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MONETARY POLICY GUIDELINES OF NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN

FOR 2010

Foreword

Due to unprecedented anti-crisis actions taken by the majority of countries in 2008-2009, the global economy started to recover from recession caused by the global financial crisis. In years to come, especially in 2010, one of the challenges faced by the government authorities both of the countries with developed and emerging markets will be to implement the "exit strategy" for winding up the anti-crisis package. In doing so, the major challenge will be to determine the right timing for completion of these programs.

On the one hand, early termination of the government stimulus packages may provoke a new round of crisis in the global economy. Economic entities may be unable to spur up their activities on their own because of the insufficient resources.

On the other hand, continuing with the anti-crisis measures also bears risks for further economic development because of the increased burden on the country's resources and significant growth in the state budget deficits. Massive injections in the economy have resulted in accumulation of excessive liquidity in financial institutions, which, in the environment of a low investment activity, may result in new “bubbles”. Moreover, “soft” monetary policy will generate new inflation risks.

Thus, implementation of a balanced policy, i.e. gradual surrender from a further substantial support of the economy by the government will allow recovering the economic growth rates while retaining the price stability. In doing so, the growth recovery is anticipated to be slow, despite improved economic and financial conditions in the global economy since the second half of 2009.

There was also a crucial point in the macroeconomic development of the Republic of Kazakhstan.

Starting from Q3 2009, some recovery of the economic growth has been observed, which offset a significant decrease in the real GDP in the first half of 2009. According to preliminary outcomes of 2009, the real GDP increased by 1.1%. Despite the fact that the economic growth rate in 2009 was lower than in 2007-2008, the governmental support measures made it possible for restoring positive expectations of economic entities and stabilizing the economic situation.

Inflationary potential in the economy of the Republic of Kazakhstan in 2009 was minimal. A steady disinflation was observed. At the end of 2009 the year-on-year inflation was at 6.2% (in December 2008 – 9.5%).

In 2010 no further decline in the inflationary pressures in the Republic of Kazakhstan is anticipated, which is related to the existence of a number of risks. Consumer demand expansion may be ensured by the increase in wages, social benefits and retirement benefits from the budget scheduled for 2010. In addition, the increase in prices for imported products is possible due to the increase in customs duties in connection with the establishment of the Customs Union of the Republic of Kazakhstan, Russian Federation and the Republic of Belarus.

The situation in the country’s financial market will be gradually improving in 2010, however, there will be no dramatic growth in the lending activity of banks due to remaining economic and financial risks.

In general, further development of the Kazakh economy will depend on many factors. It is virtually impossible to unambiguously assess their impact at this point, and put them under control of the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan is quite difficult.

In the environment of remaining instability and uncertainty in the global markets and the domestic market, the National Bank of the Republic of Kazakhstan decided to draft its Monetary Policy Guidelines for one year – for 2010. As such uncertainty diminishes, the National Bank of the Republic of Kazakhstan intends to go back to its practice of drafting the Monetary Policy Guidelines for a three-year period.

1. The Monetary Policy of the Republic of Kazakhstan in 2009

At the end of 2008 – beginning of 2009, a significant increase in negative devaluation expectations was observed in the domestic foreign exchange market. At that, the National Bank of the Republic of Kazakhstan made considerable efforts to ensure stability of the exchange rate and maintain the implicit rate band within the range of KZT 120/US$ ±2%.

Only during the period of October 2008 through February 2009, the National Bank of the Republic of Kazakhstan sold over US$ 9 bln. to ensure stability of the Tenge exchange rate. The volume of gold and foreign currency reserves decreased by 10.4% over the period.

However, the situation in the global economy by the beginning of 2009, including the devaluation of currencies in the countries – trade partners of the Republic of Kazakhstan and significant decrease in prices for energy resources which are the basic exports item of Kazakhstan didn’t ensure stable balance sheet indicators for 2009 and could result in their dramatic deterioration.

In conditions of inevitable changes of approaches to the monetary policy implementation, the National Bank of the Republic of Kazakhstan studied the options for shifting the focus from ensuring the price stability and continuing with the policy of transition to inflation targeting to the establishment of exchange rate band. The review of the global experience showed that the only correct decision in this situation would be to implement a one-time devaluation of the domestic currency followed by the exchange rate maintenance at a new level.

In this connection, in February 2009 the National Bank of the Republic of Kazakhstan fixed a new exchange rate band at KZT 150/US$ +/-3%. This allowed not only decreasing devaluation expectations in the market significantly but also ensuring that the competitiveness of domestic producers would restore and the gold and foreign currency reserves would be retained.

As a result of these measures, as well as resumed growth in global prices for the major exports items of Kazakhstan the situation in the domestic foreign exchange market stabilized, and by the end of 2009 the trend for appreciation of the domestic currency had outlined. The National Bank of the Republic of Kazakhstan managed to replenish the volume of its gold and foreign currency reserves. At the end of 2009 it accounted for US$ 23.2 bln., which is by 16.8% higher as compared to 2008.

The minimum inflationary potential in the economy enables the National Bank of the Republic of Kazakhstan to identify taking measures for restoring the confidence of population in the domestic currency, as a key monetary policy guideline.

For this purpose, the National Bank of the Republic of Kazakhstan took actions to provide a short-term Tenge liquidity to banks. As part of this guideline, refinancing loans were provided to banks, the list of instruments accepted as collateral for these operations have been adjusted. The official refinancing rate was gradually lowered from 10.5% to its historical minimum of 7.0%. In March 2009 minimum reserve requirements to banks were lowered from 2% to 1.5% on the domestic liabilities and from 3% to 2.5% on other liabilities. In order to maintain current liquidity of the banks which undergo the debt restructuring process, in November 2009 individual minimum reserve requirements of 0% in respect of all liabilities of such banks were established.

In addition to that, the support provided to the banking system by the Government as part of the joint Plan of Actions of the Government of the Republic of Kazakhstan, the National Bank of the Republic of Kazakhstan and the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations for stabilization of the economy and the financial system for 2009-2010, contributed to a significant improvement of the situation with the bank liquidity. As a result, from Q2 2009 the demand for resources of the National Bank of the Republic of Kazakhstan on the part of banks decreased.

Remaining high risks in the economy of the Republic of Kazakhstan and limited demand of the real sector for credit resources as well as low quality of bank loan portfolio didn't promote the increase in the lending activity. As a result, banks have accumulated a significant volume of liquidity in the instruments of the National Bank of the Republic of Kazakhstan, despite the lowered interest rates and increased maturities of deposits attracted from banks and issued short-term notes of the National Bank of the Republic of Kazakhstan.

The effect of actions taken by the National Bank of the Republic of Kazakhstan, given the time lag, may become apparent in 2010.

2. Scenarios for the Development of the Economy of the Republic of Kazakhstan for 2010

A slow recovery of the global economy, moderate world prices in the commodities markets, including prices for major items of Kazakhstani exports, remaining uncertainty in the global financial market will be the key factors determining the development trends in the economy of the Republic of Kazakhstan.

In 2010 direct foreign investments in Kazakhstan are expected to decrease, mainly due to the reduced financing of the North Caspian Project that peaked in 2009.

Despite the fact that the access to the global market of long-term financial instruments will be limited for the Kazakh banks, this doesn't preclude recommencement of foreign borrowings by some banks, and financing of projects in the real sector that were started up in 2007-2009 will also continue.

Potential outflow of resources in 2010 associated with the increased revenues to the National Fund of the Republic of Kazakhstan will be determined by the level of world oil prices and the mechanism of accumulation and use of resources of the National Fund of the Republic of Kazakhstan.

Based on the degree of impact on the Kazakh economy, the level of world oil prices was used as a key criterion for choosing scenarios when devising the monetary policy for 2010. Three scenarios of the macroeconomic situation were reviewed. In doing so, the first and the second scenarios anticipating the level of world oil prices to be at $US 30 and 50 per barrel, respectively, are synchronized and coordinated with the estimates of the Government of the Republic of Kazakhstan when preparing the Forecast of the Socio-Economic Development of the Republic of Kazakhstan for 2010 – 2014. Also, based on the average annual level of oil prices in 2009, the National Bank of the Republic of Kazakhstan designed a third scenario in which oil prices were estimated at US$ 70 per barrel.

When implementing all scenarios for the development of the economy in the Republic of Kazakhstan in 2010, the main goal of the National Bank of the Republic of Kazakhstan is to ensure price stability, which implies keeping the inflation within 6.0-8.0%.

Under ***the first scenario,*** contraction of the Kazakh economy is anticipated in 2010.

The modeling and forecasting outcomes under this scenario obtained by the National Bank of the Republic of Kazakhstan demonstrate deteriorated indicators of the balance of payments reduced lending and decreased money supply. This is related to the impact of objective factors such as decline in the business activity, restraint of aggregate demand.

The current account deficit in 2010 may be about 8.5% of GDP, deficit of the overall balance of payments – over 4% of GDP.

Keeping the inflation within the given band with the decreased money demand by the economy will be achieved by contracting the reserve money by 2.3%, decreasing money supply by 4.7%, credits to the economy – by 1.4%, deposits in the banking system – by 5.4%. At the same time, the level of monetization will remain virtually unchanged having reached 45.9% at the end of 2010 (Appendix 1).

According to the estimate by the National Bank of the Republic of Kazakhstan, it is very unlikely that this scenario will be implemented.

In the event ***the second scenario*** is implemented, a higher level of oil prices will have a favorable effect on the external flows of Kazakhstan as a result of which the current account deficit in 2010 will account for about 4% of GDP, deficit of the overall balance of payments – about 2% of GDP.

Money demand under this scenario will remain limited. The expansion of reserve money will account for 10.0%, money supply will increase by 9.6%, deposits in the banking system – by 9.2%, volume of credits to the economy – by 5.9%. At the same time the level of monetization in the economy will increase to 46.5% (Appendix 1).

The developments under this scenario will allow the National Bank of the Republic of Kazakhstan and the Government of the Republic of Kazakhstan to encourage economic activity, which will ensure moderate growth rates of the economy in 2010.

Under the ***third scenario,*** the economic growth rate in 2010 is expected to be higher as compared to the previous scenarios.

More favorable environment in the global markets will have a positive effect on the Kazakhstan's exporters. An insignificant current account deficit is expected not to exceed 1% of GDP, overall balance of payments will have a positive sign and will account for about 1% of GDP.

In these circumstances the money demand will appear to be higher as compared to the previous scenario. In 2010 the reserve money will expand by 11.3%, money supply will increase by 15.4%, deposits in the banking system – by

15.2%, credits to the economy – by 8.5%, the level of monetization will account for 46.5% (Appendix 1).

The implementation of this scenario will allow the National Bank of the Republic of Kazakhstan to increase the volume of its gold and foreign currency reserves.

The National Bank of the Republic of Kazakhstan considers implementation of the second and third scenarios of the development of the economy in the Republic of Kazakhstan for 2010 as the most likely; accordingly the monetary policy actions for 2010 were designed.

3. Monetary Policy of the Republic of Kazakhstan for 2010

The primary objective of monetary policy is to ensure the price stability. Actions taken by the National Bank of the Republic of Kazakhstan to attain this goal will contribute to ensuring economic growth, developing the deposit market potential as well as recovering lending activity of the banking sector.

The National Bank of the Republic of Kazakhstan will continue implementing exchange rate policy aimed at ensuring the balance between the domestic and foreign competitiveness of the Kazakh economy. The exchange rate policy will be implemented in order to avoid significant fluctuations in the real exchange rate of the domestic currency which may have a negative impact on the competitive capacity of the domestic production in the ever-changing global environment.

In order to provide conditions for increasing flexibility of exchange rate formation, the exchange rate band of the Tenge will be expanded from February 5, 2010: KZT 150/$US (+)10% or KZT 15, (-)15% or KZT 22.5. Dominating trends in the dynamics of the Tenge exchange rate will be stipulated by the situation in the global financial and commodity markets and the status of the balance of payments.

Interest rate policy of the National Bank of the Republic of Kazakhstan will be intended for maintaining the market rates in the money market of short-term instruments within the rate band of the National Bank of the Republic of Kazakhstan. Arrangements made will ensure that volatility of the market rates will decrease and the money market will stabilize, as well as ensure efficient liquidity management. The official refinancing rate as the upper bounder of the band will be determined based on the situation in the money market and the inflation rate. The rate on bank deposits placed with the National Bank of the Republic of Kazakhstan will be fixed as a lower bounder of the band of short-term rates in the money market. At the same time it will be fixed at a marginal minimum level in order to discourage banks from accumulation of available resources on deposits with the National Bank of the Republic of Kazakhstan.

With a view to withdraw an excessive liquidity, the National Bank of the Republic of Kazakhstan will continue issuing short-term notes. Their issue will be also directed to support the secondary government securities market, build up the yield curve on financial instruments with maturity less than one year.

With the expected insignificant inflationary pressures from fundamental factors, the National Bank of the Republic of Kazakhstan will make efforts to ensure financial stability. It will further monitor the level of bank liquidity and related risks including foreign exchange risks. Where necessary, the National Bank of the Republic of Kazakhstan will provide refinancing loans to support current liquidity of banks. Maturities of these transactions will remain short.

The National Bank of the Republic of Kazakhstan will contribute to further re-orientation of banks to the domestic sources when building up their funding base. To this end the National Bank of the Republic of Kazakhstan will increase the capital of JSC “Kazakhstan Deposit Insurance Fund” in 2010 by KZT 11 bln.

To stabilize the resource base of banks, the transfer of temporary available cash assets of non-bank financial organizations deposited with the National Bank of the Republic of Kazakhstan to deposits with the domestic banks will be also considered.

Implementation of these monetary policy measures will allow the National Bank of the Republic of Kazakhstan to reach its inflation benchmarks. This will help the economy in getting to the path of sustainable and strong growth.

Appendix 1

FORECAST OF KEY INDICATORS OF MONETARY POLICY FOR 2010

end of period

	2008 (actual)	2009 (estimate)	2010 (forecast)		
			Scenario 1	Scenario 2	Scenario 3
Inflation, % **- EoY, %**	9.5	6.2	6.0-8.0	6.0-8.0	6.0-8.0
Official refinancing rate, %	10.5	7.0	6.0	7.0	8.0
Reserve money, KZT bln.	1525	2451	2395	2697	2728
% change	*4.2*	*60.7*	*-2.3*	*10.0*	*11.3*
Money supply, KZT bln.	6267	7386	7042	8097	8524
% change	*35.4*	*17.9*	*-4.7*	*9.6*	*15.4*
Deposits of residents in the banking system, KZT bln.	5409	6473	6123	7070	7459
% change	*39.0*	*19.7*	*-5.4*	*9.2*	*15.2*
Credits from banks to the economy, KZT bln.	7460	7644	7539	8092	8296
% change	*2.8*	*2.5*	*-1.4*	*5.9*	*8.4*
Monetization level of the economy, %	39.0	46.2	45.9	46.5	46.5