

Republic of Kazakhstan
National Bank

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Inflation Report
1st Qtr 2005

Contents

Contents	2
1. Inflation	3
a. Consumer Prices	3
b. Base Inflation	5
c. Prices in the Real Sector of the Economy	7
Prices in Industrial Production	7
Prices in Agriculture	7
Enterprise Monitoring	7
2. Tax and Budget Policy	9
3. Monetary Policy	12
a. The Supply of Money	12
Monetary Base	12
Monetary Survey of Second-Tier Banks	13
Money Supply	14
b. Instruments and Operations of Monetary Policy	17
Official Rates of the National Bank	17
Minimum Required Reserve Ratio	18
Issuance of Short-Term Notes	18
Repo and Reverse Repo Operations	20
Attraction of Deposits	20
Granting of Loans	21
Foreign Exchange Rate	21
Bill Rediscounting	24
4. Inflation Forecast	25
a. Assessment of the Inflation Forecast for the First Quarter of 2005	25
b. Inflation Forecast for 2005	25
Inflation Forecast for the Second Quarter of 2005	26
Inflation Forecast for the Third Quarter of 2005	27

1. Inflation¹

a. Consumer Prices

A distinguishing feature of inflation in the first quarter of 2005 is its lower level (1.9 percent) compared to inflation in the preceding quarter (2.8 percent), while in comparison to inflation in the first quarter of 2004, it ended up higher (1.5 percent). This year's inflation, both monthly and annual, is observed to exceed last year's level (Table 1).

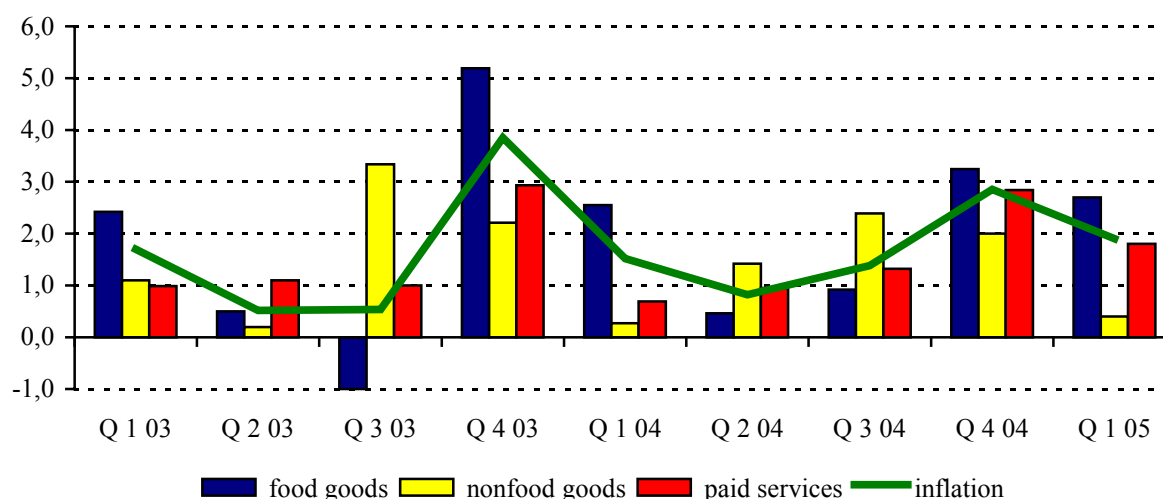
Table 1. Dynamics of Inflation in 2004 and 2005
(% of Preceding Period)

	Monthly inflation		Annual inflation	
	2004	2005	2004	2005
January	0.7	0.8	6.4	6.8
February	0.5	0.6	6.4	6.9
March	0.4	0.6	6.5	7.1
Quarter 1	1.5	1.9	6.5	7.1

Source: Republic of Kazakhstan Statistical Agency

Price dynamics in the structure of inflation were determined to the greatest degree by food goods, which grew 2.7 percent more expensive in January-March 2005, negligibly surpassing the indicator of the same period of 2004 -- 2.6 percent (Figure 1).

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



Source: Republic of Kazakhstan Statistical Agency

The largest increase in prices in the structure of food goods since the current year's start was for vegetables and fruits -- 16.6 percent (especially for vegetables -- 18.6 percent). Besides that, prices increased 5.3 percent for fish and seafood products and 3.1 percent for

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

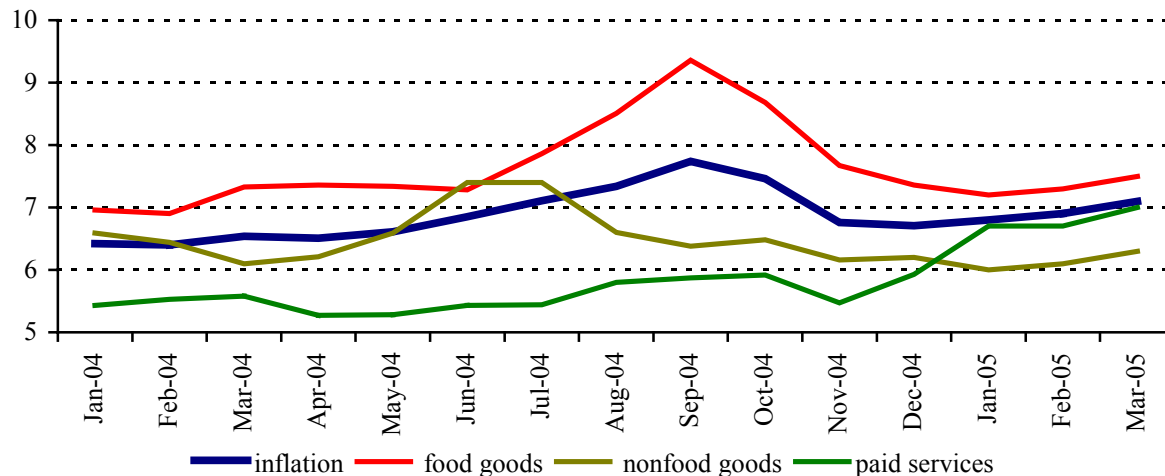
meat and meat products, which is explained by the seasonal dynamics of the prices of these kinds of edible products. A 7.8 percent decrease was noted in the price of eggs.

The main reason, however, why inflation exceeded the past year's indicators was an increase in the price of paid services to the public -- 1.8 percent in the first quarter of 2005, compared to 0.7 percent in the same period of 2004. Within their structure, both regulated and unregulated services determined the dynamics of prices. Among them, housing and municipal services grew 2.0 percent more expensive (including 3.9 percent for gas supply and 2.3 percent for electricity). Besides that, increases occurred in the prices of passenger transportation services -- 2.5 percent, health care services -- 1.6 percent, education -- 1.2 percent, and the services of cultural institutions -- 1.0 percent.

Among nonfood goods, which grew 0.4 percent more expensive (prices increased 0.3 percent in the first quarter of 2004), the price increases were 1.7 percent for clothing, 1.3 percent for personal hygiene products, 1.2 percent for footwear, and 1.0 percent for medicaments. At the same time, gasoline and diesel fuel grew cheaper by respectively 11.9 percent and 4.9 percent.

Inflation in annual terms was 7.1 percent as of the end of March 2005 (6.7 percent in December 2004). Food goods grew 7.5 percent more expensive, nonfood goods grew 6.3 percent more expensive, and paid services grew 7.0 percent more expensive (Figure 2).

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



Source: Republic of Kazakhstan Statistical Agency

The following may be distinguished as the main factors impacting inflation processes in Kazakhstan:

- monetary factors

An aggressive credit policy and high liquidity of second-tier banks, a significant inflow of foreign currency into Kazakhstan, and an increase in the income of individuals and enterprises remain the main factors responsible for growth of the demand for money.

Despite the fact that according to the results for the first quarter of 2005, among the money measures only the money supply increased, while the monetary base and cash in circulation decreased compared to the start of the current year, and significant growth of money measures in preceding years continues to harbor a certain inflation potential. The pressure exerted on inflation by growth of money in Kazakhstan, however, remains negligible, inasmuch as this increase is absorbed by the growing economy. Persistence of low inflation in the face of further increase in lending by banks and of aggressive growth of personal incomes may be ensured through parallel creation of the conditions promoting expansion of the production base and increase of the supply of goods and services in the economy.

- economic growth and increase in income

Continuing economic growth in the country is contributing to the persistence of a certain inflationary pressure. The increase in incomes connected with economic growth, both of personal income and that of economic agents, is leading to growth of investment and consumer demand, which in turn is having the impact of increasing prices.

- "import" of inflation

"Import" of inflation, which manifests itself through high world oil prices and increase of the prices of imported goods, is a factor of no small importance contributing to the increase in prices of consumer goods. In particular, prices increased in the first quarter of 2005 by 11.4 percent for imported products made from fish, by 9.2 percent for vegetable oil, by 7.3 percent for tea, by 7.0 percent for textiles and clothing, and by 6.9 percent for footwear.

The dynamics of prices of such goods continue to be difficult to predict because they evolve under the influence of the price index of import receipts and of the dynamics of the exchange rates of domestic currencies.

b. Base Inflation

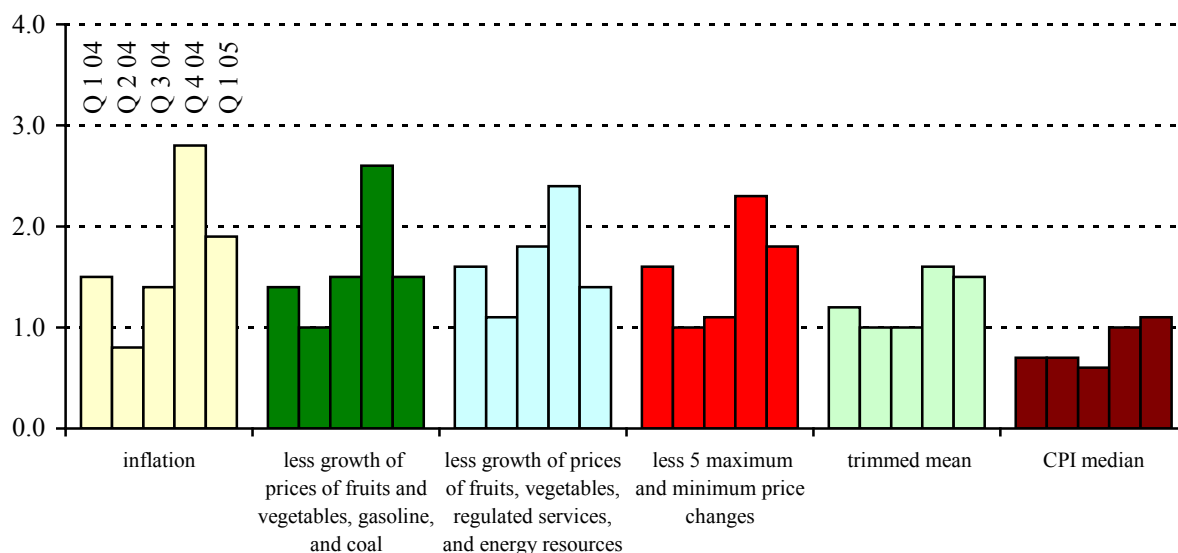
Starting in 2004, the Republic of Kazakhstan Statistical Agency has been calculating the base inflation indicator in addition to "overall" inflation. This indicator is analytical to a larger degree, and it is used exclusively in the implementation of monetary policy, inasmuch as it reflects the main directions of inflationary trends.

In the first quarter of 2004 compared to the preceding quarter, we observed seasonal slowing of the rate of inflation in Kazakhstan's economy, as is evidenced not only by the "overall" inflation indicator but also by the indicators of base inflation. Indicators calculated by the "CPI median" method, which pointed to an increase in inflation, and by the trimmed mean method, the value of which remained practically unchanged, are an exception (Figure 3).

"Base" inflation decreased faster in versions 1 and 2 than did "overall" inflation. This is connected with the fact that the increase in prices of goods and services that are excluded from the calculation of inflation by these methods (vegetables and fruits) were negligible, with the exception of the prices of gasoline, which decreased in the period under analysis.

In version 3, base inflation came in the first quarter of 2005 to a level close to the value of "overall" inflation, at the same time that base inflation demonstrated lower values in versions 4 and 5.

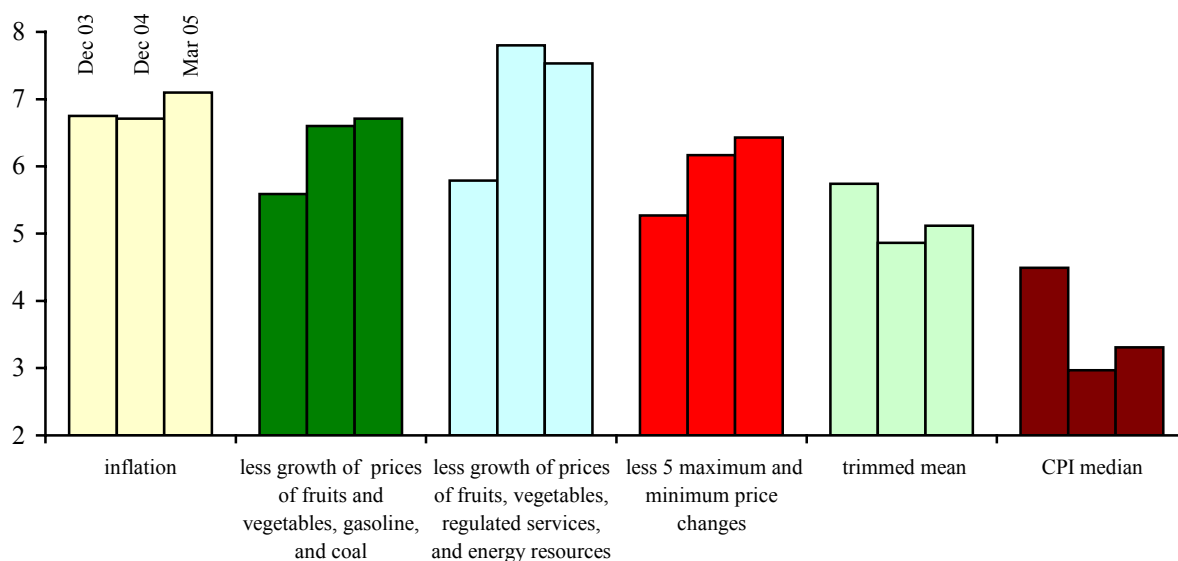
**Figure 3. Inflation and Base Inflation in 2004-2005
(Percent of Preceding Period)**



Source: Republic of Kazakhstan Statistical Agency

Significant deviations in the trends of inflation and base inflation are also observed when the indicators are expressed in annual terms. While inflation in the first quarter of 2005 exhibited an increasing trend, base inflation remained practically unchanged in version 1 and decreased negligibly in version 2, at the same time that in versions 3, 4, and 5 it increased (Figure 4).

**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 the products and services of industrial enterprises increased 5.3 percent in the first quarter of 2005 (2.6 percent in the preceding quarter). There were increases in the cost of products of intermediate consumption -- 6.1 percent, consumer goods -- 1.5 percent, production resources -- 3.3 percent, and services related to production -- 1.1 percent.

The bulk of the increase in prices within the structure of industrial production was credited to mining industries -- 7.2 percent (4.4 percent in the fourth quarter of 2004), prices increased 3.6 percent (0.8 percent) in processing industry, and they increased 1.9 percent (0.6 percent) in the production and distribution of electricity, gas, and water.

In January-March 2005 a 5.5 percent increase occurred in the prices of energy resources, within the structure of which we can note a 6.7 percent increase in the price of natural gas, a 6.3 percent increase in the price of oil, and a 2.6 percent increase in the price of petroleum products.

Prices in Agriculture

Agricultural products grew 1.3 percent more expensive in the first quarter of 2005, in which case the prices of plant farming products fell 0.4 percent, while the prices of livestock products climbed 3.5 percent.

Despite the decrease in prices of plant farming products, mainly of cereal crops (0.6 percent), a 2.4 percent increase in the prices of vegetables was documented in the period under analysis, which had the impact of increasing the prices of food goods to a certain degree.

Increase of the prices of livestock products -- in particular, 2.9 percent for livestock and poultry and 12.9 percent for milk -- manifested itself practically simultaneously as an increase in the prices of edible products (meat and meat products, milk and dairy products).

Enterprise Monitoring

Enterprises of the real sector are being subjected to monitoring by the National Bank in respect to industries of Kazakhstan's economy. Among other indicators, the demand for and prices of finished products and of raw materials and supplies of enterprises participating in the survey are being watched.

According to this survey, the demand of surveyed enterprises for finished products decreased in the first quarter of 2005 compared to the preceding period. Thus, the proportion

of enterprises that increased their demand for products was 26.6 percent (31.2 percent in the fourth quarter of 2004), while demand of 20.5 percent of the enterprises (15.3 percent) decreased.

Even so, change in the prices of the finished products of these enterprises was negligible in the first quarter of 2005. Stable prices were reported by 72.2 percent of surveyed enterprises (68.4 percent in the fourth quarter of 2004), and an increase in prices occurred among 20.8 percent of the enterprises (25.6 percent). Further stabilization of prices is projected in the second quarter of 2005: the prices of products will be stable for most of the enterprises (80.6 percent), with only 18.1 percent of the enterprises anticipating an increase in prices.

The situation with the prices of raw materials and supplies also improved somewhat in January-March 2005 compared to the preceding period. Thus, 54.5 percent of the enterprises reported an increase in prices, while 55.5 percent reported an increase in the fourth quarter of 2004. A decrease in prices was reported by 44.4 percent (42.3 percent in the past quarter). This trend will continue into the second quarter of 2005: 60.0 percent of the enterprises anticipate stabilization of the prices of raw materials and supplies, while 37.1 percent expect prices to increase.

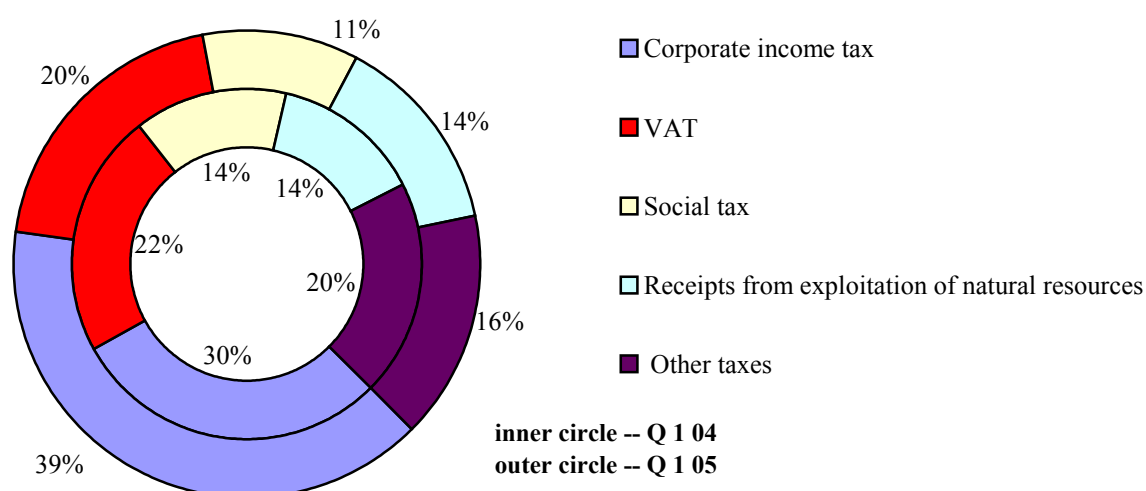
2. Tax and Budget Policy²

The Budget Code of the Republic of Kazakhstan, which is a consolidation of legislative acts concerning budget policy, the National Fund, and management of state debt, came into force on January 1, 2005.

The Budget Code introduced a new budget structure comprised of budget revenues and expenditures, budget credits, and operations with financial assets. The difference between revenues and expenditures is the operating balance. The budget deficit (surplus) is equal to the operating balance less net budget credits and the balance of operations with financial assets. Budget deficit financing covers the budget deficit with the use of borrowings and the uncommitted balance of budget resources.

To permit further analysis, execution of the state budget in 2004 is reported in terms comparable to the structure of the 2005 budget.

Figure 5. Structure of Tax Receipts of the State Budget



Source: Republic of Kazakhstan Ministry of Finance

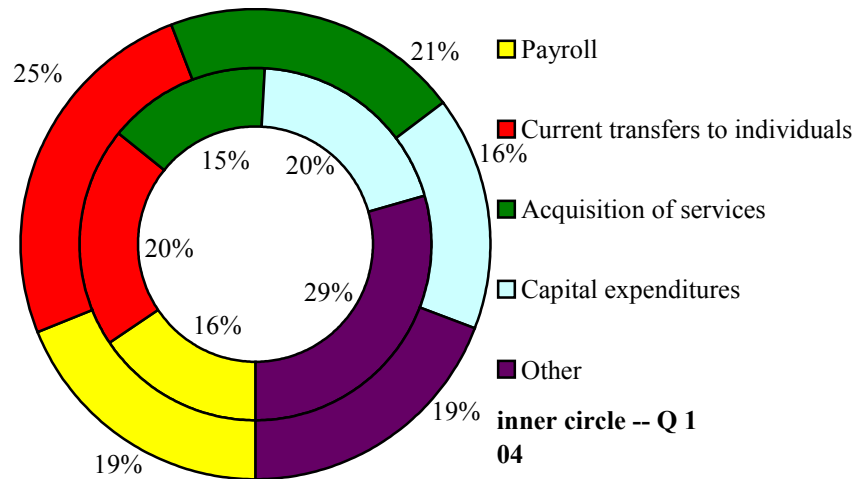
Revenues of the state budget in the first quarter of 2005 were T395.0 billion. Revenues increased 39.3 percent compared to the indicators for the same period of the preceding year. Tax receipts constituted the bulk of the budget's revenues (97.2 percent), with corporate income tax, VAT, social tax, and receipts from exploitation of natural resources continuing to be the largest within the structure of tax receipts. Compared to the first quarter of 2004, the proportion of corporate income tax increased significantly while that of other taxes decreased or remained unchanged (Figure 5).

Financing of state budget expenditures in the first quarter of 2005 came to T279.5 billion. Compared to the indicators for the same period of the preceding year, expenditures increased 21.5 percent. Current expenditures increased in the first quarter of 2005 by 15.5 percent compared to the same period of 2004. A sizable share of their structure is made up of cash expenditures of the budget: current transfers to individuals and payroll expenditures, the

² Based on data of the Republic of Kazakhstan Ministry of Finance.

overall proportion of which grew from 36 percent in the first quarter of 2004 to 44 percent in the first quarter of 2005. Capital expenditures decreased 27.6 percent (Figure 6).

Figure 6. Structure of Expenditures of the State Budget



Source: Republic of Kazakhstan Ministry of Finance

The operating balance of the state budget came to a volume of T116.5 billion (T55.3 billion in the first quarter of 2004).

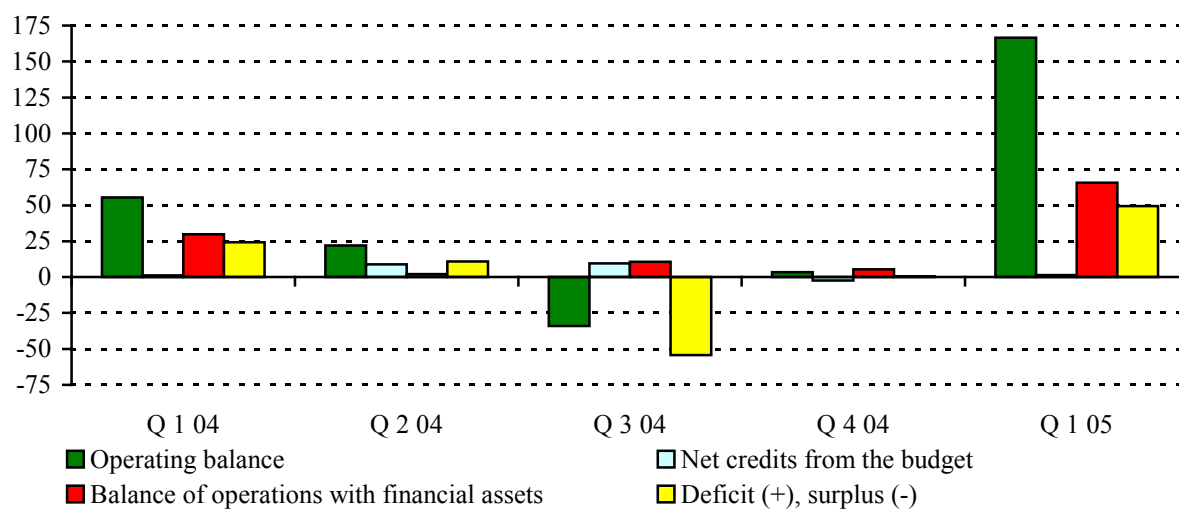
Net budget credits increased 12.4 percent in the first quarter of 2005 compared to the same period of 2004. This includes respectively a 19.1 percent and a 26.6 percent decrease in granting and repayment of credits. Acquisition of financial assets grew by a factor of more than 2.2 due to growth of expenditures on creation of state developmental institutions and increase of their capitalization.

As a result the state budget ended up with a surplus of T49.4 million in the first quarter of 2005, having increased by a factor of 2.0 compared to the same period of 2004 (Figure 7).

The financing sources for the possible deficit shaped up as follows: receipts of loans -- T57.1 billion, their repayment -- T41.5 billion, movement of the balance of budget resources - - T65.1 billion. As a result there were T148.1 billion in the government's accounts with the National Bank at the end of March 2005.

Government internal debt increased 23.7 percent in the first quarter of 2005, reaching T285.8 billion, while external debt decreased 5.4 percent to a figure of \$2.6 billion.

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



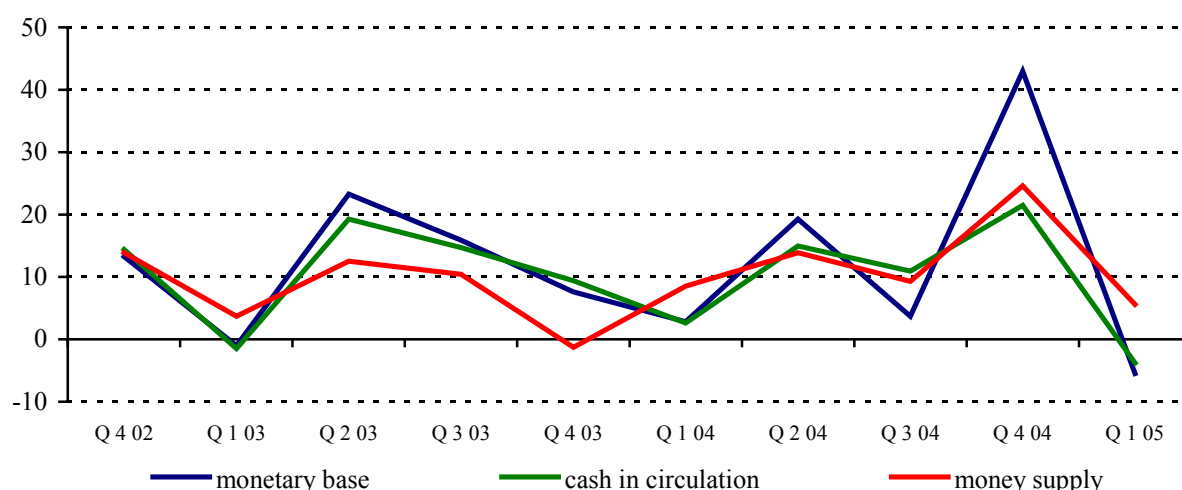
Source: Republic of Kazakhstan Ministry of Finance

3. Monetary Policy

a. The Supply of Money

A seasonal slowdown in the rate of growth of the monetary measures at the start of each year has been observed in their behavior over the course of the last 3 years, and 2005 is no exception. As rule, the main contribution to such dynamics is credited to January indicators, inasmuch as the money measures ordinarily grow in February and March. Even so, the rate of growth of the money supply is maintaining a positive value based on the results of the first 3 months of the year, and the dynamics of the monetary base are varying synchronously with the dynamics of cash in circulation (Figure 8).

**Figure 8. Dynamics of Money Measures
(Percent of Preceding Period)**



Source: Republic of Kazakhstan Ministry of Finance

Monetary Base

Shrinking of the monetary base by 5.5 percent to T546.1 billion due to the seasonal factor was one of the typical features of the first quarter of 2005.

A sizable budget surplus promoted an increase in the balances of the government's accounts with the National Bank, which in turn brought about a significant drop in net claims against the government. The decrease of the latter led to a 16.0 percent drop in the National Bank's net internal assets in the first quarter of 2005.

As for the National Bank's net international reserves, their volume decreased negligibly in dollar terms in the first quarter of 2005. The National Bank's net international reserves decreased 0.1 percent in current prices to a figure of \$9,267,300,000. External debt service by the Ministry of Finance and sale of foreign exchange with the goal of replenishing the National Fund's assets were compensated by passage of foreign exchange to the government's accounts with the National Bank. As result, net foreign exchange reserves

underwent hardly any change within the structure of net international reserves, while gold assets decreased 1.2 percent as result of a 2.4 percent drop in the price of gold on the world markets (Table 2).

**Table 2. Dynamics of Changes in the Monetary Base
(Percent of Preceding Period)**

	Q 1 04	Q 2 04	Q 3 04	Q 4 04	Q 1 05
Monetary base	2.7	19.3	3.7	43.0	-5.5
Net international reserves	10.4	14.6	1.5	31.3	1.9
Net internal assets	-15.6	-12.1	2.2	-2.8	-16.0
net claims against government	-48.8	-79.7	-5.6	47.0	-98.4
claims against financial institutions	-36.0	-17.9	5.2	-25.2	-3.3
claims against the rest of the economy	35.6	61.8	-9.7	18.1	-15.7
other net internal assets	21.7	41.2	3.3	-4.1	1.9

Source: Republic of Kazakhstan National Bank

Monetary Survey of Second-Tier Banks

The overall assets of second-tier banks grew 8.6 percent in the first quarter of 2005 to a figure of T1,428,100,000. Although moderate growth of overall assets is typical of this period, even so, as in preceding quarters it was brought about by an increase in the internal assets of second-tier banks in a time when their net external assets shrank (Table 3).

**Table 3. Monetary Survey of Second-Tier Banks
(Percent of Preceding Period)**

	Q 1 04	Q 2 04	Q 3 04	Q 4 04	Q 1 05
Net external assets	-11.0	-25.1	-7.4	-17.4	-3.9
Internal assets	7.9	13.9	10.2	18.1	7.3
claims against National Bank	22.9	14.7	-3.9	75.8	0.1
net claims against government	10.7	15.2	21.1	-21.5	11.2
claims against economy	6.5	13.3	12.7	11.6	9.1
other net internal assets	-14.0	-12.3	-15.4	-8.7	-8.8
Liabilities	6.9	10.2	11.3	18.4	8.6

Source: Republic of Kazakhstan National Bank

Growth of net claims against the government should be noted within the structure of the internal assets of second-tier banks. In the first quarter of 2005 the Republic of Kazakhstan Ministry of Finance placed government securities amounting to T57.0 billion. As a result the volume of securities in circulation increased 23.8 percent compared to the year's start to a figure of T284.2 billion as of the end of March 2005, thus bringing about an 11.2 percent increase of net claims of second-tier banks against the government.

In addition, a high rate of lending by banks to the economy persisted. In the first quarter of 2005, the claims of second-tier banks against sectors of the economy grew 9.1 percent. As a result, the internal assets of second-tier banks increased 7.3 percent.

The claims of second-tier banks against nonresidents grew within the structure of their net external assets by 25.0 percent in the first quarter of 2005 owing to an increase in deposits and in securities placed abroad. Obligations to nonresidents grew in this case by 16.4 percent in connection with growth of deposits of nonresidents in accounts with Kazakhstani banks and of securities placed in the internal financial sector. Increase of the increment in obligations to nonresidents in absolute value over claims against nonresidents led to a 3.9 percent decrease in net external assets.

Money Supply

Growth of the money supply in the first quarter of 2005 was 5.6 percent, reaching a figure of T1,726.0 billion, which is below the indicator for the same period of the past year (8.5 percent).

Continuing growth of the volume of lending to the nonfinancial sector of the economy remains a significant factor contributing to the increase in the money supply during the period in question. The increment in the claims of deposit institutions against the economy during the first quarter of 2005 was 8.9 percent compared to the preceding period. As a result, despite significant decrease of net claims against the government, the internal assets of deposit institutions grew 9.6 percent during the period in question.

The 0.6 percent increase in the net external assets of deposit institutions during the period in question, which was brought about by growth of the National Bank's gold and foreign exchange assets, also facilitated growth of the money supply (Table 4).

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

	Q 1 04	Q 2 04	Q 3 04	Q 4 04	Q 1 05
Money supply	8.5	13.9	9.3	24.6	5.6
Net external assets	10.1	8.0	-2.8	42.7	0.6
Internal assets	7.2	18.9	20.0	12.0	9.6
net claims against government	-22.8	-93.8	780.2	127.8	-107.6
claims against economy	6.6	13.4	12.7	11.6	8.9
other net internal assets	-3.5	-1.1	-8.0	-15.0	-0.3

Source: Republic of Kazakhstan National Bank

Comparison of the quarterly dynamics of the money supply reveals slowing of its growth rate in the first quarter of each year. This is brought about first and foremost by the influence of a particular factor -- seasonal slowdown of business activity in the economy at the year's start, and as a result, the rate of growth of claims of deposit institutions against the economy is more moderate compared to other quarters.

Analysis of the dynamics of the main constituents of the money supply -- cash in circulation and the deposits of residents with deposit institutions -- shows that the latter of these constituents was responsible for growth of the money supply. The volume of cash in circulation decreased 3.8 percent during the first quarter of 2005, while deposits with deposit institutions exhibited the reverse, increasing by 8.4 percent. As a result the proportion of the

latter in the structure of the money supply grew in the first quarter of 2005 to 78.9 percent from 76.8 percent (Table 5).

**Table 5. Dynamics of Changes in Constituents of the Money Supply
(Percent of Preceding Period)**

	Q 1 04	Q 2 04	Q 3 04	Q 4 04	Q 1 05
Money supply	8.5	13.9	9.3	24.6	5.6
cash in circulation	2.6	15.0	10.9	21.5	-3.8
deposits of residents	10.4	13.5	8.8	25.5	8.4

Source: Republic of Kazakhstan National Bank

Expansion of the money supply in the period in question on the backdrop of shrinkage of the monetary base led to an increase in the value of the money multiplier to 3.16 from 2.83.

- Cash in Circulation

Cash in circulation decreased 3.8 percent in the first quarter of 2005 to T364.8 billion. Data on turnover of cash in banks permit identification of the factors responsible for the slowing of the rate of its growth (Table 6).

Table 6. Balance of Payments and Receipts of Cash through Bank Cash Departments

	Q 4 04	Q 1 05	Q 1 05 compared to Q 4 04
	T billion	T billion	%
Goods, services, and completed work payments	-48.6	-67.6	-39.1
sales receipts	229.8	169.0	-26.5
	278.4	236.6	-15.0
Payroll (accounting for money in automatic teller machines)	244.3	200.6	-17.9
Agricultural products	25.9	9.8	-62.1
Operations with foreign currency	-90.2	-95.6	-5.9
issuance for purchase of currency by banks for their own exchange bureaus	96.1	81.4	-15.3
receipts from sales of currency by exchange bureaus of banks	186.4	177.0	-5.0
Deposits of individuals	-21.5	-5.2	75.9
Pensions and benefits	48.8	52.0	6.4
Other items	-68.6	-90.1	-31.3
Overall balance of cash payments and receipts	90.0	3.9	-95.6

Source: Republic of Kazakhstan National Bank

Compared to the fourth quarter of 2004, net payments of cash from bank cash departments in payment of goods, services, and completed work decreased in the first quarter of 2005 by 39.1 percent. This is connected first and foremost with seasonal reduction of retail turnover through all sales channels, which was 8.5 percent in the first quarter of 2005 compared to the past quarter. Reduction of retail turnover is usually associated with a

slowdown in business activity in the economy, and leads to a decrease in demand for cash on the part of economic agents.

Net payments for agricultural products decreased 62.1 percent, which is explained by the seasonal nature of work in this industry.

The next factor contributing noticeably to change in the amount of cash in circulation in the first quarter of 2005 is the decrease in net payroll payments and payments to fill automatic teller machines. Compared to the fourth quarter of 2004, their volume fell 17.9 percent. Such dynamics are determined in many ways by the volume of payroll expenditures from the budget, which are in turn distributed nonuniformly over the course of the year (decreasing at the year's start and growing significantly at the year's end).

- Deposits of Residents

Deposits of residents grew 8.4 percent in the first quarter of 2005, reaching T1,361.2 billion (Table 7).

**Table 7. Dynamics of Changes in Deposits of Residents
(Percent of Preceding Period)**

	Q 1 04	Q 2 04	Q 3 04	Q 4 04	Q 1 05	Share % ³
Deposits of residents	10.4	13.5	8.8	25.5	8.4	100.0
Transferred tenge deposits of individuals	14.2	16.2	9.5	18.2	7.1	23.5
of nonbank legal entities	-1.5	16.6	4.9	22.8	-2.9	3.2
Other tenge deposits of individuals	17.5	16.1	10.3	17.5	9.0	20.3
of nonbank legal entities	13.6	8.9	13.9	38.3	7.1	32.9
Transferred foreign currency deposits of individuals	28.5	12.9	12.5	32.7	8.8	16.9
of nonbank legal entities	1.2	4.7	15.4	44.6	5.4	15.9
Other foreign currency deposits of individuals	25.6	22.1	-0.7	-32.0	74.2	8.9
of nonbank legal entities	-4.6	23.9	-7.3	-2.1	0.6	1.1
Other foreign currency deposits of nonbank legal entities	33.1	21.8	0.5	-37.0	93.4	7.8
Other foreign currency deposits of individuals	1.8	13.1	7.3	36.7	0.6	34.8
of nonbank legal entities	-5.5	3.8	-0.9	-9.6	5.5	13.2
	18.8	30.2	19.2	93.3	-2.1	21.5

Source: Republic of Kazakhstan National Bank

Within the structure of the deposits of residents, growth is noted in relation to both transferred (19.9 percent) and other deposits (3.8 percent). The proportion of other deposits, which are one of the main sources of lending to the real sector of the economy, remained at a high level, coming to 67.6 percent as of April 1, 2005.

Deposits of nonbank legal entities made the main contribution to the increment in the deposits of residents in the period in question (about 75 percent). Slowing of the rate of growth of foreign exchange deposits is a typical feature of the structure of the deposits of

³ As of April 1, 2005.

nonbank legal entities in the first quarter of 2005. This is possibly connected with the fact that enterprises try not to expose themselves to foreign exchange risk in a time of significant variability of the exchange rates of the world's currencies.

In the first quarter of 2005 compared to the preceding period, other deposits of the population grew 7.3 percent, at the same time that transferred deposits of individuals exhibited the reverse, decreasing by 2.0 percent.

b. Instruments and Operations of Monetary Policy

The first quarter of 2005 was characterized by persisting high liquidity of second-tier banks. The average daily balances of the correspondent tenge accounts of second-tier banks with the National Bank decreased 8.9 percent compared to the preceding quarter, even though they did increase 87.0 percent compared to the first quarter of 2004.

The situation on the internal exchange market of Kazakhstan was characterized by a decrease in trading volume.

During this period, the Ministry of Finance significantly increased placements of its government securities. Their issuance reached T57.0 billion, which is one of the maximum quarterly levels for the entire history of this segment of the market.

This situation on the financial market determined the nature of the measures of influence implemented by the National Bank in the first quarter of 2005 to regulate inflation.

Official Rates of the National Bank

In the face of inflationary processes showing no signs of decrease in the Republic, the National Bank raised official rates.

The official refinancing rate was raised to 7.5 percent from 7.0 percent on February 1, 2005.

Besides that, in keeping with the Guidelines of Monetary Policy for 2005-2007, the practice of quarterly revision and establishment of such policy was introduced into practice starting this year.

In January 2005 the official rate for repo operations was 4.25 percent -- that is, it remained at the level of the preceding month. The band of its permissible deviations was narrowed to +/-175 basis points from +/-200, which signifies for practical purposes an increase in the lower limit of the rate to 2.5 percent from 2.25 percent. The repo rate was raised to 4.50 percent on February 1, 2005, with the band of permissible deviations remaining at +/-175 basis points.

The official rate for overnight loans remained unchanged at 8.5 percent during the first quarter of 2005.

Minimum Required Reserve Ratio

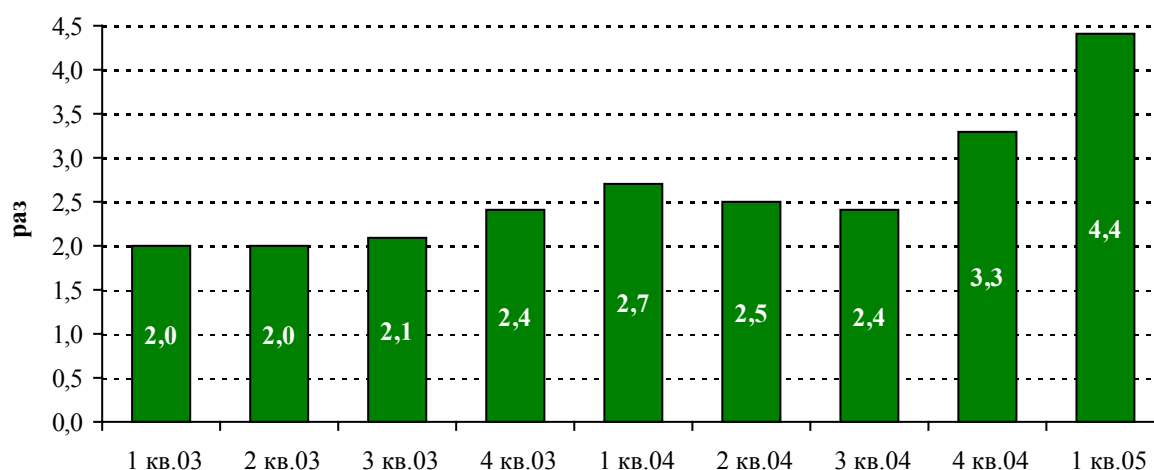
The minimum required reserve ratio did not change in the first quarter of 2005, standing at 6 percent of a bank's liabilities maturing all or in part in the current month and following month.

The number of banks satisfying the minimum reserve requirement by the first method⁴ was 34 at the end of the first quarter of 2005.

High liquidity of second-tier banks made possible a sizable volume of surplus reserves. While reserved assets exceeded the reserve requirement by an average of 4.4 times in the first quarter of 2005, in the fourth quarter of 2004 the requirement was exceeded by 3.3 times (Figure 9).

The volume of liabilities of banks satisfying the minimum required reserve ratio by the second method⁵ constituted a negligible amount (less than 0.03 percent of deposit liabilities of banks satisfying the minimum required reserve ratio by the first method as of the end of December 2004), and consequently they had no influence on the banking system's liquidity.

Figure 9. 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

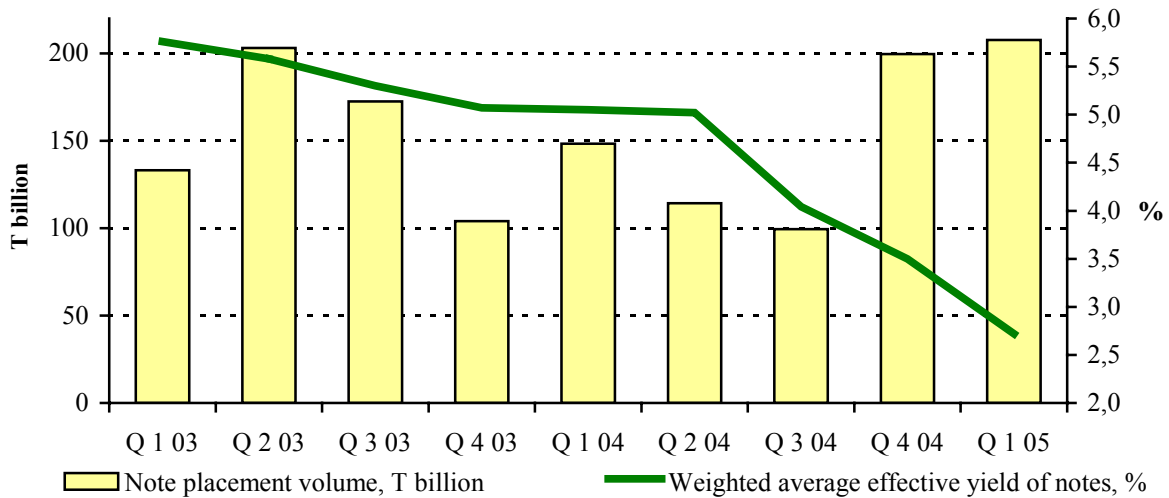
Issuance of Short-Term Notes

In January-March 2005 the National Bank placed short-term notes amounting to T207.7 billion, which is the maximum note issuance volume. Compared with the preceding quarter, placement of notes increased 4.0 percent (Figure 10).

⁴ Placement of money by a bank in reserved assets.

⁵ Deposition of money by a bank in the National Bank.

Figure 10. Placement of Short-Term Notes by the National Bank and the Weighted Average Yield Thereon (during the Period)



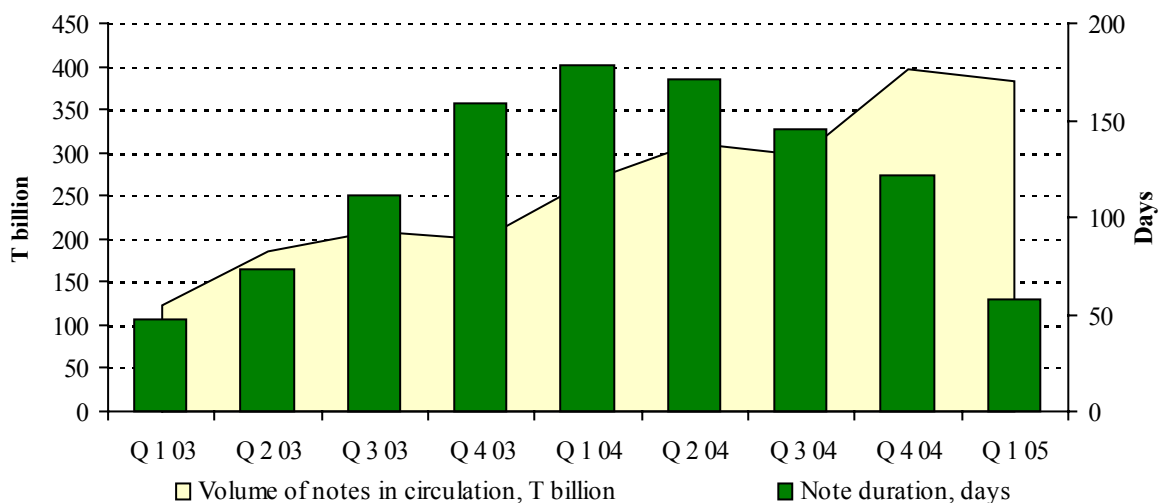
Source: Republic of Kazakhstan National Bank

A decreasing trend in the yield of notes continued into the first quarter of this year. The weighted average effective yield based on the quarter's results established itself at 2.72 percent, at the same time that in the fourth quarter of 2004 it was 3.50 percent.

In the first quarter of 2005 as a whole, the volume of short-term notes in circulation decreased by 3.2 percent, coming to T383.6 billion at the end of March 2005.

Significant decrease of the maturities of issued short-term notes has been observed over the course of the last three quarters. The average maturity of issued notes in the first quarter of 2005 was 47 days, while as recently as in the second quarter of 2004 it was equal to more than 300 days. The duration of short-term notes in circulation fell as a result (Figure 11).

Figure 11. Short-Term Notes in Circulation (As of Period's End)



Source: Republic of Kazakhstan National Bank

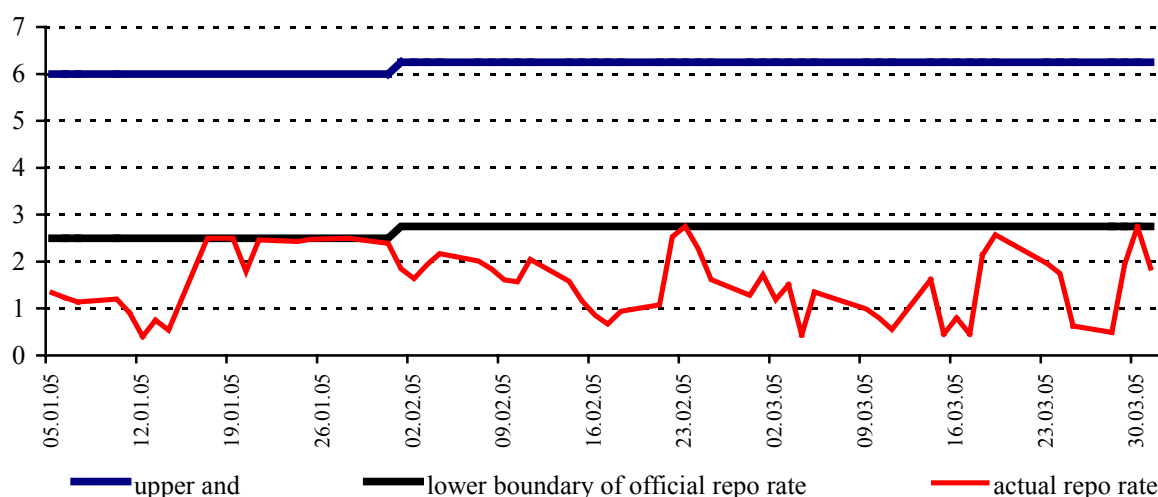
Repo and Reverse Repo Operations

The volume of repo operations conducted by the National Bank in the first quarter of 2005 was T224.8 billion, which is 2.5 percent less than the volume for the fourth quarter of 2004. One of the reasons was a 4.6 percent reduction in the volume of government securities in the National Bank's portfolio.

The weighted average rate for repo operations of the National Bank climbed to 1.55 percent in the first quarter of 2005, as compared to 1.24 percent in the preceding quarter. All operations were conducted as overnight operations -- that is, repayment occurred on the next business day.

The effectiveness of these operations of the National Bank continues to be too low for regulation of short-term market rates. The National Bank is playing a negligible role on the interbank repo market, being credited with less than 30 percent of the volume of this market's operations. As a consequence the National Bank is unable to keep the weighted average rate for repo operations within the bounds of the official repo rate band (Figure 12).

Figure 12. Dynamics of the Weighted Average Repo Rate for National Bank Operations, Percent



Source: Republic of Kazakhstan National Bank

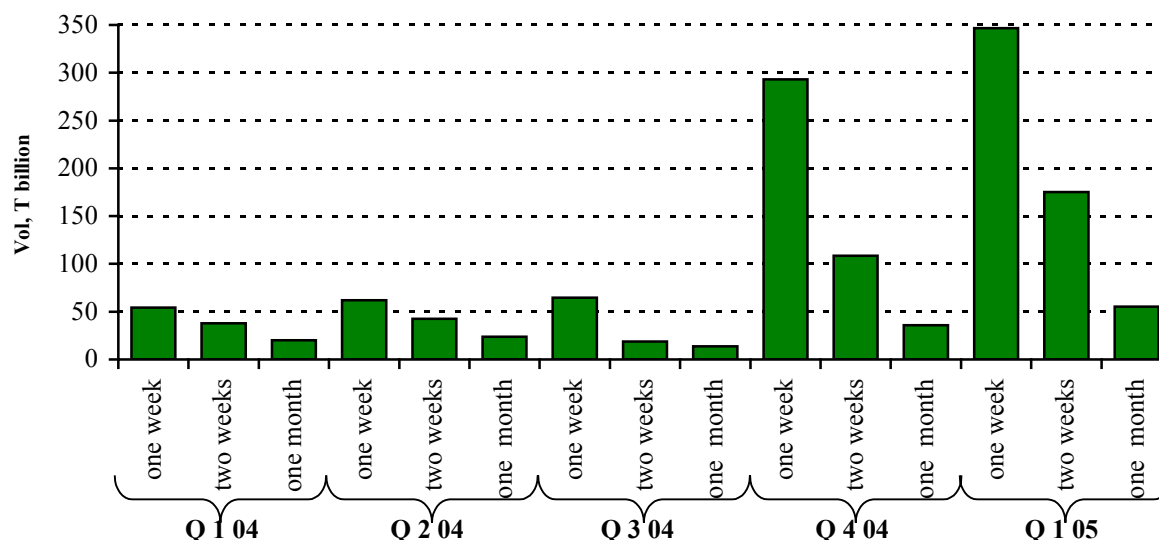
Attraction of Deposits

In the first quarter of 2005 the National Bank attracted tenge deposits from second-tier banks amounting to T577.3 billion, which is 29.8 percent more than in the fourth quarter of 2004. 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 13).

One-week deposits, which were 60.1 percent of the total volume of attracted deposits in the first quarter of 2005, continue to be the most popular. Their volume increased 14.9 percent compared to the fourth quarter of 2004. The volumes of 2-week and 1-month

deposits attracted increased by 60.3 percent and 51.6 percent, and their share in the structure of deposits attracted by the National Bank reached 30.3 percent and 9.7 percent respectively.

**Figure 13. Volume of Deposits Placed with the National Bank:
Amounts and Maturities**



Source: Republic of Kazakhstan National Bank

The yield on attracted deposits remained practically unchanged in the first quarter of 2005 -- 2.24 percent (2.26 percent in the fourth quarter of 2004). The yield of deposits maturing in 1 week decreased from 2.15 percent in the fourth quarter of 2004 to 2.09 percent in the first quarter of 2005, the yield of deposits maturing in 2 weeks decreased from 2.27 percent to 2.26 percent, and that of 1-month deposits decreased from 2.46 percent to 2.41 percent.

Granting of Loans

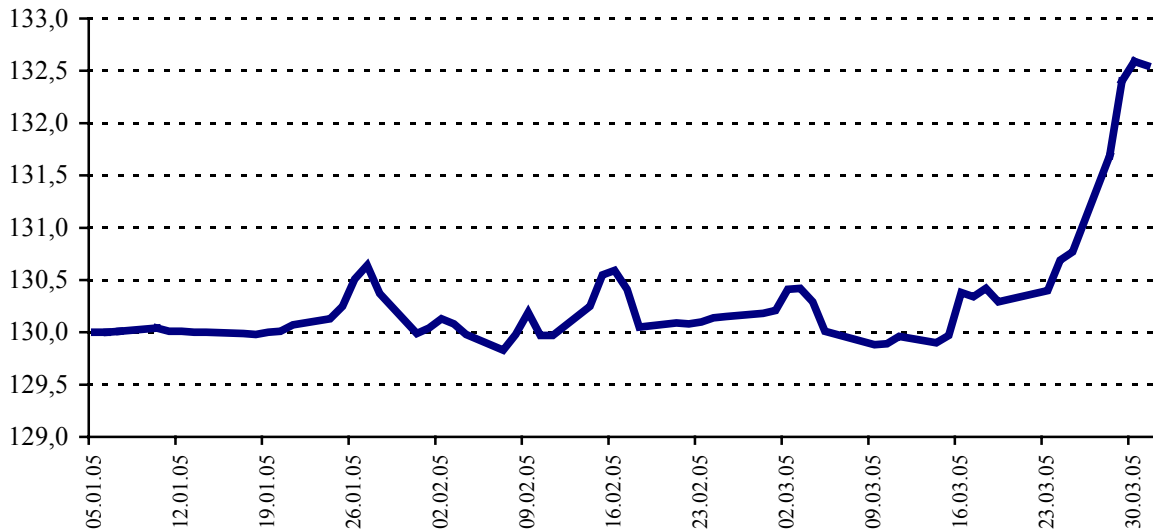
The National Bank did not conduct any loan granting operations in the first quarter of 2005.

Foreign Exchange Rate

Nominal strengthening of the U.S. dollar against the tenge was noted in the first quarter of 2005: according to the quarter's results the exchange rate of American currency grew 2.0 percent -- to T132.55/US\$ from T130.00/US\$. The direction of the dynamics of the U.S. dollar's exchange rate against the tenge was consistent with the conditions of the world currency market, being characterized by significant strengthening of the American currency: the exchange rate of the U.S. dollar against the euro grew 4.8 percent in the first quarter.

The weighted average exchange rate of the tenge in the first quarter of 2005 was T130.37 to the U.S. dollar. During the quarter the tenge varied against the U.S. dollar within a band of T129.83-T132.59 to the dollar (Figure 14).

Figure 14. Dynamics of the Nominal Exchange Rate of the Tenge against the U.S. Dollar



Source: Republic of Kazakhstan National Bank

In January the exchange rate of the tenge against the U.S. dollar varied within a narrow band, increasing only 0.01 percent during the month.

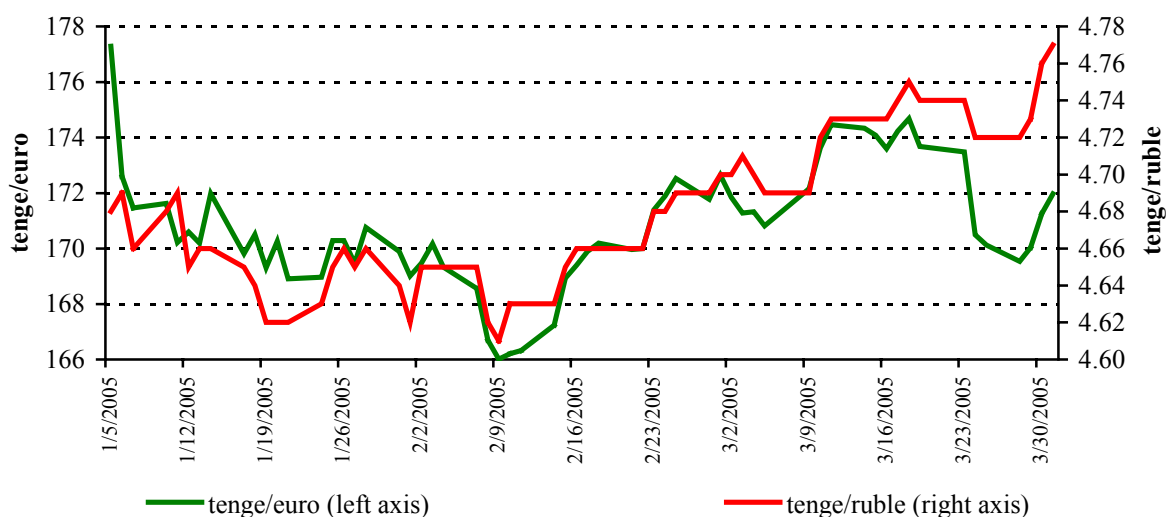
In February the fluctuations in the exchange rate of the tenge against the U.S. dollar were observed to be bidirectional on the internal exchange market, with a clearly pronounced rising or falling trend being absent. During the month the tenge fell in value against the U.S. dollar by 0.15 percent.

In the first half of March the information released on unemployment and on the number of new jobs in the USA fell short of projections, spokespersons of Asian central banks announced possible revision of the structure of gold and foreign exchange reserves, and the demand for the euro increased in connection with placement of large government loan bonds by certain European countries, as a consequence of which the exchange rate of the U.S. dollar against the principal world currencies decreased. On this backdrop, the exchange rate of the tenge against American currency grew somewhat. In the second half of March, however, the U.S. dollar began to grow stronger on the world exchange market on the eve of revision of the basic refinancing rate by the Federal Reserve System, and after it was increased by 25 basis points to 2.75 percent on March 22, the rate of growth of the U.S. dollar's exchange rate increased. The dynamics of the American currency's exchange rate against the tenge on the internal exchange market were consistent with the trend that took shape on the world market. In March the tenge lost 1.8 percent of its value against the U.S. dollar.

The status of the single European currency on the international financial market and stabilization of the tenge's exchange rate relative to the U.S. dollar had an impact on the dynamics of the tenge's exchange rate relative to the European currency on the Kazakhstani market. During the first quarter of 2005 the tenge's official exchange rate against the euro increased 2.9 percent, reaching T177.97 to the euro at the period's end.

The dynamics of the Russian ruble's exchange rate against the tenge were determined chiefly by Russian Central Bank policy on the exchange rate of the Russian ruble against the U.S. dollar. Thus, in the first quarter of 2005 the official exchange rate of the tenge against the Russian ruble fell 2.1 percent (Figure 15).

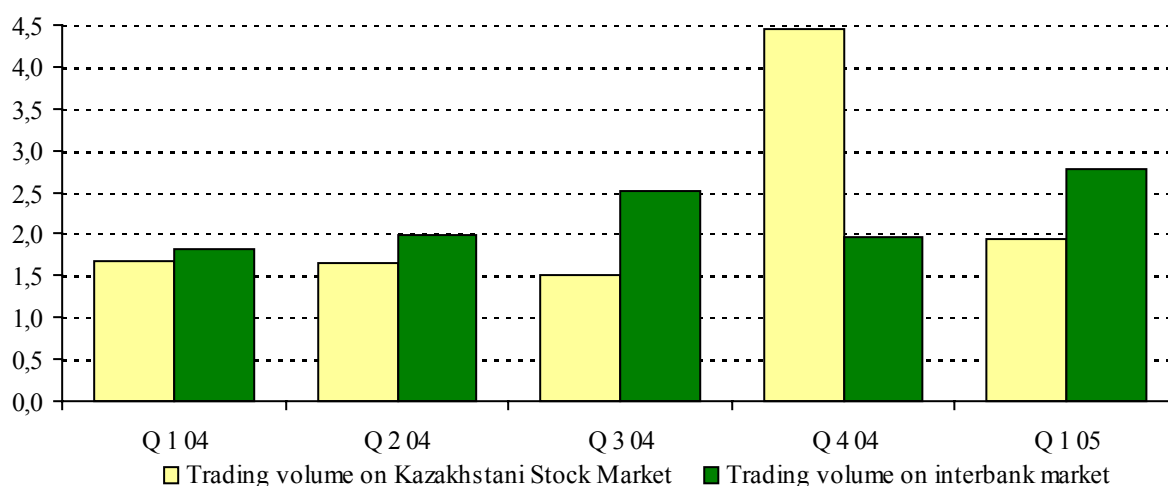
Figure 15. Dynamics of the Official Exchange Rate of the Tenge against the Euro and the Russian Ruble



Source: Republic of Kazakhstan National Bank

In the first quarter of 2005 the volume of exchange trading in the dollar position on the Kazakhstani Stock Exchange was US\$1.9 billion, which is 15.4 percent above the level for the same period of 2004 (Figure 16).

Figure 16. Trading Volume on the Internal Exchange Market, US\$ Billion



Source: Republic of Kazakhstan National Bank

During the first quarter of 2005 the volume of operations on the over-the-counter exchange market increased 53.7 percent compared to the same indicator for the past year, to a figure of US\$2.8 billion (Table 8).

Table 8. Trading Volume on the Internal Exchange Market, US\$ Million

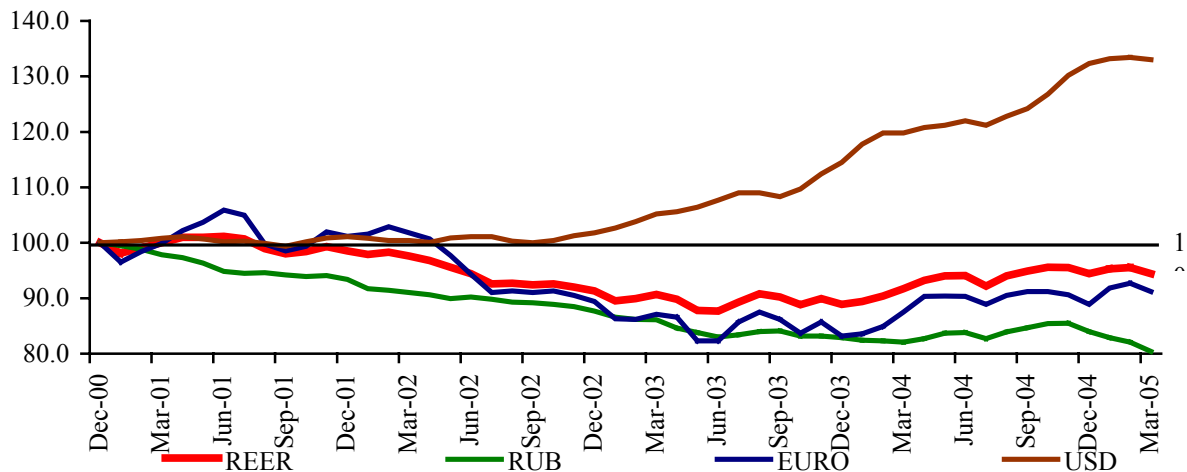
	Jan 05	Feb 05	Mar 05
Trading volume on Kazakhstani Stock Market	557.6	614.0	770.4
Trading volume on interbank market	569.5	1 036.6	1 176.8

Source: Republic of Kazakhstan National Bank

In the first quarter of 2005 the National Bank maximally decreased its presence on the exchange market, ending up as a net seller of foreign exchange. The coefficient of the National Bank's participation was about 1.2 percent.

The index of the real effective exchange rate (REER) of the tenge did not change relative to December 2004 according to the results of the first quarter of 2005. Real strengthening of the tenge was 0.5 percent relative to the U.S. dollar and 2.5 percent relative to the euro. Relative to the Russian ruble the tenge fell in value in real terms by 4.4 percent (Figure 17).

**Figure 17. Real Exchange Rate Indexes, Percent
(December 2000 = 100%)**



Source: Republic of Kazakhstan National Bank

Bill Rediscounting

In the period in question, 55 bills amounting to T2.0 billion were accepted for rediscounting. As of April 1, 2005 the National Bank's portfolio contained bills amounting to T1.8 billion.

Owing to their insignificant volume, bill rediscounting operations conducted by the National Bank in the first quarter of 2005 did not have an influence on the liquidity of second-tier banks.

4. Inflation Forecast

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

Actual inflation in the first quarter of 2005 (1.9 percent) exceeded the forecast for this period (1.5-1.7 percent) due to understatement of the action of certain factors.

The main deviation of projected inflation from the actual level occurred in March -- 0.2 percent, while the total deviation for January-February was 0.1 percent. And if in January and February the increase in rates of paid services to the public was underestimated, in March both services and food and nonfood goods were underestimated.

The rates of paid services to the public unexpectedly demonstrated high growth. These rates increased not only in January (usually this increase occurs in the first month of the quarter), but also in February and March, albeit at a slower pace.

The "vitamin" component once again had a significant impact on increasing inflation. Prices of fruit and vegetable products grew far higher than anticipated.

In all probability the Message of the President to the People of Kazakhstan, which proposed a significant hike in pensions, benefits, and wages of employees of budget-supported institutions and state civil servants, impacted prices somewhat, increasing them in March 2005. Despite the fact that this increase will occur in the second half of this year, local selling prices are already beginning to rise. This will manifest itself especially greatly in basic necessities (food products, clothing, footwear, etc.).

Annualized inflation also came to a higher level at the end of March 2005 (7.1 percent) than forecast (6.7 percent).

b. Inflation Forecast for 2005

The Guidelines of Monetary Policy for 2005-2007 of the National Bank of the Republic of Kazakhstan projected inflation in 2005 at within 4.9-6.5 percent.

Given considerable growth of budget expenditures however, especially under social programs in keeping with the Message of the President to the People of Kazakhstan, the limits of the inflation forecast were updated. It is anticipated that the National Bank will be in a position to keep average annual inflation within 5.2-6.9 percent (Figure 18). Its level is projected, moreover, to be closer to the upper limit of the band.

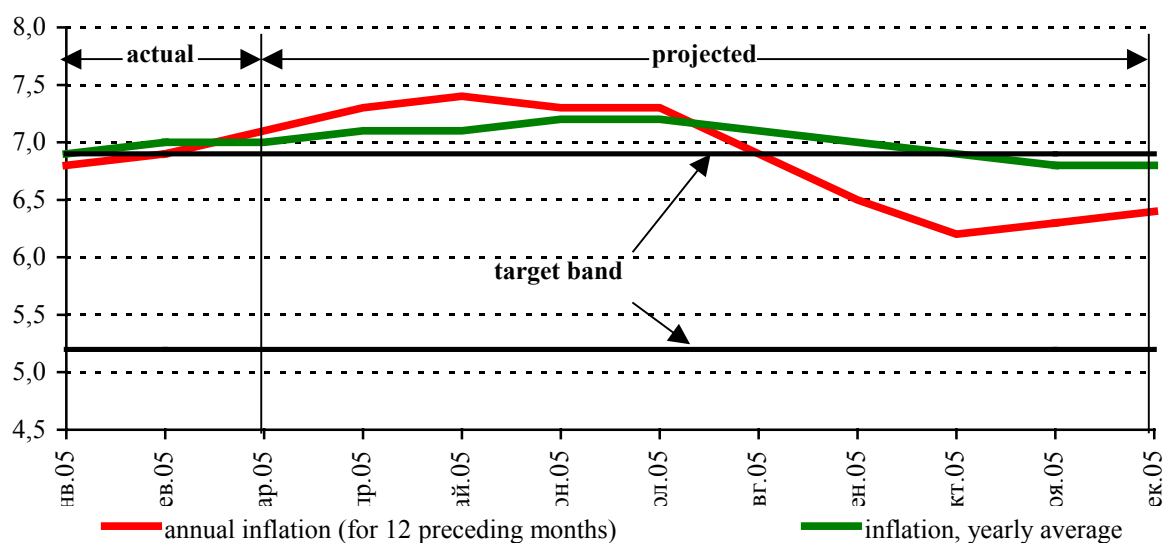
It is believed that in 2005 as a whole, the dynamics of inflation will be determined by high economic growth, a significant inflow of foreign currency, and growth of the people's purchasing power. Besides that, robust growth of the prices of producing enterprises in 2004 could become the dominant factor contributing to growth of consumer prices in 2005.

The National Bank is implementing measures to strengthen its influence on money market rates through flexible change of its official rates. The National Bank intends to abandon the "multiple" official rates currently in place in favor of a "single" rate. For this purpose, it is looking at the possibility for unifying certain operations of monetary policy in terms of maturities and rates. This pertains mainly to deposit and credit operations, to issuance of short-term notes, and to the conduct of direct and reverse repo operations. This means that the National Bank will hold short-term market interest rates for the associated maturities within the prescribed band. Its lower limit will be the rate at which the National Bank attracts resources, and its upper limit will be the rate for placement of resources.

Deposits of banks with the National Bank will become the main instrument for sterilization of surplus liquidity. The time of circulation of short-term notes is being decreased as a way to influence short-term liquidity. It is currently 28 days. Longer-term liquidity will be regulated with the assistance of minimum reserve requirements.

In addition to measures of the National Bank to maintain the stability of prices, the government on its part will also take the necessary steps to prevent increases in prices on the backdrop of an increase in personal income. In particular, on May 5, 2005 the government adopted Resolution No. 430 "On Certain Measures to Stabilize Prices on the Consumer Market," which specifies actions to be taken to enhance the market's competitiveness and to constrain monopolization, and provides for a decrease in the rates of customs duties on a number of entering food and nonfood goods.

Figure 18. Actual and Projected Inflation in 2005



Source: Republic of Kazakhstan National Bank

Inflation Forecast for the Second Quarter of 2005

Slowing of inflationary processes is anticipated in the second quarter. This is explained in large part by the seasonal dynamics of consumer prices. As the experience of the past years shows, price increases are far smaller as a rule in the second quarter than in the two preceding quarters.

Increases of prices of fuel and lubricants could become a major threat to price stability. This growth is absolutely unpredictable in terms of its rate, the moment of its commencement, and its duration.

Tax and budget policy may be characterized as a rule as moderate from a spending standpoint in the second quarter. Nor should significant changes be anticipated this year. Growth of budget expenditures in keeping with the Message of the President to the People of Kazakhstan will begin in the second half of the year.

Continued pursuit of an aggressive credit policy by second-tier banks, inflow of foreign currency, and the need for its sterilization should be included among the main factors that may facilitate growth of consumer prices in the second quarter of 2004.

It is anticipated from the results of the second quarter of 2005 that inflation will be 0.9-1.0 percent, which is consistent with annualized inflation of 7.3 percent at the end of June.

Inflation Forecast for the Third Quarter of 2005

As has been demonstrated in past years, the third quarter is characterized as a rule by the lowest level of inflation over the course of the year, which is connected in large part with the seasonal factor. The situation on the consumer market in this period will be determined in large part by the harvest, both in Kazakhstan and in neighboring countries.

Increases in social expenditures from the budget starting July 2005 will also impact inflation.

The increase in official rates of the National Bank undertaken in the fourth quarter of 2004 and the first quarter of 2005 is anticipated to have the impact of decreasing inflation starting in the third quarter.

Inflation is projected at 0.6-0.8 percent in the third quarter of 2005. This is consistent with an annualized rate of 6.4-6.6 percent, or with an average annual rate of 7.0-7.1 percent.

In all probability average annual inflation will "escape" the predicted bounds in the second quarter of 2005, as it did in the first quarter. After that, however, according to our estimates inflation will decrease, which will make it possible to keep it within the target band in 2005 as a whole.