

INFLATION TARGETING: KAZAKHSTAN'S EXPERIENCE

Three years ago, in the midst of a severe economic crisis, the National Bank of Kazakhstan (NBK) made a crucial decision to drastically change its monetary policy. The country's financial regulator switched over to the inflation targeting and floating exchange rates.



Daniyar Akishev,
NBK

Daniyar Akishev, governor of NBK, explains:

On August 20 2015, after the government had announced the floating exchange rate, the national currency of Kazakhstan – tenge – lost more than 35% of its value against the US dollar in just a couple of hours: it plummeted from 188 to 252 tenge for one US dollar. It was an unpopular and painful measure, which provoked a negative reaction in our society. However, when the shock wore off, our economy and the country as a whole adapted themselves to the new realities reasonably quickly.

The conditions for launching the inflation-targeting framework and a floating exchange rate in 2015 were very unfavorable for the export-oriented economy of Kazakhstan, as the world prices for the country's main export commodities were falling and national currencies in the countries of Kazakhstan's trading partners considerably devaluated. The currency market experienced severe turbulence, the population's savings

were being dollarized, local banks' tenge liquidity was declining while the money market rates skyrocketed.

All these factors put together undermined trust in the tenge and the National Bank as a whole. Forecasts of some analysts in 2015 were hence quite sceptical. The expected range of the dollar-tenge exchange rate spanned from 220 to 400 tenge for one dollar. Rising inflation was predicted by some economists.

In these circumstances, NBK set a target to restore the balance in the currency and money markets. Since November 2015, the bank had minimized its participation in the currency market. This turned out beneficial for establishing a well-balanced tenge exchange rate. The liquidity in tenge was provided sparingly in a targeted way to prevent its overflow to the currency market.

After the first three months of turbulence while the market was adapting to the new economic conditions, the situation stabilized. As a result, the volatility of rates in the money market decreased, and the target rate of the TONIA interbank money market was within the framework of the interest rates.

In steadier circumstances, NBK resumed short-term liquidity lending to commercial banks and started to carry out operations aimed at stabilizing the interest rates. In February 2016, the routine practice of establishing the base rate was re-introduced.

Decisions about the base rate are taken eight times a year. The date and time for reviewing the rate are set in

advance and are officially published on the bank's web site. This frequency of the base rate review guarantees a prompt reaction to the changing market conditions. The base rate is set at a level that allows the economy to reach the medium-term inflation target. The policy of managing the expectations of the population and the market coupled with a large-scale information campaign proved to be a stabilizer.

Today, the results of NBK's endeavours are obvious. In a short period of time the inflation rate dropped by more than three times: from its peak of 17.7% in July 2016 to 5.9% in July 2018. The annual inflation rate is within the target range of 5%-7% set for 2018. Estimates for 2019 testify to a further slowdown of inflation, which is expected at a lower level of 4%-6%. The medium-term guideline for inflation is 4% by the end of 2020 and beyond.

The households' perception of inflation has improved while the inflationary expectations remain on a manageable level. Last July the households' opinion poll showed that next year's inflation is expected at 5.6%, which is within the target inflation range for 2018-2019.

The situation in the forex market has stabilized. Although the exchange rates did not return to their pre-devaluation levels, the population and market players understood and accepted the new rules of the game. The current exchange rate is determined by such fundamentals as oil prices and the Russian rouble exchange rate. Since November 2015

until today the tenge exchange rate has varied in a wide spectrum: from 310 to 383 tenge for a US dollar, thus reflecting the influence of the global financial fundamentals. A floating exchange rate fuels Kazakhstan's economic climb without accumulating imbalances, which was typical for the period of tenge's fixed rate.

Kazakhstan has also managed to reduce bank deposits' dollarization from 70% in January 2016 to 45% in July 2018. Two steps played a key role here: the spread of suggested deposit rates has increased to a maximum of 12% in tenge and 1% in foreign currency, while the insurance coverage for individual deposits has grown to KZT 10 million for tenge-denominated deposits and KZT 5 million for foreign currency deposits.

In 2017 the programme for increased financial sustainability of banks was successfully implemented. As a result, the country's credit market recovered. Kazakhstan's enterprises can now obtain financing in tenge on favourable terms. The annual increase in lending to the economy by healthy banks is estimated at 14%. This is considerably higher than the nominal GDP growth.

NBK's shift to inflation targeting coupled with a floating exchange rate proved to be the right step to take. The economy is rebounding and growing, the financial sector is gradually recovering and stabilizing, and the macros are improving. At the same time, NBK now faces new challenges: further improvements of its efficiency and sustainable development of the market's segments.

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NATIONAL BANK OF KAZAKHSTAN

KAZAKHSTAN'S SECURITIES AVAILABLE ON CLEARSTREAM

Clearstream enabled access to the government securities of Kazakhstan by opening a new domestic link. The project was launched on July 30, 2018.



Clearstream became the first international securities depository which established a link to Kazakhstan. The link provides access to the local market of government bonds and National Bank notes issued in the national currency, tenge. Citibank Kazakhstan acts as a local custodian and a cash correspondent bank.

Commenting on the event, Philip Brown, Co-CEO of Clearstream Banking S.A., emphasized that the new partnership with Kazakhstan was an important step for Clearstream, as it was aligned with the depository's strategic goal to provide access for its global customers to issuers from the CIS and the Caucasus.

Earlier, on June 27, the project was presented to a wider audience of investors at the 'Investment opportunities in Kazakhstan'

international conference held in London, co-organized by Bloomberg and Clearstream along with the National Bank of Kazakhstan (NBK). Speaking at the event, Daniyar Akishev, governor of NBK, highlighted the new opportunities for investors opened up by including Kazakhstan's government securities in Clearstream.

"Kazakhstan's economy is moving towards a sustainable growth. We believe that Clearstream's capabilities will support current positive trends in the market," noted Mr. Akishev by welcoming Kazakhstan's inclusion in the Clearstream system and its launch in Kazakhstan. "This project substantially expands the sources of long-term funding and will enable [us] to lower the cost of borrowing for the government of Kazakhstan. It will have a positive impact on the

yield curve formation and further development of the Kazakhstani securities market."

The country's financial regulator is convinced that financial viability, stable and well-balanced monetary and economic policies, along with the country's social stability, make Kazakhstan an attractive borrower for foreign investors.

According to Mr. Akishev, NBK together with the government of Kazakhstan have set the following priorities in order to enhance favourable trends in the national economy: maintaining macroeconomic stability, predictable monetary and budget policies, further improvement of the investment climate and diversification of the economy.

Kazakhstan's authorities expect that the inclusion of its government securities in Clearstream will result

in an increased demand for the country's state securities from foreign investors, government bonds' liquidity growth and their attractiveness in the international markets.

From the strategic point of view, Kazakhstan believes that this project will allow to deepen integration of Kazakhstan with the international financial markets and will also ensure additional portfolio investments. A relatively high base rate of 9% signifies that Kazakhstan's bonds may be welcomed by foreign investors with great interest. It signifies that a

potential investor can expect similar yield while investing in risk-free assets.

"A possibility to settle government securities of Kazakhstan via Clearstream implies a considerably easier access for foreign investors to the Kazakhstani stock market," Aliya Moldabekova, head of monetary operations at NBK, said. "We hope that attractive and liquid tenge-denominated bonds will help us boost our own national financial market. This is why we consider the launch of the project as a start of the next stage in developing Kazakhstan's financial market."

Local analysts believe that the trading of the Kazakhstani government securities on Clearstream will make it possible for portfolio investors to invest in Kazakhstan's economy in a safer and more comfortable way.

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