



# Monetary Policy REPORT

SEPTEMBER 2021



NATIONAL BANK OF KAZAKHSTAN

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**Monetary Policy Report** is a quarterly publication of the National Bank, which contains the analysis of key macroeconomic factors affecting inflation as well as the forecast of macroeconomic parameters in the short- and medium-term horizon.

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## PREAMBLE

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At present, recurring COVID-19 outbreaks slowed the business activity worldwide and intensified the problems of global supplies. Thus, there is a deceleration of the Global Manufacturing PMI index, retail turnover and the consumer activity in developed and developing countries. Despite this, according to the IMF forecast, the world economy will grow by **6.0%** in 2021, followed by a slowdown to **4.9%** in 2022. Developed countries will be the main contributors to the global growth, while developing countries will remain exposed to the pressure from slow immunization rate and disruptions of supplies. The forecasts of international organizations regarding the growth of economies in Kazakhstan's trading partner countries have been improved for the EU and Russia, while for China they have been slightly lowered. So, given the outstripping growth of actual dynamics over the previous assessment, the forecasts about the GDP growth for 2021 in the EU and Russia were increased to 4.6% and 4.3%, respectively. At the same time, forecasts regarding the Chinese economy growth in 2021 have been lowered to 8.1%.

Currently, the increased inflationary background is persisting worldwide, where the main reasons include an active recovery of the consumer demand, the global rise in prices for energy resources, raw materials and food, and the effect of a low inflation base in 2020.

In the US, the consumer spending deflator in July 2021 hit a record high for the first time since February 1991, accelerating to 4.2% on an annualized basis. The PPI in China, which is largely taken into account in the decision-making on the monetary policy, after negative dynamics last year rose to 9.0%, reaching its highest value since 2008. The growth of consumer prices in Europe in August this year broke a 10-year record, accelerating to 3.0%, while in December 2020 the same indicator accounted for 0.2%. Inflation in Russia continues to remain at higher levels accounting for 6.5% in July 2021 (4.9% in December 2020). The heightened inflationary background in Russia is accompanied by a slower increase in supply compared to the expansion of demand, an increase in world prices for raw materials (primarily for wheat, steel and oil) and heightened inflationary expectations.

Baltic Dry Index, which characterizes the cost of transporting dry cargo (grain, ore, coal, etc.), has made new highs since 2010 and has grown significantly compared to 2020, indicating that considerable external inflationary pressure may persist in the short term. The world prices for shipping containers have increased, and a high rise in prices for semiconductors is given their shortage. Thus, the crisis in the supply chain because of the negative consequences of COVID-19 is becoming prolonged.

After a decline in June-July of this year, in August the FAO food price index resumed its growth by 3.1% compared to the last month, being driven by higher prices for sugar, meat, vegetable oils and grains. In annual terms, the index went up by 32.9%. From March to August of this year, the annual growth of the index exceeds 25% showing the highest values since 2011.

Given the increasing inflationary processes worldwide, countries move to the cycle of monetary policy tightening and make decisions about an increase of their policy rates.

Since the beginning of August 2021, Brent oil prices have fluctuated in the range of **66-72** US dollars per barrel 2021. It is expected that from 2022, due to the ramp-up in oil production in the United States and OPEC + countries, oil supply will outpace the growth in demand putting pressure on oil prices. Taking into account the current epidemiological situation in the world and forecasts of international organizations, the National Bank did not change the assumptions on the oil price and, within the framework of the baseline scenario, it considers the oil price of USD 60 per barrel until the end of the forecast period.

The economic activity in Kazakhstan demonstrates dynamic growth rates amid recovery in many sectors of the economy. During seven months of 2021, the GDP growth accounted for **2.7%** in annual terms. The positive contribution to the GDP growth is mainly made by the manufacturing industry, trade, construction, information and communication, agriculture and the public sector.

The consumer activity continues to demonstrate active recovery. Thus, household spending on consumption in the first quarter of 2021 increased by 3.7%. The recovery dynamics of consumer demand is accompanied by a high growth in retail turnover – by 7.2% in January-July 2021. Accelerated growth in consumer lending persists – by 24.0% in July this year. Despite acceleration of inflationary processes, the real income of the population has retained its positive dynamics since the beginning of the year. This is promoted by high growth rates of real wages of employees in practically all sectors of the economy, with the exception of the mining industry and accommodation and catering services.

The annual inflation in August 2021 accelerated to **8.7%**, reaching a record high in the last 4.5 years. Acceleration of inflationary processes is accompanied by a negative external inflationary background due to the increased inflation in the trading partner countries of Kazakhstan, a significant rise in prices in the world food markets, the recovery of consumer demand and the persisting imbalance in supply and demand in certain food markets.

Acceleration of price growth is observed among all inflation components. The main contribution to the headline inflation continues to be made by the food component, whose annual growth in August 2021 reached **11.4%**. Acceleration of food inflation is associated with record-high increases in prices for shelf-stable vegetables in the summer months. There is a rise in prices for meat and meat products in the context of growing producer prices, accompanied by an increase in the cost of forage crops. The prices of sunflower oil continued to accelerate, which is a global trend caused by a decrease in supply in the world market because of a poor harvest in 2020-2021.

Non-food inflation accelerated to **7.3%** amid the recovering economic activity and expanding consumer demand, rising prices for imports, increasing production costs. The largest increase was observed among prices of fuels and lubricants, clothing and footwear.

The rise in prices for paid services amounted to **6.6%**. In the structure of service inflation, tariffs for regulated utility services went up against the rising electricity prices. Alongside with that, there is an increase in the cost of air transport services and a number of other non-regulated services, which is due to the recovery in demand and the effect of the low base of 2020.

Inflation forecasts up to the end of 2021 have been revised upward. At the same time, when updating the inflation forecast, the set of anti-inflationary response measures approved by the Government on behalf of the President of the Republic of Kazakhstan was taken into account to stabilize non-monetary inflation factors. The adoption of prompt measures will allow, according to the Government, to reduce food inflation to 8% by the end of this year. Given the historical dynamics of inflation in the last months of the year as well as the degree of effectiveness in implementation the Package of Measures, in 2021 the annual inflation will be in the range of 7.5-8.5%. In case of effective implementation of this Package of Measures in 2021, the annual inflation will be closer to the lower boundary of the forecasting range. Meanwhile, taking into account the inertia of inflationary processes, the recovering consumer demand and the indirect effect of increase in prices for fuel and lubricants and electricity, it is highly likely that inflation will maintain its current dynamics by the end of the year. The prospects of grain harvest this year are also an important factor of inflation.

In 2022, as the high base of 2021 is excluded from the calculation, inflation will begin to decelerate towards the upper limit of the target range. Deceleration of inflation will be taking place against a

softening of the external inflationary background and the expected decline in world food prices after their significant rise during this year. At the same time, the following risks can be pointed out among the main risks for disinflation processes in 2022: a significant pro-inflationary impact of a poor grain harvest in Kazakhstan, a worsening situation in the global supply chains and a stronger fiscal stimulus for the economy in 2022-2023.

The path of the output gap has been revised upward compared to the previous forecasting round. At the same time, already from the third quarter of this year, the output gap will move into the positive zone and will remain in it until the end of the forecast period indicating pro-inflationary pressure from the demand side.

The forecast for the GDP growth until the end of 2021 was revised slightly downward, since the previous forecast exceeded the actual dynamics. In 2021, the growth of Kazakhstan's GDP is expected to be at the **3.5-3.8%**. The main growth driver will be the actively recovering consumer demand, which is supported by the increase in real income of the population. A minor rise in the investment demand is expected, which will be promoted by the implementation of investment projects in the industry and the continued implementation of government programs for stimulation of economic activity. The GDP growth will also be supported by real exports due to the expanding external demand and modest growth in energy production. In turn, an increase in imports as a result of the recovering domestic consumer and investment activity will have a restraining effect on the GDP growth. The economic growth in 2022 is estimated at **4.1-4.4%**, which is slightly higher than the previous estimate. Accelerating economic growth will be accompanied by a weaker impact of the pandemic on the economic activity and by the increased oil and gas condensate production due to the easing of OPEC + restrictions.

Compared to the previous forecasting round, the risk profile has slightly deteriorated, which is an indication of significant risks that inflation path will be rising in comparison with the forecast under the baseline scenario. The worsening situation with the COVID-19 pandemic could lead to falling prices for raw materials and disruptions in the supply of final and intermediate products. Internal risks of increased demand, limited supply and growth in production costs remain high.

On the basis of a detailed analysis of developments in the foreign and domestic economy, consistency of the projected inflation dynamics with the actual data as well as updated forecasts of key macroeconomic indicators in the medium term, on **September 13, 2021**, the Monetary Policy Committee of the National Bank of the Republic of Kazakhstan made the decision to rise the base rate to **9.5% per annum** with the interest rate band of +/- 1.0 pp.



## I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

## I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

### 1.1. Forecast Assumptions

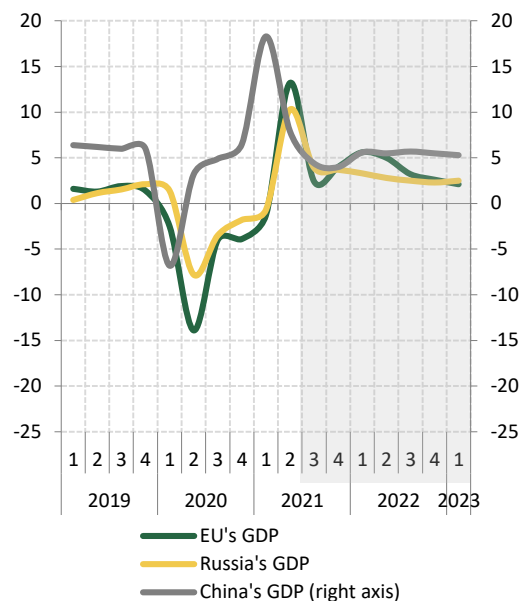
**The global economy continues to recover; however, the risk balance has shifted towards a feeblar growth being associated with the emergence of new COVID-19 strains, an increased inflationary pressure and with a possible faster curtailment of fiscal stimuli in developed countries.**

The development of the global economy during the forecast period is generally assessed in positive terms. However, given unequal immunization, discrepancies in stimulative measures and heightened inflation risks, the development prospects for developed countries look more sustainable than for developing countries. According to the IMF's estimates, in 2021 developed economies will demonstrate a 5.6% growth (in January, the IMF projected a 4.3% growth), and developing countries will advance by 6.3% (the estimate had not changed). In 2022, developed countries are also expected to show a stronger rebound. Thus, in 2021 the global economy will boost by 6.0%, and will slightly slow down to 4.9% in 2022.

The progression of the COVID-19 pandemic will continue to pose the greatest threat for the prospects of global economic recovery. Risks are also seen in the persistence of sluggish economic activity in China for a longer period. Other key risks include possible tightening of global financial conditions coupled with a lengthier inflationary pressure.

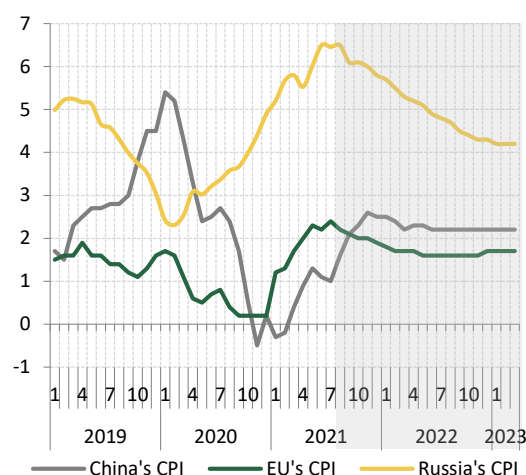
The EU member countries have had a higher than expected economic growth in the second quarter of 2021, which resulted in a significant improvement in projections for the rest of the year and for the next year (Figure 1). It is supposed that the unsatisfied demand, due to the substantial savings of households, will give a significant impetus to development, especially in those industries that have been most affected by restrictions imposed by the pandemic. Imports will not exert significant pressure, as their potential may be limited by a number of external factors (lengthy time of supply chains, travel restrictions). The growth of external demand for exported products will provide an additional support to the economic activity. Considering the current positive dynamics of development, Consensus Ecs. improved the EU forecasts

Figure 1. GDP Growth Rates in China, the EU, Russia in Real Terms\*, YoY, %



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

Figure 2. Inflation in China, the EU, Russia, YoY, %



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

for 2021 from 4.0% (YoY) to 4.6% (YoY) (the previous estimate of May 10, 2021) (Figure 1), and for 2022 – from 4.2% (YoY) to 4.3% (YoY).

In the second quarter of 2021, the Chinese economy had demonstrated a more moderate economic growth given that the last year's low base effect had expired. In the second half of 2021, a further deceleration is anticipated caused by recurring coronavirus outbreaks and also by floods in a number of Chinese provinces. Exports will serve as an additional indicator of a slower economic growth and will be still characterized by the weak dynamics given the recovery of domestic production in many countries due to a gradual lifting of pandemic restrictions. Nonetheless, starting from 2022, the impact of viral outbreaks and floods is expected to decrease. The economic growth in China will gradually accelerate. The volumes of government support via the increased investments into infrastructure projects are expected to grow. Consensus Ecs., taking account of the existing restraining factors, have slightly lowered their forecast for 2021 from 8.7% (YoY) to 8.6% (YoY) (the previous assessment of May 10, 2021) (Figure 1). As for 2022, the assessment remained unchanged at 5.6% (YoY).

Projections for 2021 made by Consensus Ecs. about the Russian economy were increased from 3.6% (YoY) to 4.3% (YoY) (Figure 1); this was nurtured by a more rapid recovery of the economy in the first half of 2021 due to a strong domestic demand, the increased output in the industry as well as high investment activity. According to expectations, starting from the third quarter of 2021 and up to the end of the forecast period, a positive effect of the above factors will weaken. For this reason, as well as due to the anticipation of some decline in world oil prices, growth rates of the Russian economy will stabilize during the forecast period. In this connection, forecasts for 2022 appeared to be slightly lower – 2.7% (YoY) (the previous assessment – 2.9%, YoY).

**According to the IMF's assessments, the existing high inflation in developed countries is of a temporary nature and inflation will come back to the pre-pandemic levels by 2022. As for developing countries, the forecast turned out to be more negative. As a result of anticipated persisting pressure on the part of the food price growth and depreciation of national currencies, the IMF expects that inflation will remain heightened in developing countries.**

Inflation forecasts of Consensus Ecs. for 2021-2022 regarding inflation in the EU countries are slightly increased. According to expectations, a further improvement of the economic activity, somewhat higher energy prices as well as a heightened consumer demand coupled with a more limited supply will lead to intensification of the price pressure. Nonetheless, these factors are supposed to have a short-term effect, therefore inflation is not expected to go beyond the set target (Figure 2).

As for China, inflation forecasts remain virtually unchanged. As before, inflation is expected to accelerate by the end of 2021 given the last year's low base (Figure 2). However, a projected rise in prices will be limited by a more moderate growth in prices of meat and fuel.

Regarding Russia, there is an expectation that by the end of 2021, given that the existing temporal factors expire and owing to the policy pursued by the Central Bank of Russia, inflation will be also decelerating. By the end of the forecast period, inflation is expected to come back to the 4.0-4.5% range.

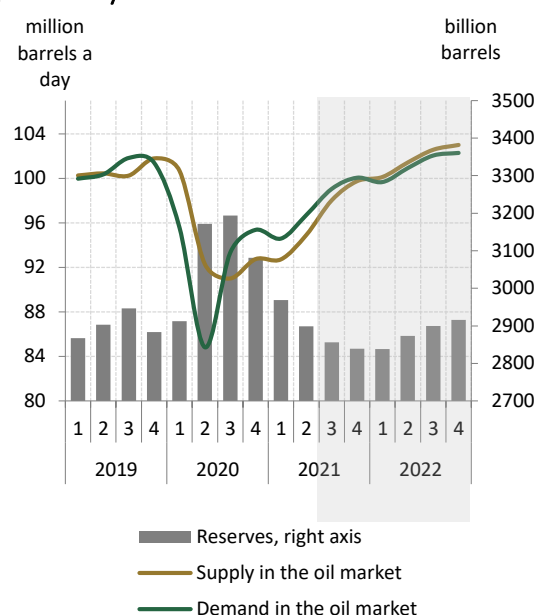
**The IMF sees additional risks for developing countries also in a possible tightening of external financial conditions due to the upcoming normalization of monetary policy of central banks worldwide, especially in the US.**

**Development prospects of the global oil market have not undergone significant changes.** Starting from 2022, due to the anticipated ramp-up of oil production in the US and in OPEC+ countries, the supply of oil will start to overrun the growth in the demand. As a result, an oil surplus will be gradually building up in the market putting pressure on quotes for oil prices (Figure 3).

Forecasts of international organizations regarding the world demand for oil for 2021-2022 will generally remain unchanged.

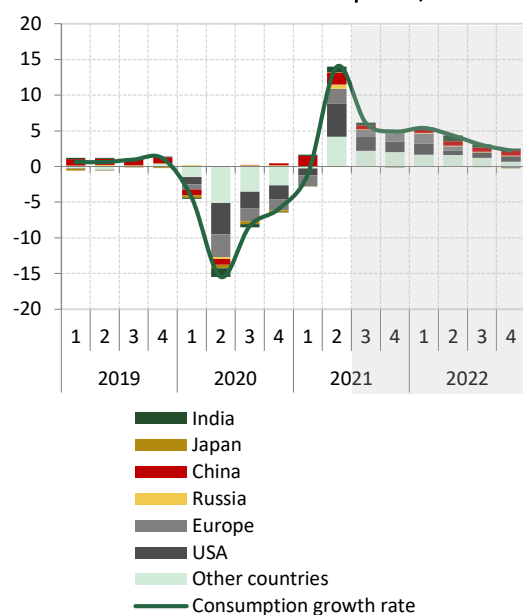
According to expectations, the increased forecasts about the economic growth of a number of countries will not exert an upward effect on oil consumption since the projected recovery is expected in the sectors that do not use oil. At the same time, recurring coronavirus outbreaks and associated restrictive measures, especially for Asian countries, could reduce mobility and, therefore, oil consumption.

Figure 3. Dynamics of the Global Oil Market



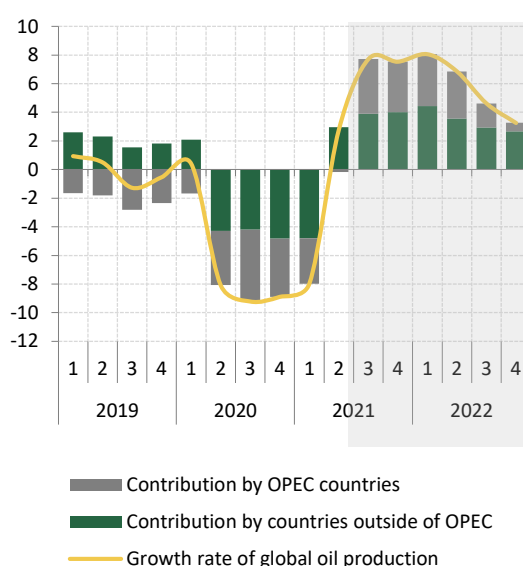
Source: EIA

Figure 4. Global Oil Consumption, YoY



Source: EIA

Figure 5. Global Oil Production, YoY, %



Source: EIA

According to estimates of international organizations, in 2021 the oil consumption will be 96-98 million barrels a day on average, which exceeds consumption in 2020 by 5.3-6.0 million barrels a day (Figure 4). In 2022 versus 2021, oil consumption will grow by 3.0-3.6 million barrels a day and will go up to 100-101 million barrels a day on average.

In turn, global oil production, starting from the third quarter of 2021, will begin growing at a (Figure 5). This will be promoted by the increased oil production by OPEC+ countries within the framework of updated agreement on a gradual buildup of oil production as well as by a more rapid growth of oil production in the US as compared to earlier forecasts.

The spread of the Delta strain of coronavirus has not significantly shifted the risk balance towards deterioration. Nonetheless, the coronavirus factor is considered as a major risk for a further development of the global oil market. Other key risks are being associated with a more rapid cancellation of restrictions to oil production by OPEC+ countries as well as with larger volumes of oil production in the US and other countries outside of OPEC.

Taking account of the existing epidemiological situation in the world and forecasts of international organizations, in designing macroeconomic forecasts for the period from the third quarter of 2021 to the first quarter of 2023, the National Bank considers **3 scenario-based versions of the economic development: baseline, pessimistic and optimistic.**

Under the **baseline scenario**, Brent oil price is assumed to be 60 US dollars per barrel throughout the forecast period.

Under the **optimistic scenario**, Brent oil price is assumed to be 70 US dollars per barrel throughout the forecast period.

Under the **pessimistic scenario**, Brent oil price is assumed to be 50 US dollars per barrel throughout the forecast period.

## 1.2. Dynamics of the Economic Development under the Baseline Scenario

**The NBK's expectations about the dynamics of short-term GDP growth until the end of 2021 have been revised slightly downward. At the same time, forecast assumptions have not undergone significant changes and the revision was related to slower current rates of economic growth compared to those expected. In this regard, in 2021 the upturn of economic activity in Kazakhstan according to the baseline scenario assuming the Brent oil price at 60 US dollars per barrel until the end of the year, will account for 3.5-3.8%.**

Further realization of the post-pandemic household demand is expected, which will become one of the main drivers of GDP growth this year. The increase in household consumption will be supported by a moderate increase in the real income of the population. The growth of revenues is associated with a high rise in real wages in the economy due to the growing budget spending on wages in the public sector, as well as the recovering wage growth in the real sector due to the revival of business activity and income of enterprises. Consumer lending will make an additional contribution to the increase in household consumption.

The growth rates of government consumption will be moderate due to the continuing escalation in expenditures for labor compensation to the general government and some increase in current expenditures for goods and services.

A slight increase in gross capital formation is expected, which will be facilitated by the implementation of investment projects in the manufacturing industry and the preservation of funding from the government for such programs as "Economy of Simple Things", "Employment Roadmap", SPIID, etc. An additional contribution to the growth of investment activity will be made by the mining industry due to the planned construction of a gas processing plant at Kashagan.

In addition to consumer demand, real exports will act as a driver of the GDP growth in the second half of 2021. It is expected that exports will enter the growth zone in the second quarter of 2021, which will be largely due to the effect of the low statistical base in the same period of the last year when real exports fell by almost 40%. From the third quarter of 2021, the increase in exports will be driven by the expected recovery in the growth rate of oil and gas condensate production in Kazakhstan due to the easing of OPEC + restrictions on daily oil production. An additional factor for the growth of exports will be the expansion of external demand due to recovery of the EU economy with an active upturn of the industrial sector.

The expansion of imports will restrain the GDP growth because of recovery of the domestic consumer activity of the population and a moderate increase in investments in the main sectors of the economy.

Medium-term forecasts regarding the GDP growth have been revised slightly upward due to the continuing fiscal stimulus to the economy in 2022.

In 2022, the GDP growth rates will accelerate to 4.1%-4.4%. Positive dynamics of the economic activity will be nurtured both by the improved situation with the spread of COVID-19 and a weaker impact of the unstable epidemiological environment on the business activity because of a gradual adaptation of economic agents to new conditions of doing business. Besides, arrangements for a gradual easing of OPEC+ restrictions and a planned completion of agreement between oil producing countries will lead to the increased oil and gas output compared to 2021. This will cause acceleration of the growth rate of exports and investments. In 2022, the positive dynamics of consumer demand will continue given the expected growth in real income of the population, wages and consumer lending. At the same time, in 2022, higher growth rates of government consumption are expected compared to previous estimates. The output gap path has been revised upward compared to the previous forecasting round.

From the third quarter of this year, the output gap will enter the positive zone and will stay there until the end of the forecast period.

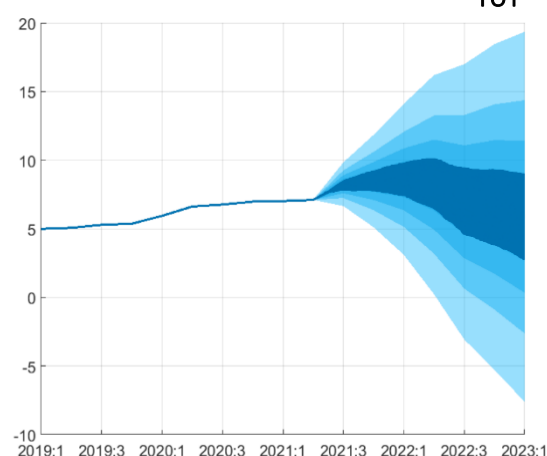
**Short-term inflation forecasts have been revised upward (Figure 6). At the same time, the Package of Anti-Inflation Response Measures approved by the Government upon instruction of the President of Kazakhstan in order to stabilize non-monetary inflation factors was taken into account in updating the inflation forecast. Efficient measures will allow, according to the Government's estimate, to bring down the food inflation to 8% by the end of this year. Based on the historical inflation dynamics over the last months of the year as well as the degree of effectiveness in implementing the Package of Measures, in 2021 the annual inflation will be within 7.5-8.5%. With the effective implementation of this Package of Measures, in 2021 the annual inflation will be closer to the lower boundary of the forecasting range. Meanwhile, taking into account the inertia of inflationary processes, the recovering consumer demand and the indirect effect of the increase in prices for fuel and lubricants and electricity, it is highly likely that inflation will maintain its current dynamics by the end of the year. The prospects of grain harvest this year are also an important factor for inflation.**

The pro-inflationary pressure on goods and services in the consumer basket will be exerted by high inflation expectations as well as by an indirect effect from the rise in prices for fuel and lubricants and electricity through an increase in the cost of goods and services.

The current dynamics of food inflation is expected to continue, which will largely be due to the persistence of inflationary processes and the presence of some imbalances in certain food markets. In addition, this year there are risks of reduction in the yield of grain crops in Kazakhstan, which thus will put an additional upward pressure not only on prices for milling products but also on prices of other foodstuffs, in particular for meat products due to an increase in forage prices. Besides, there are still risks of a significant increase in external and domestic prices in certain commodity markets.

The buildup of inflationary processes in the food markets will be associated with the recovery of purchasing activity of the population and the expectations of an increase in import prices.

Figure 6. Inflation, Quarterly Average, %, YoY



Source: NBK's forecasts

Pro-inflationary pressure on the part of demand will be associated with higher wages, including due to an increase in the minimum wage, high rates of consumer lending and withdrawal of pension savings.

In the short-term horizon, a moderate rise in prices for paid services is expected, which will be conditioned by persistence of the current pricing in the market of regulated utility services. At the same time, there are risks of further growth in electricity tariffs against the expected rise in prices of coal. Along with that, the expected rise in prices for non-regulated services will be constrained by retention of moderate quarantine restrictions.

**In 2022, the annual inflation forecasts are also revised upward compared to previous estimates due to a higher short-term forecast, stronger fiscal stimulus, intensification of the external inflationary background and higher dynamics of world food prices. Despite this, given that the high base of 2021 will expire in 2022, inflation will decelerate to the upper boundary of the target band of 4-6%.**

Inflation will be slowing down against the easing of external inflationary background. It is assumed that inflation in China and the EU will not reach its target levels and inflation in Russia will slow down but at the same time will be building slightly above the target level. However, the disinflationary impact of a slowdown in inflationary dynamics in trading partner countries will be less pronounced compared to previous assessments.

In the medium-term horizon, a gradual decline in world food prices is expected after their growth in the short term. Forecasts for the FAO Cereal Index are revised upward compared to the previous forecasting round. This is due to the deterioration in prospects for wheat harvest in the USA, Canada and Russia as a result of unfavorable weather conditions. However, in the medium term, in the context of gradual normalization of situation with the harvest and the mitigation of problems with disruptions of supplies, a slight decline in world cereal prices is expected. At the same time, the presence of output gap in the positive zone amid the recovering domestic and foreign economic activity will be curbing the disinflationary impact of the world food prices in the medium term (Figure 6).

### 1.3. Alternative Forecast Scenarios

**Due to the presence of risks associated with the development prospects of the global economy and the corresponding dynamics of demand for raw materials, in addition to the baseline scenario the National Bank considered alternative scenarios of oil prices.**

**As the pessimistic scenario, the National Bank considered the scenario, where oil prices fall to 50 US dollars per barrel in 2021 and will remain at this level until the end of the forecast horizon.**

This scenario could be realized if the global epidemiological situation deteriorates due to the emergence of new COVID-19 strains, the world economy's growth is feeble and serious imbalances in the oil market appear.

If the pessimistic scenario is realized, the less positive dynamics of external demand from Kazakhstan's main partner countries (the EU, China, Russia) will somewhat restrain the path of the export recovery. A weaker growth in income of enterprises in the mining sector as compared to the baseline scenario will cause a decline in production and investment, which will have a negative impact on the construction, transport, trade and other services industries, and then on the economy as a whole. Weaker dynamics of real money income of the population (due to a smaller increase in the business activity and higher inflation) will somewhat limit the growth of consumer demand. As a result, recovery of Kazakhstan's economy in 2021-2022 will be more moderate as compared to

the baseline scenario. **In 2021, due to the low base of 2020, the economic growth will account for 3.1%-3.4%, and in 2022 – 3.7%-4.0%.**

During the forecast period, inflation will continue to remain above the target range. Because of the more depressed economy, the pressure from the demand side will be more disinflationary. Nonetheless, the higher dynamics of inflationary processes compared to the baseline scenario will be caused by a weaker real exchange rate of the tenge, a possible disruption in the supply of import products and a corresponding increase in inflation expectations.

If the **optimistic scenario** is realized, the path of oil prices is assumed to be at **70 US dollars per barrel over the forecast horizon**. Such price path, despite the planned increase in oil production by OPEC+, will be due to the confident recovery of the global economy given the lifting of epidemiological restrictions. High oil prices and strong external demand from trading partner countries will lead to higher growth rates of Kazakhstan's economy than under the baseline scenario. **The GDP growth will account for 3.7%-4.0% in 2021 and 4.4%-4.7% in 2022.**

If the optimistic scenario is realized, inflation will slow down at a faster pace than under the baseline scenario. This will be ensured by the stronger dynamics of the tenge exchange rate and lower external inflationary pressure, mainly due to a faster deceleration of inflation in Russia. During the forecast horizon, inflation will be building around the upper boundary of the target band.

#### 1.4. Risks in the Medium Term

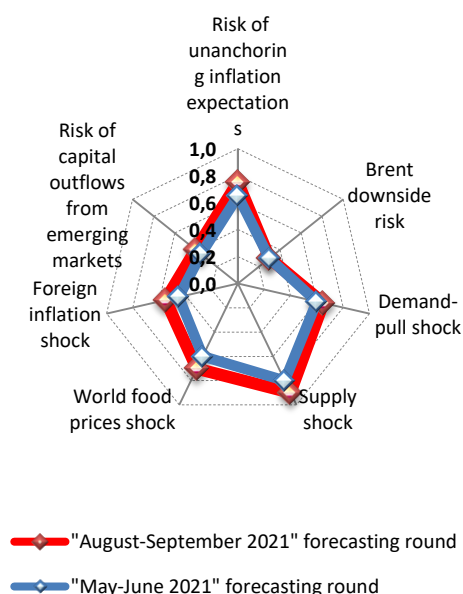
**As compared to the previous forecasting round, the risk profile somewhat deteriorated, which is evidenced by the fact that risks of inflation deviation from the baseline scenario are very likely to be realized. Deterioration of the situation with the COVID-19 pandemic could lead to the fall in prices for raw materials and disruptions in supplies of final and interim goods. Internal risks of heightened demand, a limited supply and the growing cost of production remain high. The impact of these factors can cause a significant acceleration of inflation in Kazakhstan (Figure 7).**

Recovery of the global economy and validity of the OPEC+ agreement on reduction of oil production precondition that Brent oil prices to stay within the range of 60-70 US dollars per barrel. Hence, the risk of oil prices dropping below 40 dollars remains low. However, this risk may be realized in case if the number of individuals infected with COVID-19 increases against the emergence of new strains and reduction of the global demand as well as a larger supply of oil by the OPEC+ member countries and the USA.

The risk of importing external inflation from the countries – Kazakhstan's trading partners slightly increased. The continuing acceleration of inflation in Russia as the main supplier of imported goods may lead to higher prices in Kazakhstan. Nonetheless, in the medium term, as inflation in Russia returns to its target, this risk looks less pronounced than in the short term. In addition, despite the growing inflationary pressure, inflation in the EU and China is expected to remain below the target.

The risk of importing high external food inflation remains significant and it slightly increased because of a strong rise in world prices for a wide range of foodstuffs (wheat, meat, vegetable oils). Logistic problems in the context of the pandemic, a heightened demand due to the desire of many countries to ensure food safety as well as a potential reduction in the volume of crops can cause imbalances in food markets and subsequently lead to an excessive rise in food prices in Kazakhstan.

Figure 7. Risk Map Based on the Expert Judgment



Source: NBK's calculations

The risk of capital outflow from emerging markets in favor of developed countries has increased. Insufficient rates of immunization of the population against COVID-19 in developing countries compared to developed countries may cause an increase in the incidence and low growth rates of the economies of these countries. Apart from that, a dramatic tightening of monetary policies in developed countries due to a strong economic recovery and increased inflationary pressure may result in high uncertainty in financial markets. These factors can lead to depreciation of the currencies in developing countries, including Kazakhstan.

Among internal factors, the risk of inflationary pressure on the demand side increased against the growing real income of the population, a confident recovery in consumer lending and the announced increase of the minimum wage. Due to a possible poor harvest of wheat in Kazakhstan and the increased production costs, enhanced restriction quarantine measures in Kazakhstan and abroad, the risk of acceleration of inflation on the part of supply factors has heightened.

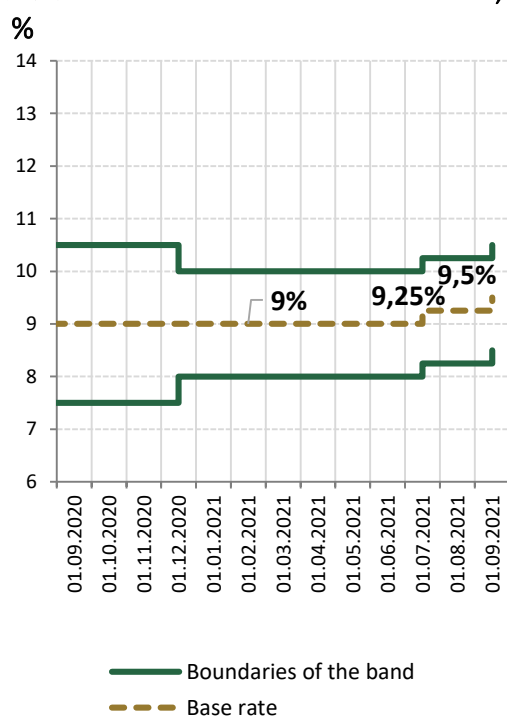
Moreover, the risk of unanchoring inflation expectations is being already realized and will persist in the medium term in the environment of high food inflation and a surge in prices of non-food goods and services.

## II. MONETARY POLICY



## II. MONETARY POLICY

Figure 8. Base Rate Band in 2020-2021, %



Source: NBK

### 2.1. Decisions on the Base Rate

From June 2021, the National Bank made three decisions on the base rate (Figure 8).

**The decision about retention of the base rate from June 8, 2021 was predicated by** the persisting external inflationary pressure as a result of growth in world food prices and acceleration of inflation in countries – Kazakhstan’s main trading partners. The gradual recovery of the business activity and consumer demand has become the major factor of the domestic economy.

In June and July 2021, after some deceleration in the prior months, the annual inflation accelerated to 7.9% and 8.4% respectively.

Therefore, **from July 27, 2021, the base rate was increased to 9.25%.** The realized supply shocks and a steady pro-inflation pressure in the economy from the demand side had been the main factors. Inflation was building up above the forecasts and expectations about the price growth remained high and unanchored.

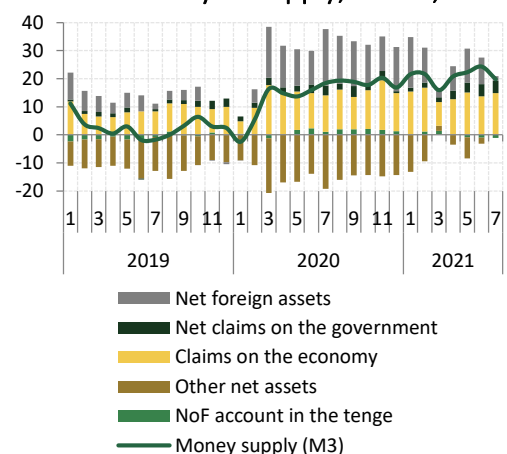
**On September 13, 2021, a decision was made to increase the base rate to 9.5%.** The decision is due to the prevailing pro-inflationary pressure in the economy caused by the global inflationary tendencies of rising prices for food and raw materials, with the leading recovery in global demand over output capabilities.

A prudent tightening of monetary conditions is aimed at preventing risks of a further price growth and the comeback of inflation to the established target band of 4–6% in 2022.

### 2.2. Money Supply

**The growth rate of the money supply remains high due to the increased lending to the economy (Figure 9).** The rates of expansion in the reserve money keep slowing down given the last year’s high base. The money multiplier remains at a stable level.

Figure 9. Money Supply, YoY, %



Source: NBK

The annual growth rates of money supply in the economy are building up at the levels comparable with the last year's performance (Figure 10). At the same time, from the beginning of this year, the money supply growth is persistently high accounting for 13.3% versus 10.5% in the same period of the previous year.

The growth of claims on the economy is primarily nurturing the increase in the money supply, namely, lending to the population due to the growing consumer activity as well as claims on non-bank financial organizations, which is associated with anti-crisis programs aimed at supporting the business activity.

The next important factor is the rise in claims on the Government on the part of the banking sector because of government securities purchases by banks. Since the last year, the NBK, jointly with the Ministry of Finance, has been actively working on increasing the government securities offering in the medium-term segment in order to build an adequate yield curve.

The contribution by gold and foreign exchange reserves decreased in July of this year primarily due to revaluation of gold given the decline in its price. The same period of the previous year was characterized by high prices for gold because of doubts among investors about the prospects of the global economic recovery after the crisis caused by the coronavirus pandemic.

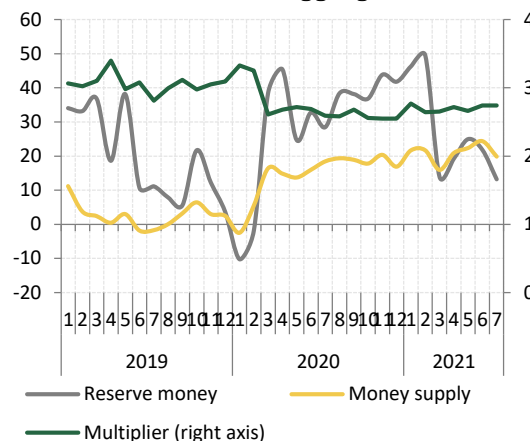
The reserve money slowed down its growth rates in annual terms in July of this year in connection with the last year's high base, which was characterized by a high level of gold and foreign exchange reserves due to a record-high rise in gold prices (Figure 10).

The money multiplier (the ratio of the money supply and the reserve money) since March 2020 has been staying at 2.6 – 2.7, which decreased because of a larger expansion in the reserve money compared to the growth in the money supply (Figure 10).

### 2.3. Money Market

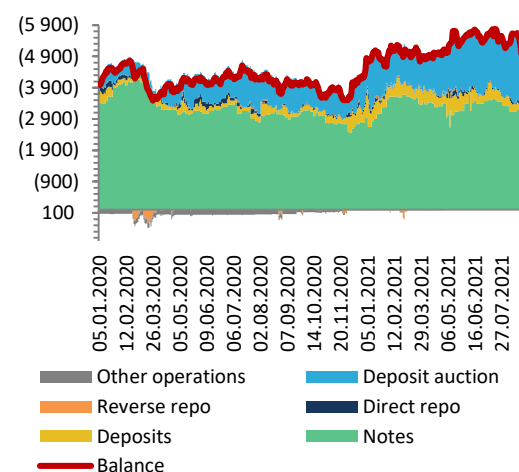
**Due to the persisting liquidity surplus, money market rates keep building mainly between the base rate and the lower boundary of the target band. Along with that, the exposure on the NBK's operations has been decreasing since the second half of August (Figure 11).**

Figure 10. Growth of Monetary Aggregates, YoY, %



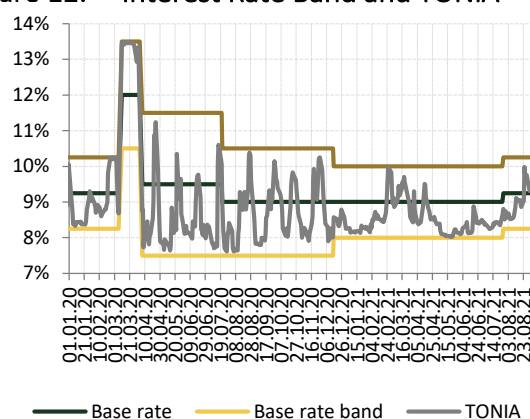
Source: NBK

Figure 11. Exposure on the National Bank's Operations, billion tenge



Source: NBK, KASE

Figure 12. Interest Rate Band and TONIA



Source: NBK, KASE

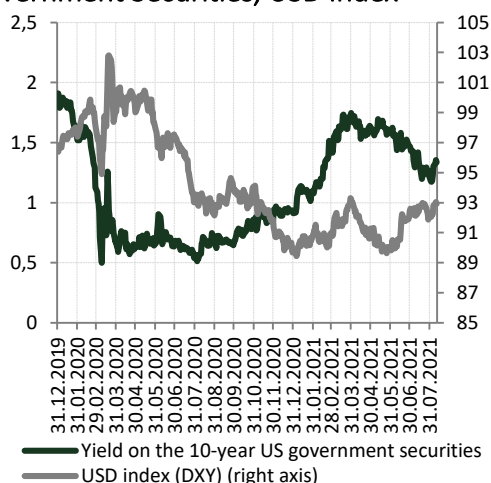
The money market continues to function in the environment of liquidity surplus. At the same time, liquidity withdrawal volumes have been decreasing from May of this year as at the end of this August. In general, the balance on the NBK's operations was fluctuating at about 5.5 trillion tenge.

The NBK's operations helped keeping the money market rates within the base rate band. The bulk of liquidity is withdrawn by the open market operations (about 90-95%), namely via short-term notes, deposits and deposit auctions (Figure 12).

Given the demand for the tenge liquidity by the end of this August, the NBK was conducting operations to provide liquidity via reverse repo operations. The increase in demand for liquidity led to the growth of the TONIA interest rate in the money market closer to the upper boundary. In view of the fact that interest rates in June-August were staying primarily between the base rate and the lower boundary of the target band, the spread between TONIA and the base rate has widened to (-) 0.5 pp while during February-May of this year it was (-) 0.3 pp. The spread volatility also decreased in June-August to 0.3 compared to 0.6 in February-May of this year (Figure 12).

## 2.4. Foreign Exchange Market

Figure 13. Yield on the 10-year US Government Securities, USD Index

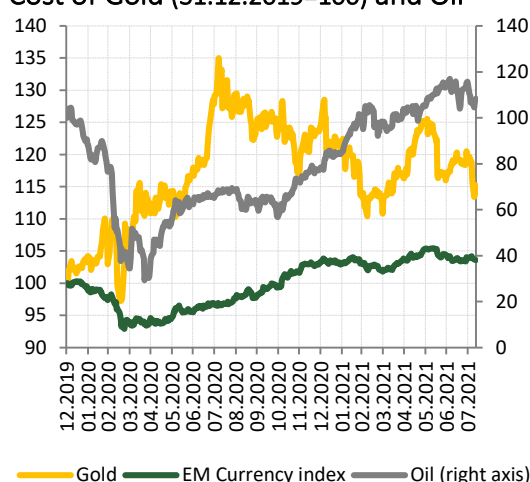


Source: Refinitiv

**The exchange rate of the tenge continues to be formed under the impact of divergent external and internal factors. The increasing attractiveness of defensive assets, coupled with expectations of the imminent curtailment of the asset buyback program, led to appreciation of the US dollar. Volatility is growing in the oil market with a slowdown in the growth of quotations after a long upward path. At the same time, given the ongoing recovery of Kazakhstan's business activity in the domestic market, the demand of market participants for foreign currency increased.**

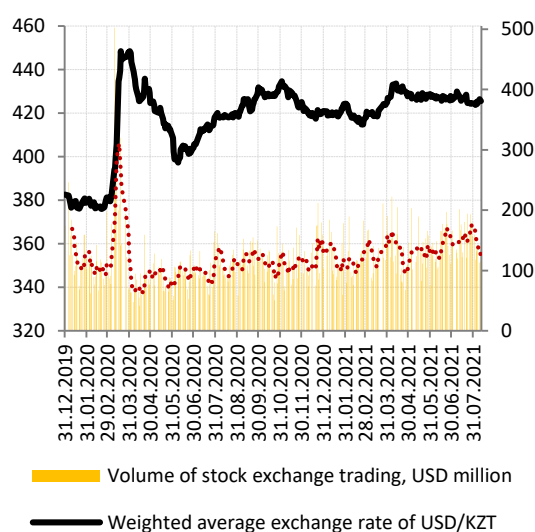
In connection with a massive spread of the delta strain of coronavirus in certain regions of Asia, Latin America and Europe, the investor demand for risky assets decreased, which negatively affected the dynamics of currencies of emerging markets (Figure 14). Another important external factor is the rhetoric of the US Federal Reserve and market expectations regarding the timing of tightening of monetary conditions. As a result of the increased risk and, accordingly, the inflow of foreign capital into the US securities, the US dollar appreciated against most world currencies (Figure 13).

Figure 14. Dynamics of the Emerging Market Currency Index, and of the Cost of Gold (31.12.2019=100) and Oil



Source: Refinitiv

Figure 15. Dynamics of the Exchange Rate of the Tenge and the Trading Volume



Source: KASE, NBK

As a consequence, the downward path of the cost of gold, an alternative defensive asset, continued in the reviewed period (Figure 14).

The commodity market was volatile. Oil quotes were under the pressure of concerns about a further reduction of the demand for energy resources due to the deteriorated epidemiological situation in the world. The optimism in the oil market in June-July of this year was primarily supported by the information about the reduced reserves of oil in the US. However, already in August of this year, the reduction in oil imports by China in the environment of decelerating business activity was reported. In June-August of this year, oil prices were building up within the range of 65-77 US dollars per barrel (Figure 14).

Despite volatility in foreign markets, assets in the tenge were attractive for portfolio investors. Investments in Kazakhstan's government securities by foreign investors this July went up to 822 billion tenge, which is an indication of a persisting interest in the tenge assets on the part of non-residents.

Among internal conditions for pricing of the tenge, there was a high demand for foreign exchange caused by the growing business activity in Kazakhstan, recovering income of the population and sizable growth in imports of consumer goods.

A heightened demand for foreign exchange at the stock exchange was largely satisfied by operations on conversion of the National Fund's assets as part of transfer allocations to the national budget and sales of export proceeds by companies of the quasi-government sector.

Being influenced by external and internal factors, the exchange rate of the tenge during June-August 2021 was moving within the range of 423.76-429.96 tenge, having appreciated over the period by 0.8% from 428.71 to 425.42 tenge per US dollar (Figure 15). The average daily volume of stock exchange trading in June-August amounted to 142 million US dollars (in January-May of this year – 126 million US dollars, in June-August 2020 – 101 million US dollars).

In the reviewed period, the National Bank did not conduct interventions.

## 2.5. Stock Market

The trading volume of government securities in the primary market is growing due to the continuing issuance of government securities of the Ministry of Finance with maturity from one year to three years associated with the budget deficit financing of Kazakhstan.

A risk-free yield curve at the end of this August demonstrated growth on a short-term section due to the increasing yields of the NBK's notes while yields on a medium- and long-term section are decreasing given the reduction in demand for government securities of the Ministry of Finance on the part of market participants.

Performance index on corporate bonds went down by 42 pp compared to that at end-April this year and made up 10.18% per annum.

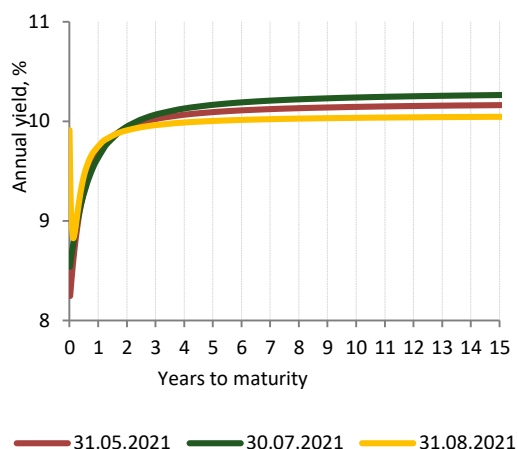
In June-August of this year, the Ministry of Finance borrowed 531.8 billion tenge in the primary market, which is by 9.4% greater than in March-May of this year (492 billion tenge).

The Ministry of Finance continued to issue its short-term government securities (with maturity from one year to 3 years) and the yield from 9.6% to 10.1% per annum. Mainly, medium-term government securities with the yield from 9.9% to 10.6% per annum and long-term government securities with the yield from 10.6% to 10.8% per annum were issued. Local executive authorities in June-August borrowed government securities in the primary market worth 59.44 billion tenge, which is by 53% greater than in March-April (38.84 billion tenge).

A risk-free yield curve by end-August this year decreased on the medium- and long-term sections. In the short-term segment of the yield curve, a surge was driven by the growth of interest rates on overnight repo at the end of August 2021 due to the tax week, which affected the placements of short-term securities (Figure 16).

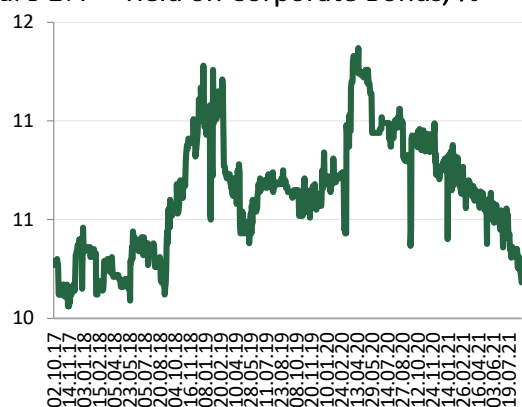
The volume of trading in the corporate bond market in June-August of this year amounted to 330.66 billion tenge, which is by 11.7% greater than in March-mae 2021 (296.1 billion tenge) (by 1.9 less than in the same period of the previous year). The quasi-government sector, Kazakhstan Sustainability Fund and banks retain their leading positions in terms of placement volumes. The tendency to issue medium- and long-term obligations is persisting among issuers.

Figure 16. Change in the Risk-Free Yield Curve, %



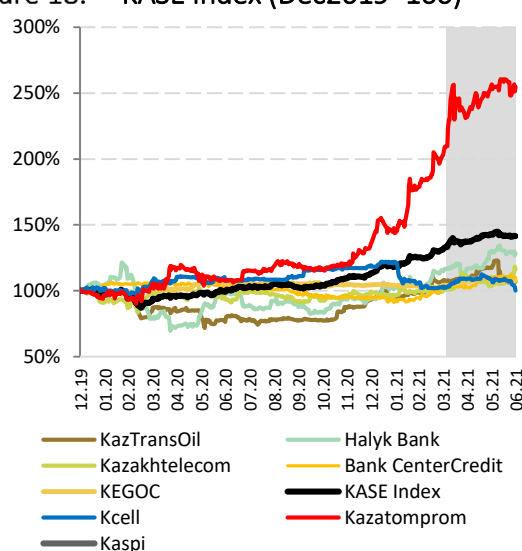
Source: NBK

Figure 17. Yield on Corporate Bonds, %



Source: KASE

Figure 18. KASE Index (Dec2019=100)



Source: KASE

Interest rates on placed bonds were varying between 9.8-13.5%, with the exception of some bonds where the yield differed from the average market numbers significantly (Figure 16).

The performance index on corporate bonds decreased by 42 pp and made up 10.18% per annum (Figure 17).

The KASE Index continued its upward trend at the beginning of the reviewed period, having reached the historical maximum on June 7, 2021 – 3 421.27 points (Figure 18). In the structure of KASE Index in the reporting quarter, the energy sector was the main growth driver. “Kazatomprom” showed the major upturn, due to the growing uranium futures. However, from the second half of this June, the index started to go down, which was mainly associated with the post-dividend period.

During the period from June to August of this year, the volume of trades in the equity market amounted to 41.8 billion tenge and increased by 69.4% compared to March-May of this year (a decline to 45.7% compared to the same period of the previous year). Interest in the equity market on the part of retail investors continued to grow.

### Box 1. Investments in Kazakhstan’s Government Securities Market by Foreign Investors

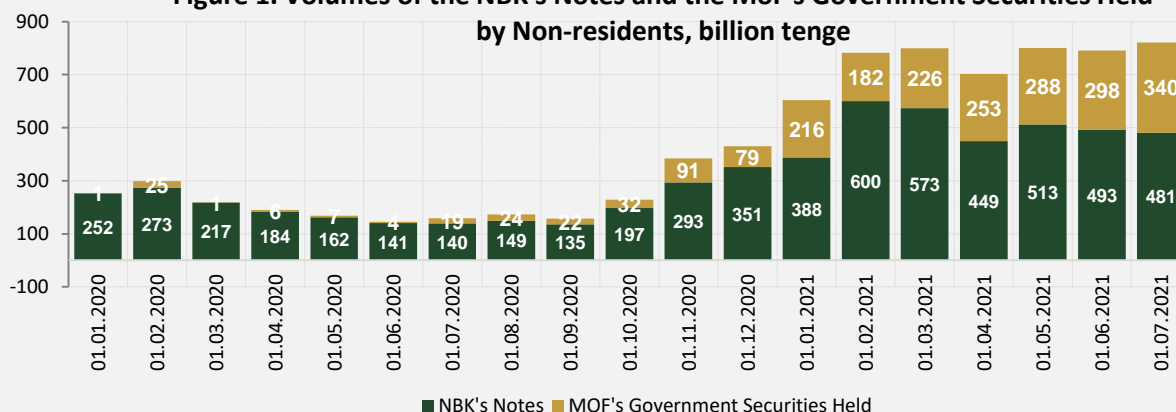
One of conditions of the developed government debt market is the presence of a wide range of investors.

The NBK, jointly with the Government, in parallel with building the risk-free yield curve, makes an effort to attract foreign portfolio investments into the country’s sovereign debt. The increase in the demand, as a rule, allows reducing the cost of borrowing, promotes the liquidity growth in the secondary market and helps develop the financial market infrastructure.

One of the results of this effort is the volume of portfolio investments by non-residents into the NBK’s notes and MoF’s government securities, which at present is at the historical maximum and amounts to 822 billion tenge as at the beginning of August 2021 (Figure 1).

The MoF’s short-term bonds are the most attractive for foreign investors – one fifth of their investments is in bonds with maturity of 360 days and the remaining maturity of five months. Further, other maturities include: 13% - bonds with remaining maturity of 20 months, 10% – 9 months, 9% – 33 months and 8% – 5.5 years.

**Figure 1. Volumes of the NBK's Notes and the MoF's Government Securities Held by Non-residents, billion tenge**



Source: NBK; NBK's notes; MoF's government securities

Liquidity in the secondary government debt market also increased. So, the total volume of trades in the secondary market of KASE in 2020 increased by 2.4 times over the year to 916.8 billion tenge. Moreover, the percentage of trades in MoF's government securities went up to 49.4% from 4.9% in 2019. In terms of major categories of investors in the secondary market, participation of non-residents in 2020 accounted for 9.7% versus 0.1% a year before.

The results achieved were preceded by a consistent set of joint actions by the NBK and MoF. Thus, with a view to revive the securities market, in 2016 the NBK initiated the construction of a risk-free yield curve of government securities.

The revitalization of NBK's activity in issuing short-term notes allowed the construction of a short-term segment of the yield curve, which had a positive impact on the formation of market expectations up to one year and led to stabilization of interest rates and an increase in non-residents' interest in instruments with a maturity of less than one year. The NBK also carried out work on the construction of medium-term and long-term segments of the yield curve by purchasing/selling government securities in the secondary market.

As part of the joint coordinated effort between the NBK and the MoF, from January 2017 a regular placement of government securities issues was resumed. As a result of this work, yields along the entire curve decreased.

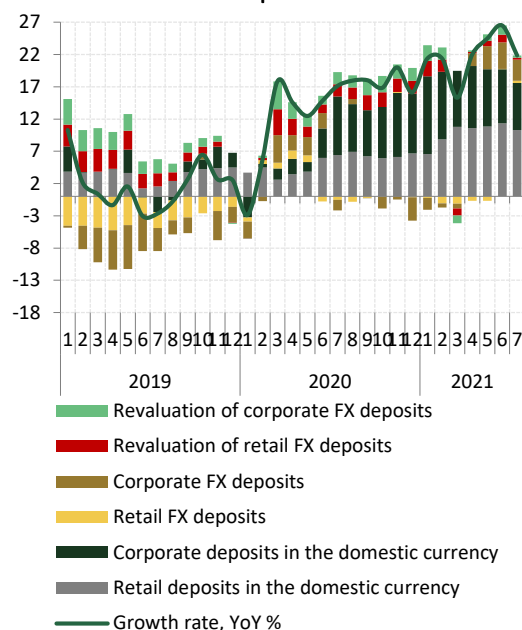
To continue development of the government securities market, in July 2018 the NBK successfully implemented the project on inclusion of Kazakhstan's government securities into the list of securities settled in the Clearstream international settlement system, which implied a significant simplification of access for international investors to the stock market of Kazakhstan.

At that time, with implementation of the project with Clearstream, no instantaneous growth of exposure of international investors occurred, since the project launching coincided in time with the overall trend of capital outflow from developing countries amid the tightening of monetary policy in the US that did not allow ensuring an inflow of portfolio investments on the part of non-residents.

True fruits of the effort made were collected from the fourth quarter of 2020, when the volume of the MoF's securities holding by non-residents started to gradually increase. This was facilitated by the fine-tuning of the international settlement line between the "Central Securities Depository" JSC and the Clearstream International Central Securities Depository up to the Delivery versus Payment type and exclusion of the NBK's one-year notes issue.

The Delivery versus Payment Standard reduces the risks for counterparties and corresponds to best international practice, thus supporting the interest from foreign investors. In addition, judging by the structure of non-residents' investments, due to exclusion of the NBK's one-year notes issue with a concurrent offering of the MoF's short-term bonds, an outflow of investments in favor of the MoF's short-term government securities took place.

Figure 19. Contribution by Components to the Growth in Deposit Volume



Source: NBK

## 2.6. Deposit Market

Deposits in the banking system keep growing. The main contribution to the growth was made by corporate foreign currency deposits and the tenge deposits, including due to withdrawals of retirement savings by the population that increase current accounts at the second-tier banks.

Overall deposit dollarization at end-July of this year decreased compared to the beginning of 2021 as a result of a significant reduction in the share of retail foreign currency deposits. Deposit dollarization of the retail sector reached the minimum during the last 13 years. Dollarization of corporate deposits slightly increased.

In September 2021, cap rates of the “Kazakhstan Deposit Insurance Fund” JSC on short-term retail deposits were raised following the increase in the base rate this July.

The deposit portfolio went up by 21.8% in annual terms. Retail and corporate deposits in the tenge as well as corporate foreign currency deposits continue to make the largest contribution to the growth of total deposits (Figure 19).

The portfolio of deposits in the tenge increased by one third or by 29.1% in annual terms. The largest contribution (about a half of the growth in total deposits in the tenge) was made by time deposits of the retail sector, which have gone up by 36.5% (by 1.7 trillion tenge) over the year.

An earlier withdrawal of retirement savings by the people keeps exerting influence on the growth in the tenge deposits of the population, which is reflected on accounts at the second-tier banks. During the period from January to July 2021, the growth of retail deposit portfolio in the tenge at banks amounted to 748 billion tenge, which exceeds the same indicator of the last year by more than three times. According to the UAPF (as at 22.08.2021), 1 730 billion tenge were transferred to accounts of banks participating in the program for improving housing conditions, of which the largest amount of 1 679 billion tenge (97% of the total amount transferred to the applicants' accounts) was credited to accounts at Otbassy Bank.

An important contribution to the buildup of the total deposit portfolio was made by the increase in foreign currency deposits (by 10.8% in annual terms) that occurred owing to the corporate sector (85% of the overall growth), exceeding the expansion in retail foreign currency

deposits by more than five times. Corporate foreign currency deposits increased owing to time and transferrable deposits in equal measure.

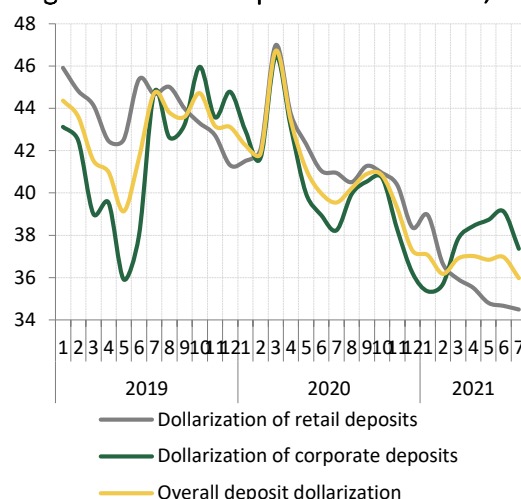
The overall level of dollarization decreased from 37.3% in December 2020 to 36.0% in July 2021 (Figure 19). At the same time, the divergent dynamics of change in the deposit dollarization was observed from February 2021. If the share of foreign currency deposits in the corporate segment was increasing, it was decreasing in the retail segment. Despite a decline in the dollarization of corporate deposits in July of this year, since the beginning of the year it grew by 1.1 pp to 38.4% (Figure 20). The dollarization of retail deposits decreased by 3.9 pp since the beginning of the year and accounted for 34.5% (the minimum level since October 2008).

The major portion in corporate sector deposits is represented by deposits with maturity less than one month accounting for 85.6% of all corporate time deposits (in July 2021). Interest rates on these types of deposits have stabilized at 7.2%-7.3% throughout this year. Interest rates on other types of corporate deposits were decreasing during the year. Corporate deposits with maturity from 3 months to one year (with a share of 10.6% of time deposits) slightly decreased from 7.5% in December 2020 to 7.4% in July 2021. Interest rates on long-term deposits with maturity of 1-5 years (with a share of 2% of time deposits) decreased most of all – from 8.6% in December 2020 to 7.9% in July 2021 (Figure 21).

In the retail sector where longer deposits prevail compared to the corporate sector (a share of deposits with maturity from 3 months to one year is 43.5%, and from one year to 5 years – 45.5% in July of this year), interest rates also decreased given a significant growth in the retail deposit portfolio in the tenge. Rates on deposits from 3 months to 1 year went down from 9.7% in December 2020 to 8.6% in July 2021, and on deposits with maturity from 1 to 5 years – from 9.7% to 8.8%. Short-term deposits with maturity less than one month (with the share of 5.1%) decreased from 7.7% to 7.4% (Figure 22).

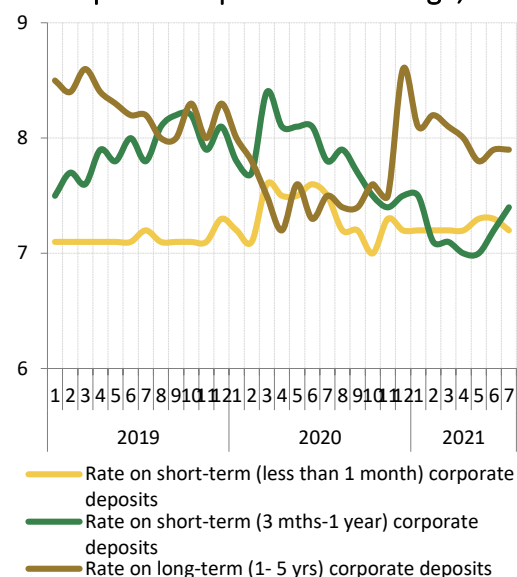
Due to the fact that the NBK increased the base rate, in July 2021 the “Kazakhstan Deposit Insurance Fund” JSC announced that in September 2021 interest rates will be increased, therefore interest rates on short-term deposits of the population are expected to be increased in the third quarter of 2021.

Figure 20. Deposit Dollarization, %



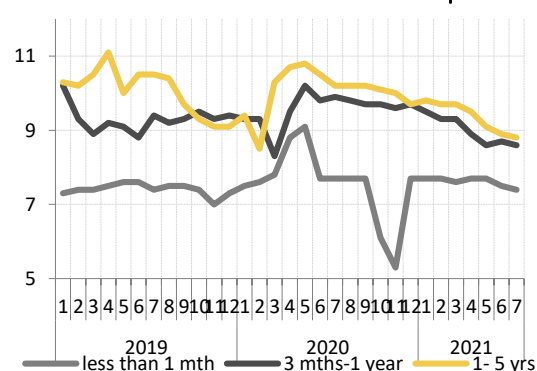
Source: NBK

Figure 21. Interest Rates on Corporate Deposits in the Tenge, %



Source: NBK

Figure 22. Interest Rates on Retail Deposits



Source: NBK

## Box 2. Marginal Propensity to Save in Kazakhstan

In the thirties of the 20<sup>th</sup> century, English economist John Maynard Keynes proposed his own model of equilibrium in the economy. Since he proceeded from the priority of aggregate demand (AD), his theory was called the theory of effective demand.

The Keynesian theory operates with such indicators as the functions of consumption, savings and investments. By saving (S), the economic science understands the part of income that is not consumed and forms the basis for investments.

The propensity to save is understood as one of the psychological factors that means a person's desire to save. Marginal propensity to save – MPS – is a portion of any increase in income that goes to savings:

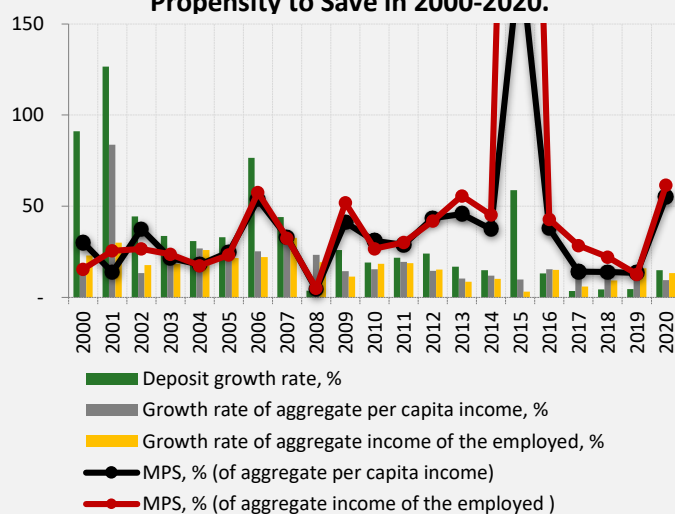
$$MPS = \frac{\text{Change in Savings}}{\text{Change in Income}}$$

In 1946, a prominent Western economist S. Kuznets, following a study of the dynamics of the US economy for the period of 1869-1938, recorded the fact of the relative stability of the savings to income ratio, from which he concluded that, throughout a long time interval, the savings rate is relatively constant over time.

In order to calculate the level of the marginal propensity to save among individuals in Kazakhstan, calculations were carried out using the statistical data on income and time deposits of the population as an indicator of personal savings of households according to the above formula for the period from 2000 to 2020.

To obtain the value of the total personal income, two options were tested: the first was to multiply the average per capita nominal money income per the population, and in the second option, the average monthly wage was multiplied by twelve months and by the numbers of the employed population, respectively.

**Figure 1. Dynamics of the Growth Rates of Retail Time Deposits, Average per Capita Income, Annual Income of the Employed Population and Marginal Propensity to Save in 2000-2020.**



*\*In 2015, the MPS was above 150% because of the exchange rate revaluation of FX savings*

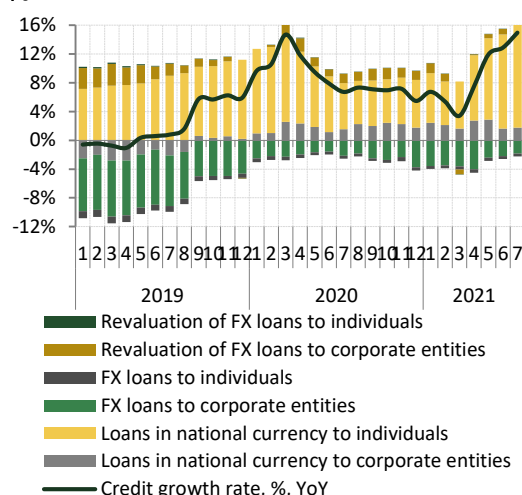
Source: NBK, NBK's calculations

The data obtained gives an average level of the marginal propensity to save for 20 years, equal to 37.4%. At the same time, in the periods of 2008, 2015 and 2020, there were significant deviations associated with economic recessions accompanied by depreciation of the exchange rate. If outliers of 2008, 2015 and 2020 are excluded, then the average level of the marginal propensity to save will be 30%.

Thus, generally the people tend to save about one third of their income in case if their personal income is growing. Taking into account that the marginal propensity to save coupled with the marginal propensity to consume gives one, we can assume that the population is prone to consume the remaining two thirds, or, more precisely, 70% of the personal income.

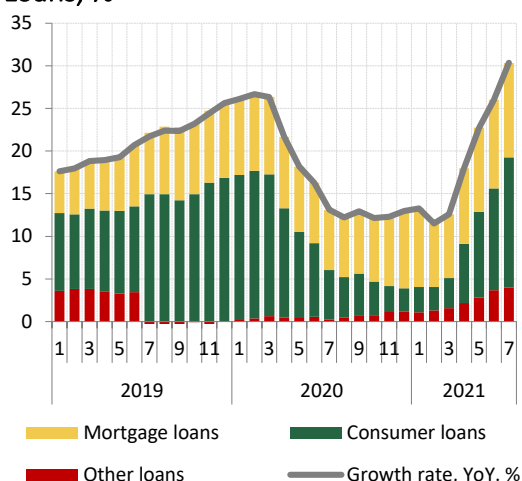
All over the economy, based on the data on gross disposable income and gross formation, the result turns out to be similar making up 30.1% for the period of 2001-2019.

Figure 23. Credits to the Economy, YoY, %



Source: NBK

Figure 24. Contribution by Components to the Annual Growth of Retail Sector Loans, %



Source: NBK

## 2.7. Credit Market

**Credits to the economy continue to grow, having reached record-high numbers over the recent 5 years. Retail sector lending is the main growth driver for portfolio of the second-tier banks. Consumer loans made a major contribution to the increase in credits to the population. The cost of loans continues to go down.**

The loan portfolio of the second-tier banks in July of this year grew in annual terms by 15.0% or 2.1 trillion tenge, totaling 16.0 trillion tenge.

The main factor for the loan portfolio growth is the lending to the retail sector in the tenge. Loans to the corporate sector in the national currency also retained a positive contribution to the growth in bank loans (Figure 23).

The ramp-up of consumer loans remains as the driver for the retail loan portfolio. Loans provided to the population for consumer purposes have gone up due to the recovering income and the growing household consumption. Marketing campaigns and reduction of interest rates from some second-tier banks also nurtured the growth in demand. Mortgage loans increased in annual terms by 38.4% in July of this year owing to the implemented housing and mortgage lending programs on the part of the government (Figure 24).

The cost of consumer loans decreased to 19.9% from 20.5% in July of the last year. The weighted average interest rate on loans provided to the people for home construction and purchase keeps setting below the base rate.

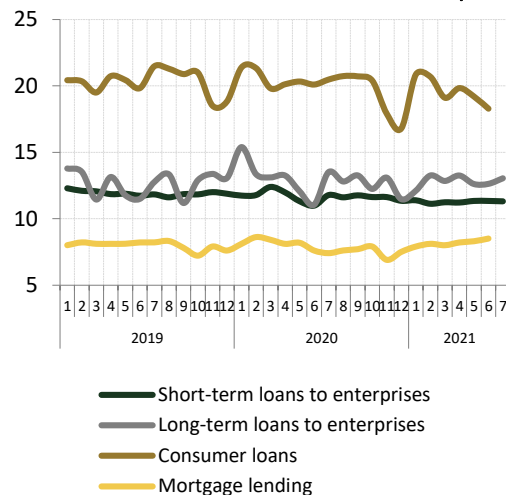
From the beginning of this year, the volume of loans provided to the real sector entities has increased by 18.1% or 914.0 billion tenge compared to the same period of the previous year. However, in view of comparable volume of repaid loans, since the beginning of this year the portfolio growth has been much lower and made up 0.8% only. A positive contribution was made by such sectors as the industry, agriculture, and communication.

Loans to small business entities went up by 12.8% to 2.8 trillion tenge.

According to the bank survey on lending, the demand for loans from the small and medium-sized business is growing. The launch of online offering of loan products at a number of banks led to a significant increase in the demand on the part of small businesses. The willingness of banks to provide loans to the small and medium-sized business somewhat increased, which shows the growing percentage of approved loan applications from the large and medium-sized business.

The weighted average interest rate on the tenge loans to businesses in the short-term segment in July of this year decreased by 0.5 pp to 11.3% from 11.8% in July 2020. The cost of long-term loans reduced by 0.5% to 13.1% (Figure 25).

Figure 25. Rates on Loans in the National Currency, %



Source: NBK



### III. MACROECONOMIC CONDITIONS

### III. MACROECONOMIC CONDITIONS

#### 3.1. External Sector

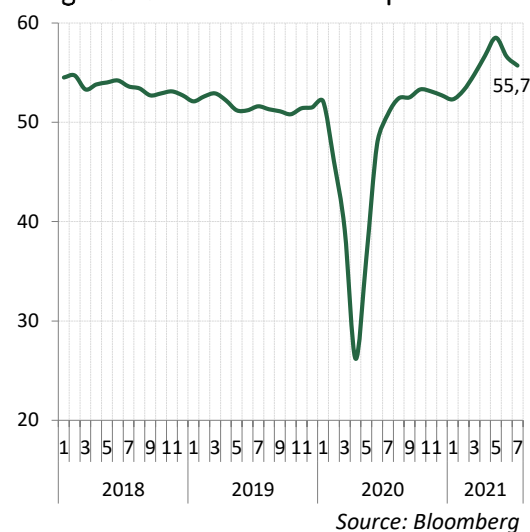
**The economic activity in the world continues to be characterized by feeble dynamics (Figure 25).** The second consecutive month, the growth of Global Manufacturing PMI has been slowing down (in July 2021, 55.4 points versus 52.0 points in May 2021). The major restraining effect is being exerted by Asian countries (Japan, Thailand, Malaysia, and Indonesia). Alongside with that, there is a risk of the economic slowdown in China where for the first time since April 2020 (the period of strict lockdown) the reduction in demand was observed (the Manufacturing PMI went down to 50.3 points in July from 51.3 in June 2021). The demand is decreasing, first of all, due to high prices of products as well as because of recurring COVID-19 incidences and floods.

**Given a heightened consumer demand as well as due to the persisting problems with global supply chains, prices for raw materials and final products are at historical maximums.** At end-June 2021, producer prices in the EU countries have gone up by 10.3% (YoY) for the first time since July 2008 (10.8%). Among large European countries, a surge in prices is observed in Spain – by 15.4% (YoY), in Italy – by 11.0% (YoY), in Germany – by 7.6% (YoY). In the US, the rise in producer prices due to the price growth in the car industry and freight industry reached 7.1% (YoY) (January 2021 – 1.7% (YoY)).

**The current worldwide trend of growth in prices for goods coupled with the excess coronavirus incidence exerts a restraining effect on the consumer demand,** which is accompanied by more sluggish volumes of retail trade. In June 2021, the growth rates of retail trade decelerated in the EU countries from 8.9% (YoY) in May 2021 to 5.3% (YoY), in the US – from 28.1% (YoY) to 18.0%. In China, the consumer activity slowed down to 12.1% (YoY) from 30% (YoY) at the beginning of the year.

**In turn, the adjustment in the global oil market is going on. Prices of Brent oil are fluctuating between 66-72 US dollars per barrel (Figure 27).** The major pressure on oil prices is still being exerted by the COVID-19 pandemic, which compromised the recovery of the global economy and the demand for oil.

Figure 26. Global Composite PMI



\* – an index value of more than 50 means an increase in the indicator, less than 50 means a decrease, and equal to 50 means its invariance

Figure 27. Price of Brent Oil, US dollars (monthly average)

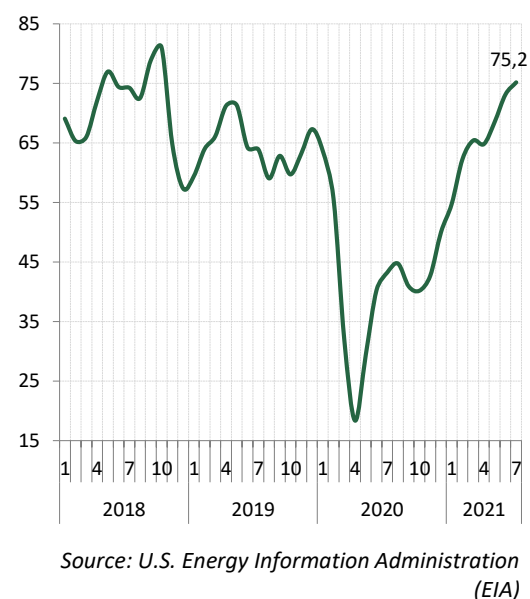
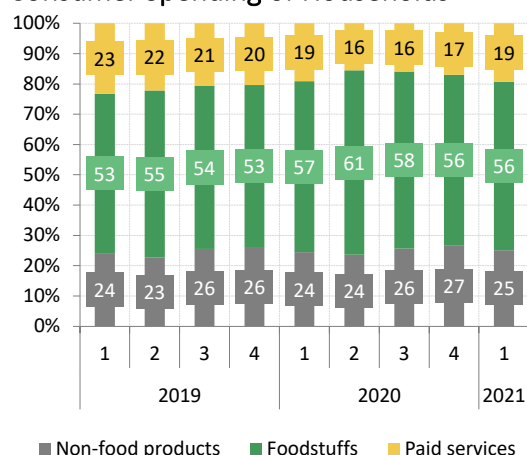
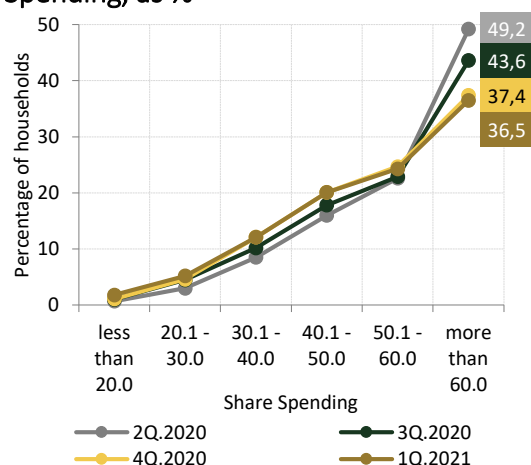


Figure 28. Structure of Nominal Consumer Spending of Households



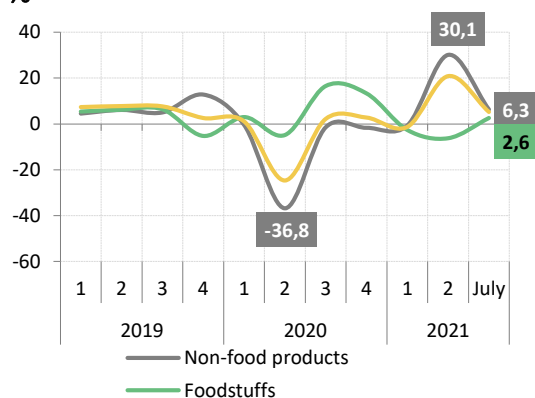
Source: BNS ASPR

Figure 29. Percentage of Household Spending on Food in the Consumer Spending, as %



Source: BNS ASPR, Percentage of spending

Figure 30. Dynamics of Retail Sales, YoY, %



Source: BNS ASPR, NBK's calculations

### 3.2 Development of the Domestic Economy

The household consumption in the first quarter of 2021 continued to recover. The annual growth in household spending on consumption accounted for 3.7%. The current dynamics of indirect indicators of household consumption in the second quarter of 2021 is also indicative of the continuing active recovery of consumption.

In the first quarter of 2021, after a significant shift in the periods of strict quarantine restrictions, the pre-pandemic structure of household consumption has completely recovered. In the total spending on consumption, the share of nominal expenditures of the population increased and the share of expenditures for foodstuffs decreased (Figure 28). This trend is also traced in the reduction of the number of households that used to allocate the largest portion of their consumer expenditures to buying foodstuffs (Figure 29).

The recovery trend in the consumer sector is accompanied by the positive dynamics of retail sales. In July, foodstuffs turnover entered the growth zone for the first time since the end of 2020 (Figure 30). The expansion of the foodstuffs turnover is supported by accelerated growth rates of the domestic production of foodstuffs (the growth of 18.6%, YoY, during July) and by food imports (in the second quarter the growth accounted for 17.7%, YoY).

The turnover of non-food products in July 2021, after a significant ramp-up in the second quarter of 2021 due to the low base of 2020, decelerated (Figure 30). At the same time, the current growth rates are in accordance with the growth dynamics of the turnover of non-food products before the pandemic (a 7.1% growth in 2019). The positive dynamics is supported by high growth rates of consumer loans, which showed a 3.1 times increase in the second quarter in annual terms, and by the accelerating rates of non-food imports (a 34.6% growth in nominal terms).

Since the beginning of the year, the following products became the best-selling products with a maximum growth in the volumes of sales: knitwear and hosiery (2.9 time growth), clothes (by 87%),

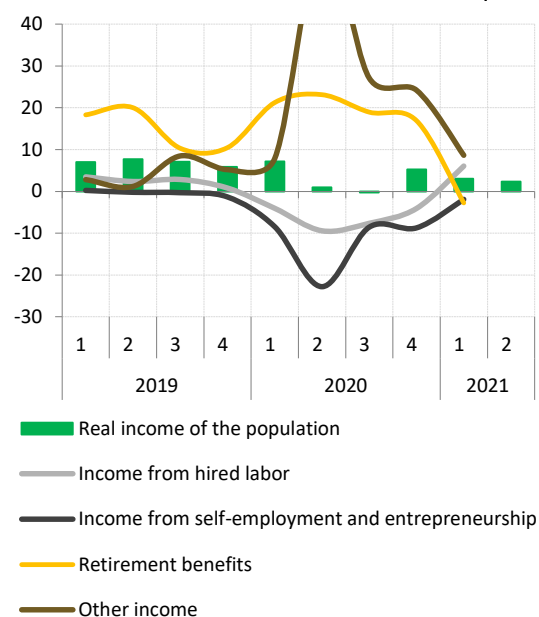
cars and their accessories (70.4%), electric and household appliances (by 53.7%), motor fuel (by 33.5%), meat and meat products (by 82.3%) and beverages (by 87%). The growth rates of prices for the above products go above the upper boundary of the target band. A sizable growth in the turnover of non-food products and some foodstuffs as well as a high rise in prices of these products is indicative of a pro-inflationary nature of the domestic demand in the economy.

The growth in consumption of the population is supported by the positive dynamics of people's income in Kazakhstan. In the first quarter of 2021, real average per capita income of the population increased by 2.2% (Figure 31). In their structure, income from hired labor and other income demonstrate growth. Real income from retirement benefits was decreasing in the environment of high inflation. Real income from self-employment, after its significant decline in 2020, demonstrates an upward trend and is gradually recovering amid the reviving business activity in the real sector and the increasing income of enterprises from realization of their products.

In the second quarter of 2021, despite further acceleration of inflationary processes in the economy, real average per capita income of the population retained moderate growth rates (Figure 31). This was ensured by high growth rates of real wages of employees (a 10.4% growth). Real wages were raised virtually in all sectors of the economy except the mining industry and accommodation and catering services.

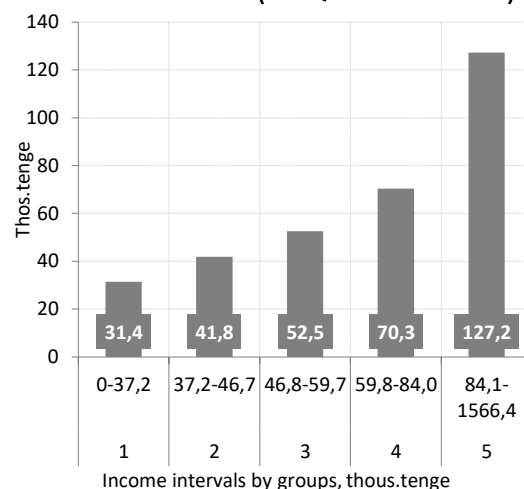
Alongside with that, there is still a notable differentiation in income of the population in Kazakhstan (Figure 32). 20% of population in Kazakhstan that belong to the least financially secured group, in the first quarter of 2021 had less than 37.2 thous.tenge a month on average per capita. The second 20%-group had earnings within the interval of 37.2-46.7 thous.tenge. The last 20%- group of the most financially secured population was characterized by the maximum spread between the largest and the lowest earnings in the group. Thus, in the first quarter of 2021, the income gap amounted to 1.48 million tenge. At the same time, the average income in the group is only 127 thous.tenge.

Figure 31. Dynamics of Real Income of the Population and its Components, YoY, %



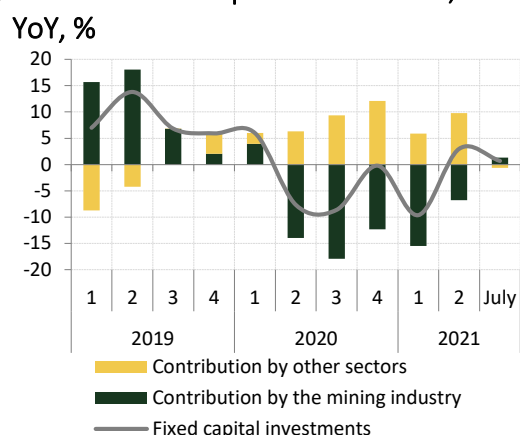
Source: BNS ASPR, NBK's calculations

Figure 32. Average Monthly Income per Capita in the Distribution of Earnings by 20%-Groups of Population (1<sup>st</sup> Quarter of 2021)



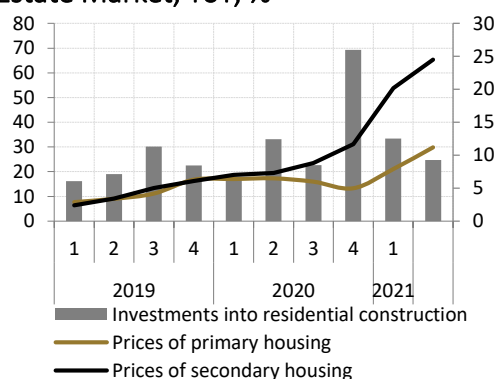
Source: BNS ASPR

Figure 33. Fixed Capital Investments,



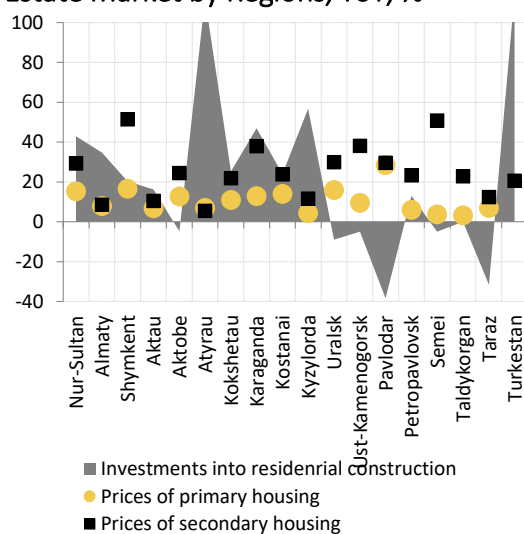
Source: BNS ASPR

Figure 34. Investments into Residential Construction and Prices in the Real Estate Market, YoY, %



Source: BNS ASPR

Figure 35. Investments into Residential Construction and Prices in the Real Estate Market by Regions, YoY, %



Source: BNS ASPR

In the first quarter of 2021, in the environment of reviving economic activity, Kazakhstani enterprises have gradually adapted to new realities, improvement in their financial condition and growing revenues from realization of production have begun to show.

This situation had a favorable effect on the investment activity in the economy. In the second quarter, fixed capital investments moved to the growth zone for the first time since the end of 2019 (Figure 33). In terms of the technological structure, construction works continued to grow and investments into machinery, equipment, transport vehicles and their major overhaul demonstrated recovery.

In July, the growth in fixed capital investments slowed down to 0.7%, however, the recovery of investments into the mining industry has outlined for the first time since the first quarter of 2020 (Figure 34).

As compared to the beginning of the year, from the second quarter of 2021, investments in the manufacturing industry, real estate operations and transport that have been the drivers for economic activity started to slow down. On the contrary, acceleration of investments is seen in the construction sector (the 2.3 times growth during 7 months of 2021), professional and scientific and technical activity (by 18%), other types of services (by 2.7 times).

In the second quarter, growth rates of investments into residential construction remained significant, despite some deceleration (Figure 34). High investment activity of the population serves one of the reasons for the continuing price growth in the real estate market. At the same time, prices are rising faster in the secondary sector, which is an evidence of a high demand component in pricing (Figure 34). In the second quarter, prices in the secondary and primary real estate market went up by 24.5% and 11.2%, respectively. However, the growth of investments in residential construction is not observed in all regions of Kazakhstan, thus, there is a decline in West Kazakhstan, East Kazakhstan, Aktope, Zhambyl and Pavlodar regions (Figure 35). Nonetheless, no price slowdown both in the primary and the secondary real estate markets in the above regions is observed. The rise of prices in the secondary real estate market exceeds 50% in some regions (Figure 35).

According to preliminary data from the BNS ASPR, in January-June 2021 the foreign trade turnover amounted to 45.3 billion US dollars and increased by 4% compared to January-June 2020, where exports grew by 2.7% (27 billion US dollars), and imports – by 5.9% (18.3 billion US dollars).

Despite expansion of total exports, exports of oil in their structure decreased in value terms by 10.8% (YoY) (Figure 36). On a country-by-country basis, there is a decline of exports in value terms: to India – by 52.2% (YoY), to Italy – by 13%, to Switzerland – by 42.9% and to China – by 39.5% (Figure 37).

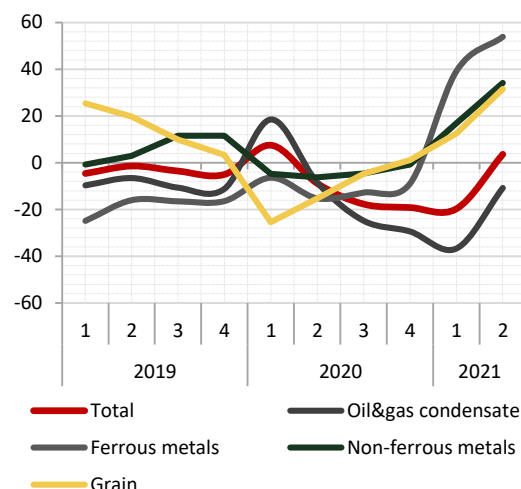
Given that in the first half of 2021 oil production decreased by 5.7% (YoY), oil exports in kind went down by 11.4% (YoY), including to India – by 51.4%, to Italy – by 13.8%, to China – by 47.3%, to Switzerland – by 45.7%. In the meantime, exports of oil to Spain increased sharply by 64.6% and to Singapore – by 20 times.

In the structure of exports of non-ferrous metals in value terms, in January-June 2021 there was an increase in exports of copper by 39.6% (YoY), aluminum – by 33.8%, silver – by 65%, zinc – by 7.8%, whereas exports of lead declined by 10%. In kind, exports of copper went down by 10.5% (YoY) due to a 16.6% reduction in supplies to China, of lead – by 40.8%, including to Vietnam – by 51.6%. Alongside with that, there is a 15.4% (YoY) increase in exports of aluminum, particularly, to Turkey – by 98.6%.

In the group of ferrous metals and their products, exports of flat-rolled products doubled in value terms (YoY), exports of ferrous ores and concentrates increased by 2.1 times and exports of ferro-alloys – by 27.7%. In kind, exports of flat-rolled products went up by 16.1%, of ferrous ores and concentrates – by 20.3%, due to the growth in supplies to Russia by 48.8% and 22.8%, respectively. Thus, the ramp-up of metals exports is largely explained by the rise in their prices.

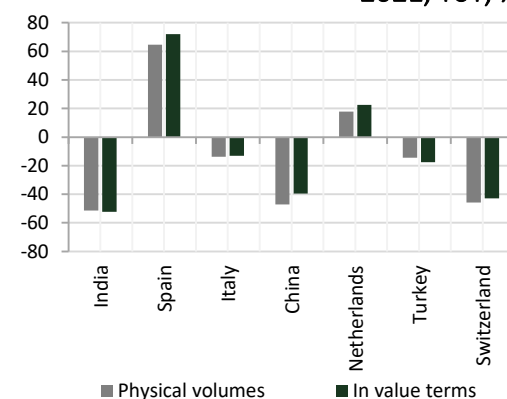
Given a gradual recovery of the consumer demand and the business activity in the first half of 2021 imports advanced by 5.9%, including from China – by 31.3% (YoY) and from the EAEU countries – by 18.8%, including from Russia – by 19.2%.

Figure 36. Exports by Major Commodity Groups, Cumulative, YoY, %



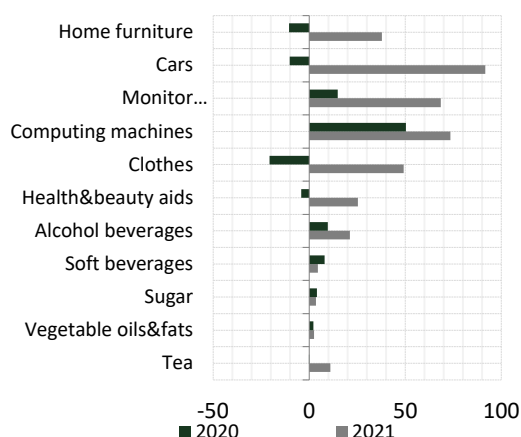
Source: NBK

Figure 37. Oil Exports on a Country-by-Country Basis in January-June 2021, YoY, %



Source: BNS ASPR

Figure 38. Imports of Some Consumer Goods in January-June 2021, YoY, %



Source: BNS ASPR

The expansion in imports of foodstuffs at end-January-June 2021 was driven by the increased imports of vegetable oils and fats – by 14.2%, sugar – by 26.8%, soft beverages – by 60.7% and alcohol beverages – by 21.2%. The rise in imports of non-food products is related to the increased imports of health and beauty aids – by 25.4%, clothes – by 49.2%, cars – by 91.6% and home furniture – by 37.9% (Figure 38). It is also worth noting a dramatic increase in imports of iron rods, motor vehicles for cargo transportation, and agricultural equipment. On the other hand, imports of taps, valves and shutters, refrigerating equipment and freezers reduced significantly.

### Box 3. Balances of Payments of the EAEU Countries in the Time of Pandemic

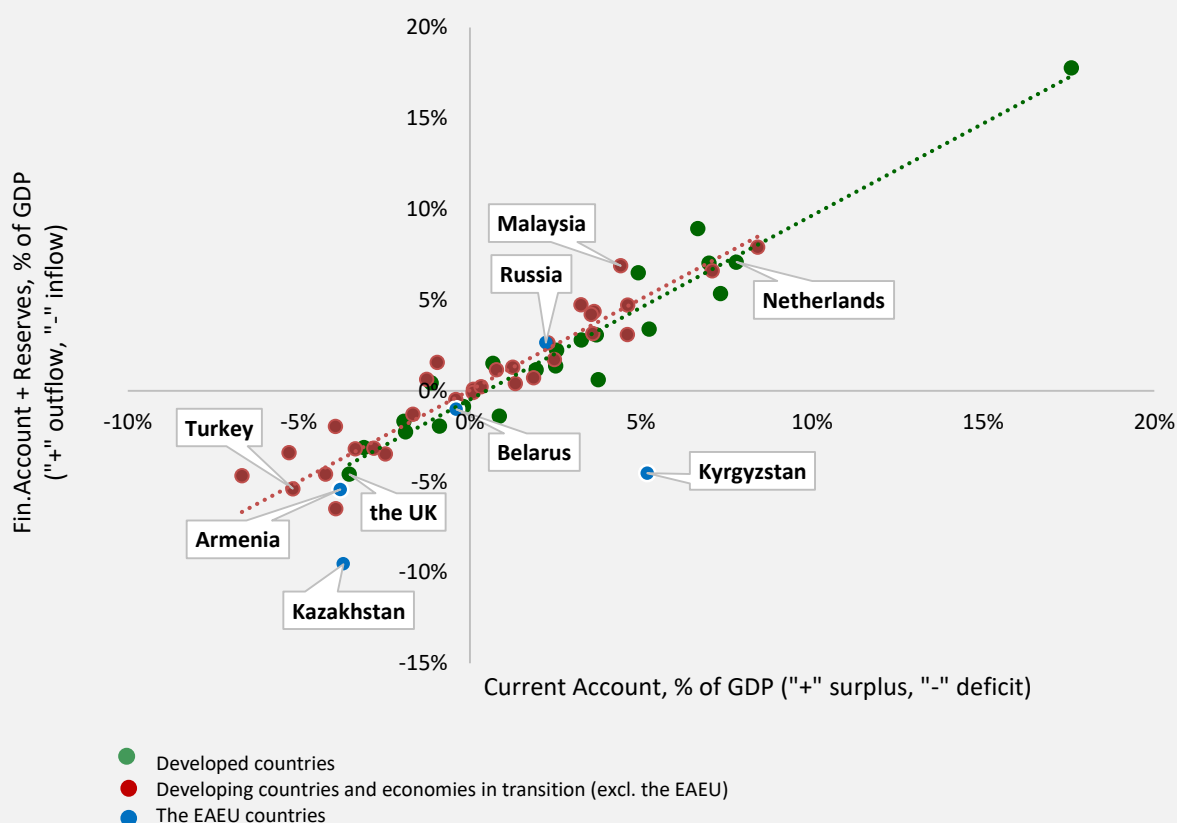
The global pandemic has led to a redistribution of world capital flows. If in 2018 and 2019, there was an outflow of capital from developed to developing countries<sup>1</sup>, in 2020 the trend was reversed. According to the data provided by the International Monetary Fund (IMF), net capital outflows from developed countries in 2019 amounted to 118.2 billion US dollars, while in 2020 there was a net capital inflow of 400 billion US dollars. This inflow was mainly provided by the USA. In 2019, developing countries and economies in transition experienced capital inflows of 167.6 billion US dollars, and in 2020 - capital outflows of 33.5 billion US dollars (Figure 1).

Border closures and disruptions in the supply chains have worsened the global trade in goods and services. According to the United Nations Conference on Trade and Development (UNCTAD), the volume of international trade in 2020 decreased by 8% compared to 2019, where trade in goods decreased by 6%, and turnover in services - by 16.5%.

The imbalances in global trade and capital flows caused by the pandemic have reduced the sustainability of the world's balance of payments. In the EAEU countries, the situation with the balance of payments was exacerbated by a relatively low degree of economic diversification.

<sup>1</sup> Countries are divided into groups in accordance with the Morgan Stanley Capital International (MSCI) classification (<https://www.msci.com/market-classification>). The sample includes the countries for which the data for 2020 is available: developed countries – 22 countries, developing countries and economies in transition – 36 countries.

**Figure 1. Balance of Payments of World Countries at Year-End 2020**



Source: IMF.

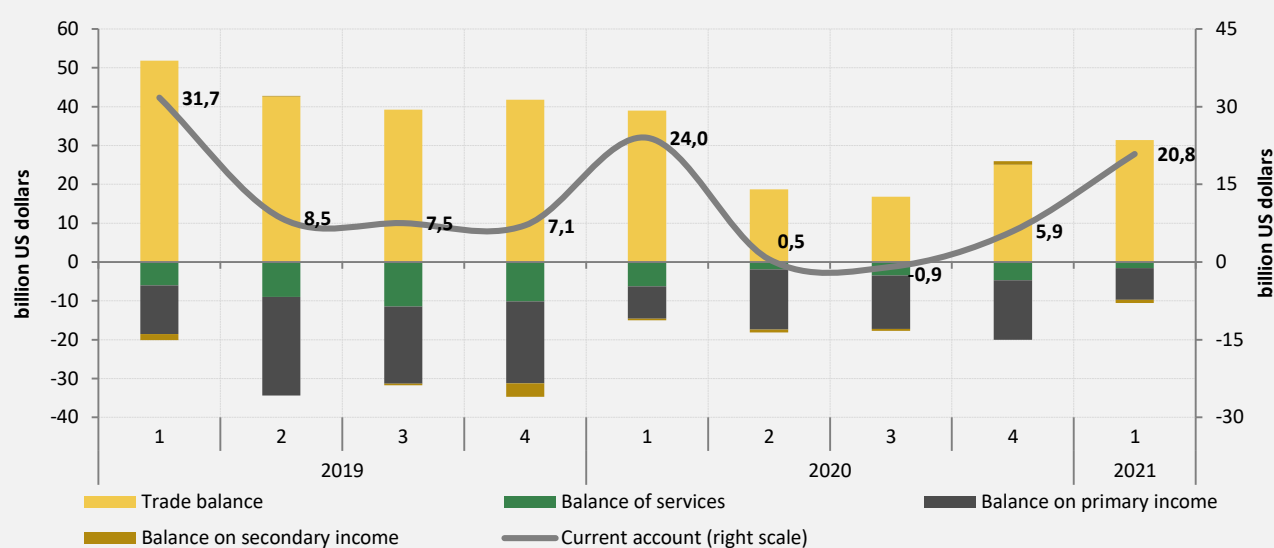
*\*Countries are divided into groups in accordance with the Morgan Stanley Capital International (MSCI) classification.*

The current account surplus of the EAEU countries began to decline in the second quarter of 2020, turning into a deficit in the third quarter of 2020 (Figure 2). This decline was largely due to the fall in oil prices in 2020 compared to 2019 (from 64 US dollar to 42 US dollar per barrel), which had a significant impact on the economies of the two main oil nations of the EAEU – Kazakhstan and Russia. In the first quarter of 2021, **the trade surplus** in these countries decreased by 40% (YoY) and 37% (YoY), respectively, due to the outstripping growth of imports over the growth of exports. The trend is explained by an increase in the demand for medications, computers, telephones and vehicles due to the recovery of business activity, the realization of deferred demand and the increase in food prices.

Belarus, unlike other EAEU countries, during the pandemic practically abandoned the imposition of restrictive measures, with the exception of a ban for mass events. As a result, in the first quarter of this year Belarus experienced a 53% reduction in the trade deficit due to the outstripping growth of exports, most of which were mineral products, foodstuffs and agricultural stock.

In the first quarter of 2021, a negative trade balance in Armenia and Kyrgyzstan contracted by 16% and 17%, respectively, due to the growing percentage of insolvent population. Exports of goods decreased by 2% and 9%, respectively, mainly owing to the restrictive measures and curtailment of consumer goods production (for example, textile production).

**Figure 2. Key Current Account Components of the EAEU Countries**



Source: EEC

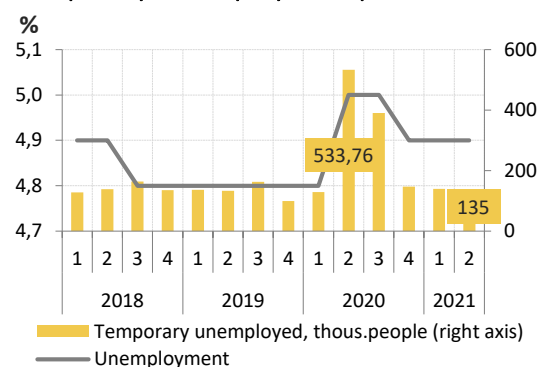
The **deficit in the balance of services** of the EAEU countries has significantly reduced due to a decrease in the volume of services that are most sensitive to quarantine measures – tourism, international transport and other business services. The Armenian economy where tourism is an important component was seriously affected by the restrictive measures and the consequences of the armed conflict in the Mountainous Karabakh in September - November 2020. In Belarus, by contrast, there was an increase in exports of services (+ 5%, YoY) compared to the practically unchanged imports (+1%, YoY). This led to an increase in the balance of services surplus by (+ 11%, YoY) in the first quarter of 2021 that was built up mainly due to telecommunication, IT and transport services.

In the EAEU countries, where a significant portion of investments is directed to the mining sector, there have been significant changes in the dynamics of the **income balance**. In Russia and Kazakhstan, the fall in oil prices in 2020 led to a reduction in the deficit on the income balance due to a decrease in the flow of foreign direct investors working in the commodity sector. In Armenia and Kyrgyzstan, a reduction in the deficit on the income balance was held up by the decline in remittances from migrants working abroad. As a result of the recovering world energy prices in the first quarter of 2021, the income balance of the EAEU countries deteriorated.

The **financial account (excluding reserve assets)** of the EAEU countries, apart from Russia, was characterized by a net capital inflow in 2020. In Belarus, the inflow is mainly due to the reinvestment of foreign investors' returns. In Kazakhstan, the inflow, in addition to the reinvestment of non-residents' returns, was provided by the public sector operations related to the sale of portfolio assets and an increase in liabilities to the rest of the world. In Armenia and Kyrgyzstan, the borrowing of funds was mainly due to the growth of residents' liabilities. In the first quarter of 2021, in the above countries, with the exception of Kyrgyzstan, a similar movement of capital was observed. In Kyrgyzstan, the net outflow was associated with the outstripping growth of assets abroad over an increase in loans. The positive balance of the financial account in Russia both in 2020 and in the first quarter of 2021 was explained by the growth of assets abroad.

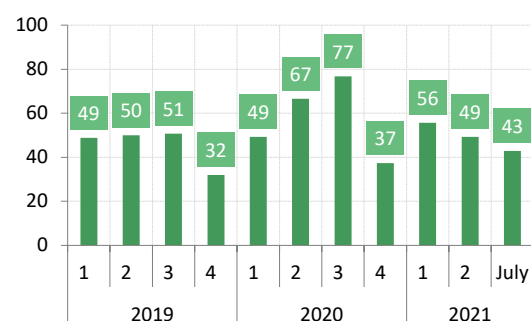
Border closures, falling prices of energy resources, the increasing incidences of coronavirus amid general uncertainty have resulted in a sharp deterioration in the current accounts of the EAEU countries. The deficit-ridden current account in the reviewed countries, apart from Russia, was partially offset by net inflows in the financial account (excluding reserve assets). The gradual recovery of the global economy and the adaptation of countries to the “new realities” in the first quarter of 2021 led to a gradual improvement in the current accounts of the EAEU countries. At the same time, the trends of 2020 persisted in the financial accounts of the countries.

Figure 39. Unemployment Rate and the Temporary Unemployed Population



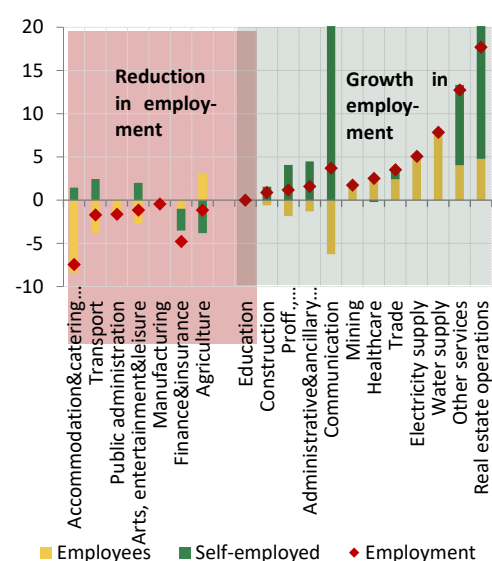
Source: BNS ASPR

Figure 40. People Who Applied to the Public Employment Authorities as Job Seekers, Thousand Individuals



Source: BNS ASPR

Figure 41. Contribution of Employment of the Population by Employees and the Self-Employed Population by Types of Economic Activities in the Second Quarter of 2021, YoY, %



Source: BNS ASPR, NBK's calculations

### 3.3 Labor Market

In the second quarter of 2021, significant improvements outlined in the labor market. The labor force increased by 1.1%, where the numbers of the employed individuals went up and the numbers of unemployed population decreased. In these conditions, the unemployment rate remained unchanged and accounted for 4.9%.

A favorable situation in the labor market was accompanied by retention of the number of temporary unemployed population at the pre-crisis levels (Figure 39). Due to reduction in the temporary unemployed population, the number of people who applied to the public employment authorities is decreasing and have stabilized at the level of 2019 (Figure 40).

Within the labor force structure, the employed population is increasing for the first time since the first quarter of 2020, the growth in the second quarter accounted for 1.2%. Among the employed population, the growth rates of the self-employed (a 3.0% increase) is outrunning the growth of employees (by 0.6%). As per the industry-based breakdown, the increase in the number of employed individuals was not even. Among the production sectors, the growth was observed in the mining industry, water supply and electricity supply, resulting from the increase in the number of employees. In the services sector, there are spheres where the reduction in employment continues from the beginning of the pandemic. For example, since 2020, the employment has been decreasing in the sectors that were primarily subject to restrictive quarantine measures including as part of the on-and-off tightening due to recurring COVID-19 outbreaks. Thus, in the sector of accommodation and catering services, the decline in the employed population accounted for 7.4%, in arts, entertainment and leisure – 1.1% (Figure 41). The reason for reduction in employment in these sectors is the curtailment of employees, and the number of self-employed individuals in these sectors is growing. In the transport sector, similarly to the above industries, since the onset of the pandemic the employment keeps decreasing (by 1.7%) because of reduction in the number of employees against the increasing number of self-employed. The rise in employment due to the increasing number of the self-employed was observed in the construction sector, in professional, scientific and technical activities, in administrative and ancillary service and in the communication sector. The reduction in employees in the above sectors

was restrained by a stronger growth of employment in the sectors. That is, despite a rise in the overall number of employees, their number is decreasing in most sectors of the services sphere in the industry-based breakdown (Figure 41).

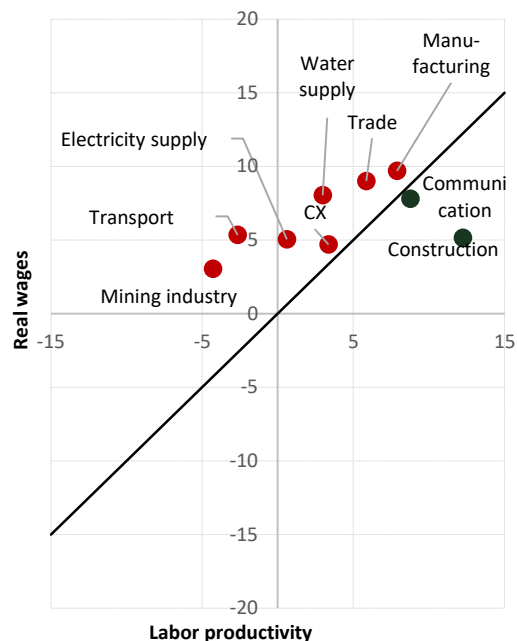
**In the second quarter of 2021, given the revival of business activity in the real sector the output in industries was recovering and Kazakhstan entered the growth zone.** As a result of a rapid growth in value added compared to the employment, the labor productivity entered the positive zone at the end of the first half of 2021.

At the same time, the growth of real labor compensation in the economy continues to accelerate, accounting for 10.4% in the second quarter. Nonetheless, despite its recovery, the growth of productivity remains low and is far behind the speed of increase in wages. In electricity supply, water supply, trade, the manufacturing industry, and agriculture the growth of real wages is not accompanied by the corresponding increase in labor productivity (Figure 42). In the transport sector and in the mining industry, the labor productivity is decreasing whereas wages are growing. Given that the growth of wages outruns the labor productivity, the pressure on the production costs appears and, as a consequence, risks of the increase in the prime cost of final products are growing. Thus, at present there is a pro-inflationary pressure on the part of producers in most branches of the real sector.

### 3.4. Inflation

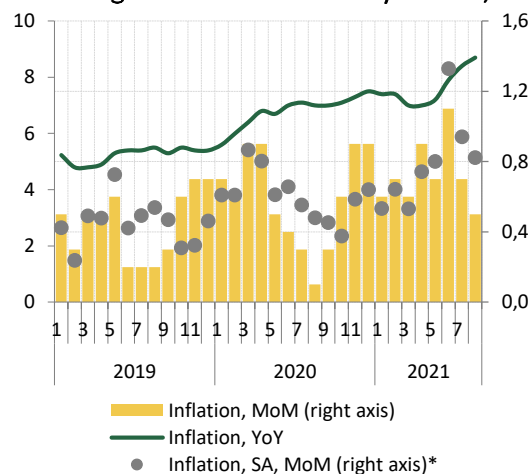
**In August 2021, the annual inflation accelerated to 8.7%, still staying above the target level of 4-6% (Figure 43). Acceleration of the price growth rates is observed among all inflation components. Thus, over the year the cost of foodstuffs increased by 11.4% (in December 2020 – 11.3%), of non-food products – by 7.3% (5.5%), and paid services – by 6.6% (4.2%).**

Figure 42. Labor Productivity and Real Wages in the First Half of 2021, YoY cumulative, %



Source: BNS ASPR, NBK's calculations

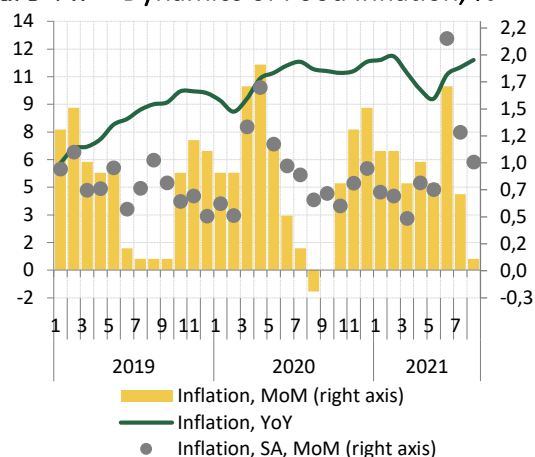
Figure 43. Inflation Dynamics, %



Source: BNS ASPR, NBK's calculations

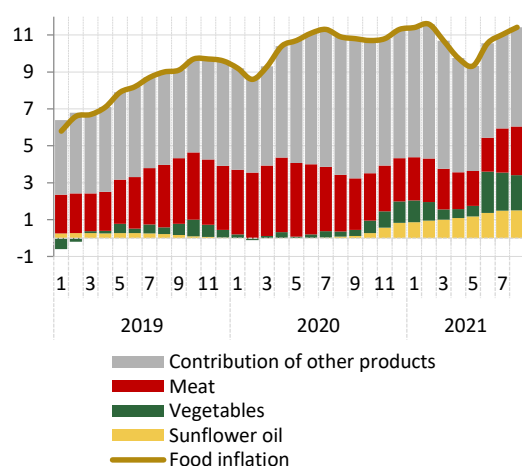
\*The seasonal adjustment was performed by using the X-12-ARIMA method from 2011 until present

Figure 44. Dynamics of Food Inflation, %



Source: BNS ASPR, NBK's calculations

Figure 45. Contribution of Particular Products to the Food Inflation, YoY, %



Source: BNS ASPR, NBK's calculations

The annual price growth of **foodstuffs**, after deceleration in May 2021 to 9.3%, continued to accelerate and at end-August accounted for 11.4% (Figure 44). Sizable contribution to the current acceleration of food inflation was made by a spike in prices of vegetables, long shelf life vegetables (potatoes, carrots, beetroots) in particular. In the environment of exhausting domestic stocks pending a new harvest, a monthly rise in prices for these products in June 2021 demonstrated record-high numbers over the recent years. Apart from that, the trend of price growth in certain food markets is persisting (Figure 45).

In August 2021, the growth rates of prices for vegetables decelerated in annual terms but are still high – 26.1% (beetroots – a growth of 124%, carrots – 68.2%, potatoes – 29.7%, cabbage – 27.1%). Disinflationary effect in the market of fruit and vegetable production is exerted by a moderate rise in prices for fruits by 1.7% due to a decline in prices of apples and oranges.

Given a rise in producer prices (by 9% YoY in July of this year) caused by the increased prices of forage (by 15.1% YoY in July of this year), the annual growth in prices for meat and poultry by 9.5% is observed in August 2021.

At the same time, the annual increase in prices of sunflower oil kept accelerating and in August 2021 made up 66.8%. A long-lasting rise in prices of vegetable oil is a worldwide trend caused by a reduction in supply in the global market as a result of poor crops in the 2020-2021 season. Thus, in June 2021, prices of import supplies had gone up by 104.4% in annual terms. In addition, domestic producer prices in July 2021 grew by 92.2% (YoY), which was associated with appreciation of the primary produce in terms of price.

In August 2021, prices of sugar in Kazakhstan rose by 32.6%. The major portion of consumed refined sugar in Kazakhstan is secured by imports (according to the BNS ASPR, in the first half of 2021 the share of sugar imports in total sales in the domestic market accounted for 51.1%). The bulk of these imports is represented by sugar from Russia, which enhances the dependence of domestic prices on prices in Russia where a high price growth caused by a failed harvest of sugar beet in Russia in 2020 is persisting (in July 2021, the annual increase in sugar prices in Russia was 41.3%).

An additional pro-inflationary pressure on the domestic food prices was put by the rising world food prices (Figure 46). Thus, in August 2021 the annual growth in world prices of oils accounted for 67.9%, sugar – 48.1%, cereals – 31.1%, meat – 22%, dairy products – 13.6%. This, in turn, may lead to the increase in price of imported food products as well as to the rise in prices of domestic producers due to the increase in the differential between external and internal prices as well as growth of exports.

In August 2021, **non-food inflation** accelerated to 7.3% in annual terms as a result of the continuing rise in prices of fuel and lubricants, clothes and footwear (Figure 47). Over the year, the cost of fuel and lubricants increased by 13.1%, of clothes and footwear – by 6.5%. The contribution of these groups of goods to the annual non-food inflation went up from 1.6 pp in January 2021 to 3.9 pp in July 2021. Nonetheless, the contribution to non-food inflation by other categories of goods has not demonstrated significant change (Figure 48).

The appreciation of fuel and lubricants in terms of price is associated with the growth in prime cost and the recovering economic activity. In July 2021, producer prices grew by 22.3% in annual terms.

Acceleration of annual growth rates of prices for clothes and footwear is taking place in the environment of rising import prices (for clothes – by 12.2% and for footwear – by 20.4% in June 2021, YoY) and of a gradual recovery of the consumer demand.

At the same time, given the high base of 2020, annual growth rates of prices for goods that showed appreciation at the time of onset of the pandemic as a result of a heightened demand, decelerated. Thus, the annual growth in prices for medications slowed down to 3.3%, for detergents and cleansing products – to 7.4%.

Figure 46. World Food Price Indices, 2014-2016=100

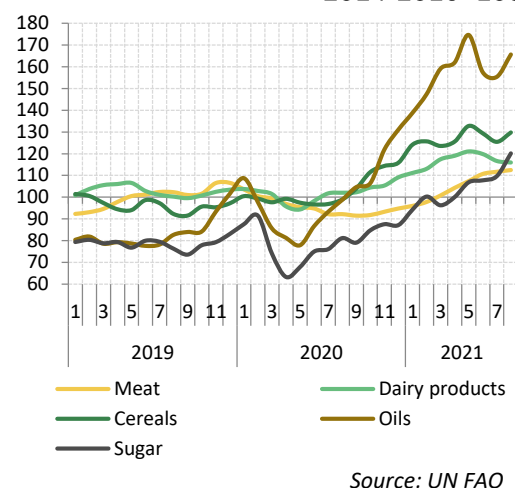


Figure 47. Dynamics of Non-Food Inflation, %

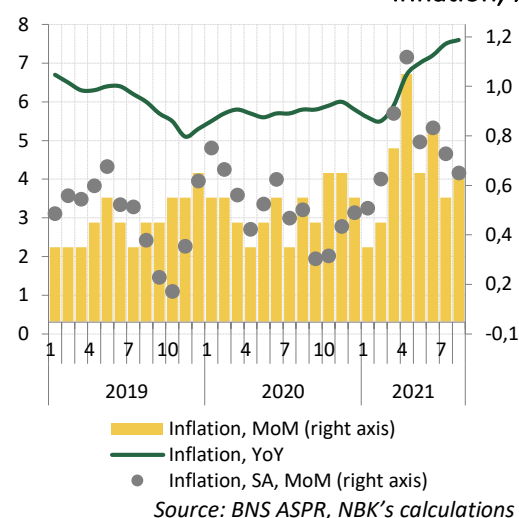


Figure 48. Contributions by Non-Food Products, YoY, %

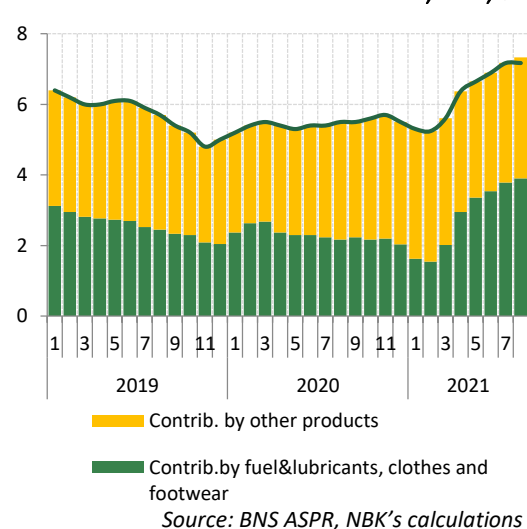
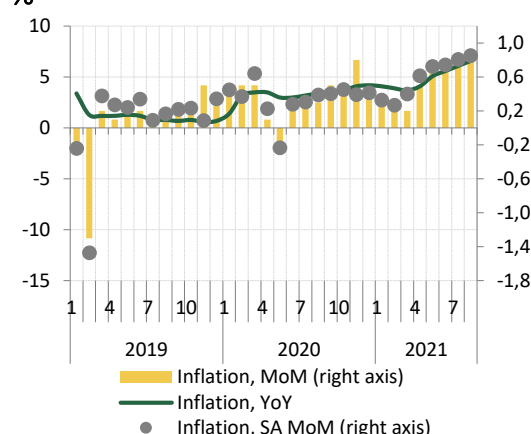
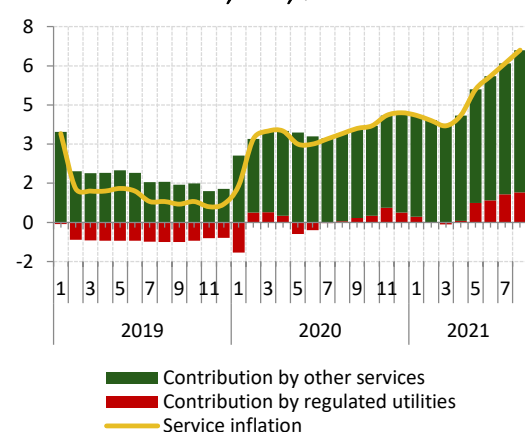


Figure 49. Dynamics of Service Inflation, %



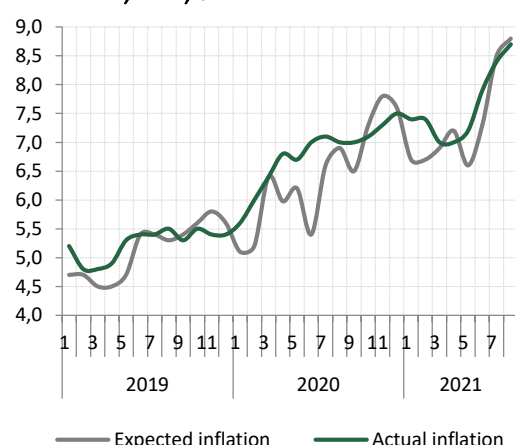
Source: BNS ASPR, NBK's calculations

Figure 50. Contributions to the Paid Services Inflation, YoY, %



Source: BNS ASPR, NBK's calculations

Figure 51. Inflation and Expected Inflation, YoY, %



Source: BNS ASPR, FusionLab

The annual growth in prices for **paid services** in August 2021 accounted for 6.6% (Figure 49). Over the year, tariffs for regulated utility services went up by 6.3% due to a 10.1% increase in electricity prices in August 2021 (Figure 50). A monthly growth in electricity fees for end users in August has not changed; however, in May-July 2021 there was a spike in prices by 7.9%, which was related to the increase in cap rates for electricity by energy producing companies.

In August 2021, in response to the increase in cap rates of wholesale prices for commercial-grade gas in the domestic market<sup>2</sup>, consumer tariffs for gas went up by 4%; in annual terms the growth rate of tariffs accelerated to 5.9%.

In July 2021, due to the growing prices of kerosene-type jet fuel, the recovering demand and the last year's low base effect, the cost of passenger air transportation increased by 45.9% in annual terms. However, in August 2021 as compared to the previous month, the cost of services decreased by 16.6%, resulting in deceleration of the annual growth to 21.3%.

In August 2021, due to the rising prices for real estate as well as the increased demand for rental housing on the part of university students because of the limited number of rooms in student hostels caused by quarantine restrictions, the cost of rental housing grew by 4.2% MoM. The maximum price growth was observed in the city of Almaty – by 14.7% MoM. In annual terms, the cost of rent in Kazakhstan went up by 16.6%.

The increase in tariffs also occurred in certain markets of non-regulated services due to the recovering demand. Thus, in August 2021, the cost of tourist services accelerated in annual terms to 5.2%, and personal care services – to 8.3%.

**Household's inflation expectations have increased over the recent three months:** the quantitative assessment of inflation for a year ahead made up 8.8% (Figure 51).

In the recent months, perception of inflation deteriorated significantly. In July-August, the majority (73-74%) of the interviewed observed an outstripping price growth in the last year.

<sup>2</sup> Order of the Minister of Energy of the Republic of Kazakhstan dated June 3, 2021 No. 188

These are the highest numbers for the entire history of conducting public polls. The major factors of increased expectations included a significant rise of energy resources prices and a surge in prices of vegetables at the beginning of this summer as well as deterioration of the epidemiological situation.

The majority of respondents who noted the price growth in the previous month chose foodstuffs. The population mentioned a rapid price growth for fruits and vegetables (63% of respondents in July, 51% in August), meat and poultry, vegetable oil as well as construction materials (Figure 52).

Given that fact, inflation expectations also remained heightened. In particular, among those people who mentioned the growth in prices, the percentage of the interviewed who perceive the inflation rate at more than 20% increased significantly – from 38% in June to 45% in July-August 2021, which is the maximum since October 2016. The consumer sentiment in July-August 2021 deteriorated largely reflecting more negative assessments about consumer expectations. Thus, based on the poll outcomes, assessments of the present and future financial standing decreased just as of the short-term prospects of the economic development. A probable deterioration in the present position and the expectations could be observed both amid the increasing prices of key foodstuffs and restrictions in the operation of trade and service facilities.

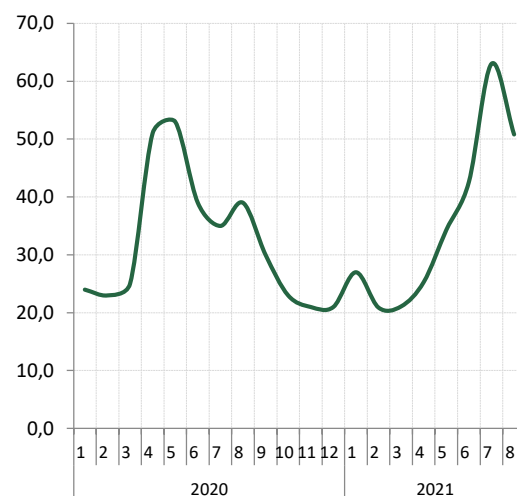
### 3.5 Fiscal Policy

**Due to the growing expenditure side of the budget, as at the end of seven months of 2021, high budget deficit numbers are persisting.**

During January-July 2021, the national budget deficit accounted for 1.9 trillion tenge, having increased by 26.7% compared to the corresponding period of 2020. The expansion in budget deficit was caused by the growth in expenditures (by 8.2%) against the reduction in revenues (by 0.2%) in annual terms. During January-July 2021, official transfers of 2 923 billion tenge were received to the revenue side of the budget, where the guaranteed transfer from the National Fund of Kazakhstan amounted to 810 billion tenge, and transfers from the subordinate government authorities – 317 billion tenge.

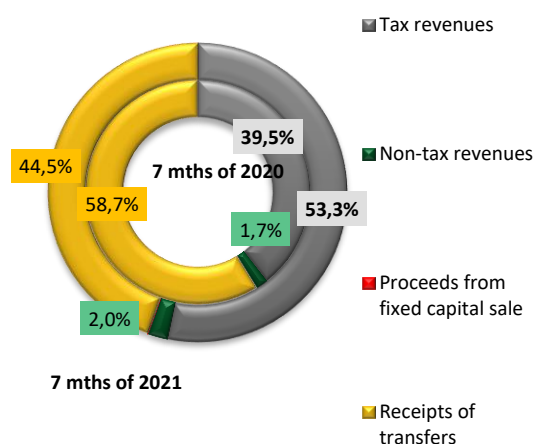
The non-oil budget deficit (budget deficit excluding transfers from the National Fund and

Figure 52. Percentage of Respondents who Noted a Rapid Growth in Prices of Fruits/Vegetables in the Previous Month, %



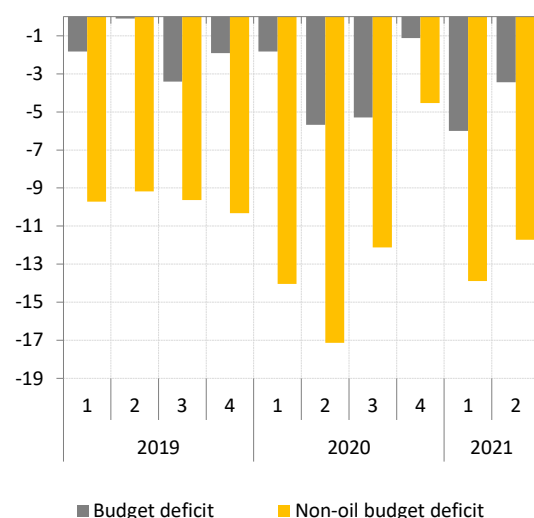
Source: FusionLab

Figure 53. Structure of the National Budget Revenues



Source: MoF RK

Figure 54. Overall and Non-Oil Deficit of the National Budget, as % of GDP



Source: MoF RK

export customs duties for crude oil), according to the National Bank's estimates, during January-June 2021 amounted to 4.1 trillion tenge, which is by 6.9% less than in the corresponding period of 2020 (Figure 53).

In August of this year, the key national budget parameters for 2022-2024 were approved. Thus, the social focus of the budget policy is expected to be preserved for the next year and will be determined by the growth in spending on indexation of retirement benefits and allowances. In addition, there is an intention to raise salaries to the medical personnel and teachers. As part of support of the real sector development, an allocation of resources is planned in order to go on with implementation of such government programs as the "Nurly Zhol", "Nurly Zher", for development of the agro-industrial complex, GPIID, "Roadmap of Business-2025".

National budget revenues during January-July 2021 reduced by 0.2% compared to 2020 and amounted to 6.6 trillion tenge. The main reason for revenue contraction is a 24.3% decrease in receipts of official transfers (their share is in the budget revenues accounted for 44.5%), namely transfers from the National Fund, where their volume went down by 27.6%. At the same time, during seven months of 2021, tax revenues increased (by 34.7%) due to recovery of the economic activity. The largest growth of taxes is observed in the wholesale and retail trade, the manufacturing and the mining industries.

A 19.3% expansion in non-tax revenues is driven by the increased receipts from administrative penalties, fines and sanctions imposed by the government authorities. The rise in proceeds from fixed capital sale by 4.3 times is related to the increased sales of tangible assets from the state stockpiles (Figure 54).

During January-July 2021, the national budget expenditures equaled 8.3 trillion tenge, having increased by 8.2% compared to the corresponding period of 2020. The main contribution to the growth in the national budget expenditures was made by the sector of education – an increase by 55.1% (the share – 9.0%), healthcare – by 21.4% (the share – 13.5%) and debt service – by 34.8% (the share – 9.3%). Alongside with that, expenditures for social welfare and social security grew by 2.4% (the share – 27.0%).

**Core inflation** – means the inflation, which excludes transitory erratic 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 that 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 non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

**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.

**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. Transferrable 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 influence the domestic 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** is the 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 instruments 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.



## LIST OF KEY ABBREVIATIONS

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**bp** – basis point

**BNS ASPR** – Bureau of National Statistics of the Agency for Strategic Planning and Reforms

**GDP** – Gross domestic product

**GPIID** – Government Program for Industrial and Innovation Development

**EM** – emerging markets

**EU** – European Union

**ECB** – European Central Bank

**CPI** – consumer price index

**KASE** – Kazakhstan Stock Exchange

**KSF** – “Kazakhstan Sustainability Fund” JSC

**NBK** – National Bank of the Republic of Kazakhstan

**NoF RK** – National Fund of the Republic of Kazakhstan

**OPEC** – Organization of the Petroleum Exporting Countries

**pp** – percentage point

**Rosstat** – the Russian Federal State Statistics Service

**REER** – real effective exchange rate

**IMF** – International Monetary Fund

**bln.** – billion

**mln.** – million

**MNE** – Ministry of National Economy of the Republic of Kazakhstan

**MoF RK** – Ministry of Finance of the Republic of Kazakhstan

**MED** – Ministry of Economic Development of the Russian Federation

**trln.** – trillion

**thous.** – thousand

**TCO** – Tengizchevroil

**CB RF** – Central Bank of the Russian Federation

**FAO** – Food and Agriculture Organization of the United Nations

**FRS** – Federal Reserve System

