarter
Broad money	1746,1	5,8	1833,3	5,0
Net external assets	1427,1	1,2	1304,7	-19,3
Internal assets	318,9	9,5	528,6	23,0
net claims against government	-4,0	-107,6	-37,3	-834,0
claims against economy	1793,6	8,9	2114,4	17,9
other net internal assets	-786,8	-0,3	-843,1	-7,2

Source: Republic of Kazakhstan National Bank

Analysis of the dynamics of the main constituents of the broad money in the second quarter of 2005 shows that the increase of cash in circulation (6.7 percent) is outpacing growth of the deposits of residents with deposit institutions (4.5 percent). Consequently, based on the results of the second quarter of 2005 the proportion of the latter in the structure of the broad money decreased from 79.1 percent to 78.8 percent (Table 4).

Table 4. Dynamics of Changes in Constituents of the Broad Money

	Q1 05		Q2 05	
	T billion	% of preceding quarter	T billion	% of preceding quarter
Broad money	1746,1	5,8	1833,3	5,0
cash in circulation	364,8	-3,8	389,5	6,7
deposits of residents	1381,2	8,7	1443,9	4,5

Source: Republic of Kazakhstan National Bank

- Cash in Circulation

Cash in circulation increased 6.7 percent in the second quarter of 2005 compared to the preceding quarter to a figure of T389.5 billion. Seasonal increase of business activity in the economy, growth of wages, and the dynamics of the tenge's exchange rate had the dominant influence on its dynamics, as is confirmed by data on the cash turnover of second-tier banks and institutions engaging in certain kinds of nonbank operations.

Compared to the first quarter of 2005, net issuance of cash in payment of goods, services, and completed work increased in the second quarter of 2005 by 35.1 percent. This is connected first and foremost with seasonal growth of retail turnover, which is estimated at 9.8 percent in nominal terms in the first quarter of 2005 compared to the past quarter.

Issuances of cash in payment of agricultural products also climbed, which is connected with seasonal resumption of activity in this industry.

The next factor contributing noticeably to change in the amount of cash in circulation in the second quarter of 2005 is the aggregate growth of net payroll payments, of payments to fill automatic teller machines, and payments into demand deposits and current accounts of individuals. Compared to the first quarter of 2005 their volume increased 28.3 percent.

Depreciation of the tenge and associated growth of the public's depreciation expectations helped to increase demand for cash foreign currency. A significant increase in cash receipts from sales of foreign exchange (36.1 percent) against the backdrop of a slight increase in issuances of cash for its acquisition (3.0 percent) restrained growth of cash in circulation (Table 5).

Table 5. Balance of Payments and Receipts of Cash through Bank Cash Departments

	Q1 05		Q2 05	
	T billion	% of preceding quarter	T billion	% of preceding quarter
Goods, services, and completed work payments	-67,6	-39,1	-43,9	35,1
sales receipts	169,0	-26,5	250,5	48,2
	236,6	-15,0	294,4	24,4
Payroll (accounting for money in automatic teller machines, demand assets, and current accounts of individuals)	200,6	-17,9	257,4	28,3
Agricultural products	9,8	-62,1	13,0	32,4
Operations with foreign currency	-95,6	-5,9	-157,1	-64,4
issuance for purchase of currency	81,4	-15,3	83,8	3,0
receipts from sales of currency	177,0	-5,0	241,0	36,1
Time deposits of individuals	-5,2	75,9	-1,0	81,1
Pensions and benefits	52,0	6,4	56,9	9,6
Other items	-90,1	-31,3	-76,6	15,0
Overall balance of cash payments and receipts	3,9	-95,6	48,8	1139,6

Source: Republic of Kazakhstan National Bank

- Deposits of Residents

Deposits of residents reached T1,443.9 billion at the end of June 2005. In the second quarter of 2005 they grew only 4.5 percent.

A slowdown in the rate of growth of deposits of residents is noted in relation to both transferred (8.4 percent) and other deposits (2.7 percent). Mention should be made of the

unfavorable decreasing trend in the share of other deposits in their total volume, which has been observed in the current year: having reached the maximum in December 2004 (70.4 percent), as of the end of June 2005 they decreased to 66.2 percent.

The tenge's depreciation relative to the U.S. dollar observed this year led to change in the public's preferences in the selection of the currency of bank deposits, which manifested itself especially clearly in the second quarter. Other deposits of the public in foreign currency grew 14.2 percent, while the volume of tenge deposits underwent practically no change -- a 0.1 percent increase.

If we analyze the same ratio for nonbank legal entities, however, the picture is absolutely the opposite: there was a 17.0 percent increase in other deposits in tenge, and a 12.6 percent decrease in other deposits in foreign currency. In all probability legal entities prefer to keep their money in the currency in which they receive their income (Table 6).

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

	Q1 05	Q2 05	Share, % ⁵
Deposits of residents	8,7	4,5	100,0
Transferred tenge deposits	7,0	11,9	25,0
of individuals	-2,9	12,0	3,3
of nonbank legal entities	8,7	11,9	21,7
Other tenge deposits	6,9	8,3	33,7
of individuals	8,8	0,1	16,0
of nonbank legal entities	5,1	17,0	17,7
Transferred foreign currency deposits	70,2	-0,5	8,8
of individuals	0,6	23,3	1,2
of nonbank legal entities	86,8	-3,5	7,5
Other foreign currency deposits	1,6	-2,6	32,5
of individuals	5,5	14,2	14,3
of nonbank legal entities	-0,5	-12,6	18,3

Source: Republic of Kazakhstan National Bank

b. Instruments and Operations of Monetary Policy

In the second quarter of 2005 the National Bank pursued monetary policy in the face of persisting high liquidity on Kazakhstan's financial market. Average daily balances in the correspondent tenge accounts of second-tier banks with the National Bank increased 4.8 percent in April-July compared to the preceding quarter, while compared to the second quarter of 2004 they practically doubled (a 91.1 percent increase). Their maximum occurred

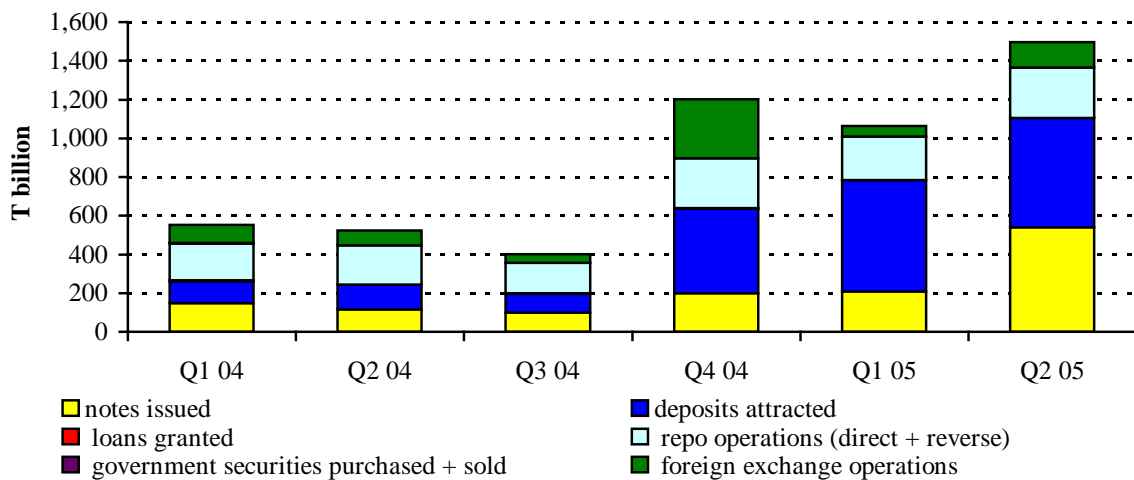
⁵ As of April 1, 2005.

in the second half of June, when they totaled T60 billion on a daily average, reaching a historical maximum on June 26 -- T95.9 billion.

After 2 years of nominal strengthening of the tenge against the U.S. dollar, this year the dynamics of the tenge are characterized by its nominal depreciation. Participants of the financial market determined their behavior on the money market based on the situation on the currency exchange. Actions of the National Bank on the financial market were determined by the behavior of the market's participants and the prevailing situation.

During all of the second quarter the National Bank carried out a number of operations on the financial market, including issuance of short-term notes, attraction of deposits, direct and reverse repo operations, purchase of government securities, and purchase and sale of foreign currency, to a sum of T1,497.4 billion. Compared to the preceding quarter the volume of its operations grew 40.8 percent, while compared to the same period of 2004 it grew by a factor of 2.9. Compared to the preceding quarter, moreover, the volume of operations increased 35.0 percent on the money market and by a factor of 2.5 on the currency exchange (Figure 11).

Figure 11. Operations of the National Bank on the Internal Financial Market



Source: Republic of Kazakhstan National Bank

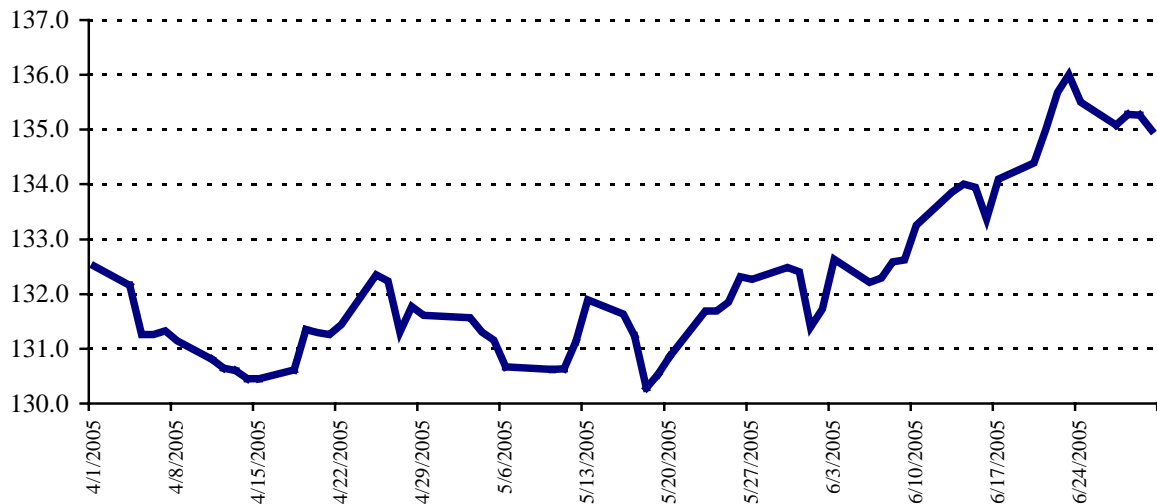
Money market operations remain the largest in volume: attraction of deposits, issuance of short-term notes, and repo operations. In the second quarter of 2005 their total volume exceeded 91.0 percent of the total volume of all operations. Operations with foreign currency (purchase + sale) were 8.9 percent, having increased from 5.0 percent in the first quarter of 2005. As in preceding periods, operations concerned with purchase and sale of government securities from the National Bank's portfolio and with granting loans are not playing a role on the financial market in view of the negligible volume of these operations.

Exchange Rate

Nominal weakening of the tenge against the U.S. dollar continued in the second quarter of 2005: according to the quarter's results, the tenge's exchange rate underwent a 1.84 percent depreciation, from T132.55 to the U.S. dollar to T134.99 to the U.S. dollar (1.96 percent in the first quarter of 2005).

The weighted average exchange rate of the tenge for the second quarter of 2005 was T132.31 to the U.S. dollar. During the quarter the value of the tenge against the U.S. dollar changed within the range of T130.28-T136.00 to the dollar (Figure 12).

Figure 12. Dynamics of the Nominal Exchange Rate of the Tenge against the U.S. Dollar



Source: Republic of Kazakhstan National Bank

The situation on the international exchange market was a significant factor influencing the dynamics of the tenge's exchange rate against the U.S. dollar and other foreign currencies in the second quarter of 2005. Negative results of referendums on the draft constitution of the European Union in France and the Netherlands, publication of data showing a decrease in the U.S. budget deficit and trade balance deficit, and of a large number of other indicators attesting to improvement of the economic situation in the USA and its relative worsening in euro area countries, and higher interest rates in the USA helped to preserve the increasing trend of the exchange rate of the U.S. dollar against the euro on the global exchange market. As a result the U.S. dollar's exchange rate against the euro on the international exchange market grew by more than 6.0 percent in the second quarter.

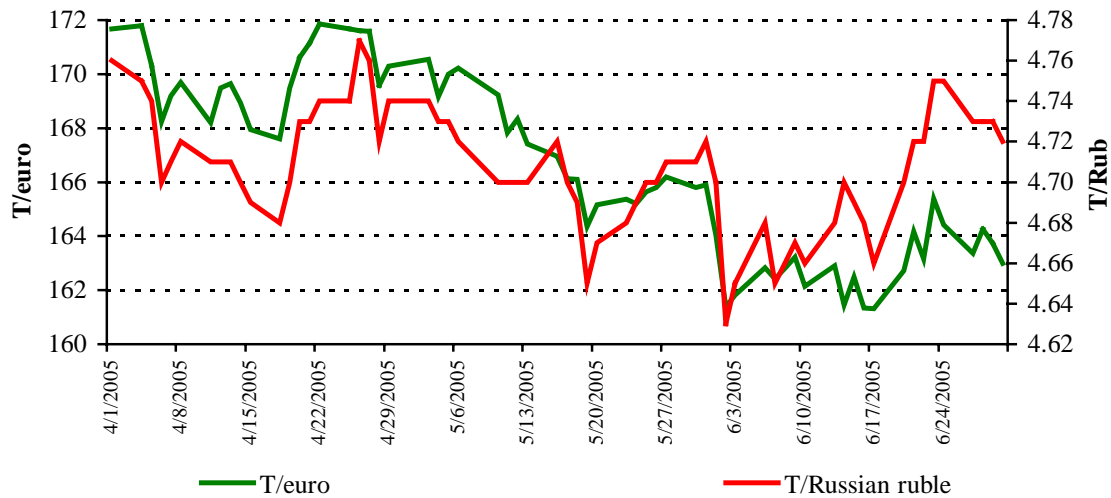
Besides the situation prevailing on the global market, an increase in demand for foreign currency on the part of second-tier banks in connection with the need banks had for

settling obligations under external loans, and with persistence of the yield of tenge instruments at a low level, influenced the tenge's exchange rate against the U.S. dollar.

The position of the single European currency on the international financial market and stabilization of the tenge's exchange rate against the U.S. dollar impacted the dynamics of the exchange rate of the tenge relative to the European currency on the Kazakhstani market. During the second quarter of 2005 the official exchange rate of the tenge against the euro grew stronger by 5.22 percent, and by the end of the period it was T163.0 to the euro (Figure 13).

The dynamics of the exchange rate of the Russian ruble against the tenge were determined mainly by policy of the Central Bank of Russia on the exchange rate of the Russian ruble against the U.S. dollar. Thus, in the second quarter of 2005 the official exchange rate of the tenge to the Russian ruble grew stronger by 1.05 percent (Figure 13).

Figure 13. Dynamics of the Official Exchange Rate of the Tenge to the Euro and the Russian Ruble



Source: Republic of Kazakhstan National Bank

In the second quarter of 2005 the volume of exchange trading in the dollar position on the Kazakhstani Stock Exchange was US\$3.22 billion, which is 66.0 percent above the level of the preceding quarter.

The volume of operations on the over-the-counter exchange market practically doubled during the second quarter of 2005 compared to the first quarter, reaching a figure of US\$5.48 billion. The lowest volume of operations was observed in April, and the maximum

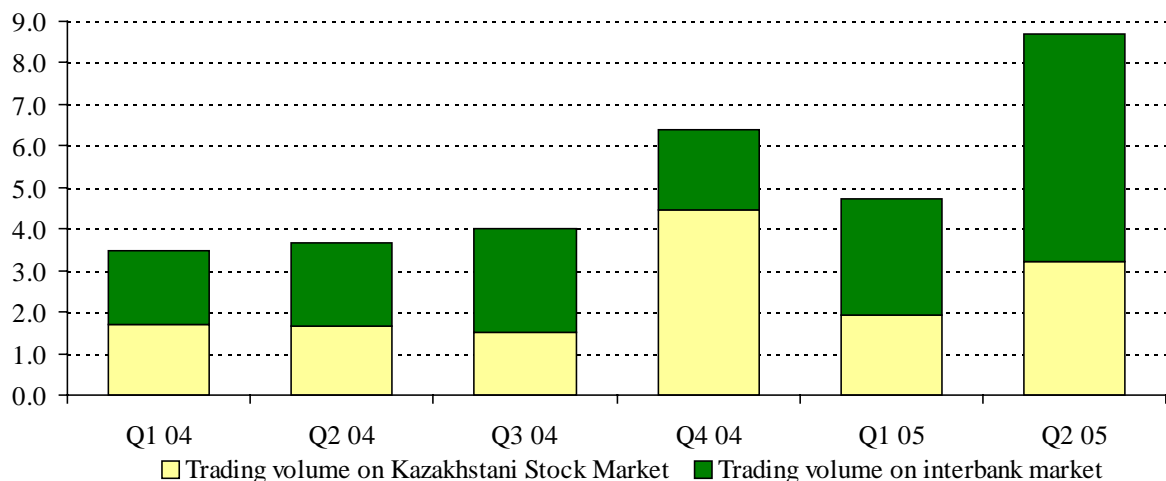
in June. On the average, the monthly trading volume during the second quarter was US\$1,826.1 million (Figure 14, Table 7).

For the purposes of maintaining a balance between demand and supply of foreign exchange on the internal exchange market, the National Bank acted as a net seller of foreign exchange. The coefficient of the National Bank's participation was about 7.4 percent.

It should be noted that the exchange market dominated the entire internal financial market of Kazakhstan in the second quarter of 2005, and participants of the financial market determined their behavior on the money market based on the situation on the exchange market.

Acceleration of the rate of depreciation observed in June was accompanied by growth of trading volume on the exchange market, with the number of currency buyers significantly surpassing the number of its sellers in certain periods. This was especially clearly evident in the period from June 20 to June 24, 2005.

Figure 14. Trading Volume on the Internal Exchange Market, US\$ Billion



Source: Republic of Kazakhstan National Bank

Table 7. Trading Volume on the Internal Exchange Market, US\$ Million

	Jan 05	May 05	Jun 05
Trading volume on Kazakhstani Stock Market	742,13	802,53	1 678,93
Trading volume on interbank market	1 730,18	1 807,89	1 940,19

Source: Republic of Kazakhstan National Bank

A significant tenge shortage arose on the money market as result of the transfer of money to the exchange market. The tenge correspondent accounts of second-tier banks with the National Bank shrank dramatically. Abrupt growth of the yields of "short" tenge

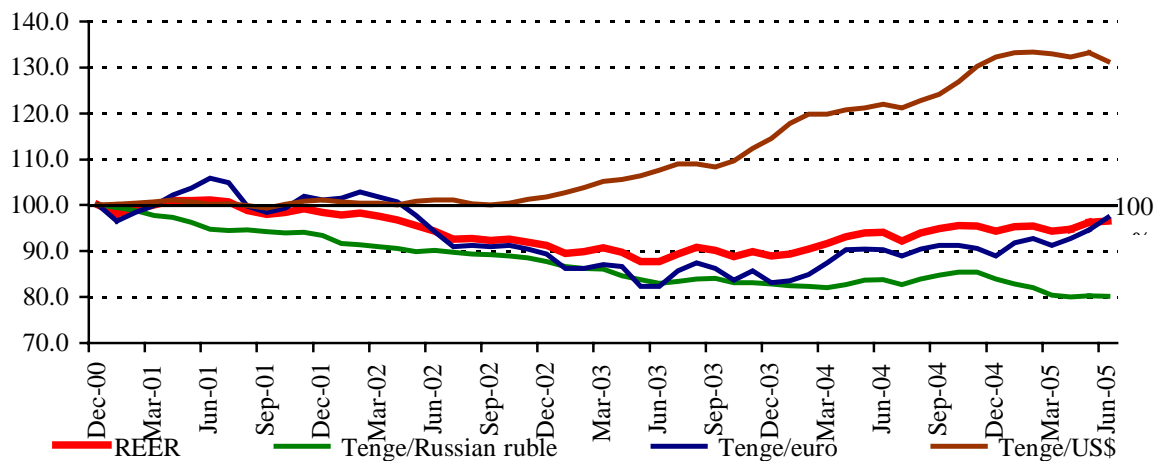
instruments was the consequence. Thus, from June 20 to June 23, 2005 the weighted average rate on the repo market for overnight operations -- that is, for operations in which repayment occurs on the next business day -- climbed from 1.8 percent to 9.2 percent (for certain operations it reached 15.0 percent).

Growth of yields in this period was also observed for tenge interbank deposits. An opposite falling trend in the yield of issued dollar interbank credits can be explained by saturation of banks with U.S. dollars.

In the subsequent period and until the end of June 2005, the situation on the financial market remained relatively stable. The tenge "regained" its positions relative to the U.S. dollar to a certain extent, and weighted average yield on the market was within the 0.3-2.0 percent range -- that is, in its usual range.

Based on the results for the second quarter of 2005 (June 2005 compared to March 2005) the index of the real effective exchange rate (REER) grew 2.4 percent stronger relative to March 2005. During the second quarter of 2005 real strengthening of the tenge relative to the euro was 6.8 percent. Relative to the U.S. dollar and the Russian ruble the tenge underwent depreciation in real terms by 1.2 percent and 0.2 percent respectively (Figure 15).

**Figure 15. Real Exchange Rate Indices, Percent
(December 2000 = 100 Percent)**



Source: Republic of Kazakhstan National Bank

Official Rates of the National Bank

Official rates of the National Bank remained unchanged in the second quarter of 2005.

The practice of quarterly review and establishment of the official refinancing rate was introduced from the start of this year. Since May 1 it has been kept at 7.5 percent.

The official rates for repo operations and for overnight loans, which are subject to monthly review, did not undergo change during the second quarter of 2005: 4.50 percent with the band of permissible deviations being +/-1.75 basis points, and 8.5 percent respectively.

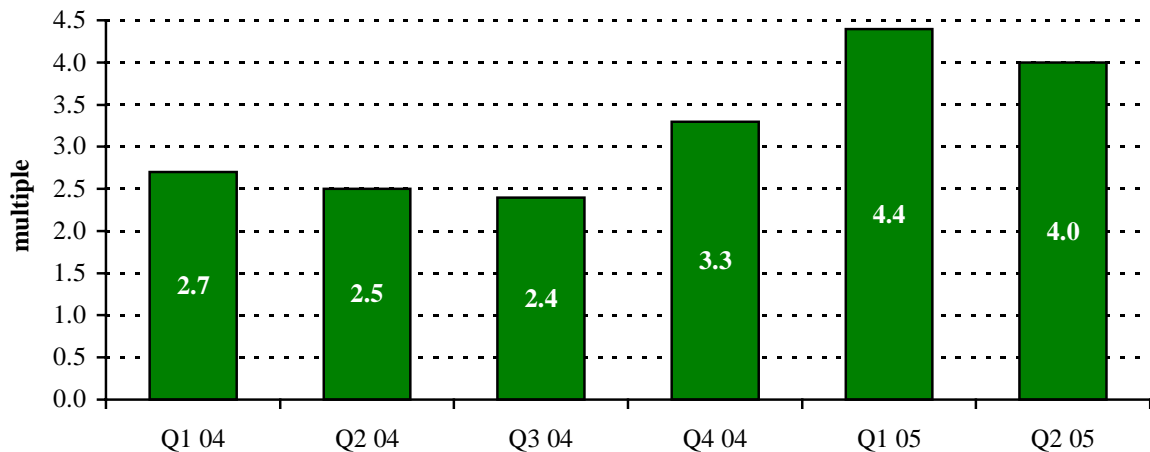
Minimum Required Reserve Ratio

The minimum required reserve ratio did not change in the second quarter of 2005, standing at 6 percent of a bank's liabilities maturing all or in part in the current month or the following month.

The number of second-tier banks satisfying the minimum reserve requirements by the first method⁶ was 34 at the end of the second quarter of 2005.

High liquidity of second-tier banks made possible a sizable volume of surplus reserves, despite the fact that they decreased somewhat in this period compared to the preceding quarter. While reserved assets exceeded the reserve requirement by an average of 4.0 times in the second quarter of 2005, in the first quarter of 2005 the requirement was exceeded by 4.4 times (Figure 16).

Figure 16. Amount by Which Reserved Assets Exceed Minimum Required Reserves



Source: Republic of Kazakhstan Agency for Regulation and Supervision of the Financial Market and Financial Institutions

The volume of liabilities of second-tier banks satisfying the minimum required reserve ratio by the second method⁷ constituted a negligible amount (their share as of the end

⁶ Placement of money by a bank in reserved assets.

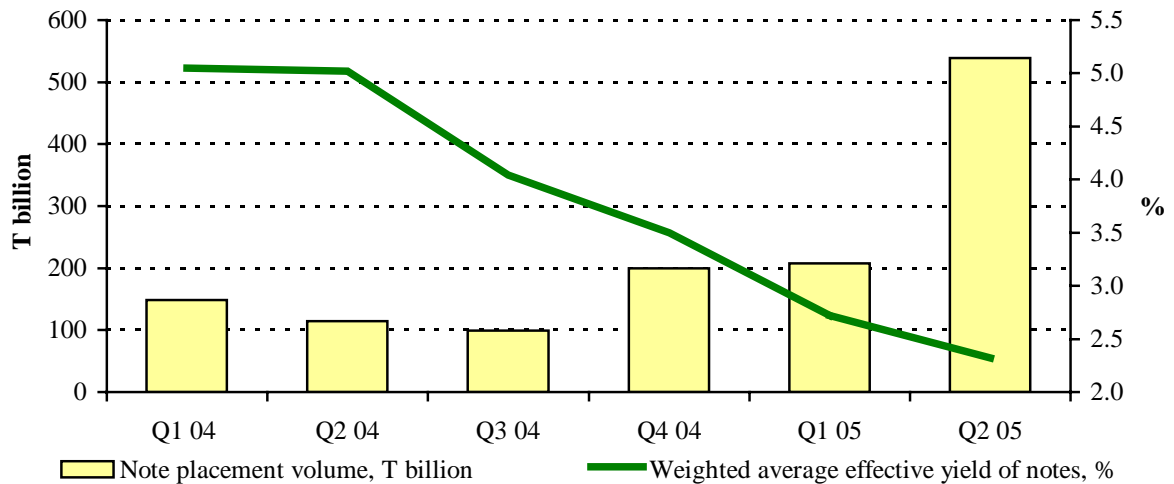
of December 2004 was less than 0.03 percent of deposit liabilities of second-tier banks satisfying the minimum required reserve ratio by the first method), and consequently they had no influence on the banking system's liquidity.

Issuance of Short-Term Notes

In April-June 2005 the National Bank placed short-term notes amounting to T538.3 billion, which is the historical maximum note issuance volume. Compared with the preceding quarter, placement of notes increased by a factor of 2.6.

Such significant growth of short-term note placement is connected with an abrupt decrease in the periods of their circulation, and consequently, with carryover of the volumes of notes issued earlier to shorter maturities. Thus, in the second quarter of 2005 notes were issued with a single maturity of 28 days, while in the first quarter of 2005 the average maturity was 47 days, and in the second quarter of 2004 it was more than 310 days.

Figure 17. Placement of Short-Term Notes by the National Bank and the Weighted Average Yield Thereon (during the Period)



Source: Republic of Kazakhstan National Bank

Besides that, persistence of a high demand for National Bank short-term notes in the second quarter is connected with insufficiency of the volume of government securities issued by the Ministry of Finance to satisfy the demand of financial market participants.

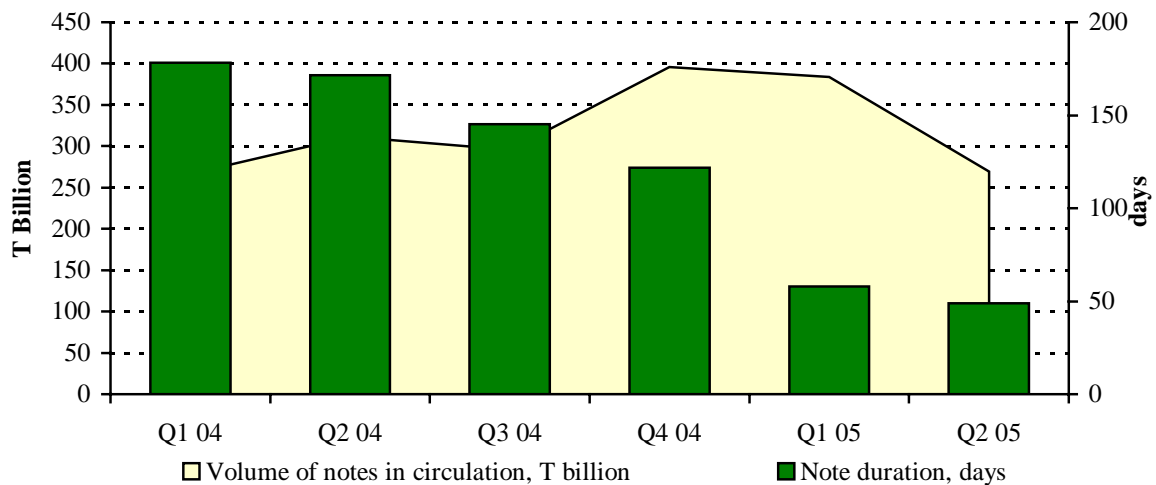
A decreasing trend in the yield of notes continued in the second quarter of this year. The weighted average effective yield based on the quarter's results established itself at 2.32 percent, while in the first quarter of 2005 it was 2.72 percent. During the year (second

⁷ Deposition of money by a bank in the National Bank.

quarter of 2005 compared to the second quarter of 2004) the yield of notes decreased by a more than a factor of two (Figure 17).

In all of the second quarter of 2005 the volume of short-term notes in circulation decreased by 29.8 percent, coming to T269.2 billion at the end of June 2005. The duration of notes in circulation decreased to 48.81 days by the end of June 2005 (Figure 18).

**Figure 18. Short-Term Notes in Circulation
(As of Period's End)**



Source: Republic of Kazakhstan National Bank

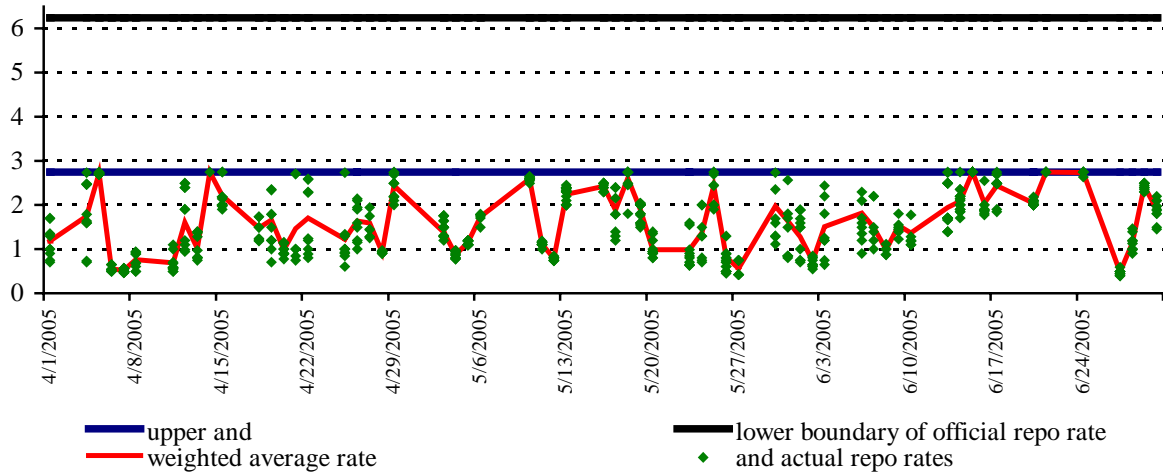
Repo and Reverse Repo Operations

The volume of repo operations conducted by the National Bank in the second quarter of 2005 was T252.6 billion, which is 12.4 percent less than the volume for the first quarter of 2005, notwithstanding a 5.9 percent increase in the nominal value of government securities in the National Bank's portfolio.

The weighted average rate for repo operations of the National Bank increased negligibly in the second quarter of 2005, to 1.58 percent from 1.55 percent in the preceding quarter. All operations were conducted as overnight operations (Figure 19).

The volume of reverse repo operations conducted by the National Bank was negligible, T6.9 billion. Compared to previous operations, which were conducted in December 2004, the weighted average yield grew from 4.95 percent to 6.12 percent.

Figure 19. Dynamics of the Weighted Average Repo Rate for National Bank Operations, Percent



Source: Republic of Kazakhstan National Bank

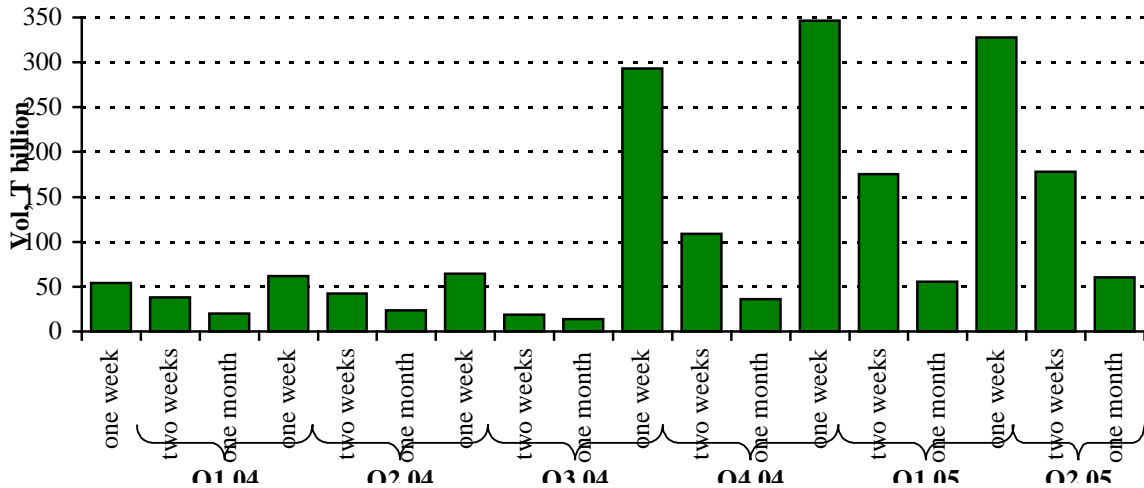
Attraction of Deposits

In the second quarter of 2005 the National Bank attracted tenge deposits from second-tier banks amounting to T566.2 billion, which is 1.1 percent less than in the first quarter of 2005 but exceeds the level for the second quarter of 2004 by a factor of 4.4. Despite the fact that the maturities of the deposits attracted by the National Bank could be as much as 1 year, their actual maturities do not exceed 1 month. The maturities of deposits attracted in the first quarter of 2005 were 1 week, 2 weeks, and 1 month (Figure 20), and the weighted average maturity of attracted deposits in the second quarter of 2005 was 12.0 days, which exceeds the indicator for the preceding quarter (11.7 days) negligibly.

Despite the fact that compared to the preceding period the volume of 1-week deposits attracted in the second quarter of 2005 fell 7.2 percent, they continue to be the most popular, representing 57.9 percent of the total volume of attracted deposits. The volumes of attracted 2-week and 1-month deposits grew 10.9 percent and 2.9 percent, and their share in the structure of deposits attracted by the National Bank reached 31.4 and 10.7 percent respectively.

The weighted average yield on attracted deposits increased in the second quarter of 2005 to 2.36 percent (2.20 percent in the first quarter of 2005). In addition, the yield of deposits maturing in 1 week increased from 2.10 percent in the first quarter of 2005 to 2.26 percent in the second quarter of 2005, that of deposits maturing in 2 weeks increased from 2.21 percent to 2.38 percent, and that of 1-month deposits increased from 2.33 percent to 2.45 percent.

**Figure 20. Volume of Deposits Placed with the National Bank:
Amounts and Maturities**



Source: Republic of Kazakhstan National Bank

Granting of Loans

The National Bank did not conduct any loan granting operations in the second quarter of 2005.

Bill Rediscounting

During the second quarter of 2005, 150 bills amounting to T2.8 billion were accepted for rediscounting. As of July 1, 2005 the National Bank's portfolio contained bills amounting to T3.2 billion.

Changes in the Mechanism of Monetary Policy

Starting July 1, 2005, the National Bank introduced certain changes into the mechanism of monetary regulation that include introduction of a "unified" rate. A "unified" rate presupposes unification of certain operations of monetary policy in terms of maturities and rates -- ones such as deposit and credit operations, issuance of short-term notes, repo operations. These measures have the purpose of keeping market rates within the prescribed band for a period of 7 days, which will make it possible to influence formation of the rates of "longer" operations of second-tier banks. The rate for liquidity absorption operations (the rate for deposit operations) is at the lower boundary of the band, and the rate for extension of

liquidity (credit operations, reverse repo operations) -- that is, the refinancing rate -- is at the upper boundary. In addition, the rates for other operations of monetary policy are either set based on the "unified" rate (official rates for repo operations and for overnight loans), or are determined by the market (yield on short-term notes). Thus, the official rate for reverse repo operations is set at the level of the refinancing rate, and the official rate for overnight loans is the refinancing rate plus 1 percent. As for short-term notes, the National Bank determines and announces in advance only the volume of notes to be issued at auction, while their yield is determined by the market based on demand.

Attraction of deposits and reverse repo operations are the "shortest" operations of the National Bank (7 days) starting July 1. The practice of carrying out direct repo operations, which were conducted with an overnight term -- that is, one business day, has been suspended in this connection. Starting September 1 of this year, the practice of granting overnight loans (with a term of one business day) and overdrafts (repaid during the day) is also suspended. Short-term notes are now issued with a maturity of 28 days with the purpose of forming the "yield curve" on the financial market.

Jointly with the Agency for Regulation and Supervision of the Financial Market and Financial Institutions the National Bank has made improvements in the mechanism of formation and calculation of minimum reserve requirements. In this connection on June 13, 2005 the Board of the Agency for Regulation and Supervision of the Financial Market and Financial Institutions adopted changes and additions to the Regulations on Minimum Reserve Requirements.

The resolution broadens the base for calculation of minimum reserve requirements insofar as concerns external liabilities of second-tier banks, it provides the procedure for fulfilling these requirements, and makes improvements in the procedure for formation of reserved assets. The reserve obligations of a bank are increased by the positive difference between external liabilities and external reserved assets of the bank, and the list of internal reserved assets includes only cash tenge and money in correspondent accounts with the National Bank.

These changes come into force October 1, 2005.

An increase in the price of external borrowing, and as a consequence, possible decrease of the volume of external borrowing are anticipated from implementation of these rules.

The changes to the mechanism for calculation of minimum reserve requirements represent the first phase of changes. If their impact on reducing inflation turns out to be insufficient, the National Bank intends to include in the calculation of minimum reserve requirements all of the internal liabilities of second-tier banks regardless of maturities (at the present time, the calculations include internal liabilities maturing in the current month and subsequent month).

4. Inflation Forecast

a. Assessment of the Inflation Forecast for the Second Quarter of 2005

Actual inflation in the second quarter of 2005 (1.6 percent) exceeded the forecast for this period (1.1-1.3 percent) by 0.4 percentage points.

The main deviation of projected inflation from the actual level occurred in May -- 0.6 percent, as opposed to a projection of 0.3 percent; in April and June together, the forecast indicator was exceeded by only 0.07 percent.

Prices of food goods revealed surprisingly high growth. As a rule, a tendency for their prices to increase is noted in the second quarter compared to the first quarter. This tendency was also typical of this year, although it was not so clearly pronounced. In 2003 food goods grew 2.4 percent more expensive in the first quarter and 0.5 percent more in the second quarter (a decrease of 1.9 percentage points), and in 2004, respectively 2.6 percent and 0.5 percent more (2.1 percentage points). This year the rate of growth of the prices of these good fell 0.9 percentage points (1.8 percent in the second quarter as opposed to 2.7 percent in the first quarter).

Increase of prices of fruits and vegetables had a significant impact on increasing inflation, with the bulk of the price increase occurring in May.

The main factors causing actual inflation indicators to deviate from the projection in the second quarter are, in all probability, first, growth of inflationary expectations owing to the increase in budget expenditures on a roll, pensions, and benefits planned starting July 1, 2005. Second, substantial increase of money measures observed in the second half of 2004 had a significant influence on the dynamics of prices on the consumer market. As result, the characteristic seasonal decrease in prices compared to preceding months of the current year did not occur in the period from April to June 2005.

Annualized inflation also came to a higher level at the end of June 2005 than forecast (actual -- 7.9 percent, forecast -- 6.9 percent).

b. Inflation Forecast for 2005

Inflation Forecast for the Third Quarter of 2005

Inflation is anticipated to be about 1.0 percent in the third quarter of 2005.

The period from July to September is usually characterized by the lowest level of inflation over the year, which is associated to a large extent with the seasonal factor. In this period the situation on the market of consumer goods and services will depend to a larger degree both on the harvest in Kazakhstan and on the situation on the markets of the Republic's main trading partners.

It is anticipated that the influence of monetary factors on inflation, which occurs with a certain delay, will decline. This is connected with the lower rate of growth of money measures in the first half of 2005 compared to preceding periods: the Money base shrank 4.7 percent, and the money supply and cash increased 11.1 percent and 2.7 percent respectively.

Besides that, the steps taken by the National Bank in late 2004 and in the first half of 2005 to tighten monetary policy will also help to decrease inflation.

In addition to measures taken by the National Bank to ensure price stability, the government on its part also took certain steps to prevent price increases in an environment of growing public income. In particular, it adopted Government Resolution No. 430, May 5, 2005 "On Certain Measures to Stabilize Prices on the Consumer Market," which specifies actions to be taken to enhance the market's competitiveness and contain monopolization, and prescribes a decrease in customs duty rates and charges for a number of entering food and nonfood goods. In addition, temporary reduced tariffs were set for the carriage of certain food goods by rail.

In the opinion of the National Bank, however, the measures implemented by the government to stabilize prices are not effective enough because they are for the most part short-term and one-time measures.

Inflation Forecast for the Fourth Quarter of 2005

As a rule, prices exhibit their greatest growth in the last months of the year. This is associated mainly with growth of consumer demand toward that year's end, and with the seasonal factor, which plays no small role.

The increase in budget expenditures on social programs will have an influence on inflation in the fourth quarter, just as it did in the third quarter.

The inflation forecast for the fourth quarter of 2005 is 2.7-3.0 percent.