



NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN

# INFLATION REPORT

June 2020

Almaty

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The **Inflation Report** is a quarterly publication of the National Bank which contains the analysis of key macroeconomic indicators affecting inflation as well as the forecast of macroeconomic parameters in the short- and medium-term.

The Report is published in electronic format on the official internet website of the National Bank in Kazakh, Russian and English languages.

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## CONTENTS

I. MONETARY POLICY: DECISION ON THE BASE RATE	4
II. PROSPECTS OF THE DEVELOPMENT OF THE ECONOMIC SITUATION	6
1.1 Dynamics of the Economic Development under the Baseline Scenario	6
1.2 Alternative Forecast Scenarios	8
1.3 Risks in the Medium Term	9
III. EXTERNAL ENVIRONMENT	11
3.1 External Economic Situation	11
3.2 External Inflation Dynamics	11
3.3 Monetary Conditions in the External Sector	12
3.4 Commodity Markets	13
IV. PRICING AND INFLATION EXPECTATIONS	15
4.1. Inflation	15
4.2. Inflation Expectations	23
V. ECONOMIC DEVELOPMENT	26
5.1. Domestic Demand	26
5.2. Domestic Supply	28
5.3. Labor Market	30
5.4. Fiscal Policy	32
VI. FINANCIAL MARKET	34
6.1. Money Market	34
6.2. Foreign Exchange Market	34
6.3. Deposit Market	35
6.4. Credit Market	37
BASIC TERMS AND DEFINITIONS	39
BOXES	
Box 1. Inflation Dynamics in Regions	20
Box 2. Sugar Market of Kazakhstan	21
Box 3. Consumer and Saving Sentiment of the Population during the Lockdown	24

## I. MONETARY POLICY: DECISION ON THE BASE RATE

On June 8, 2020, the National Bank made the decision to retain its base rate at **9.50%** per annum with the interest rate band of **+/- 2 pp.** Such decision was driven by the persisting divergent trends in the global economy and commodity markets despite a relative stabilization of situation in May compared to March-April 2020, revision of the projected developments in accordance with the updated baseline scenario and balance of risks.

Given the occurrence of signs of recovery in the Chinese economy, the easing of quarantine measures in some European countries and in the USA, oil consumption is gradually resuming which, along with the reduction of supply within OPEC+ framework, has a positive effect on the pricing environment. Certain commodity and financial markets demonstrate revival. However, a negative impact by the COVID-19 pandemic on the global economy persists. In May 2020, business activity indicators have still been at the levels close to their historical minimums. The external demand remains sluggish, restrictive measures undertaken to curb the spread of infection are still in effect in the countries-trading partners while exerting a negative effect on the economic activity and inflationary processes in Kazakhstan.

**The annual inflation is forming above the target range of 4-6% set for 2020-2021.** In May 2020, the annual inflation made up **6.7%** (6.8% in April 2020). Inflationary processes have been developing under the influence of quarantine measures in Kazakhstan and in the countries-trading partners as well as because of depreciation of the exchange rate of the tenge and its pass-through onto the domestic prices. The main contribution to the inflation dynamics is still being made by the growth of food prices which in May went up by **10.7%** in annual terms having reached their maximum since October 2016. The dynamics of non-food inflation remains moderate with its annual growth accounting for **5.3%**. The rise in prices of paid services has slowed down to **3.0%** as

a result of a negative contribution on the part of regulated utility services.

The improving situation in the global oil market in May 2020 and the prospects of further pricing dynamics motivated **the revision of baseline scenario** by the National Bank. In drafting the Forecast for Social and Economic Development of the Republic of Kazakhstan for 2020-2024, the world oil price of 20-25 US Dollars per barrel was taken as the baseline scenario for the purposes of anti-crisis plan. In accordance with updated estimates regarding the oil market, the National Bank's assumption for **the baseline scenario** is that in 2020-2021 the world price of Brent oil would be at **35-40** US Dollars per barrel on average.

Contrary to the previous forecast which projected acceleration of inflation to 9-11% by the end of this year, according to the updated baseline scenario inflation will be at **8.0-8.5%** at the end of 2020. Inflationary processes will be forming under the influence of divergent factors. A feebleness of consumer demand resulting from anticipated reduction in real money income of the population will be putting a downward pressure on prices. At the same time, intensification of the external inflationary background because of acceleration of consumer price growth in Russia in 2020 as well as a significant fiscal and quasi-fiscal impulse will be increasing pro-inflationary pressure. An upward effect on domestic prices will be produced by a limited supply of certain goods as a result of disruption in the supply chains of raw materials and products in the environment of existing quarantine measures, by the exchange rate pass-through onto the domestic prices and by the weakly anchored inflation expectations.

In May, assessments of **inflation expectations** remained heightened. At the same time, quantitative perception of the existing inflation slightly reduced, respondents observed price deceleration of goods which were in higher demand at the beginning of the lockdown. While in March 2020 the quantitative assessment of inflation

expectations one year ahead went up to **6.4%**, in April-May this indicator was ranging between **6.0-6.2%**. Consumer sentiment somewhat improved in connection with the increasing positive pattern in perception of the economic development prospects and financial position in a sign of gradual easing of quarantine measures.

The imposition of the state of emergency and quarantine measures in March to fight the COVID-19 pandemic caused a significant deterioration of the economic activity. According to the CS MNE, in January-May 2020, reduction in GDP accounted for 1.7% in annual terms as a result of production cutback in many branches of the service sector. There was a slowdown of the business activity in some sectors of the manufacturing industry amidst a drop in the external and domestic demand. At the same time, the shift to the teleworking and introduction of an online learning led to the growth in volumes of communication services. A positive contribution was also made by such sectors as healthcare, general government, the mining sector and agriculture.

Despite a gradual easing of quarantine measures in May-June of this year, the economic activity is still negatively affected by the imposed restrictions. According to the baseline scenario of the National Bank, in 2020 as a result of a negative impact on the part of the domestic demand and net exports **GDP in real terms** will contract by **1.8%** given the support provided by a significant growth of consumption by the general government sector (fiscal and quasi-fiscal impulse). In the time following, the business activity will be recovering to its potential level given the anticipated improvement in epidemic situation within the country, revival in the labor market as well as the growing income of the population. The investment activity will be recovering as a result of the expanding domestic and external demand, the improving pricing environment in the global commodity markets as well as resumption of investment projects which were postponed this year.

Despite stabilization of the situation in the global economy, risks associated with the breach of discipline of the OPEC+ agreement by some countries, with large world reserves of oil and possible aggravation of trade and economic relations between the USA and China are persisting. As the uncertainty regarding key trends in the external markets decreases and the situation is evolving in line with projections of the National Bank of Kazakhstan, the easing of monetary conditions may be considered.

## II. PROSPECTS OF THE DEVELOPMENT OF THE ECONOMIC SITUATION

### 1.1 Dynamics of the Economic Development under the Baseline Scenario

Due to deterioration in global economic prospects, reduction in demand for Kazakhstan's export products and the increasing volatility in the global commodity markets, the National Bank in the May-June 2020 forecast round revised its expectations about the oil price and assumes the average annual oil price of 35 US Dollars per barrel in 2020 and 40 US Dollars per barrel in 2021 as the baseline scenario.

**In 2020, according to the National Bank's projections, inflationary processes are expected to accelerate further. Throughout 2020, the annual inflation will be building above the target range of 4-6% and will account for 8.0-8.5% at the year-end. The main contribution to acceleration of inflation will be made by the rise in prices of foodstuffs and non-food products. The growth in prices of paid services for the population will be moderate (Figure 1).**

A key assumption for acceleration of the food inflation includes a temporary rise in the demand during the lockdown as well as a reduction in supply caused by disruption in the supply chains, and depreciation of the tenge.

The drop of the FAO Cereal Index against the anticipated growth in cereal stocks caused by a concurrent increase in production and reduction in consumption, namely of corn, for purposes of feed and for industrial purposes, will serve as a constraining factor.

A further acceleration of non-food inflation over the forecast horizon will be associated with realization of the effect of the exchange rate pass-through of the tenge against the US Dollar based on a high share of imports in the consumption of non-food products.

A rise in prices for non-food products will be curbed by a suppressed consumer demand given the reduced purchasing

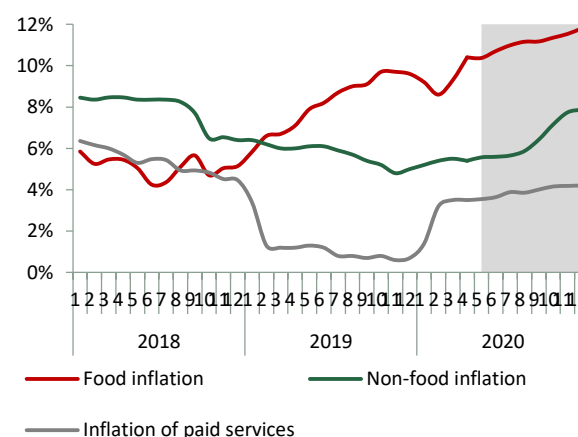
capacity of the population and deceleration of real money income. No dramatic acceleration of food inflation is anticipated after the quarantine withdrawal due to a limited demand for durable goods.

On the short-term horizon, a moderate growth in prices for paid services is anticipated. The pricing in the market of regulated services is expected to keep its current dynamics.

In view of a weak dependence of pricing in the market of non-regulated services on external factors, no significant rise in prices for such services is anticipated. The increase in the cost of raw materials and supplies for provision of services will be offset by the absence of demand for certain types of services both in the period of quarantine and for the first little while after its withdrawal.

An additional pro-inflationary pressure on the dynamics of domestic inflation will be put by acceleration of inflation in Russia, which is caused by depreciation of the ruble.

Figure 1. Forecasts of Inflation Components for 2019-2020, YoY



Source: NBRK's forecasts

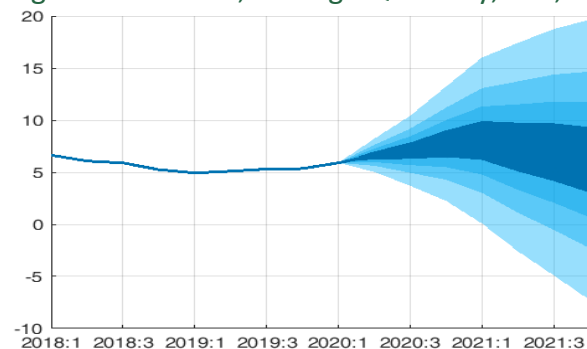
**In the medium term, inflation will be gradually decelerating to the upper boundary of the target range.**

The inflation dynamics will be decelerating as the effect of the exchange rate pass-through onto the domestic prices will be exhausting. An additional disinflation effect will be exerted by a reduction in external inflationary pressure accompanied

by the comeback of inflationary processes in Russia to their target level.

At the same time, the persisting inertia in inflationary processes, contraction of negative output gap and the rise in world food prices will be curbing disinflation impact in the economy (Figure 2).

Figure 2. Inflation, Average Quarterly, YoY, %



Source: NBRK's forecast

**In 2020, Kazakhstan's economy, just as the majority of countries in the global economy will be facing negative implications of the COVID-19 pandemic, and the business activity will demonstrate negative dynamics at the end of the year.**

According to the National Bank's forecasts, in 2020 Kazakhstan's GDP will contract by 1.8% (Figure 3). The domestic demand and net exports are supposed to make a negative contribution. However, the general government sector will be making a positive contribution based on the counter-cyclical measures on the part of the Government and the NBRK.

Real exports are expected to reduce significantly in view of the predicted decline in the production of oil and gas condensate. Oil output in 2020, according to estimates, will make up 84.5 million tons (a 6.7% reduction versus 2019). The pricing dynamics in the global oil market and reduction in the demand on the part of trading partners, specifically the main consumer of the domestic minerals – the European Union – will serve as an additional negative factor.

The consumer demand which has been one of the growth drivers over the last two years, in 2020 will be making a negative contribution to the GDP dynamics. A slump of

consumer demand will be driven by the decreasing real money income of the population given the reduced business activity in the real sector. Wage cutting in the real sector will be partially offset by the increasing budget spending on social payouts and wages to the public sector employees, specifically in the sector of education and healthcare where the number of employees is the largest in the economy. The highest reduction of the domestic consumption is expected in the second and the third quarters of 2020. A weaker tenge as compared to prior periods and acceleration of inflation will serve as a constraining factor, along with revenues. A slight recovery of household spending will be observed by the end of 2020 due to realization of the pent-up demand on the part of the population and the adaptation to a new environment.

The decreasing investment activity makes a negative contribution to the gross formation. The largest decline is anticipated in the first half of 2020 followed by a gradual recovery in the second half of the year due to better dynamics of oil prices and some resumption of large works in the mining industry. A positive impulse is expected from infrastructure projects as a result of implementation of government business support programs. It is worth mentioning that contraction of fixed capital formation will be limited by the growing stocks in the economy in view of reduction of the domestic and external demand that would lead up to near-zero values of gross formation. At the same time, there is still a high degree of uncertainty associated with implementation of large projects in the industry; this increases the risks of a stronger decline in fixed capital formation in the event if projects are to be postponed or frozen.

Reduction in the domestic demand, both consumer and investment, would tell on the dynamics of imports. The largest decline is anticipated in the investment and interim imports whose recovery will be depending on the dynamics of investment activity. A low domestic demand and depreciation of the

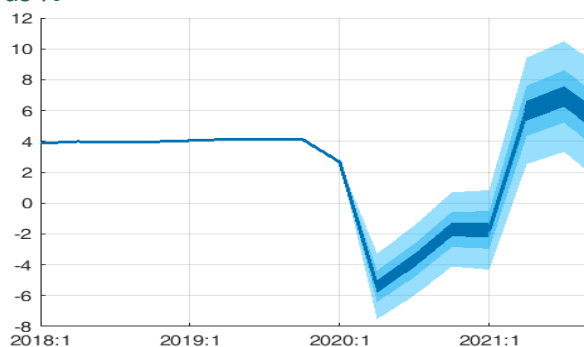
tenge will be restraining consumer imports. Thus, in 2020 real imports are expected to decrease thus making a positive contribution to the GDP and limiting its decline.

Along with that, a positive contribution to GDP will be made by government consumption. A further growth of spending for labor remuneration and current consumption of goods and services is anticipated.

**In 2021, based on the low base of 2020 and a gradual recovery of business activity, positive economic growth rates will recover to levels close to 4%.**

Expansion of the consumer activity will be supported by the increasing real income of the population and the consumer lending, mainstreaming of situation in the labor market as well as by improvement of the epidemiologic situation in the country. The investment activity will be recovering as a result of the growing domestic and external demand as well as resumption of investment projects postponed in 2020. The growth of exports will be supported by the increase in the external demand amidst the recovering positive dynamics of economic activity in the countries-Kazakhstan's trading partners. At the same time, some constraining effect on the dynamics of economic activity will be exerted by expansion of imports associated with recovery of the domestic consumer and investment demand.

Figure 3. Dynamics of the GDP Growth, YoY, as %



Source: NBRK's forecast

### 1.2 Alternative Forecast Scenarios

**Due to a high degree of uncertainty about a further development of the global**

**economy and a corresponding demand for raw commodities, the National Bank, along with the baseline scenario, considered alternative scenarios for oil prices.**

As the pessimistic scenario, the National Bank considered a scenario of a slower recovery of oil prices as opposed to the baseline scenario. So, oil prices are recovering from lower levels of 20 US Dollars per barrel in the third quarter of 2020 **to only 25 US Dollars per barrel by the end of 2020 and to 35 US Dollars per barrel by the end of 2021.**

Such developments may be conditioned by a longer and/or more massive recession in the global economy. In this case, a potentially greater negative influence of current dynamics of the coronavirus pandemic on macroeconomic indicators may intensify through the non-termination or resurgence of coronavirus in some countries.

In case of the pessimistic scenario, the external environment is supposed to deteriorate even more over the forecast horizon. So, a stronger economy shrinking in the trading partner countries including China, the EU and Russia, coupled with low oil prices, would lead to reduction in export volumes. Moreover, low oil prices will cause a more significant slump in production in the mining industry and related sectors of the economy as a result of a lower profitability of enterprises; this will lead to a slowdown of investment activity. Besides, a drop in real money income of the population as a consequence of partial or full loss of earnings as well as high inflation rate will be conducive to deceleration of the domestic demand. As a result, Kazakhstan's GDP will go down by 2.5% in 2020. In 2021, the recovery will be more moderate as compared to the baseline scenario and the real GDP will grow by 2.9% only in 2021.

This scenario assumes an even larger acceleration of inflationary processes compared to the baseline scenario against the backdrop of depreciation of the tenge, disruption in the supply of imported products and the corresponding growth of inflation

expectations. Nonetheless, because of a more distressed state of the economy, the inflationary pressure on the part of demand will be disinflationary. In 2020-2021, the annual inflation will be building above the target range.

In turn, the optimistic scenario assumes a more rapid recovery of oil prices **to 40 US Dollars per barrel by the end of 2020 and to 50 US Dollars per barrel by the end of 2021**. Such dynamics of oil prices will be promoted by a more rapid recovery of the global economy given the improving situation with the coronavirus pandemic, a positive effect from fiscal and monetary support measures as well as a strong discipline of the adherence to the oil reduction agreement by OPEC+ countries.

If this scenario is realized, the growth rates of Kazakhstan's economy are projected to be higher than under the baseline scenario. In 2020, the economic drawdown will account for - 1.5%, and in 2021 the GDP growth rates will accelerate to 4.4%, being driven by a more positive pattern of the domestic and external demand. The related growth of imports will be partially restraining the economic recovery.

A relatively rapid deceleration of inflation compared to the baseline scenario will be promoted by a stronger exchange rate and a smaller external inflationary pressure, mainly owing to deceleration of inflation in Russia. In 2020, the annual inflation will be building above the target range; however, in 2021 it will be decelerating and will be within the target range of 4-6% by the year-end.

### 1.3 Risks in the Medium Term

**As compared to the previous forecast round, risks for inflation on the part of internal and external factors somewhat decreased, although they remain high, which is stemming from some easing of uncertainty regarding the global economic development, stabilization of oil prices, and gradual withdrawal of quarantine measures in Kazakhstan and other countries worldwide.**

Given the anticipated gradual recovery of the global economy from the third quarter of 2020 and commencement of a new OPEC+ agreement from May 1, 2020, prices of oil have stabilized at the level above 30 US Dollars per barrel, thus generally reducing the risk of their further drop. However, it remains high because of a possible stronger impact of the coronavirus pandemic on the global economy and the demand for oil.

A stronger than earlier expected drawdown of the Russian economy and stabilization of the exchange rate of the Russian ruble reduces the risks of a significant acceleration of inflation in Russia to some extent. This factor, coupled with a low expected inflation in the EU and China, slightly mitigates the risk that the external inflationary pressure would intensify.

Due to the decreased demand for cereals for industrial purposes because of the global economic downturn, the risk of import of external food inflation also reduced; however, as the global economy goes out of recession and due to possible measures of different countries to strengthen their food security and limit exports, the risk of the stocks going down and of the corresponding price growth remains.

Despite a projected recovery of the global economy, the risk of capital outflow from developing markets to developed economies remains high. First, reduction of interest rates in developed countries is accompanied by concurrent reduction of rates in developing economies. Second, at present the most severe situation with the highest prevalence of coronavirus is observed in developing countries (Brazil, Russia, India, countries of Latin America). Third, probable aggravation of relations between the USA and China will reduce attractiveness of assets of developing countries. These factors may lead to depreciation of currencies in developing countries, including in Kazakhstan.

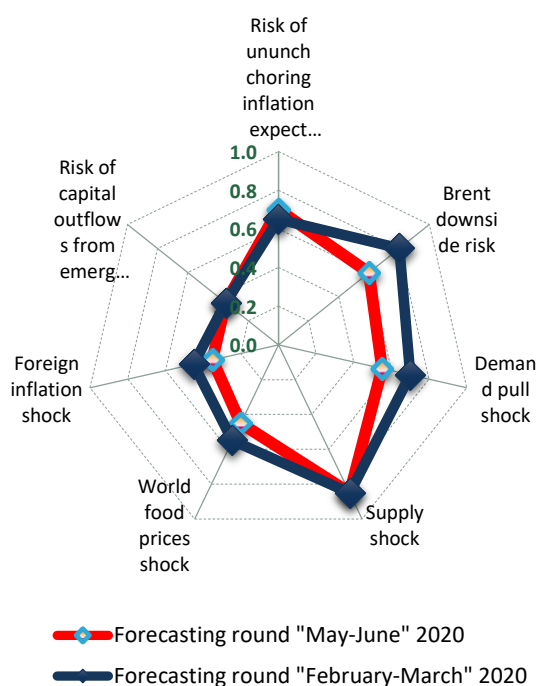
Among internal factors, a risk of inflationary pressure on the part of demand diminished, which is related both to the fall

in prices of raw commodities and the decelerating investment activity and to the imposition of quarantine measures, which weakened the consumer demand to a great degree. Nonetheless, this risk remains high as a consequence of a possible realization of deferred demand of the population as well as the government support measures for the population and business.

Due to the imposition of quarantine measures within and outside Kazakhstan, the risk of disruption of production supplies both from abroad and in the country remains high. This factor may lead to imbalances between the demand and supply in certain commodity markets and the corresponding price growth.

Finally, in terms of internal conditions the risks of unanchoring of inflation expectations remain significant; this is related both to the observed high inflation and to the risks of depreciation of the tenge under the impact of external and internal factors.

Figure 4. Risk Map Based on the Expert Judgment



Source: NBRK's calculations

### III. EXTERNAL ENVIRONMENT

#### 3.1 External Economic Situation

The outbreak of COVID-19 and the subsequent measures undertaken to curb the pandemic have caused recession in the global economy. In some countries, the unemployment rate exceeded the unemployment rate of the 2009 financial crisis. Because of the increased uncertainty, expectations about a quick recovery of the global economy shifted to a more negative side.

At the beginning of April 2020, the IMF projected that because of the COVID-19 pandemic the global economy would shrink by 3.0%. The collapse in the first quarter of 2020 was expected to be followed by a rapid growth once restrictions are withdrawn, and the global economy would be able to recover already by the end of the year. Meantime, due to existing uncertainty about the coronavirus, the growing unemployment, a downturn in virtually all countries, the IMF's expectations about a future development of the global economy deteriorated significantly<sup>1</sup>.

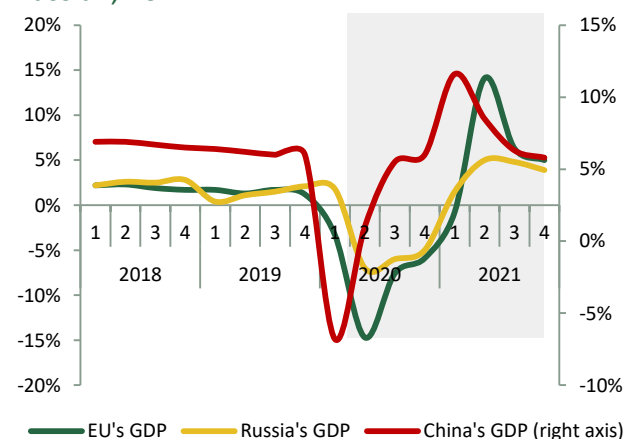
The pandemic intensified the economic recession in the EU. A dramatic deterioration of the economic environment has been observed in all European countries, especially in Italy, Spain, Germany, and France. The business activity decreased to its historical minimums. According to forecasts, in 2020 the EU economy will decline by 7.7% (Figure 5). Based on expectations, the unemployment will go up. Lower investments and employment will cause reduction in production volumes. Stimulative measures will lead to the increase of the state deficit and the level of government debt. By 2021, the economic growth in the EU will account for 6.2%.

After a decline at the beginning of the year, the Chinese economy as a result of easing of quarantine measures began to

recover rather quickly. This can be traced through the ramp-up of output in the industry and expansion of transport services. Despite a feeble demand on the part of the USA and EU, exports were growing as a result of increased supplies to the South-East Asia. According to forecasts, in 2020 China may face a slow and lengthy recovery because of low exports against the anticipated downturn in economies of key trading partners. According to assessments of international organizations, the Chinese economy will slow down to 1.4% in 2020. By 2021, a dramatic recovery of over 8.0% is expected (Figure 5).

Low business activity, declining oil price and volatility in the financial markets keep exerting a restraining effect on the Russian economy. According to expectations, the above factors including a low demand for exported products will lead to a downturn in the Russian economy by 4.1% in 2020. An anticipated economic contraction will be partially offset by high government expenditures. In 2021, Russia's economy will go up by 3.8% (Figure 5).

Figure 5. Real GDP Growth of China, EU and Russia\*, YoY



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs.

\*Latest actual data on EU's and Russia's GDP for the 4<sup>th</sup> quarter of 2019.

#### 3.2 External Inflation Dynamics

As a result of expected acceleration of inflationary processes in Russia, external inflationary pressure on consumer prices in Kazakhstan will intensify. The pressure is

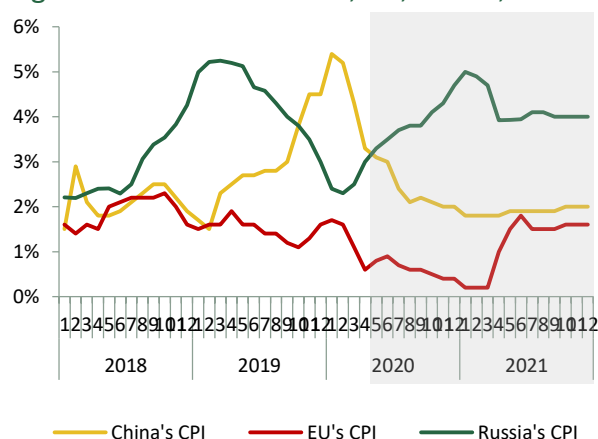
<sup>1</sup><https://www.imf.org/en/News/Articles/2020/05/28/sp052820-opening-remarks-at-un-event-on-financing-for-development-in-the-era-of-covid-19>

**expected to lessen by the end of the forecast period.**

In the EU countries, there is a possibility that the growth of prices for certain goods will persist during the lockdown because of COVID-19 but this trend is expected to have a temporary nature. Over the larger part of the forecast period, inflation will be low due to a feeble domestic and external demand as well as lower energy prices. Only by the end of 2021, once the economic activity in the EU and worldwide recovers, inflation will approximate its target level of 2.0%.

In China, inflation in 2020 compared to 2019 will slightly accelerate being caused by heightened food prices, especially the prices for pork meat. Slackening of economic activity and decline in prices for raw commodities will partially offset high food prices. In 2021, inflation will be below 2.0%.

**Figure 6. Inflation in China, EU, Russia, YoY**



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Central Bank of Russia, Consensus Ecs., European Commission

In Russia, depreciation of the ruble and a heightened demand for certain goods as well as the growing inflation expectations among the population will be putting pro-inflationary pressure during this year. Nonetheless, an overall decline of the external and domestic demand will exert a restraining effect. By 2021, inflation will be close to 4.0%.

### 3.3 Monetary Conditions in the External Sector

**In response to a negative effect of the pandemic and associated restrictive measures, central banks across the globe continue to support their economies through various stimulative measures and soft monetary policy.**

At its April session, the US Federal Reserve System retained the policy rate at 0-0.25%. It is expected that the policy rate will be maintained at this level until there is a certainty that the shock of pandemic has been overpassed. Also, the US Fed will continue buying treasury bonds and securities and is also considering the possibility of going on with large-scale overnight repo operations.

The ECB, based on the outcomes of its session in April 2020, retained the base interest rate on loans at zero, and the interest rate on deposits – at -0.5%. As before, the ECB believes that interest rates should be maintained at their existing levels until inflation approaches to 2.0%. Also, the launch of a new bond purchase program, PEPP (Pandemic Emergency Purchase Programme) which amounts to 750 billion Euro and reduction of interest rate on the Targeted Long-Term Repo Operation (TLTRO III) was announced.

At its session on May 20, 2020, the People's Bank of China retained the key rate at 3.85%, taking account of a more favorable economic situation in the country. Nonetheless, the market anticipates that the Chinese authorities anytime soon will implement a more aggressive monetary policy and tax stimuli in order to support the economy.

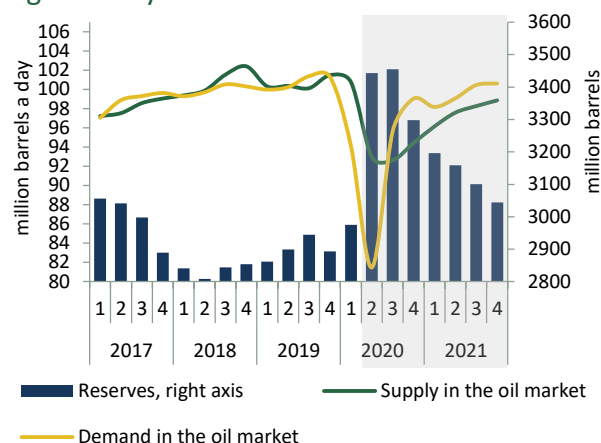
At the end of April 2020, the Central Bank of Russia decided to reduce its key rate by 50 bp to 5.5% because of a disinflation effect exerted by the coronavirus pandemic and the fallen oil prices on the Russian economy. Given the existing situation, the market expects that at the next session the key rate will be reduced at least by 100 bp.

### 3.4 Commodity Markets

The global oil market, going through the peak of coronavirus pandemic worldwide, has revealed first signs of improvement. Since the beginning of May, oil prices have been demonstrating positive dynamics. Expectations concerning a further development of the oil market slightly improved. According to projections, the global demand for oil during this year will first shrink a lot and then will start to recover abruptly. In the period of low consumption, oil reserves will grow to historical maximums which will be restraining resumption of the oil price growth. In turn, because of lower oil prices compared to 2019, oil production will be sluggish throughout the entire forecast period (Figure 7).

At end-April 2020, Brent oil price in the global market was going down below 20 US Dollars per barrel for the first time since the end of 1990s. The fall was accompanied by the growing concerns of the market because of uncertainty regarding the pandemic, shortage of warehouses for crude oil as well as by increasing volumes of oil production in OPEC countries. Since the beginning of May 2020, owing to recovery of the industry and the transport sector in China, the easing of quarantine measures in some European countries and the USA, the oil price has been demonstrating positive dynamics by not falling below 29 US Dollars per barrel. The enforcement of the OPEC+ agreement from May 1, 2020 and the statement of the Saudi Arabia, UAE and Kuwait about an additional reduction of oil production by 1 million barrels a day as well as a cut of oil production in some countries outside of OPEC have also added some positivism.

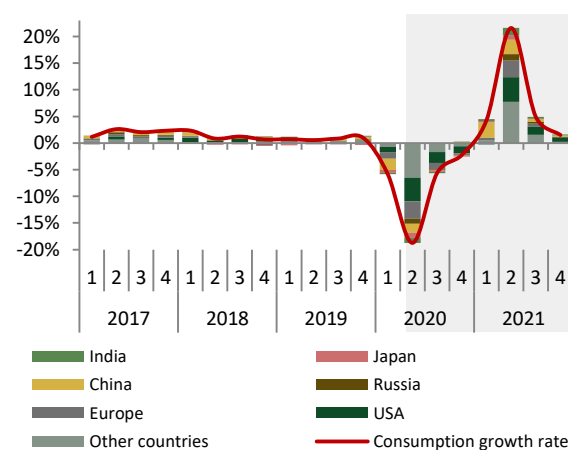
Figure 7. Dynamics of the Global Oil Market



Source: EIA

According to EIA's estimates, the global demand for oil in 2020 will be lower than in 2019. The maximum fall will occur in the second quarter of 2020, followed by a rapid recovery of demand (Figure 8). The largest drop in the oil consumption is expected in Canada, USA, in the EU and China (Figure 8). By 2021, compared to the average annual value in 2020, the global demand for oil will go up by 7.5%.

Figure 8. Global Oil Consumptions, YoY

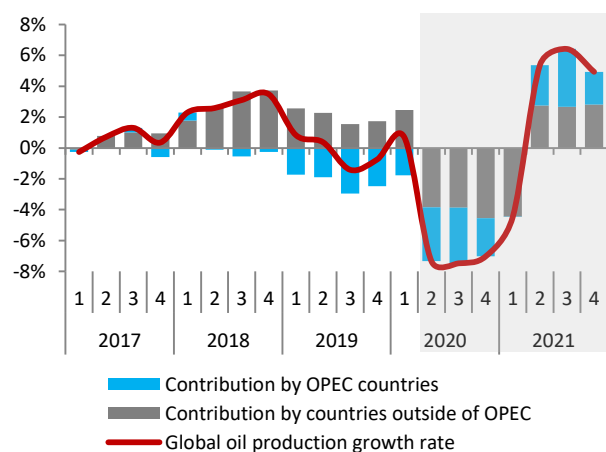


Source: EIA

Given low world oil prices, EIA also revised its projections regarding the global oil production. In 2020, the oil production in countries outside of OPEC is expected to decline approximately by 3.8%. In the USA, oil producers announced their plans to cut capital expenditures and to reduce the drilling depth; this will lead to reduction in oil production for the first time since 2016. Feebler dynamics are also expected in

Canada and Argentina. Acceleration of oil production is projected in Norway and Brazil. In OPEC countries, as a result of the reached agreement on reduction of oil production and weak performance in Venezuela and Iran, total oil production will decrease. In 2021, as the global economy recovers its growth, oil production is expected to accelerate, both in countries outside of OPEC and in OPEC+ member countries (Figure 9).

Figure 9. Global Oil Production, YoY



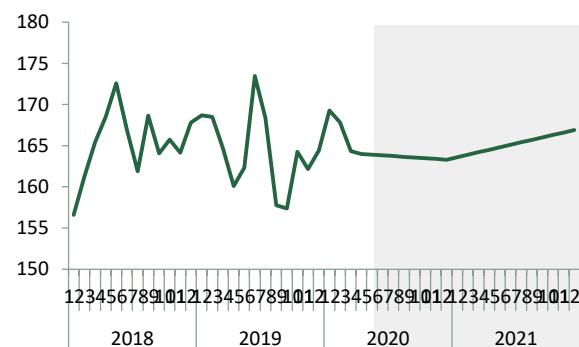
Source: EIA

The most significant risk for future development of the oil market is a slow coming-out of the global economy from recession after the pandemic which may result in a lower demand. Also, taking into account that in the course of prior rounds of OPEC+ agreements some countries breached their production quotas, there is a possibility that on the forecast horizon oil producers would not want to lose their market share again and would start to ramp-up production. Lately, an important group of risks also has included the risks of a possible escalation of trade war between the USA and China which may subsequently result in a longer and ongoing shrinking of the global economy and, thus, have a negative effect on a sluggish demand for oil.

**As a result of the COVID-19 pandemic, consumption of cereals is expected to be lower than their supply. As a result, this would lead to a buildup of cereal stocks and, as consequence, to lower prices compared to those projected earlier (Figure 10).**

The UN Food and Agriculture Organization (FAO) anticipates that a low economic growth in many countries as well as lower world energy prices will inevitably lead to the reduced consumption of cereals, especially for industrial purposes. In turn, production of cereals in the agricultural season of 2019–2020 will grow by 2.5% versus the previous season. Cereal stocks will increase from 870.2 million tons to 883.7 million tons.

Figure 10. FAO Cereal Price Index, 2002-2004 = 100%



Source: the UN Food and Agriculture Organization (FAO)

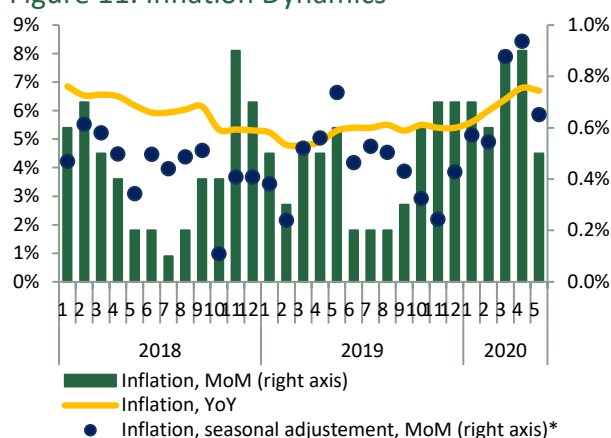
## IV. PRICING AND INFLATION EXPECTATIONS

### 4.1. Inflation

In March-May 2020, inflationary processes have been evolving under the impact of both a heightened demand for certain goods and services and a limited supply as a result of disruption in the supply chains of raw materials and products in the setting of the state of emergency in Kazakhstan and quarantine measures in countries-trading partners.

In May 2020, the annual inflation somewhat decelerated to 6.7%. The growth in food prices which went up by 10.7% in annual terms continues to make the main contribution to acceleration of inflationary processes. The dynamics of non-food and service inflation remains moderate. The annual rise in prices for non-food products accounted for 5.3%, for paid services – 3%. The seasonally adjusted inflation indicator in March-May is comparable with the dynamics of the headline inflation thus reflecting the presence of pro-inflationary pressure which is not related to the seasonality factor (Figure 11).

Figure 11. Inflation Dynamics



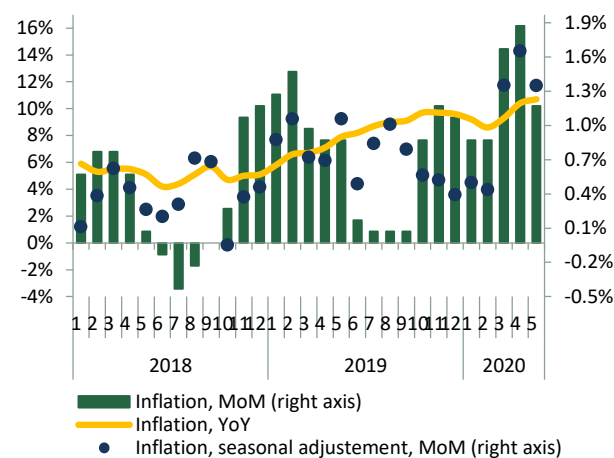
Source: CS MNE

\*Seasonal adjustment was made with the help of the X-12-ARIMA method on a time series from 2011 till present<sup>2</sup>.

In May 2020, a monthly rise in prices of foodstuffs slowed down to 1.2%, after 1.9% a

month earlier, which is the maximum since November 2016 (Figure 12).

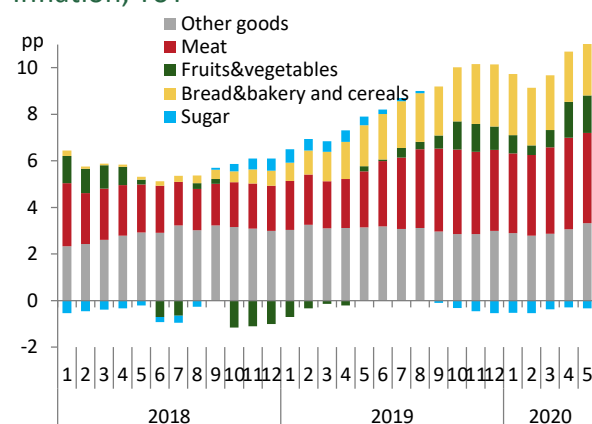
Figure 12. Dynamics of Food Inflation



Source: CS MNE

The main contribution to the growth of food inflation is being made by the change in prices for meat, fruit and vegetable prediction, and bread and bakery (Figure 13).

Figure 13. Contributions by Groups of Food Inflation, YoY



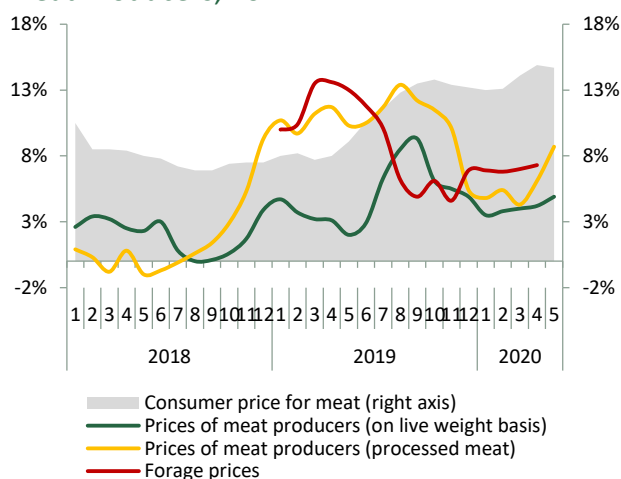
Source: CS MNE, NBRK's calculations

In May 2020, prices for meat and meat products increased by 1.3%, and the price growth slowed to 14.7% in annual terms. One of the factors for acceleration in the growth rates of consumer prices for meat in the previous months is the rise in the producer prices given the increase in prices of forage crops to 7.3%, YoY. The advance in prices of forage crops was caused by a 14.3% reduction of their stocks in January-March 2020 compared to the same period of the last year.

<sup>2</sup> A more detailed presentation of the seasonal adjustment algorithms is provided in the study "Specifics of seasonal adjustment of the consumer price index for Kazakhstan" at the National Bank's web-site, in the research section.

As a result, in May 2020 the annual price growth of meat producers in live weight accelerated to 4.9% (January 2020 – a 3.5% growth), and in the manufacturing industry – to 8.7% (4.8%) (Figure 14).

Figure 14. Consumer Prices and Prices of Meat Producers, YoY



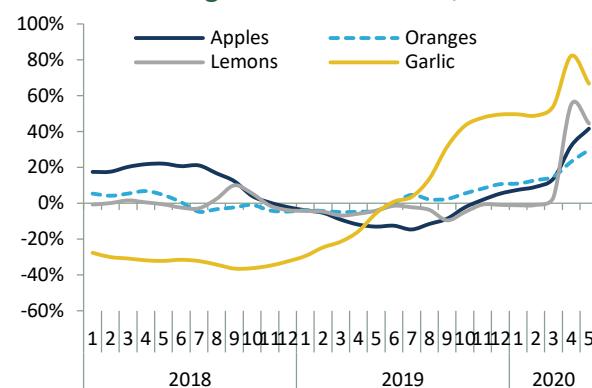
Source: CS MNE

The rise in the price of forage also has caused the increase in the cost of production of dairy products, oils and fats as derived products of the animal production sector. In May 2020, the rise in prices for dairy products accounted for 0.6%, in annual terms – acceleration to 9.7%. The annual growth of agricultural producer prices in April 2020 was 8.8% (January 2020 – a 6.7% growth). The growth of producer prices for oils and fats in April 2020 accelerated to 4.4% YoY (3.6%), thus causing the rise in consumer prices by 7.1% in annual terms in May 2020.

In May 2020, prices of fruit and vegetable production increased by 1.5%, in annual terms – by 10.1%. There is a significant rise in prices for fruits, specifically, apples (by 41.6%, YoY), oranges (29.7%), lemons (44.5%), potatoes (45.8%) and garlic (66.7%) (Figure 15). The price growth was driven both by an increased demand for these fruits and vegetables on the part of the population with a view to fight the coronavirus infection and by the rise in the cost of imported products, by advancement of wholesale prices, disruption of supplies because of the closed borders and

contraction of the domestic production (gross crop of apples in 2019 went down by 3%).

Figure 15. Consumer Prices for Certain Types of Fruit and Vegetable Production, YoY



Source: CS MNE

There is an annual acceleration of price growth rates of bread and bakery and cereals to 13.4% in April 2020 (January 2020 – a growth of 15.8%). The price of buckwheat increased significantly (May 2020 – a growth of 48.5% YoY) given the reduction of acreage for buckwheat and a nearly twofold decline of gross harvest in Kazakhstan in 2019 (because of low profitability and labor intensity of buckwheat harvesting). The increase in price of this item is observed in Russia (a monthly growth of 12% in April 2020) – the main supplier of buckwheat to the domestic market.

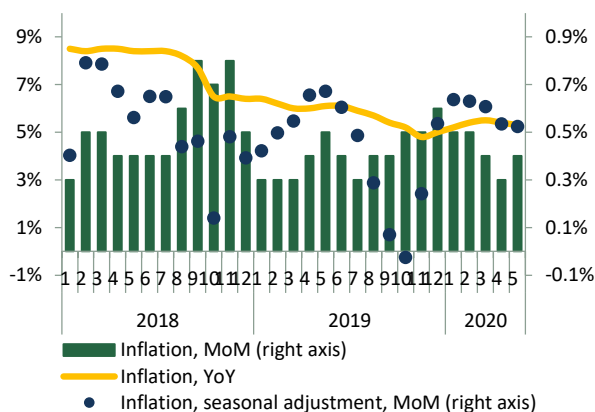
After a long period of decline in prices for sugar, in March-April 2020 this trend was followed by a growth of 8.5% and 6.2%, respectively. The main reason for the rise in the price of sugar was the decline in the domestic production (in January-April 2020 production decreased by 68.6% compared to the corresponding period of 2019) and the increasing imports of refined sugar from Russia where consumer prices for sugar went up by 13.5% in March and by 7.1% in April in monthly terms. Meantime, in annual terms sugar prices continue to make a negative contribution to inflation given the accumulated low base (April 2020 – an 11.6% decline, YoY). However, in May 2020 the price of sugar again went down by 1.2%.

A constraining effect on the food inflation has been made by the Government measures aimed to limit the growth of food prices during the state of emergency<sup>3</sup>.

This is proved by the dynamics of inflation for staple foods<sup>4</sup>. In March 2020, the price of staple foods increased by 3.4%, in April 2020 the price growth slowed down to 1.5%, which is related to a decline in prices or their more moderate growth on all items excluding onions, chicken meat and buckwheat.

**Non-food inflation** slowed down to 5.3% in annual terms (Figure 16). One of the factors for deceleration was a decline in the price of gasoline and diesel fuel due to the increased domestic production of gasoline along with a reduced demand because of restrictions of transportations by all means of vehicles during the state of emergency and lockdown.

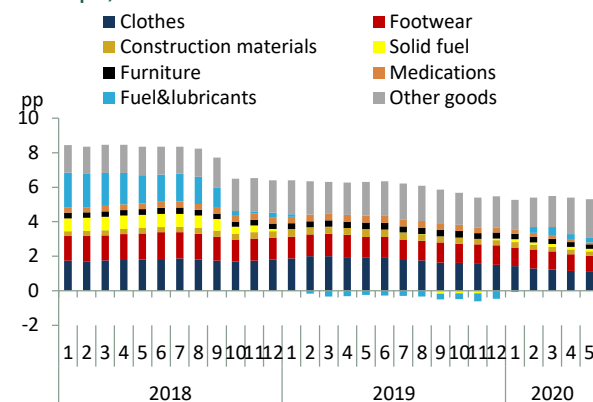
Figure 16. Dynamics of Non-Food Inflation



Source: CS MNE

In the structure of non-food products, the growth rates of prices for clothes, footwear and furniture were slowing down as a result of closures of trading facilities during the lockdown as well as the decreased consumer demand (Figure 17).

Figure 17. Inputs of Non-Food Inflation Groups, YoY

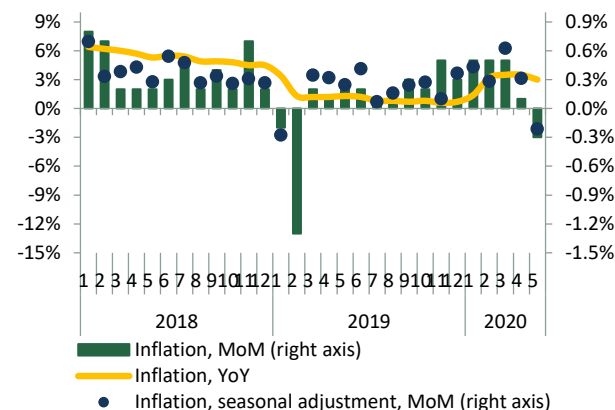


Source: CS MNE, NBRK's calculations

The trend of declining import prices for clothes and footwear persists against the increasing volumes of imports (in January-March 2020 compared to 2019, physical volumes of imported clothes increased including from China – by 2.3 times, from Uzbekistan – by 2.3%, and Belarus – by 21.3% with their reduction in value terms). This is an evidence of a shift in consumer preference towards cheaper goods.

Reinforcement of sanitary measures for fighting the infection has driven a heightened demand for personal care products and detergents; their price growth accelerated in May 2020. Also, in May 2020 the rise in prices of vitamins, anti-fever medications, and antiseptics was observed because of an increased demand with a view to prevent the coronavirus infection.

Figure 18. Dynamics of Service Inflation



Source: CS MNE

In May 2020, the annual price growth of **paid services** to the population slowed down

<sup>3</sup> Setting marginal prices for 9 staple foods.

Imposition of a temporary ban for export of buckwheat, sugar, potatoes, onions, sunflower seeds and refined sunflower oil.

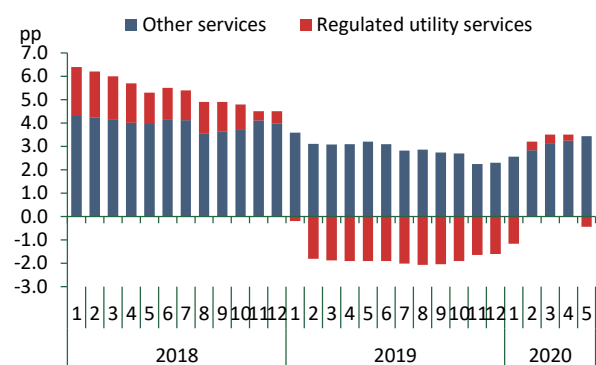
Imposition of a quota on agricultural exports.

Enforcement of an obligation for traders to sell wheat at a fixed price in the domestic market 30% of export volume.

<sup>4</sup> According to the List approved by the Government Decree of the Republic of Kazakhstan as dated March 27, 2017 No.137

to 3%. The rise in prices since the beginning of 2020 has been 1.2%, while the cost of paid services during 2019 as a whole increased by 0.7% (Figure 18).

Figure 19. Inputs to the Service Inflation by its Groups, YoY



Source: CS MNE, NBRK's calculations

In February-April 2020, the low base effect secured by reduction of regulated tariffs for utilities in 2019, had fully exhausted in the first quarter of 2020. At the same time, the contribution by other paid services to the growth of service inflation increased (Figure 19).

During the state of emergency, from April 1, 2020 tariffs for utilities were reduced. According to the data from the Committee for Regulation of Natural Monopolies with the MNE RK, tariffs were reduced by 7% on average across the country<sup>5</sup>. It is worth mentioning that reduction of tariffs in some regions will be reflected on inflation in May 2020. In May 2020, tariffs for regulated utility services decreased by 3%, and in annual terms – by 1.9%.

As a result of imposed restrictions on the public transport operations the demand for taxi services heightened, which resulted in a 0.5% rise in prices in April 2020 (a growth of 5.6% in annual terms) (Figure 20). As per a regional breakdown, a monthly growth of the cost of taxi services in April 2020 made up: in Nur-Sultan – 13.6%, in Petropavlovsk – 6.8%,

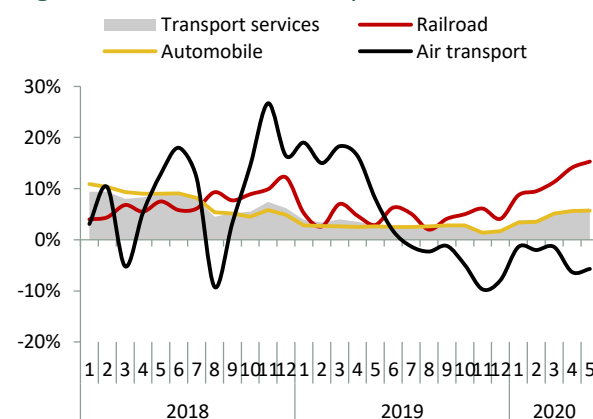
Turkestan – by 6.4%, Kokshetau – by 6%, Uralsk – by 5%.

Apart from the automobile transport, the cost of railroad transportations along socially important routes increased by 7% from March 5, 2020. In March 2020 as a whole, the price of passenger railroad transport services went up by 5.5%, in April-May it remained unchanged. An upward pressure on the price of tickets in March 2020 was put by the system of dynamic tariff pricing which sets out that the price of a ticket is subject to change depending on the date of purchase and the utilized capacity of trains.

In essence, in May 2020 the annual growth of prices for railroad transport services accounted for 15.3%.

The reduction of air fares caused by a considerable shrinkage of demand as a result of quarantine measures imposed in Kazakhstan and in many countries worldwide as well as by suspension of air travels exerted a restraining effect on the cost of transport services.

Figure 20. Prices for Transport Services, YoY



Source: CS MNE

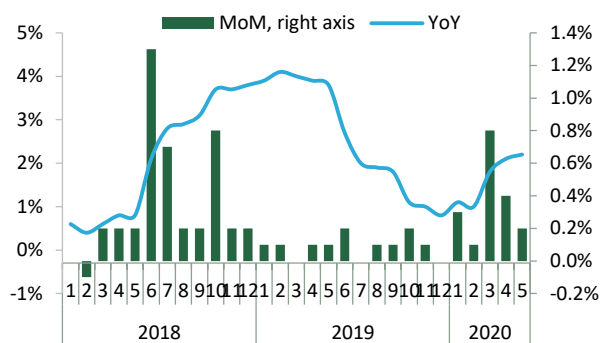
In the structure of non-regulated paid services for the population, in May 2020 the growth of prices for house rent accelerated by 10.5% in annual terms as well as tariffs for legal services – by 10% in connection with the increase of minimum calculation index by 5% from April 1, 2020. The transition of the majority of employees and school students to the teleworking and e-learning in March-April led to a significant growth in the demand for

<sup>5</sup> Tariffs were reduced for water supply (by 7.6%), wastewater disposal (by 8.2%), heating (by 6.8%) and electricity supply (by 4%). <https://www.gov.kz/memleket/entities/krem/press/news/details/v-kazhastane-snizilis-tarif-zhkh?lang=ru>

communication services. This, in turn, provoked the rise in the cost of communication services (mobile communication and Internet). In March 2020, prices increased by 0.8%, which is the maximum since October 2018. In May 2020, consumer prices for communication services accelerated to 2.5% in annual terms (Figure 21).

In April 2020, core annual inflation (excluding prices for fruits, vegetables, regulated services and fuel and lubricants) accelerated to 7.5% against the growing prices of key foodstuffs (Figure 22). The core inflation is still exceeding the headline inflation.

Figure 21. Prices of Communication Services

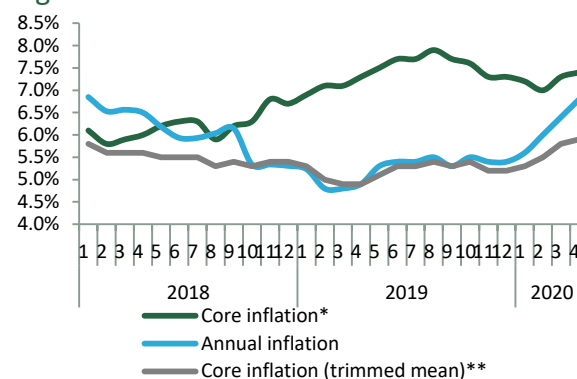


Source: CS MNE

Trimmed mean core inflation (excluding eight percent of maximum and minimum changes of prices) is still below the headline inflation. In April 2020, it accelerated to 5.9% in annual terms.

Since the beginning of 2020, the annual trimmed mean core inflation has accelerated significantly; this reflects intensification of pro-inflationary not only in certain commodity markets but also in the consumer basket in general.

Figure 22. Inflation and Core Inflation\*



\*Excluding prices of fruits and vegetables, utility services (regulated), railroad transport, communication, gasoline, diesel fuel and coal

\*\* All goods and services excluding price changes of eight percent of maximums and minimums

Core inflation

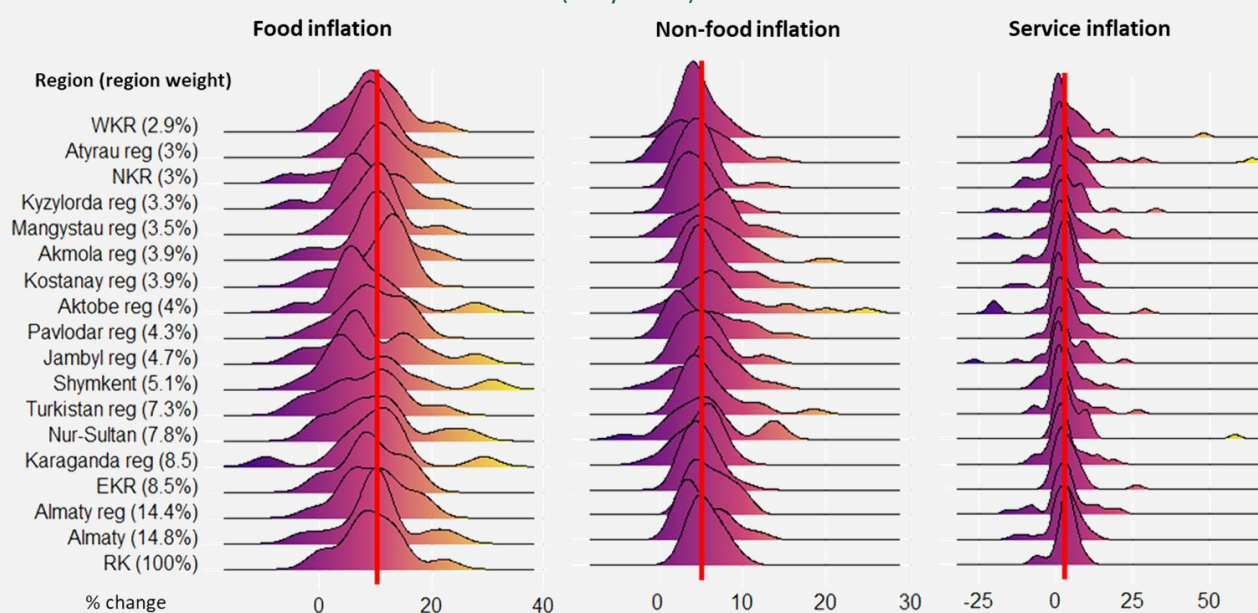
Source: CS MNE, NBRK's forecasts

### Box 1. Inflation Dynamics in Regions

Since the beginning of 2020, inflationary processes in Kazakhstan have been developing under the impact of quarantine measures and restrictions imposed both in Kazakhstan and in many other countries across the globe in order to fight the spread of coronavirus infection. Placing cities under quarantine resulted in a temporarily heightened demand and a disruption in the supply chains which led to the rise in the cost of goods, foodstuffs in particular. So, the food price growth accelerated from 8.6% in February 2020 to 10.7% in May 2020. At the same time, the dynamics of non-food inflation remains moderate due to a sluggish consumer demand for durable goods and closures of trading facilities which sell non-food products for quarantine. The price growth of communication and transport services was offset by a temporary administrative reduction of prices for some (water supply, waste water disposal, heating, and electricity supply) regulated utility services<sup>6</sup>.

Despite the nation-wide trend of appreciation of food prices, pricing patterns and the magnitude of changes differ from region to region. So, each region has its own distribution pattern with different mean and standard deviations. Some regions show the asymmetry in inflation component distributions (Figure 1).

Figure 1. Distribution Dynamics of Groups of Goods of Annual Inflation based on a Regional Breakdown (May 2020)



It should be noted that given a 1.1% annual rise in prices for vegetables in Kazakhstan as a whole in May 2020, their growth in Shymkent was maximal and accounted for 18.2%. However, in the neighboring Turkestan Region which is the main producer of vegetables their annual prices demonstrated a 4.3% decline. At the same time, Karaganda Region is standing out from the general picture: in May 2020 there was a hike in prices for fruits – by 29.4% while vegetable prices declined – by 9.6%.

The mean distribution of non-food inflation and service inflation in the majority of regions is equal to the nation-wide distribution. However, there are some outliers. For instance, in Aktobe Region there is a maximum growth in prices for durable goods (personal electric appliances – by 24.7%) and one of the maximum annual declines in utility prices (heating – by 21.2%, water supply and wastewater disposal – by 20%).

It is important to mention that a region's weight is of a great importance in the calculation of the headline inflation. So, the aggregate weight of two cities of national importance (cities of Almaty and Nur-Sultan) and three regions (Almaty Region, East Kazakhstan Region, and Karaganda Region) makes up 54%, which determines a high correlation of the average value of distribution of the above regions with the nation-wide inflation.

<sup>6</sup> <https://www.gov.kz/memleket/entities/krem/press/news/details/v-kazahstane-snizilis-tarify-zhkh?lang=ru>

## Box 2. Sugar Market of Kazakhstan

In Kazakhstan, sugar consumption in 2019 was by 45% secured with domestic production, while the remaining part was covered by imports (Figure 1). The domestically produced sugar is mainly manufactured from raw cane sugar imported from Brazil and to a smaller extent – from local sugar beet. In order to satisfy its needs in full, Kazakhstan is importing refined white sugar. From 2017, import of raw cane sugar decreased and Kazakhstan started to import more refined white sugar from the EAEU countries, Russia in particular, with its share growing on an ongoing basis (in 2017 – 66%, in the first quarter of 2020 – 78.5%). If in 2016, production to imports made up 79% versus 21%, at the end of 2019 this ratio made up 45% to 55%. Domestic consumption of sugar in 2019 exceeded 400 thousand tons, where the share of Russian sugar accounted for 190 thousand tons (47.5%).

In the first quarter of 2020, the domestic production of sugar continued to go down, accounting for 42% (YoY). The demand was satisfied with the increased imports of refined sugar, primarily from Russia, which went up by 3.4 times (in total, imports of sugar from all countries expanded by 2.1 times).

Given a high share of imports of refined sugar in consumption as well as a high share of imported raw materials in the production, the dynamics of domestic prices for sugar are to a large extent dependent on the price of sugar in Russia and prices of unrefined sugar (Figure 2). So, since mid-2019, given a record-high production of sugar, a decline in the prices of sugar has been observed in Russia; this had a positive effect on the cost of sugar also in Kazakhstan. In 2020, production in Russia continues to grow and stocks remain high. Apart from low sugar prices in Russia, a downward pressure on prices in Kazakhstan was made by duty-free imports of white sugar from countries outside of the EAEU<sup>7</sup>, as well as crude sugar<sup>8</sup> for industrial production and further consumption.

A “special sugar regime” was provided to Kazakhstan for ten years with a view to develop domestic sugar beet production and to reduce reliance on imports. In the first years after enactment of the agreement, the acreage of sugar beet was steadily increasing (till 2012). However, because of the reduced exports to the Kyrgyz Republic which started to develop its own production, the planted acreage for cultivation of sugar beet has been cut by nearly 10 times – to 2 thousand hectares in 2014. Despite the restoration of sugar beet acreage from 2017, the existing rate is still lower than that of 2012 (Figure 3).

During the period of “sugar” preferences, Kazakhstan failed to fully develop its sugar production complex. Efficacy of the concessional regime for imports of foreign raw materials caused a significant

Figure 1. Sugar Resources and Use, thousand tons

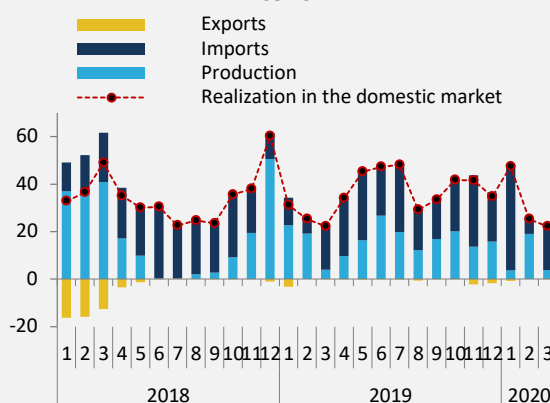


Figure 2. Sugar Price Indices

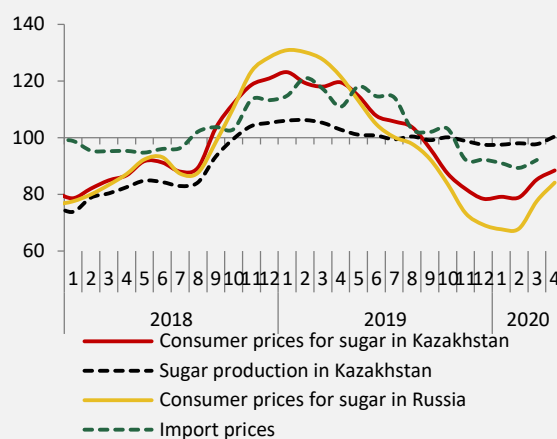
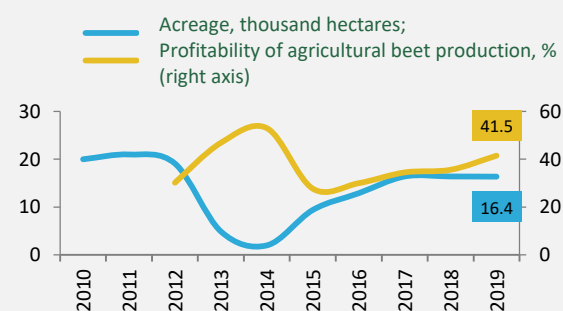


Figure 3. Acreage of Sugar Beet



Source: CS MNE

<sup>7</sup> Imports of white sugar for several producers of confectionery products, juices and soft beverages. Governmental Decree of the Republic of Kazakhstan as dated 29.12.2018 No.917 “On a Change to the Governmental Decree of the RK as dated January 14, 2016 No.13 “Regarding Some Matters Pertinent to Implementation of the Government Support of Investments”.

<sup>8</sup> According to agreements, Kazakhstan was relieved from import duties on raw cane sugar for the industrial processing and further domestic consumption for 2010-2019. This privilege is granted to a sole sugar producer in Kazakhstan – the Central Asian Sugar Corporation LLP.

reduction in the production of sugar from the domestic raw materials. In recent years, the harvest of sugar beet was rich and profitability of sugar beet producers exceeded 40%. At present, a sole producer of sugar in Kazakhstan is the Central Asian Sugar Corporation; this reduces the competition significantly and limits the development of the sector in general.

A “special sugar regime” for Kazakhstan had ended in 2019, and from January 1, 2020 each ton of crude sugar imported to Kazakhstan will be levied with a customs duty of 5%.

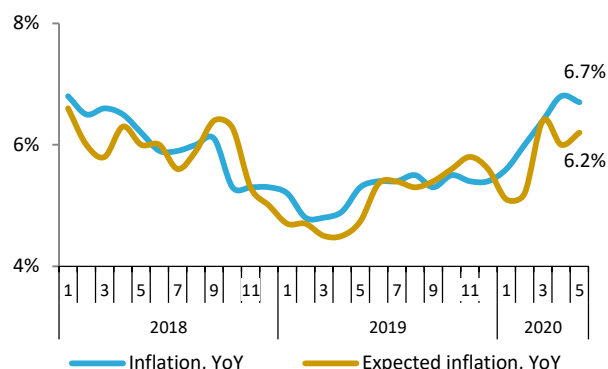
Therefore, cancellation of a privileged regime for Kazakhstan, reduction of the domestic sugar production as well as a heavy reliance on sugar imports from Russia where the growth of consumer prices for sugar has outlined in 2020 (a monthly growth in March accounted for 13.5%, in April – 7.1%) create pro-inflationary risks for the domestic sugar prices. A monthly growth of consumer prices for sugar which was observed in January, March and April 2020 in Kazakhstan, as a result of concurrent factors including given the heightened temporary demand on the part of the population because of the imposed quarantine measures, suggests that a period of low sugar prices in Kazakhstan is probably coming to an end. At the same time, the end of a privileged regime may serve as an impulse to develop the domestic production and increase the local content and the production of sugar.

## 4.2. Inflation Expectations

**In May 2020, inflation expectations of the population slightly decreased after their surge in March.**

In May 2020, a quantitative quantified assessment<sup>9</sup> of inflation one-year ahead made up 6.2% after a jump to 6.4% in March (Figure 23).

Figure 23. Expected Inflation



Source: CS MNE, FusionLab

According to the public poll conducted in May 2020, the percentage of respondents who anticipate that the existing price growth rates will persist or will go down increased to 62% (in April – 56%).

A temporary boost of inflation expectations in March 2020 occurred due to depreciation of the tenge and the imposition of the state of emergency in the country<sup>10</sup>. In April-May 2020, a quantitative assessment of the price growth slightly decreased owing to the measures undertaken by the government during the quarantine.

In April-May 2020, price changes were assessed by respondents when positive judgments about their current and future financial standing and the purchasing capacity reduced significantly (Box 3).

In April 2020, inflation expectations were forming in the environment of a temporarily heightened demand for certain goods in the

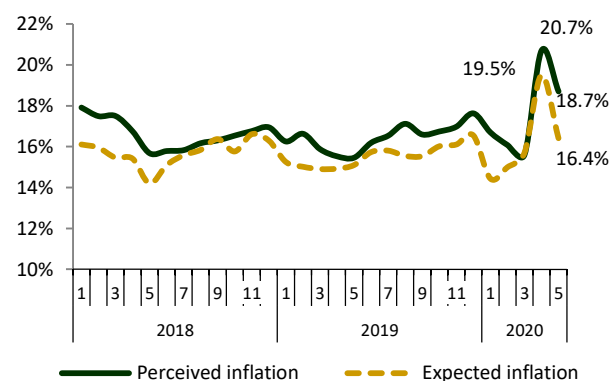
period of quarantine measures both in Kazakhstan and worldwide.

A rapid growth of food prices during the last month was observed by the majority of respondents (91%). At the same time, in May compared to April, there was a reduction in the percentage of respondents who noted the rise in prices for goods which were in the great demand during the lockdown (fruits and vegetables, cereals and macaroni products, sugar, home care products, and medications).

Among respondents who anticipate the rise in prices, in May 2020 after the peak in April, quantitative assessments of the price growth rates both for the past and future periods decreased.

The median assessment of perceived inflation over a one-year horizon went down from 20.7% in April 2020 to 18.7% in May 2020, and of expected inflation – from 19.5% to 16.4%, respectively (Figure 24).

Figure 24. Assessment of Quantitative Price Growth over the Last and the Next 12 Months\*



Source: FusionLab, NBRK's calculations

\*on the basis of responses which noted/expect the price growth

<sup>9</sup> The Methodology for calculation of quantification of inflation expectations is published on the National Bank's Internet resource in the "Monetary Policy" – "Inflation and Inflation Expectations" Section

<sup>10</sup> The poll was conducted in the period between March 2-20, 2020

### Box 3. Consumer and Saving Sentiment of the Population during the Lockdown<sup>11</sup>

Figure 1. CSI and its Sub-Components

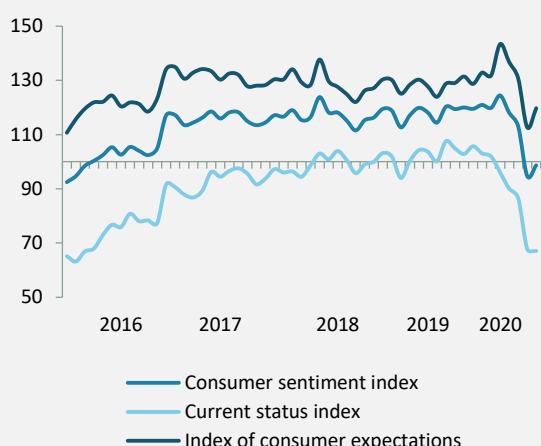


Figure 2. Subscript CSIs

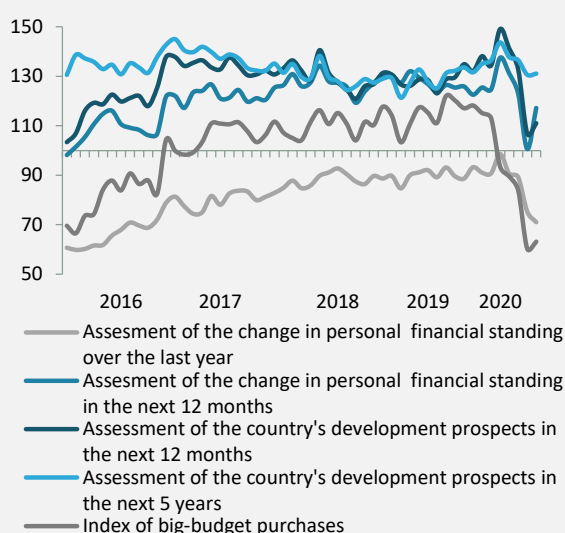
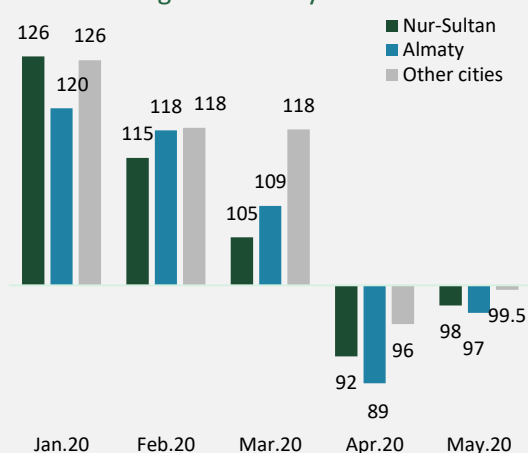


Figure 3. CSI by Cities



In light of the spreading coronavirus infection, the state of emergency was imposed in Kazakhstan from March 16, 2020. From March 19, 2020 quarantine measures and restrictions for the operation of public transport, trading and catering facilities started to be introduced in the cities of Nur-Sultan and Almaty followed by other cities and towns and regions of the country.

In this context, public polls conducted in April 2020 showed a dramatic deterioration of consumer sentiment (Figure 1). This index was demonstrating decline as far back as in February-March 2020, and in April-May 2020 this trend accelerated significantly. Consumer sentiment index (CSI), having found itself in the negative zone for the first time since March 2016, fell from 113 in February to 94.7 in April.

Such dynamics was caused both by the growing negative assessments concerning the existing situation and by less optimism regarding the prospects of economic development in the near term and future financial standing of respondents. The decline in indices was observed on all components (Figure 2), however, long-term prospects of economic development have changed insignificantly.

In May 2020, CSI remained in the negative zone (98.7). At the same time, consumer sentiments somewhat improved due to the growing positivism on all components, except current financial condition. Government support programs and gradual easing of quarantine measures could have caused the improvement of economic development prospects and financial standing one year ahead.

As per a regional breakdown, consumer sentiment in Nur-Sultan and Almaty started to deteriorate already in March 2020. Probably, this stemmed from detection of first cases of coronavirus infection and imposition of early quarantine measures in these cities (Figure 3).

Consumer sentiment in April 2020 shifted to the negative zone among all interviewed persons. In doing so, men have been more negative in their assessments of current financial position and its prospects while women have been more positive in assessing the economic development; however, they have been more pessimistic about big-budget purchases. On the contrary, men had demonstrated the escalation of

negative sentiment earlier than women (Figure 4). In May, assessments of current financial condition continued to deteriorate among women to a larger extent.

<sup>11</sup> The analysis is based on the outcomes of a monthly public poll on assessment of inflation expectations that is conducted by FusionLab for April 2020

Index of big-budget purchases in April 2020 fell to minimum values since inception of public polls due to shutdowns of trading facilities and limited opportunities for going into big-budget expenses. At the same time, it is worth mentioning that this index has been demonstrating a downward trend since January 2020, just as the growth rates of retail sales of non-food products (Figure 5).

The largest deterioration in consumer sentiment was observed among the self-employed population, and the smallest – among employees. Negative sentiment was observed to a larger extent among the category of people with low income and no savings.

Assessments of usefulness of the time period for savings also deteriorated: only 15% of respondents interviewed in April and 18% in May gave positive feedback. At the same time, the percentage of population that consider the current time period favorable for savings slightly exceeds the percentage of those who believe that it's good for making big-budget purchases (Figure 6).

The percentage of population with savings has been fluctuating around 20% on average throughout the entire history of polls. In April and May 2020, the population with savings noted the reduction of savings over the last 12 months. In May, their share reached 28%, which appeared to be the maximum since January 2016. This fact may be associated with the spending of savings for current needs during the lockdown. It should be noted that since March 2020 the percentage of households which mentioned public welfare payments as one of their sources of income has increased significantly and reached the maximum of 55% in May. Among employees, this percentage went up from 15% in March to 40% in May, and among the self-employed population – from 20% to 54%.

Note: the CSI is calculated as the mean of subscripts based on 5 questions. CSI consists of the current status index (the change in personal financial standing over the last year and the index of big-budget purchases) and consumer expectation index (the change in personal financial standing in the next 12 months; the country's development prospects in the next 12 months and 5 years).

Subscripts and balances of responses are calculated as the difference between the percentages of positive and negative responses +100. Values of indices are subject to change within the range from 0 to 200, above 100 – prevalence of positive assessments, and below 100 – of negative assessments.

Figure 4. CSI by Gender

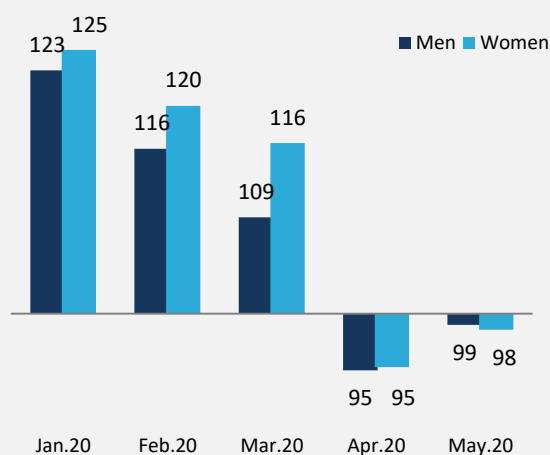


Figure 5. Big-Budget Purchases and Retail Turnover

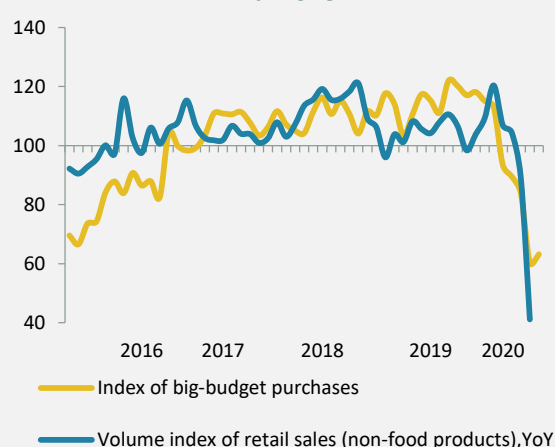
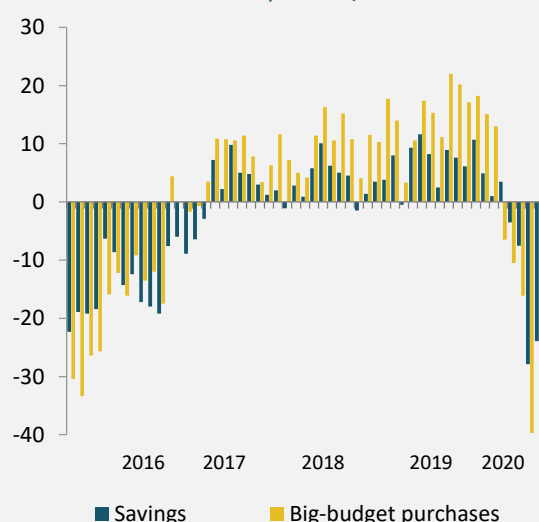


Figure 6. Assessment of Usefulness of Big-Budget Purchases and Savings (Balance of Responses)



## V. ECONOMIC DEVELOPMENT

### 5.1. Domestic Demand

In the first quarter of 2020, the consumer demand was supported by the growing real money income of the population whose growth rates remained high and accounted for 6.4% in annual terms.

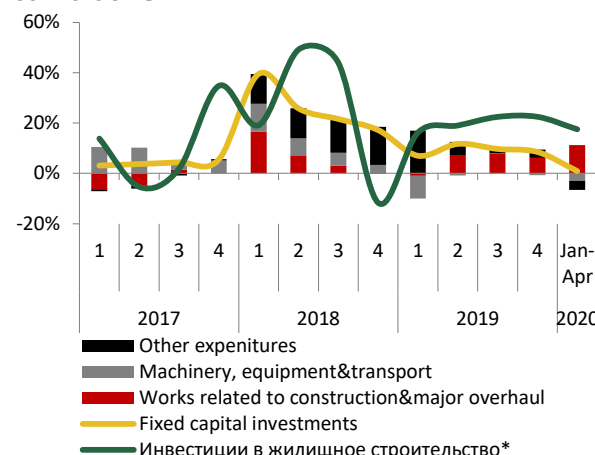
A high growth in real income of the population was promoted by the increase of real wages (excluding the employees of small enterprises engaged in entrepreneurial activities) at the end of the first quarter of 2020 by 12.2% (YoY). The largest growth in wages was observed in the public sector against a 35% growth of budget spending on labor compensation in the first quarter of 2020.

An additional support to the growth of personal income was provided by the social focus of the government policy as part of its aid to the population in the period of the state of emergency and lockdown. Total expenditures of the national budget for social security and welfare in the first quarter of 2020 went up by 14.9%. Apart from that, an indexation of retirement benefits to the population was carried out (the national budget spending on retirement benefits increased by 6.8%). The amount of subsistence allowance was raised by 85.5% in annual terms due to a 29% growth in the number of individuals receiving this type of social benefits compared to the first quarter of 2019.

**The spread of coronavirus pandemic has negatively affected the business activity in Kazakhstan. Given that the external demand reduced and prices in the global commodity markets fell significantly as well as because of placements of production facilities under quarantine, investment activity in the economy has decreased.** In January-April 2020, fixed capital investments slowed to 0.9% in annual terms. In March 2020, fixed capital investments went down by 5.1%, and in April – by 9.7%. The main contribution to such deceleration was made by a reduction

of investments in the mining industry by 2.3%, with their share in total investments accounting for 57% in the first quarter of 2020. Reduction of investment was also observed in construction (by 51.4%), trade (by 33%), transport (by 25.4%), professional, scientific and technical activities (by 62.1%) and in the manufacturing industry (by 8.6%). At the same time, other sectors of the economy demonstrate positive dynamics of fixed capital investments.

Figure 25. Investment Activity Indicators, YoY cumulative



Source: CS MNE

Investments into residential construction

In the structure of fixed capital investments, in January-April 2020 the growth was demonstrated only by expenditures related to construction and major overhaul (by 28.1%), which accounted for 49.8% in total investments (the first quarter of 2019 – 39.8%). Investments into machinery, transport and equipment went down. Other expenditures which include costs related to design work and preparation of estimates, upkeep of administration of buildings under construction, preparation of the construction site that have been one of the growth drivers for investments in the economy over the last two years made a negative contribution.

As per a regional breakdown, 41.3% of fixed capital investments were secured by Atyrau Region where in January-April 2020 investments decreased by 10% in annual terms. A key investment project in Atyrau

Region has been the construction of the third-generation plant at the TCO. The investment slump was also observed in Almaty, Shymkent and Kyzylorda Region. In 2019, due to construction of the Saryarka gas pipeline in Kyzylorda Region, a high base had been formed thus causing the reduction of investments in the region in January-April 2020 by 47.1% in annual terms.

Investments in residential construction continue to demonstrate a high growth. However, the total floor space of residential buildings commissioned in January-April 2020 went down by 10.1%.

Based on performance in January-May 2020, fixed capital investments continued to slow down and their growth accounted for 0.1%.

**The foreign trade turnover in January-March 2020 increased by 2.7% in annual terms owing to 4.2% advancement in export volumes and due to the fact that volumes of imports remained virtually unchanged (a decline by 0.06%).**

The growth of export volumes in value terms by 4.2% was entirely secured by the increased exports of mineral resources (a 14.3% growth). All other commodity items showed a decline. Oil exports went up by 14% in physical volumes due to the increased volumes of exports to Italy (a 14.5% growth) and the Netherlands (66.9%). Reduction of exports to France, Switzerland and Korea was offset by the growth of exports to China (by 2.1 times), Lithuania (by 2.1 times), Poland (by 4.3 times), India (by 3.8 times), and Turkey (by 82.3%). Exports of ores were growing, except for chrome and manganese ores exported to Russia.

Exports of non-ferrous metals decreased by 33% in value terms, being furthered both by a reduction in physical supplies and by the pricing dynamics. The decrease in exports of ferrous metals (ferro-alloys) was caused by a considerable deterioration of the price dynamics. However, physical supplies of ferrous metals in the first quarter of 2020 went up by 28.1% as a result of increased

exports to Russia (by 4.3 times), India (by 4.5 times), and China (by 23%).

Given the repel of a ban on export of fuel and lubricants in order to support local producers, in the first quarter of 2020 exports of motor gasoline to Afghanistan and the Netherlands increased (124 thousand tons were exported in total).

In the structure of imports, there was a decline on investment goods (by 5.7%) and non-food products (by 0.5%) as a result of deceleration of the investment activity and the weakening of consumer demand. Import volumes of interim goods and other imported goods remained virtually unchanged (a growth of 0.2% and 0.8%, respectively).

At the end of the first quarter of 2020, food imports demonstrated a significant growth, including imports of meat (in physical volumes – growth of 16%), dairy products (by 22.6%), sugar (by 2.1 times), soft beverages (by 33.8%), and alcohol and strong drinks (by 75.4%).

In the structure of non-food imports, imports of clothes and accessories demonstrated a sizable growth (by 38.4%). There is a decline in the import of clothes from Russia and Kyrgyzstan concurrently with the increased imports from China.

A stronger decline in imports was curbed by maintaining the unchanged dynamics of interim imports (a 0.2% growth) and other imported goods (a 0.8% growth).

According to preliminary data, the foreign trade turnover decreased by 2.5% in value terms, where exports showed a decline by 1.0%, and imports – by 5.0%.

In the structure of exports, all commodity items demonstrate reduction except mineral products (a growth of 7.3%) and construction materials (a growth of 3.6%).

The following imports continue to demonstrate a positive trend: imports of foodstuffs (a growth of 12.7%), fuel and energy products (by 17.6%) and products of the chemical industry (by 2.3%). There is a decline on all other groups which belong to

the group of investment goods, interim goods and non-food products.

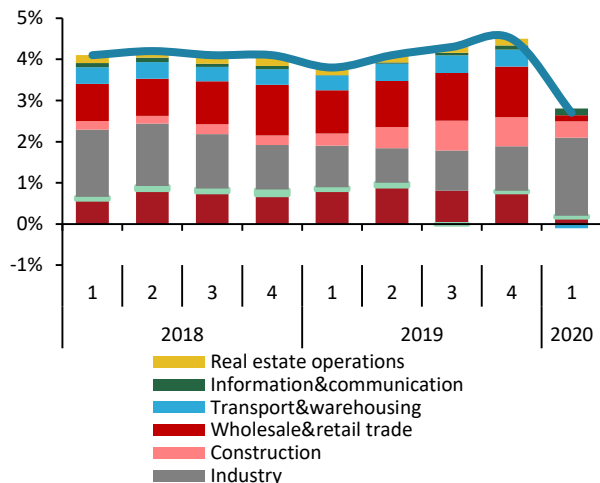
## 5.2. Domestic Supply

In the first quarter of 2020, the economic activity in Kazakhstan showed a significant deceleration. According to preliminary estimates of the CS MNE, the annual real GDP growth by the production method slowed down to 2.7%.

Prolongation of the state of emergency and quarantine measures in April 2020 provoked deterioration of situation in the real sector of the economy.

Key branches of the service sector have suffered contraction, except information and communication. Volumes of sales turnover and transport services decreased. At the same time, a positive contribution to the GDP dynamics was made by the production of goods (Figure 26).

Figure 26. GDP Decomposition. Contribution by Economic Sectors to the GDP Growth, YoY, cumulative



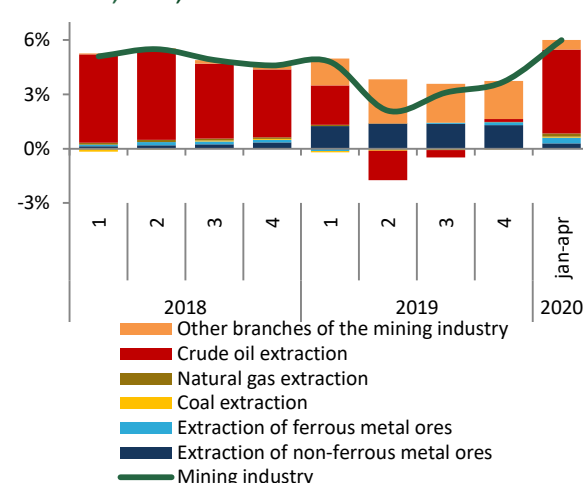
Source: CS MNE, NBRK's calculations

In the structure of production of goods, in January-May 2020 the growth of industrial production was observed. As a result of the low base of the last year as well as the increasing extraction volumes in 2020 pending the commencement of OPEC agreement, volumes of crude oil production increased in January-May 2020 by 5.4%. The growth rates of the mining industry accounted for 5.2% in total. A positive impact

was also made by higher volumes of extraction of coal and lignite (a growth of 2.3%) and metal ores (iron ore – by 8.9%, ores of non-ferrous metals – by 3.3%) (Figure 27).

Production volumes in the manufacturing industry in January-May 2020 went up by 4.9%. The main contribution to the growth was made by a 3.7% growth of output in the metallurgical industry driven by a 6.6% expansion in production of precious metals and non-ferrous metals (production volumes of copper wire rod and gold increased). Owing to the increased production of cars, trailers and semi-trailers, the engineering industry keeps demonstrating high growth rates, which accounted for 18.5%.

Figure 27. Decomposition of the Mining Industry. Contribution by Sectors to the Growth, YoY, cumulative



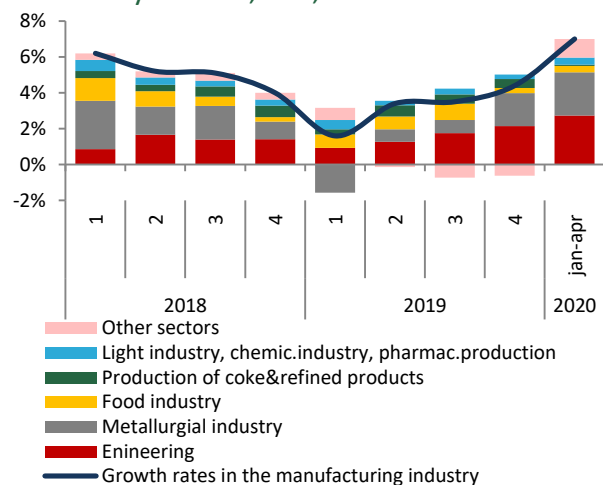
Source: CS MNE, NBRK's calculations

Quarantine measures imposed in the country did not apply to the production of socially important goods and foodstuffs. So, in January-May 2020, the food industry ramped up by 2.3% in annual terms; specifically, there was an increase in the production of meat and meat products, grain mill products, macaroni products, and dairy products.

In addition to the food industry, the expansion of production volumes has been observed in the manufacturing of metal constructions – by 23.7%, and

pharmaceuticals and medical supplies (by 21.2%) driven by a heightened demand for the protection means from coronavirus infection. Production of paper including wet wipes and paper towels, and toilet paper has increased by 14.8% (Figure 28).

Figure 28. Decomposition of the Manufacturing Industry. Contribution to the Growth by Sectors, YoY, cumulative

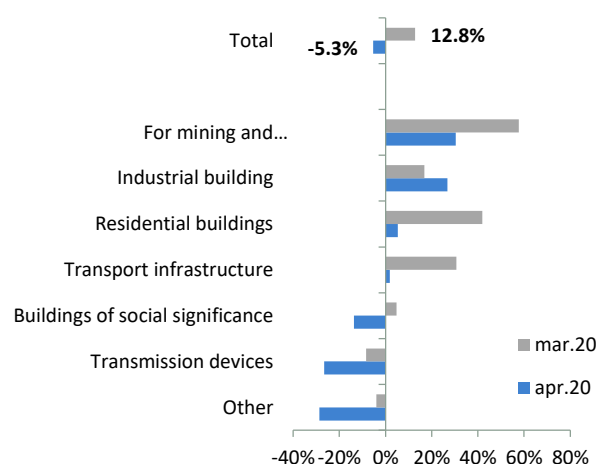


Source: CS MNE, NBRK's calculations

A temporary suspension of construction works during the state of emergency and lockdown led to a deceleration in the industry to 5.9% in January-May 2020. In a regional breakdown, curtailment of construction works was observed in Kyzylorda (by 50.8%) and Mangystau Regions (by 9.4%).

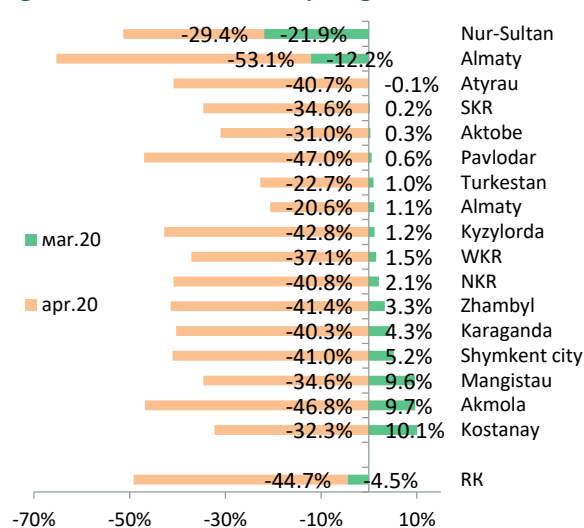
As per types of facilities in progress, there were less socially important buildings under construction (medical, educational, sports facilities, cultural and entertainment facilities), transmission units and other structures (Figure 29).

Figure 29. Volume of Construction Works (Services) by Types of Construction Facilities in Progress, YoY



Source: CS MNE, NBRK's calculations

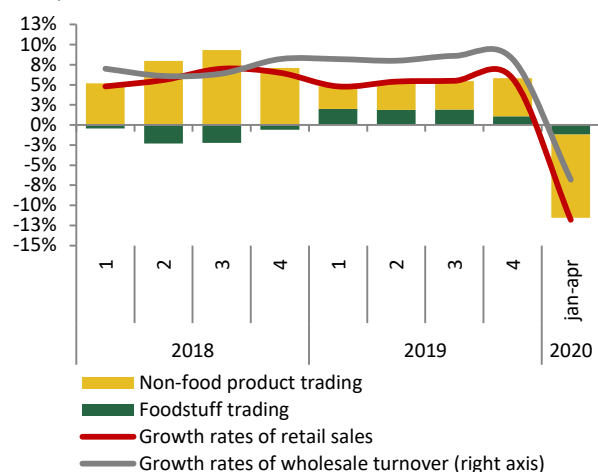
Figure 30. Retail Sales by Regions, YoY



Source: CS MNE, NBRK's calculations

As at the end of January-May 2020, volumes of wholesale and retail trade have decreased by 2.3%. However, a significant reduction was observed in April 2020 (in April 2020 – a 34.8% reduction). A 9.0% contraction in wholesale trade was stemming from the decreased demand for the domestic export items on the part of key consumers. During January-May 2020, the volumes of retail sales went down by 16.2%. Contraction of retail trade was observed in all regions of the country, where the largest decline occurred in Nur-Sultan – by 24.4% and in Almaty – by 22.3% being caused by an earlier imposition of quarantine measures (Figure 30, 31).

Figure 31. Growth Structure of Retail Sales and Growth Rates of Wholesale Turnover, YoY, cumulative



Source: CS MNE, NBRK's calculations

Given a reduction in the trading volumes in January-May 2020, volumes of transport services decreased by 14.1%. Since the beginning of 2020, the cargo turnover by all types of transport has declined by 2.9%, including by railroad transport – by 12.9% (share in the total volume – 24%), and by pipeline transport – by 4.3% (share 24%).

As a result of imposed restrictions for moving around within communities and for the public transport operation during the state of emergency and lockdown, passenger turnover decreased by 38.4%. The contraction occurred in all types of transport and in all regions of Kazakhstan.

Due to the transition to the teleworking regime by the majority of institutions and companies, the demand for the services of the information and communication sector has soared. So, the upturn of the sector during January-May 2020 accounted for 9.2%. There was a step-up in the services of mobile communication (a 3.6% growth), Internet (by 12.4%) and services of data transmission via telecommunication networks (by 10.9%).

During January-May 2020, gross agricultural output increased by 2.3%, including due to the growth in volumes of animal production (an increase in the volumes of cattle and poultry slaughtering in

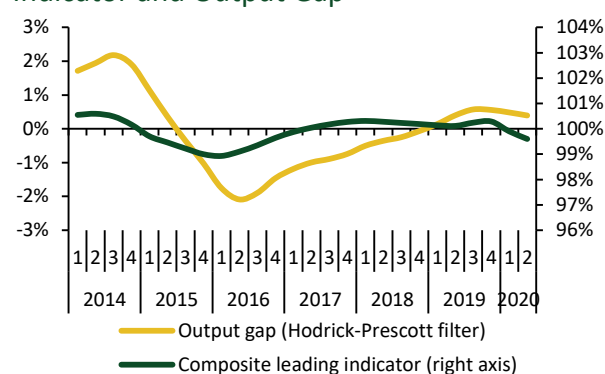
live weight by 3.2%, and yield of unpasteurized cow milk – by 3.1%).

The outcomes of the composite leading indicator (CLI) which represents an aggregated assessment based on the enterprise survey in the real sector conducted by the National Bank on a quarterly basis are also indicative of the negative dynamics in the development of Kazakhstan's real sector.

The interviewed enterprises (the industry, agriculture, transport, trade, and construction sector) note reduction in the demand for finished goods, deterioration of investment activity caused by the rise of average interest rates on foreign currency loans. In addition, a negative factor was that the number of enterprises which have suffered from a negative impact from the movement of the exchange rate of the tenge against the US Dollar and Euro increased.

In the second quarter of 2020, respondents expect that the economic activity will decelerate further mainly because of the anticipated reduction in the demand (Figure 32).

Figure 32. Behavior of the Composite Leading Indicator and Output Gap



Source: CS MNE, NBRK, NBRK's calculations

### 5.3. Labor Market

**Imposition of quarantine in large cities of Kazakhstan in the first quarter of 2020 because of the spreading coronavirus pandemic had not produced a negative effect on the labor market since the regime was imposed in the second half of March. Therefore, the labor market in Kazakhstan showed a growth of employment and**

**reduction in the number of unemployed in the environment of the growing labor compensation in real terms.**

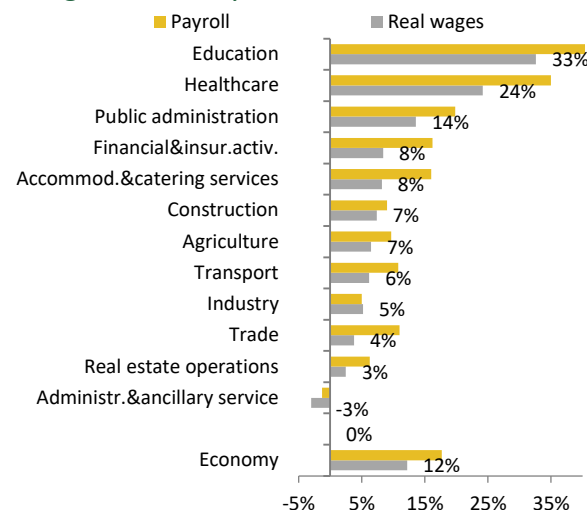
The labor force in the first quarter increased by 0.7% in annual terms. In the labor force structure, there is a 1.1% decline in the most numerous group of the population (share 31.1%) at the age from 25 to 34 years old. The downtrend was also demonstrated by the group of population at the age from 45 to 54 years old by 0.3% and the employable population over 65 years old – by 4.0%.

Given a limited labor force growth in the first quarter of 2020, employment rates increased insignificantly (by 0.1%, YoY). In the structure of employed population, the number of employees went up (by 1.2%) and the self-employed population decreased (by 0.8%).

As per industry-based breakdown, the annual decline continues in agriculture (by 5.1%) and information and communication (by 1.7%); the downward pattern was also observed in the sector of administrative and ancillary service (by 2.6%).

On a regional basis, the reduction in employment was noted in Akmola, Almaty, Karaganda, Kostanai, Pavlodar, North-Kazakhstan and East-Kazakhstan Regions. One of the reasons for that could be migration of the labor force from rural areas to large cities since the above mentioned regions show the largest negative balance on the internal migration. Cities of Nur-Sultan, Almaty, Shymkent and Mangystau Region are the leaders in terms of influx of population within the country.

**Figure 33. Real Wages and Nominal Payroll Budget in January-March 2020, YoY**



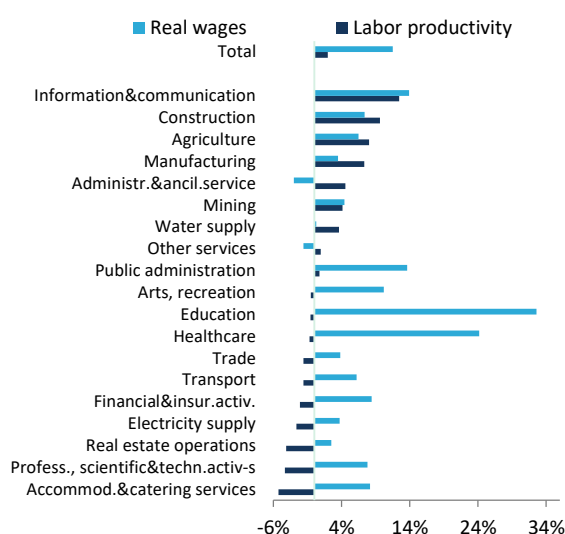
Source: CS MNE

Alongside with the growing employment in the first quarter of 2020, real wages also accelerated their growth to 12.2% (excluding small businesses); this was driven by an 8.4% increase of the payroll budget in the real sector (Figure 33).

The main contribution to acceleration of the wage growth is made by the increased budget spending for wage payments to the public sector which went up by 35% in annual terms in the first quarter of 2020 and resulted in expansion of the payroll budget in the sectors of education, healthcare, general government and defense. In the industry-based breakdown, reduction of real wages was observed only in the sectors engaged in provision of other types of services and in activities on administrative and ancillary service.

In the first quarter of 2020, the labor productivity continued to demonstrate positive dynamics (Figure 34).

Figure 34. Real Wages and Labor Productivity in the 1<sup>st</sup> Quarter of 2020

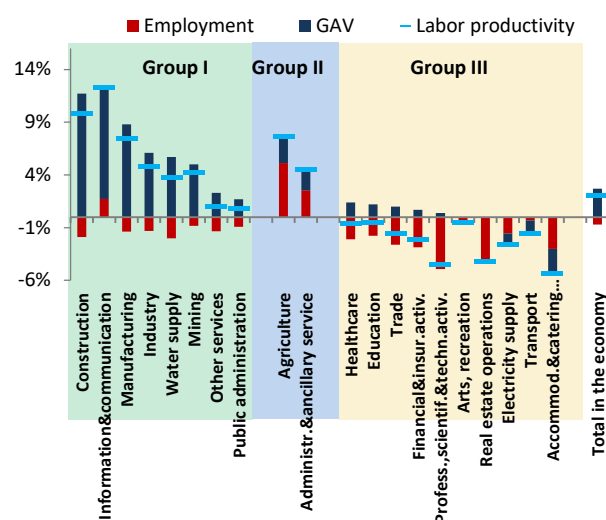


Source: CS MNE, NBRK's calculations

The labor productivity increased in the environment of moderate growth of the gross value added in the economy (a 2.7% growth in annual terms) and a minor rise in employment. Along with that, the growth of real wages was overrunning the growth rates of labor productivity to a great extent.

In the industry-based breakdown, such trend was observed in all branches of the public sector, in trade, transport, real estate operations, electricity supply, and professional, scientific and technical activities. In these sectors, the labor productivity showed negative dynamics against the outstripping growth of employment compared to the gross value added in the sectors (the third group – Figure 35).

Figure 35. Contribution of the Change in Employment\* and GAV to the Labor Productivity in the 1<sup>st</sup> Quarter of 2020



Source: CS MNE, NBRK's calculations

\*- Rates of change in employment were taken with an opposite sign since the increase in employment along with the unchanged GVA results in the reduced labor productivity.

The growth of labor productivity was outrunning the growth rates of real wages in the sector of information and communication, construction, in the manufacturing and mining industries. The abovementioned sectors of the economy demonstrated positive dynamics due to the outstripping growth rates of the gross value added over the growth rates of employment (the first group – Figure 35).

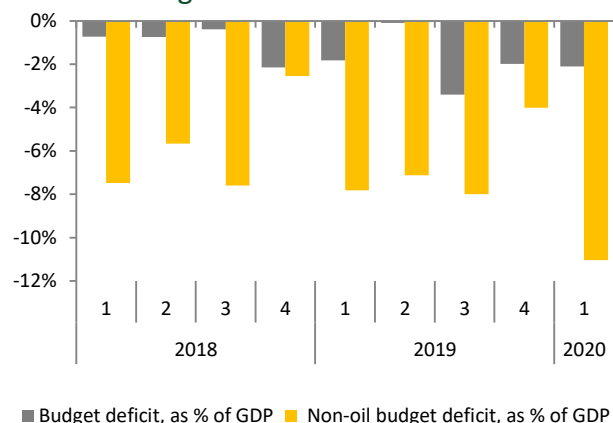
The growth of real wages was also outpacing the increase in labor productivity in agriculture. However, improvement of labor productivity in these sectors was accompanied by a more rapid reduction of employment compared to the rise in gross value added (the second group – Figure 35).

#### 5.4. Fiscal Policy

In April 2020, against the backdrop of deteriorating macroeconomic situation because of the spreading coronavirus infection in Kazakhstan and imposition of the state of emergency, amendments to the national budget for 2020 had been made. The new budget provides for an increased spending, first of all, for social security and

social welfare, healthcare, utilities sector, and the public order. The ramp-up of the revenue side of the budget is anticipated from a significant increase of transfers from the National Fund alongside with reduction of tax revenues.

Figure 36. Overall and Non-Oil Balance of the National Budget



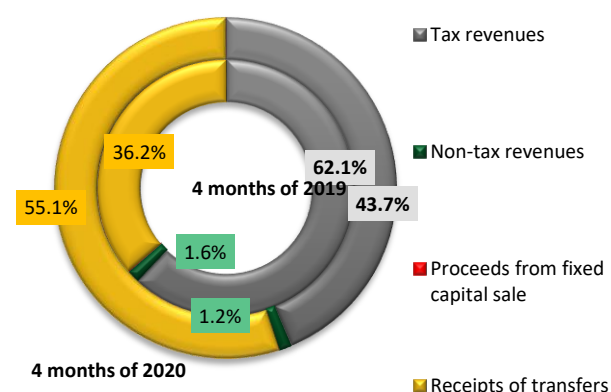
Source: Kazakhstan's Ministry of Finance, NBRK's calculations

In January-April 2020, the national budget showed up a deficit of 632.9 billion tenge, having increased by 2.2 times compared to the corresponding period of 2019. Expansion of the budget deficit is primarily caused by the outstripping growth of expenditures over revenues.

During the first quarter of 2020, the non-oil budget deficit (budget deficit excluding transfers from the National Fund) amounted to 1.4 trillion tenge (10.8% of GDP), which is by 41.2% greater compared to the corresponding period of 2019 (Figure 36).

Transfers from the National Fund in 2020 will be increased from 2.7 trillion tenge to 4.8 trillion tenge. In January-April 2020, transfers worth 1.9 trillion tenge were withdrawn from the National Fund.

Figure 37. Structure of the National Budget Revenues



Source: Kazakhstan's Ministry of Finance

During January-April 2020, the national budget revenues went up by 10.8% compared to the same period of the previous year and amounted to 3.7 trillion tenge (Figure 37). Such growth was secured owing to a 68.5% increase in official transfers (their share in the budget revenues accounted for 55.1%). Along with that, given the declaration of the state of emergency and imposition of restrictive measures to prevent from the spread of coronavirus, the following revenues and receipts decreased: tax revenues (by 22.0%), non-tax revenues (by 15.7%) receipts of transfers and proceeds from fixed capital sale (by 76.9%) (Figure 37).

During January-April 2020, the national budget spending increased by 23.6% compared to the corresponding period of the previous year and amounted to 4.1 trillion tenge. The main contribution to the growth of the national budget spending has traditionally been made by expenditures for social security and social welfare where the growth accounted for 27.0% (the share – 30.6%), and healthcare – a 21.7% growth (the share – 14.0%). Also, the growth of expenditures was observed on the following items – education – by 43.0% (the share – 6.8%), official transfers – by 42.3% (the share – 15.8%), and debt servicing – by 19.2% (the share – 7.2%).

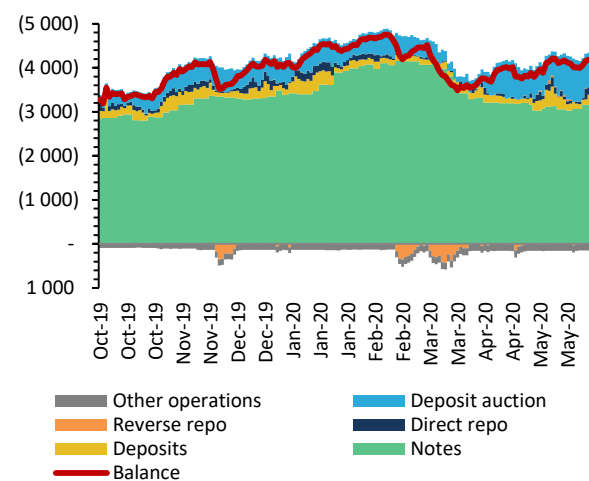
## VI. FINANCIAL MARKET

### 6.1. Money Market

After stabilization of the situation in the money market and in the foreign exchange market in April, the growing liquidity surplus continued to affect the money market rates. The National Bank's operations on liquidity regulation help to keep the operating target within the base rate band. In certain periods, interest rates and their spreads in different segments of the money market were going up.

As external conditions were improving, in April-May the situation in the money market stabilized. This led to reduction in the demand for the tenge liquidity and to resumption of the liquidity surplus growth in the money market. An excess liquidity is withdrawn through short-term notes, direct repo as well deposit operations, including deposit auctions.

Figure 38. Exposure on the NBRK's Operations in the Domestic Market



Source: NBRK

The main contribution to the growth in the balance of the NBRK's operations is made by the increased volumes on deposit auctions. The bulk of liquidity is still withdrawn through short-term notes of the National Bank, primarily 6- and 12-month notes. The volume of notes, due to a heightened demand for the tenge liquidity, went down in March and has been staying at these levels. The share of 6- and 12-month

notes has slightly decreased from 78% at the end of the third quarter of 2019 to 77% at end-May 2020 (Figure 38).

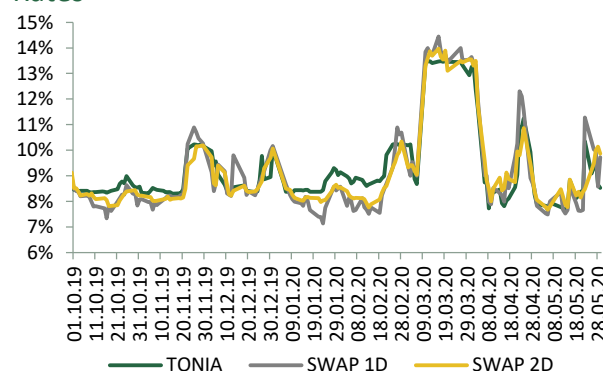
Figure 39. Interest Rate Band and TONIA



Source: NBRK, KASE

On April 27, 2020, the base rate was retained at 9.5% with the range of  $\pm 2$  pp. In this environment, TONIA has been setting primarily between the base rate and the lower boundary of the interest rate band, except for some periods. Short-term periods when TONIA was exceeding the base rate level were related to the increased demand for the tenge liquidity (Figure 39).

Figure 40. Dynamics of the Money Market Rates



Source: KASE

In April-May 2020, interest rates in the swap market were setting closer to TONIA. However, the periods when interest rates in the repo market went up were followed by the expansion of spread (Figure 40).

### 6.2. Foreign Exchange Market

In April-May of this year, the demand and supply in the domestic foreign exchange

market were mainly in balance, which resulted in a notable appreciation of the domestic currency.

The demand and supply were significantly influenced by the measures undertaken by the National Bank and the Government on currency exchange regulation with respect to quasi-government companies and exporters of natural resources.

The increase in oil prices, positive sentiment in the equity market, and appreciation of currencies in developing economies and oil exporters also set a trend for appreciation of the tenge.

The OPEC+ agreement to cut oil production by 9.7 million barrels a day, which was reached on April 10, at first did not raise the spirits in the commodity market because of the increasing oil reserves and the concerns about a deeper drop in the demand for commodities. As a consequence, the Brent oil price was declining to the minimum of 15.98 US dollar per barrel during tradings on April 22, 2020. Nonetheless, by the end of April 2020, oil price recouped from falling and reached 25.27 US dollars per barrel.

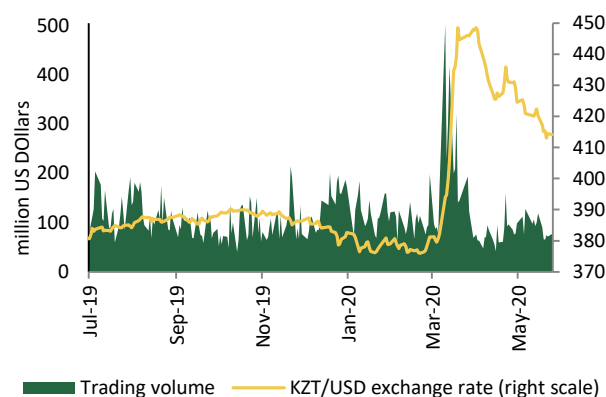
In May, relatively positive expectations formed in the global markets amid the gradual easing of quarantine measures and hence the opening of economies. News about resumption of the global economic activities alongside with actual reduction of oil production under OPEC+ had a favorable effect on oil prices. In May, the Brent oil price in the global markets was forming within the range of **26 – 36** US dollar per barrel.

Owing to favorable external factors, in May currencies of countries-Kazakhstan's trading partners were demonstrating appreciation. The Russian ruble appreciated against the US dollar by 2.2%, the euro against the US dollar- by 0.2%.

In the period reviewed, the demand for foreign currencies in the domestic foreign exchange market was to a large extent covered by the supply which was forming by exporting companies, by foreign currency sales from the National Fund in order to

allocate the guaranteed transfers to the budget, as well as a mandatory partial sale of foreign currency revenue proceeds raised by quasi-government companies.

Figure 41. Exchange Rate Dynamics and Trading Volume in the Foreign Exchange Market



Source: KASE

In April-May, many companies were functioning in restricted mode because of the quarantine. This resulted in a reduction of the demand for foreign currency and, consequently, in the trading volumes at the local stock exchange. As compared to March 2020, the volume of stock exchange trades in the USD/KZT currency pair fell by half from 3.46 billion to 1.27 billion US dollars (Figure 41).

In May, quarterly tax payments by local companies coupled with stable external conditions supported the tenge.

As a result, in April 2020 the domestic currency appreciated by 5.2% from 447.67 to 424.57 tenge per US dollar, and in May 2020 – by **2.5%** to **414.13** tenge per US dollar.

### 6.3. Deposit Market

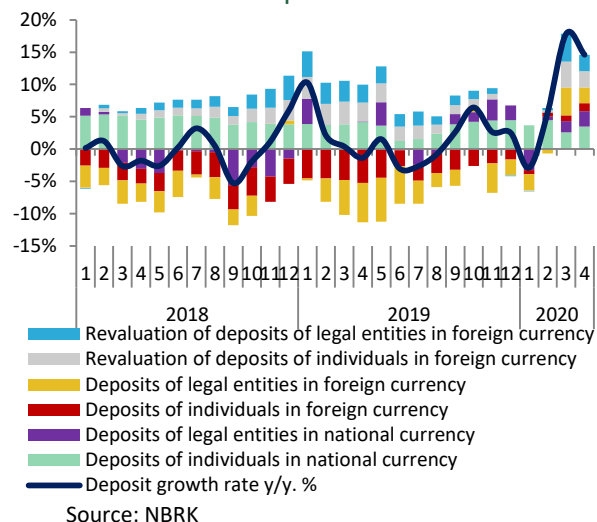
After a significant growth of deposit volumes with depository institutions in the first quarter of 2020, in April their volumes were decreasing because of reduction in foreign currency loans. In April 2020, deposits in the tenge went up largely owing to the growth of retail deposits.

Reduction of foreign currency deposits and buildup of deposits in the tenge

resulted in a smaller degree of deposit dollarization.

In annual terms, as at the end of April 2020, deposits went up by 14.6% to 19.6 trillion tenge (Figure 42).

Figure 42. Contribution by Components to the Growth in the Deposit Volume



A sizable growth of foreign currency deposits in the first quarter of 2020 which was mainly related to revaluation because of depreciation of the tenge in March, in April was replaced by reduction of foreign currency deposits.

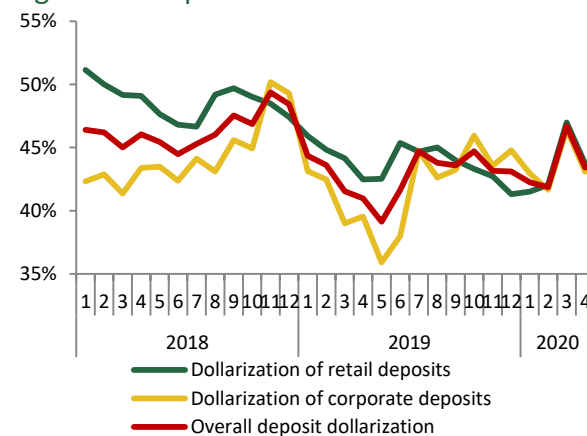
The exchange rate movement also affected the dynamics of foreign currency deposits in April 2020. Appreciation of the tenge furthered the decrease in foreign currency deposits both of the corporate sector and of retail sector. In April 2020, foreign currency deposits went down by 10%, including corporate deposits – by 12.5%, and retail deposits – by 7.2%. Excluding the effect from appreciation of the tenge, reduction in foreign currency deposits accounted for 5.1%.

Deposits in the tenge, after a minor reduction in the first quarter of 2020, grew by 2.9% in April. Retail deposits in the domestic currency were growing to a larger extent compared to the corporate sector which is an evidence of effectiveness of the

measures taken to increase regulated interest rates on retail deposits in 2020<sup>12</sup>.

As a result, dollarization of deposits, after a swing at the end of the first quarter of 2020 (46.7%), returned to its level of the beginning 2020 and made up 43.4% (Figure 43).

Figure 43. Deposit Dollarization

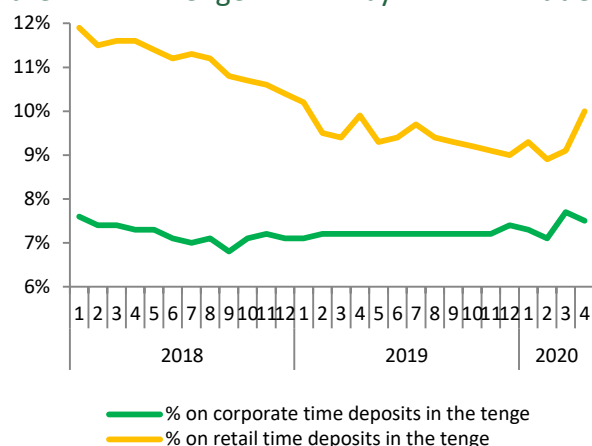


The change of the base rate in April 2020 caused a reduction of interest rate on the corporate sector deposits in the domestic currency that made up 7.5% at the end of April (a 0.2 pp reduction over the month).

In April, the Kazakhstan Deposit Insurance Fund retained marginal interest rates on retail deposits; nonetheless, an interest rate on retail time deposits in the tenge continued growing and in April 2020 accounted for 10.0% (Figure 44).

<sup>12</sup> In March 2020, following the raise of the base rate, the Kazakhstan Deposit Insurance Fund increased marginal interest rates on retail deposits on all deposit types

Figure 44. Interest Rates on Time Deposits in the Tenge by Entities



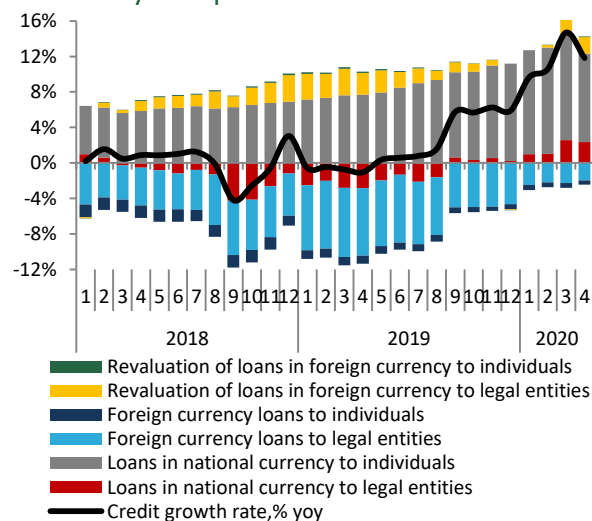
Source: NBRK

#### 6.4. Credit Market

**The loan portfolio continues to grow owing to the retail sector and to revaluation of corporate foreign currency loans. In April 2020, following reduction of the base rate, interest rates on loans were decreasing.**

Bank loan portfolio in April 2020 in annual terms expanded by 11.8% or by 1.5 trillion tenge, amounting to 14.1 trillion tenge (Figure 45).

Figure 45. Contribution to the Annual Loan Growth by Components



Source: NBRK

The retail sector still represents a key factor which had an effect on the growth of credits to the economy; it has expanded by 21.7% or by 1.2 trillion tenge over the year. The share of retail loans in total loans accounted for 47.9%.

An increasing contribution of consumer loans which account for 2/3 of the retail lending volume is a key factor for the growth in loans to individuals (a ramp-up of 20.4% or 710.3 billion tenge). Mortgage lending is also expanding owing to implementation of government housing programs (a growth of 33.3% or 464.1 billion tenge).

In April, the corporate segment's loan portfolio increased in annual terms by 4.1% or 285.5 billion tenge to 7.3 trillion tenge. Despite the fact that the physical volume of corporate foreign currency loans keeps on with a downward trend, currency revaluation of these loans made a positive contribution to the loan growth against depreciation of the tenge.

New loan disbursements to businesses in January-April 2020 increased by 9.0% compared to the same period of 2019.

According to the survey conducted by the NBRK among enterprises in the real sector of the economy, in the first quarter of 2020 assessments of the lending terms (level of interest rates, maximum amount, and tenor) remained negative. The number of enterprises which mention deterioration of the lending terms has increased.

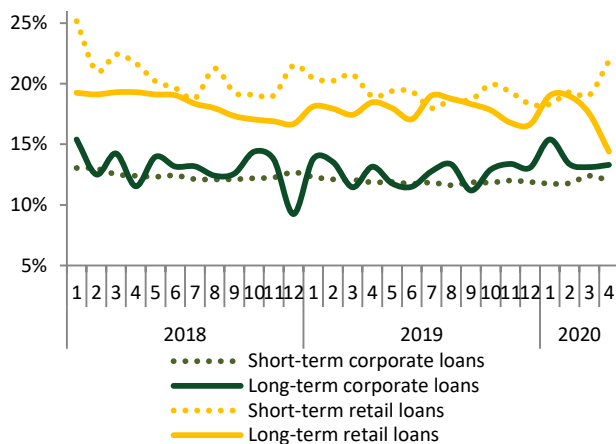
16.7% of enterprises participating in the NBRK's survey applied to banks for loans, of which loans were obtained by 94.6% of enterprises. In general, the percentage of denials to provide a loan was 0.9% of the total number of respondents participating in the survey (5.4% of the number of those who applied for a loan).

In April 2020, interest rates on short-term and long-term loans to businesses in the domestic currency were decreasing after their growth in March. The weighted average interest rate on corporate loans in the domestic currency in April 2020 was 12.1%, which is by 0.4 pp. lower than in March (Figure 46). Weighted average interest rates on short-term loans decreased from 12.4% to 12.0%, and interest rates on long-term loans went up from 13.1% to 13.3%.

Compared to April of 2019, interest rates slightly increased.

In the first quarter of 2020, the spread between the actual interest rate on loans and the rate acceptable for enterprises slightly widened (to 6.5 pp. compared to 5.9 pp in the fourth quarter of 2019) because of reduction of the interest rate acceptable for enterprises which accounted for 5.5% (6.4% in the fourth quarter of 2019).

Figure 46. Interest Rates on Loans in the Domestic Currency



Source: NBRK

## BASIC TERMS AND DEFINITIONS

**Core Inflation** – means the inflation which excludes transitory price changes subject to certain factors of administrative, event-related and seasonal nature. The base rate – is the National Bank's key monetary policy instrument which enables to regulate nominal interbank interest rates in the money market. By setting the base rate level, the National Bank determines a target value of the targeted interbank short-term money market rate in order to achieve the goal of ensuring the price stability in the medium term.

**Gross Fixed Capital Formation** – is the growth in non-financial assets which have been used in the process of production for a long time. Gross fixed capital formation includes the following components: a) acquisition, less retirement, of new and existing fixed assets; b) costs for major improvements of tangible produced assets; c) costs for improvement of tangible non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

**FX Swap** means a foreign exchange transaction which involves the concurrent purchase and sale of a certain amount of one currency in exchange of another currency with two different value dates.

**Gross Domestic Product (GDP)** is an indicator that reflects the market value of all final goods and services produced during a year in all sectors of the economy within the territory of the country for consumption, exports and saving, irrespective of the national identity of the used production factors.

**Reserve Money** includes cash issued into circulation by the National Bank, other than cash at the cash departments of the National Bank, transferrable and other deposits of banks, transferrable deposits of non-bank financial organizations and current accounts of government and non-government non-financial organizations in the tenge at the National Bank.

**Money Supply (M3)** is determined on the basis of consolidation of balance sheet accounts of the National Bank and banks. It consists of cash in circulation and transferable and other deposits of non-bank corporate entities – residents and the population in the domestic and foreign currency.

**Dollarization of the Economy** means the situation where a foreign currency (largely – the US Dollar) starts to be used for transactions within a country or in certain sectors of its economy, pushing out the domestic currency from the domestic money turnover, and acting as the means of saving, measure of value and the legal tender.

**Inflation** – is an increase in the overall price level of goods and services. In Kazakhstan, inflation is measured by the consumer price index.

**Consumer Price Index** – is the change in the overall price level of goods and services purchased by the population for consumption. The consumer basket of Kazakhstan used for calculation of inflation reflects the structure of household spending and contains goods and services which represent the largest portion in the consumption of population. The CPI is calculated as the ratio of the cost of a fixed set of goods and services in current prices and its cost in the prices of the previous (base) period. The index is calculated by the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan.

**Inflation Targeting** – is a monetary policy regime which is oriented at achieving a target inflation rate.

**Composite Indicator** – is a generalizing indicator which is used to reflect short-term trends in the development of the real sector of the economy. Composite indicator as possessing the forward-looking feature is used to reflect a cyclical change and to identify turning points when recovery and downturns in the economy occur and change. A composite indicator is built on the basis of the outcomes of survey among enterprises

which participate in the market research conducted by the National Bank.

**Short-term economic indicator** is calculated with a view to ensure efficiency and is based on the change in the output indices in key sectors: agriculture, industry, construction, trade, transport and communication accounting for over 60% of GDP. The indicator is built without recalculations for the unobservable economy and without other macroeconomic adjustments.

**Credit Auctions** mean the National Bank's auction for the securities buy/sell back.

**Minimum Reserve Requirements (MRRs)** mean the mandatory share of bank's liabilities which a bank is to keep in the form of cash in its cash department and monies on correspondent accounts with the National Bank in the domestic currency (reserve assets). The volume of reserved liabilities of banks is regulated by the MRR ratios.

**Reverse Repo** is the purchase of a security with the commitment to sell it after a specific period of time and at a specific price. The National Bank conducts reverse repo operations with a view to provide the tenge liquidity to banks against the pledge of securities in line with the National Bank's list of collateral.

**Open Market Operations** are regular operations of the National Bank in the form of auctions for liquidity provision or withdrawal in the money market with a view to set interest rates around the base rate.

**Standing Facilities** refer to monetary policy instruments for adjustment of volumes of liquidity, which resulted from the open market operations. Standing facilities are provided as part of bilateral arrangements where the National Bank is one party to the transaction. Such operations are conducted at the initiative of banks.

**Transferrable Deposits** refer to all deposits which: 1) can be converted into cash at face value at any moment in time without any penalties and restrictions; 2) are freely transferable through a check, draft or endorsement orders; and 3) are widely used for making payments. Transferable deposits

represent a part of the narrow money. Other deposits primarily include savings and time deposits that only can be withdrawn on expiration of a certain period of time, or can have different restrictions which make them less convenient for use in the ordinary commercial transactions and, mainly, meet the requirements established for saving vehicles. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

**Potential Output** reflects the level of output in the economy that can be reached subject to full utilization of inputs and full employment. It reflects the volume of production which can be manufactured and realized without creating prerequisites for the change in the price growth rates.

**Consumer Basket** means a sample of goods and services which characterizes the standard level and the structure of monthly (annual) consumption of an individual or a family. Such sample is used to calculate the minimum subsistence level, based on the cost of the consumer basket in current prices. The consumer basket also serves as a comparative basis for estimated and real consumption levels and also as the basis to determine the purchasing capacity of currencies.

**Interest Rate Channel of the Monetary Policy Transmission Mechanism** is the transmission mechanism channel which describes the impact of the central bank on the economy through the interest rate regulation.

**Direct Repo** is the sale of a security with the commitment to repurchase it after a specific period of time and at a specific price. The National Bank conducts direct repos with a view to withdraw excess liquidity in the tenge.

**Free Floating Exchange Rate.** According to the IMF's current classification, under the floating exchange rate framework a central bank does not establish any pegs including operating ones for the level or the change in the exchange rate, allowing the exchange rate to be determined by the market factors.

In doing so, the central bank reserves the opportunity to periodically intervene in the foreign exchange market in order to smooth out the volatility of the domestic currency exchange rate or to prevent its dramatic movements as well as to ensure the financial system.

**Output Gap.** Deviation in GDP expressed as a percentage of a potential output. Expresses the difference between an actual GDP and potential GDP for a certain time interval. Serves as an indicator which reflects the effectiveness of resources utilized in the country. If an actual output exceeds the potential one (a positive gap), other things remaining equal, the trend of acceleration in the price growth rates would be anticipated because of the overheating of the economy.

**Real Exchange Rate** refers to a relative price of a commodity produced in two countries: the proportion of commodity exchange between countries. The real exchange rate depends on the nominal rate, on relation between exchange rates of currencies, and prices of goods in the domestic currencies.

**TONIA Rate** – represents a weighted average interest rate on one-day repo opening transactions made on the stock exchange with government securities in the automatic repo sector.

**Monetary Policy Transmission Mechanism** is the process, by which monetary policy tools influence final macroeconomic indicators such as the economic growth, inflation.

**Narrow Reserve Money** is the reserve money excluding other deposits of banks at the National Bank.

**Fiscal Impulse** means the difference of operating balances in periods  $t$  and  $(t-1)$ . If the operating balance at the time  $t$  is greater than the balance at the time  $(t-1)$ , the fiscal impulse in relation to the economic activity is negative (contractionary fiscal policy); if the operating balance at the time  $t$  is smaller than its previous value – the impulse is positive (stimulative fiscal policy). Where the balances at periods  $t$  and  $(t-1)$  are equal thus implying their zero difference, there is no fiscal impulse.

**LIST OF KEY ABBREVIATIONS**

bp – basis point  
GDP – gross domestic product  
GPIID - the Government Program for Industrial and Innovation Development  
EU – the European Union  
ECB – the European Central Bank  
CPI – consumer price index  
CS MNE – the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan  
KASE – the Kazakhstan Stock Exchange  
KSF – the “Kazakhstan Sustainability Fund” JSC  
NBRK – the National Bank of the Republic of Kazakhstan  
VAT - value-added tax  
OPEC – Organization of the Petroleum Exporting Countries  
Rosstat – the Russian Federal State Statistics Service  
REER – real effective exchange rate  
IMF – the International Monetary Fund  
bln. - billion  
mln. - million  
MNE – the Ministry of National Economy  
MoA RK – the Ministry of Agriculture of the Republic of Kazakhstan  
MED – the Ministry of Economic Development of the Russian Federation  
thous.– thousand  
TCO - Tengizchevroil  
CB RF – the Central Bank of the Russian Federation  
FAO – Food and Agriculture Organization of the United Nations  
US Fed – the Federal Reserve System