



NATIONAL BANK OF KAZAKHSTAN

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The base rate remains unchanged at 9.00%

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Nur-Sultan

The National Bank of Kazakhstan has made a decision to maintain the base rate at **9.00%** per annum with the interest rate corridor of **+/- 1.5 percentage points**. Consequently, the rate for the liquidity provision standing facilities will be 10.50% and for the liquidity withdrawal standing facilities – 7.50%.

The decision was made taking into account the balance of inflation risks in the short and medium term. Pro-inflationary risks are expressed in weakly anchored inflationary expectations, in increased volatility in financial markets amid growing sanctions rhetoric against Russia, expectations of a slower recovery in oil demand and the risk of further stimulating economic activity with fiscal and quasi-fiscal measures. At the same time, the impact of disinflationary factors related to the reduction in economic activity, a slowdown in consumer demand and the expected decline in prices for food products in world markets is observed.

The current level of the base rate will allow maintaining control over the dynamics of inflationary processes and ensuring a smooth deceleration of annual inflation in the medium term.

The annual inflation gets formed in accordance with the estimates. In August, 2020 it amounted to **7.0%** in the annual term. The main contribution to the acceleration of inflation was made by the increased prices of the food goods (10.9%). The dynamics of nonfood inflation (5.5%) and inflation of paid services (3.4%) remained relatively stable. The main premise for the acceleration of food inflation was the inertial rise in prices for most food products, including meat, bakery products, fish and seafood, fruits. The annual decline in sugar prices continues to have a moderating effect on food inflation. The re-introduction of quarantine measures led to a smooth dynamics of non-food inflation. The exchange rate depreciation pass-through was offset by suppressed consumer demand for nonfood products and a slowdown in gasoline price growth and an annual decline in diesel prices. The effect of a temporary reduction in utility tariffs was exhausted in the 2nd quarter of 2020, however, this factor was partially offset by a decrease in demand for services due to the quarantine measures. In general, the actual dynamics of annual inflation at the end of August 2020 is in line with the forecast estimates.

By the end of the year, the annual inflation is expected to accelerate to 8.0%, closer to the lower limit of the previous forecast of 8.0-8.5%.

Inflationary processes will accelerate due to continued high growth in food prices and a slight increase in inflation of paid services. At the same time, the weak dynamics of real incomes of the households and the expected decline in prices for world food products will limit the growth of inflation in 2020.

In 2021, inflation will gradually slow down to the upper limit of the target band of 4-6% at the end of the year. The slowdown in inflationary processes will occur due to the high inflation base in 2020 and weak external inflationary pressures. An additional disinflationary effect will be exerted by the normalization of the rise in prices for food products. At the same time, the decline in inflation

will be restrained by the additional allocation of a targeted transfer from the national fund of the Republic of Kazakhstan in the amount of 1 trillion tenge in 2021.

Inflationary expectations remain high and weakly anchored. The quantitative estimate of inflation for the year ahead was 6.9% (July – 6.6%). The share of respondents expecting continued or accelerated price growth over the past 12 months remains at maximum values (in August – 65%, in July – 64%, in the first quarter - 44%). A rapid rise in prices for food products was noted by 88% of respondents (in June - 89%, in July - 83%), for nonfood products - 7% (in July - 10%). In the structure of paid services for the population, respondents noted an increase in tariffs for housing and utilities, as well as an increase in the cost of domestic services (hairdressing, ateliers).

At the end of the seventh month of 2020, Kazakhstan's GDP decreased by 2.9% in annual terms. Strengthening of the decline in economic activity was due to the downturn in the services sector, particularly in trade and transport. In addition, a slowdown in the goods manufacturing sector was due to the decline in the mining industry.

The positive contribution to the GDP dynamics was made by the information and communication in light of continuation of distance work and online learning. The growth of the industry in seven months of 2020 amounted to 8.7%. The growth in services of mobile communication (2.2%), Internet networks (13.2%) and services for data transmission via telecommunication networks (18.4%) is observed. Gross agricultural output increased by 2.5% in January-July 2020, due to an increase in livestock production by 2.6% and crop production - by 2.1%.

The National Bank worsened its expectations for economic growth in 2020, considering a deeper decline in economic activity in the second quarter of 2020, as well as the introduction of a lockdown in July 2020. According to the updated forecasts of the National Bank, in 2020 Kazakhstan's GDP will decrease by **2.0% -2.3%**. In 2021, in conditions of a low base of 2020 and an improvement in the epidemiological situation, economic growth will recover to **3.5-3.8%**. It will be contributed by a gradual recovery in external demand, the realization of deferred investment projects, a positive fiscal impulse, an improvement in the labor market and a revival in consumer demand.

The decline in consumer and investment activity puts pressure on aggregate demand. The introduced quarantine measures had a negative impact on the income of the households, affecting the decrease in consumer activity. The main factor was the slowdown in the growth of real wages of employees. In addition, the closure and suspension of activities of certain industries led to a deterioration in the situation in the labor market.

Fixed capital investment is declining. In July 2020, the reduction in investment activity turned out to be deeper, the annual decline was 16%. The main contribution to the negative dynamics of investment activity from the beginning of the year continues to be made by a decline in investment in the mining industry by 17.2%, due to the suspension of construction work at the Tengiz oil field. The negative dynamics of investments in trade (44%), transport (5%), construction (47.1%) and professional scientific and technical activities (47.9%) persists. In other industries of the real sector and in the government sector, the growth of investments in fixed assets is observed.

The situation in the external sector remains uncertain. The preservation of the lockdown regime in many countries of the world as part of the fight against the COVID-19 pandemic resulted in a significant reduction of economic activity in both developed and developing countries. According to the World Trade Organization, the global trade declined by 18.5% in annual terms in the second quarter of 2020. However, the reduction in international trade is slowing down as evidenced by a slight improvement in the dynamics of leading indicators of new export orders in industry. The outlook for the development of the world economy are still associated with high uncertainty due to the beginning of the second wave of COVID-19 in some countries. In addition, the growth of volatility in the world financial markets is not excluded taking into account the turbulence expected by investors associated with the upcoming presidential elections in the United States. At the same time, international organizations believe that the largest recession in the global economy took place in the

second quarter of 2020, that will be followed by a reversal, and in 2021 the growth rate of the global economy will turn upward. **The estimates for the growth prospects of the trading partners of Kazakhstan in 2020 are revised downward.** According to Consensus Economics' expectations, the Russian economy in 2020 will contract by **5.1%** as the result of longer duration of the restrictions than previously expected. Due to the deterioration of the situation with consumer demand amid the coronavirus pandemic, the EU economy is expected to contract by **7.8%** in 2020. Forecasts for the growth of China's economy for 2020 increased to 2.1% in light of improving indicators of the real sector.

The Russian ruble is under the influence of geopolitical risks. The risks of new sanctions have risen, which is reflected in the increased volatility of the ruble. The new package of sanctions by the United States and a number of European countries, affecting the national debt and foreign exchange transactions of the largest Russian exporters, may have negative consequences for Russia. Nonetheless, balanced monetary and fiscal policies restrain significant ruble depreciation, reflecting the adaptive nature of the economy.

The situation in the world oil market has improved with the remaining uncertainties. The decrease in the world oil production was observed, which is explained by the actions of the OPEC+ participants in the framework of the oil reduction agreement and weaker oil production in the United States and Canada. Taking into account the opening of economies after the lockdown, the dynamics of world oil consumption improved. The growth in oil consumption was recorded in most of the large importing countries. By the end of 2020 and in 2021, oil demand is expected to grow further. Consequently, this may lead to a reduction in accumulated reserves by the end of 2020 and a shortage in the oil market from the first quarter of 2021.

The negative factors for oil remain the risks of a larger second wave of coronavirus, which may lead to a slower recovery in demand and the formation of a surplus of oil on the market. This is also the evidence of the state of the labor market in the United States, where, despite the recovery, the unemployment rate remains high (8.4% in August 2020). There are also concerns about the excess of oil production in Iraq. The country will not be able to fulfill the obligations associated with the OPEC+ agreement due to its difficult financial situation.

In recent days, the price for Brent oil has decreased by **5%** to **\$42.2** per barrel due to increased OPEC+ production and a possible decline in demand from China. Saudi Arabia's pricing policy for discounts sets the tone for other oil-producing OPEC states, thereby creating additional pressure to lower oil prices.

External inflation rose slightly, remaining at a low level. Inflation in the EU amounted to 0.8% in July. The annual price increase in China in July was 2.7%, being below the target. In Russia inflation was around 3.4% in July.

External monetary conditions remain stimulating. The Federal Reserve System revised its monetary policy strategy, signaling about a prolonged period of low rates. At the same time, it is worth to mention the statement of the Chairman of the Central Bank of Russia, according to which, as disinflationary risks are exhausted, a return to a neutral monetary policy in the medium term is inevitable.

The National Bank will continue to monitor internal and external factors that affect the dynamics of inflation. Further decisions on the base rate will be made taking into account the compliance of the actual inflation dynamics with its forecast, as well as the balance of internal and external risks.

The next planned decision of the National Bank of the Republic of Kazakhstan about the base rate will be announced on October 26, 2020 at 15:00 Nur-Sultan time.

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