

The National Bank explained decision on base rate hike

Deputy Governor of the National Bank of the Republic of Kazakhstan Akylzhan Baymagambetov in an interview with Kazinform talked about a base rate decision, results of forecast round and anti-inflationary measures.

– Akylzhan Malikovich, what is the basis for the decision of the National Bank related on the base rate?

- The decision was made based on the results of August-September forecast round which allowed us to update forecasts and take into account current trends in the domestic and global economy.

Based on our analysis, we observe a **significant external inflationary environment**, which is attributed to a **record growth of prices** for food and raw materials. This is evidenced by annual **32.9% surge** of FAO food price **index** this August.

The situation is aggravated by disruptions in a supply chain and acceleration of global demand, which is connected with **unprecedented fiscal stimulus measures**.

As a result, total level of inflation continues to grow worldwide, exceeding targets set by monetary authorities. In the **United States**, July inflation reached its peak of **5.4%** in 13 years, in the **Euro area** - a peak of **3%** in 10 years in August, in **Russia** – a peak of **6.7%** in 5 years in August.

Internal factors also deteriorate the inflation picture. These include a record rise in prices for fruit and vegetable products in **off-season time** accelerating domestic demand with a high level of **fiscal stimulus**, rising prices for electricity, fuels and lubricants and gas. All these factors contributed to acceleration of inflation to **8.7%** in August 2021. Thus, our decision on the base rate is a logical response to risks being realized. It is aimed to reduce inflation to **4-6%** in **2022**.

- What were consequences of the base rate rise in July?

- Current and previous decisions are steps to implement the inflation targeting policy. Essence of inflation targeting is to anchor inflation at the target level using the main instrument - the base rate. If there are persistent risks of inflation deviating from the target upwards, direction of monetary conditions gradually changes - the base rate rises.

Thus, our actions are like links in one chain, first of all intended to **stabilize inflation**. However, keep in mind that effect of the rate rise on the price level does not occur immediately. It takes a certain amount of time.

Nevertheless, there are still some short-term effects. For example, growth of the base rate facilitated **balancing of the domestic foreign exchange market** due to preservation of **tenge attractiveness** and tenge assets. A more attractive rate on tenge assets prevents unfavorable equilibria on money and foreign exchange markets and supports internal trend of de-dollarization of deposits.

In July this year, dollarization of corporate deposits decreased to **37.4%**. Dollarization of retail deposits continued to decline reaching a record low over the past 13 years - **34.5%**. As a result, general dollarization in July fell from **37%** to **36%**.

- What are main factors driving prices up?

–We are witnessing big differences from previous crises, when there was a pronounced impact of the exchange rate on inflationary processes. Since the beginning of the year, tenge has lost only **1.4%** of its value, while external prices are hitting long-term records.

Key factors of inflationary pressure today are concentrated on a **non-monetary** side - in prices for food products, which in August rose by **11.4%** year-on-year, a sharp rise in prices for fuels and lubricants and electricity.

Despite a slight decrease in **FAO food price index** in June-July, its growth continued this August. This means that high increases in food prices have persisted since the onset of the **global pandemic**.

In our country, this tendency is aggravated by **off-season shocks** and, in general, **periodic supply imbalances**. As a result, there has been a record in recent years **off-season growth** in prices for vegetables, hike in prices for meat, vegetable oils, sugar and eggs.

Higher food prices are also linked to **higher producer prices**, lower supply due to **depletion of last crop stocks** and **higher global food prices**. Unfortunately, given that we have de facto **missed** much of a **seasonal decline** in vegetable prices - usually there is **low** monthly **food** inflation or even **disinflation** at the end of summer. That is, the food inflation currently observed in the **summer months** is **not typical** for them.

Non-food inflation accelerated to **7.3%** year-on-year as a result of **growing prices for gasoline, clothing and footwear**. Cost of fuels and lubricants rose by **13.1%** amid **rising costs and recovery of business activity** in the country. Clothes and footwear went up by **6.5%**, which was facilitated by the rise in import prices. Upward trend in non-food inflation is supported by implementation of effect from **pent-up demand** given the dynamic recovery in consumer activity and credit. This is supported by an indicator of **consumer goods import**, which soared by **27.3%** in the first half of 2021, and this is not a base effect.

Paid services inflation is also accelerating, and made **6.6%** increase in August due to an annual **10.1%** rise of **electricity** prices. This caused a **6.3% increase in cost of utility** tariffs. Electricity is an item which is largely similar to fuel and lubricants in terms of overall impact on inflation of.

- The government together with the National Bank have developed and adopted a set of anti-inflationary response package after President's instructions announced in the Address. How effective are measures outlined in the document and what should be expected in 2021-2022?

- In his Address to the nation of Kazakhstan dated 1 September 2021, the President instructed the National Bank and the Government to **cut inflation**, return it to the **4-6%** corridor in **2022**, paying particular attention to a **non-monetary nature** of growing inflation.

Therefore, the main goal of this package of measures is to stabilize precisely **non-monetary factors** of inflation. According to the Government, effective implementation of the measures will allow to bring down food inflation to **8%** by the end of this year and to **6% next year**. For non-food inflation and service inflation, Government's target for 2022 is **5%** and **4%** respectively. The task is quite difficult but feasible. If the Government copes with it, it will provide necessary conditions to stabilize inflation on the supply side and enter the target corridor of **4-6%** in 2022. This, in turn, can create preconditions for softer monetary policy.

- Taking into account current trends and adopted plans to curb inflation, how have your forecasts changed?

- The most **important update** in August-September forecast round is revision of the **inflation corridor**. Given key factors of inflation, which we talked about earlier, by the end of this year it is expected that inflation in annual terms will be within **7.5-8.5%**.

According to our baseline scenario, inflationary processes will **maintain their current dynamics** until the end of the year, and in 2021 inflation will be **closer to the upper limit** of the forecast range. We have left such a corridor based on the historical dynamics of inflation in the last months of the year. At the same time, if Government's measures within the Anti-Inflation Response Complex are effective, food inflation will drop to 8% by the end of the year, which means that overall inflation will be at the lower border of the corridor - **7.5%**.

As for the **GDP forecast**, currently negative impact of the pandemic on the economy of Kazakhstan is gradually weakening. Improving epidemiological situation and softening of quarantine measures are observed.

As a result, business activity is **rapidly recovering**, both in production of goods and in service sector. Following results of 7 months of this year, GDP growth

made **2.7%**. This corresponds to the forecast dynamics of the updated baseline scenario, where the **oil price** is set at **\$60** per barrel until the end of 2022. Forecast for GDP growth in 2021 has been revised **slightly downward**. In 2021, GDP will grow by **3.5-3.8%**. Along with that, in 2022, GDP growth is expected to accelerate to **4.1-4.4%**.

Main growth drivers in the economy of Kazakhstan are consumer demand and an exports increase. Consumer demand is supported by positive dynamics of real incomes of the population, wages and consumer credit. Increase in exports, in turn, will be ensured by softening of OPEC+ restrictions on oil production and an increase in demand for Kazakhstan's products from trading partner countries. This also affects the improvement of the balance of payments.

Recovery in domestic consumer activity of the population and a moderate increase in investment in main sectors of the economy will be the most significant factors in growth of imports, which will restrain increase in the GDP.

- You have mentioned balance of payments. And how is it developing, what can we expect in the future?

- Data from the country's balance of payments indicate a gradual **improvement in a current account balance** following the **rise in oil prices**. We will see a whole positive effect on the current account only in the second half of the year. This is connected with a delay in reflecting changes in global oil prices on official statistics of international trade in Kazakhstan.

By the end of the current year, the National Bank expects an almost **twofold decrease** in the current account deficit of the balance of payments - to **USD 3.2 billion** with an oil price of USD 60 per barrel by the end of the year. Last year, the deficit was **USD 6.3 billion**.

Meanwhile, improvement in the current account keeps down growth of imports, which grew by 9.2% in the first half of the year to **USD 17.5 billion**. Main contribution is made by imports of consumer goods, which surged by **27.3%** to **USD 5.8 billion**.

While in previous years main drivers were investment and intermediate goods, in the first half of this year it was consumer goods that showed the greatest growth. Consider this, in the first half of the year, **import** of cars alone has almost doubled in comparison with the first half of 2020, reaching **USD 683 million**. Moreover, this indicator has **soared** by **75%** or by **USD 292 million** even in relation to pre-Covid 2019.

All this is an indirect **sign** of realization of **pent-up demand** and economic activity **recovery**. Despite this, we expect a significant improvement in the balance of payments in 2021 and 2022.

- Situation in the global economy remains unstable, which is associated with both the epidemiological situation and geopolitical risks. What are your expectations for further development of events, and how can this affect the economy of Kazakhstan?

- Today **main risks** for our economy are new coronavirus strains and uneven global vaccination. These risks could be reflected in a slower recovery in global demand and, as a consequence, a lower trajectory of oil prices.

Along with that, forecasts of international organizations regarding further development of the global economy remain **positive**, largely due to significant fiscal and monetary incentives of both developed and emerging markets. According to IMF estimates, the global economy will grow by **6%** in 2021 and slow down slightly in 2022 - to **4.9%**. In this scenario, strong global demand through favorable oil prices will support our economy. But at the same time, we need to understand that the positive economic growth is reflected in the **global** acceleration of **inflationary processes**, which represents **another major risk** for our economy.

In this regard, in current realities, given account domestic and global challenges, efforts only within monetary measures are clearly **not enough**. **Well-coordinated** anti-inflationary policy is important. Decisive effect on stabilization of inflation will be exerted not only by instruments of monetary policy but also by **joint measures of the National Bank and the Government**.

Our further actions will depend on **dynamics** of actual and expected inflation and, in fact, will be determined by effectiveness of implementation of Government's anti-inflationary measures aimed at **reducing the influence of non-monetary factors**. The National Bank will monitor inflationary processes on an ongoing basis.