

Keynotes of NBK Deputy Governor Akylzhan Baimagambetov Concerning a Base Rate Decision

Concerning reasons for an increase in the base rate by 0.25 p.p. up to 9.75%

When taking a decision on the base rate, we analyze an effect of many factors both in the external sector and the domestic economy. Within the current decision, I would classify the following internal factors as the most significant ones.

First, inflation is formed above a baseline scenario trajectory of **7.5%-8.5%**. This factor is the most important one and **all our actions are aimed to bring the inflation into a target corridor of 4-6% by the end of 2022.**

Second, it is an expansion of demand for goods and services. It is connected with the active recovery of Kazakhstan's economy and the growth of consumer activity of the population. Nominal consumer spending of households rose in the second quarter to **19.5%**, in real terms – by 8.1%. Such consumption growth is explained by a double-digit growth rate of household income by **12.9%** for 8 months in nominal terms or by **4.9%** in real terms. Rapidly growing demand exceeds supply expansion and affects acceleration of inflationary processes. Kazakhstan is no exception here, similar trends are observed worldwide.

Third, currently we see an increase in inflation expectations of the population. Estimates of one-year ahead inflation has risen to **9%** in September. This is partly due to a perception of current high price increases. According to survey results, **71%** of respondents still indicate a strong increase in prices over the past year, which is one of the highest rates in the entire history of the survey.

We will continue to monitor and analyze key inflation factors and all our actions will be focused to enter the target corridor of **4-6%** by the end of 2022.

The National Bank responds to these objective factors by raising the base rate to continue stimulating economic agents to saving behavior. This solution will also help to prevent undesirable equilibria in the money and foreign exchange markets.

Concerning inflation factors that have made the most significant contribution to acceleration of consumer prices

In general, today many countries worldwide have come up with increased inflationary pressure - this is a global trend. Both developed

countries and emerging markets faced with accelerated price increases. It is a **rise in food prices that remains a key driver of the global inflation.**

Half of the contribution to the annual inflation is still made by the rise in food prices, which accelerated to **11.5%** in September. Non-food inflation was **7.5%**, inflation of paid services – **6.8%**.

Internal imbalances have a significant impact on inflationary processes. An off-season shock has led to an uncharacteristic acceleration in vegetable prices to **31%** in June 2021, up from only **2.6%** in June 2020. We have mentioned this in past interviews. Yes, at the same time we see stabilization of the situation, as annual growth of prices for vegetables slowed down in September (to **23.5%**) but this is a seasonal decline in prices, and the indicator remains in a zone of high double-digit figures. Taking into account the end of the season for field vegetables, there are risks of higher prices for vegetables.

Let's not forget about **external factors** that affect dynamics of food prices in the country. FAO food price index soared by **32.8%** in September. Accelerating growth of global food prices has been observed since the middle of last year. Along with that, price increase has been recorded for all major product groups. A rise in prices for grain crops, vegetable oils, dairy products, meat, and sugar should be also highlighted.

Concerning factors contributing to growth of non-food inflation

Contribution of food inflation is 50%, therefore it cannot be ignored. **Non-food goods** are also important. General pro-inflationary pressure on them is exerted by an expanding consumer demand, pent-up demand that was not satisfied during the quarantine, as well as an increase in a real money income of the population. All these are connected with recovery of the economic activity due to the easing of quarantine restrictions. In particular, in September, acceleration of non-food inflation was attributed to growing prices for household items, clothing, footwear, fuels and lubricants, diesel fuel that everyone is talking about, and solid fuel.

Accelerating inflation of paid services was recorded in September. Start of a school year was accompanied by a steep increase in rental prices and cost of education. Appreciation of the rental services is noted amid the rising real estate prices. Cost of regulated services is also increasing. In September, its growth made 5.6%. This is due to the effect of deferred inflation, which we warned about in our Monetary Policy Strategy. Containment of electricity tariffs in the past results in an **8.3%** increase in the present (*10.1% in August*), which, of course, indirectly affects the overall inflationary background.

We also observe an increased rate of inflation expectations since this spring, both on the part of the population and enterprises. This was mainly

due to outbursts of growth in prices for fuels and lubricants, electricity and, of course, food.

As before, there is a high sensitivity of expectations to the most consumed goods - socially significant food products, such as meat, vegetables, bread.

In terms of quality of indicators, in particular in terms of answers in polls, there was a decrease from peaks in August. Thus, a share of respondents expecting acceleration and preservation of the current inflation rates dropped to 59% (in August – 61.5%). In assessments of price dynamics over the past month, the share of respondents who noted a very high rise in prices also declined from a maximum in July and made 52% (in July – 65.7%). But, of course, we need to consolidate this positive impulse.

We assume that implementation of a set of anti-inflationary response measures and an increase in the base rate will have a positive impact on dynamics of expectations and stabilize them in the future.

Concerning import of inflation through a foreign trade channel

No doubts, the concept of 'imported inflation' has a place to be and today it is relevant. Economic and inflationary processes in our country depend on external economic factors. This is due to a high level of foreign trade turnover of Kazakhstan (around 50% of GDP).

'Imported inflation' should be viewed through an analysis of the inflation situation in the countries which are our trading partners. For example, in September, annual inflation in the **European Union** reached 3.6%. A similar situation was reported only during the 2008 financial crisis. Another major trading partner of Kazakhstan is **Russia**, which accounts for almost **41%** of total imports (*around 40.7%*) for 8 months of this year. Annual inflation is accelerating there and reached **7.4%** in September, and given weekly dynamics in October - **7.8%**, which is almost twice the target (*around 4%*).

Imports of consumer goods have a direct effect on inflation. Its share has remained unchanged over the past few years and plays a significant role in consumption. For the past 7 years, share of imports in consumption has fluctuated between **37-39%**. A significant presence of imported products is observed mainly in consumption of non-food products (**60%** share in 2020).

If we talk about imports in general, then it certainly also pressures on balance of payments. In early November, the National Bank will publish a preliminary estimate of the balance of payments for 9 months of this year. But already today, having statistics for 8 months, we can say that pressure from imports is not weakening.

Consider this, for 8 months of 2021, imports of consumer goods grew by **23.9%** compared to 2020 and amounted to USD **7.7** billion.¹ Along with that, it is non-food consumer goods that are in the lead with a **29.8%** surge.

Since Kazakhstan is an open economy and **does not produce** a broad range of consumer goods **domestically**, we are **forced** to import such goods from abroad. Accordingly, growing prices abroad for these goods will significantly affect domestic prices.

Concerning a need to improve fiscal discipline through increased countercyclical fiscal policy

Fiscal and monetary policies are integral parts of an overall macroeconomic policy of the country, which ultimately determine indicators such as a level of consumer prices, exchange rate, dynamics of economic activity and volume of sovereign assets.

The purpose of the monetary policy is to keep inflation within the defined targets. Fiscal policy, in turn, in addition to ensuring government spending, is focused on maintaining economic growth. Both these goals do not contradict each other since achieving a consistently low inflation is a prerequisite for long-term economic growth.

Given the structural features of our economy with predominance of raw materials exports, the dynamics of budget revenues and expenditures highly depends on external macroeconomic conditions. In this regard, an increase in fiscal discipline through the introduction and application of a countercyclical budget rule will help to stabilize government spending and restrain their growth rates, thus, it will determine budget limits in advance.

This will allow to minimize the impact of external prices on domestic conditions and isolate the economy from oil price volatility. As a result, periodically arising inflationary pressures will decrease, which will have a positive influence on monetary policy effectiveness.

Concerning a current situation in the economy, concerning implementation of the NBK's forecasts, concerning return of the economy to a pre-crisis level

Our forecasts for economic growth for 9 months have been broadly realized. The economy grew by **3.4%** in January-September. This is in line with our optimistic estimates. Let me remind you that under an optimistic scenario of the August-September forecast round, we set the price for Brent oil at USD 70 per barrel until the end of the year. From the beginning of the year to October 22, an average price is **USD 69.3** per barrel.

¹ This indicator is also higher than the 2019 level (27%)

Economic activity continued to recover due to the rise in global commodity prices and the easing of quarantine restrictions. Manufacturing, trade, construction, information and communications as well as the public sector demonstrate high growth rates. For the first time since March last year, there is a positive growth rate in transport.

The easing of quarantine measures and opening of shopping centers had an extremely positive effect on indicators of wholesale and retail trade. The trade grew by **9.3%** year-on-year. The increase in trade turnover also led to a positive growth rate in transport services.

Unlike other industries, the mining industry demonstrated a **0.8%** decrease in activity. This is due to a shrinking crude oil production (by 3.4%) and gas condensate (by 5.6%) as part of the OPEC + deal.

In fact, the economy of Kazakhstan has already returned to the pre-pandemic level. If the economic growth trajectory remains in line with our optimistic scenario, it will reach **3.7 - 4.0%** by the year-end.

Concerning NBK position in relation to different offers of experts, including those related to reduction and significant increase in the base rate

The National Bank pursues the main goal of returning inflation back to the medium-term target. The base rate is our key tool to achieve the goal. Regardless of its influence degree, it forms important for us inflation expectations in the economy. That is why we are responding to accelerating inflationary processes in the country by raising the base rate.

In the meantime, we pay attention to a number of factors when making decisions, including prospects for development of the global and national economies, which determine inflationary background. Current recovery is fragile, especially in emerging markets. Based on regular surveys of enterprises, we see that business activity in Kazakhstan is not fixed in the positive zone - above 50. In September, the Business Activity Index was 49.8 points.

Under these conditions, the National Bank makes weighted and balanced decisions. At the recent three meetings, we have consistently raised the base rate, raising it from 9% to **9.75%**.

Along with that, we accompany each of these decisions with a statement on continuation of monetary policy normalization while maintaining pro-inflationary pressures in the economy.

The government and akimats continue to implement the Anti-inflationary Response Package. Decisions taken by the National Bank are based, among other things, on assessment of its effectiveness.

Therefore, we will continue to pursue a disinflationary monetary policy. Keeping in mind, our main goal is to stabilize inflation this year and return it to the target corridor of **4-6%** in 2022.