

Comment of Sabit Khakimzhanov, Director of the Department - Research and Analytics Center of the National Bank Concerning Increase in the Base Rate by 25 bp.

Inflationary risks that we talked about over the past three years are starting to come true. We are already responding not to expectations of inflation growth but to the fact. In June, prices rose much more than we expected.

We are also responding to rising inflationary risks and uncertainties. If optimistic forecasts still assume that inflation is close to the target, then right tails of inflation expectations have become thicker and longer.

Rate hike in such conditions is expected. I think that the decision to raise the rate has not surprised anyone in the market - given the logic of the current situation, and taking into account what we said earlier, and especially in communications after the June decision to keep the rate.

I believe that the market needs to have an idea of the rate for the future, what factors are behind the rate decisions, understanding of many causes of inflation and, depending on the cause of inflation, effectiveness of the interest rate policy.

Let's start with an **increase in government spending**. This is the most important factor because it is a macro policy instrument and determines medium-term inflationary background. This factor forms demand of households, both directly through transfers and salaries of civil servants, and more indirectly through public procurement and cycle of money and commodity turnover, involving a broad mass of consumers. **In order to constrain inflation, it is more important to ensure discipline of government spending.**

Interest rate is a weaker and more indirect instrument in this respect. One should not expect that the rate hike will lead to a decrease in inflation against the background. We have a more realistic goal - to ensure monetary discipline, within the framework set by fiscal policy, in order to mitigate a risk of panic crackdown and inflation 'runaway' following exchange rate expectations.

Currently, actual inflation does not have this component but the risk is present. What we see today in prices on the commodity market is, to a large extent, an inevitable and necessary adjustment of the economy to accumulated price distortions and imbalances. Almost all of these factors are on the supply side. For today, I would single out three.

The first is **a risk of exchange rate infiltration into import prices**. It has always existed and it exists today. An increase in the rate will slightly change the balance between risks and profitability in the foreign exchange market in favor of tenge but it is more important for us to send a signal to the market that we are ready to raise further so that speculation against the tenge would be unprofitable. However, it would be wrong to try to control the rate through the rate. We have already gone through this.

The second factor is **a risk of growing utility tariffs**. It has persisted in our market for a long time, and it still exists today. If tariffs of monopolists are understated, then equipment wears out, quality and reliability of utilities decreases. Such latent inflation is much worse than open inflation, both for development of

the economy and for a consumer. Therefore, tariff growth, if driven by a need to stabilize relative prices, is not a factor to which monetary policy should respond.

Finally, the third factor is **growing prices for domestic vegetables, agricultural products and oil**. This is of course a mix of supply and demand factors. However, summer vegetable prices tend to reflect seasonal abundance, mostly of domestic produce. Rise in food prices in June indicates that prices rose first in the field and then on shelves. The rise in the price for vegetable oil is a trickle of growing import prices, that is, the supply factor.

All three of these inflation risk factors are currently on the rise. However, one should not expect that the rate hike will immediately reduce inflation.

The task is not to use the rate to slow down or restrain market processes of adjusting relative prices. We need to be aware that instruments of monetary policy do not affect the economy immediately but with a large and variable lag.

In order to be effective and persuasive, monetary discipline cannot afford to be radical and unpredictable. **Stability and predictability of credit conditions is much more important.**