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PREAMBLE

At present, the geopolitical crisis continues to be one of the key factors influencing the formation of inflationary processes and economic activity in the world. The aftermath of developments in Ukraine, which have been progressing for more than three months now, has exacerbated the problems with global logistics and production chains that got underway during the pandemic. Given the expectations about a shortage of supply due to the sanctions imposed on Russia, energy prices continued to rise actively. Thus, the price of Brent oil grew from 86.5 US dollars per barrel in January to 104.6 US dollars per barrel in April of this year (a 20.9% growth). World food prices keep growing significantly. The FAO Food Price Index in February-April of this year went up by 16.9%.

High energy prices, rising food prices as well as the deteriorating situation with supply contributed to an increase in the pro-inflationary background worldwide and in countries-Kazakhstan's trading partners. In April 2022, inflation in the EU accelerated to 8.1%, remaining at record-high levels. In Russia, despite the slowdown in weekly inflation rates, the annual inflation is still at elevated levels (*17.8% in April of this year*). The risk of a short-term acceleration of inflationary processes in Russia persists as inventories are reduced and prices for imported goods are rising due to the increasing complications with logistics chains. In China, because of intensified disruptions in logistics and rising food prices, inflation accelerated from 1.5% in March to 2.1% in April of this year. With inflation rising, central banks in developed economies are either tightening their rhetoric or raising interest rates. In turn, a stronger Fed rate as compared to that expected by the market participants could lead to further capital outflows from developing countries, affecting their exchange rate dynamics and, subsequently, inflation.

High oil prices, high inflation and disruptions with supplies will have a dampening effect on the global economic activity. According to the IMF forecasts, in the near future the world economy will develop at a slower pace than previously predicted. In 2022-2023, the global economy is expected to grow by 3.6% (a previous forecast for 2022 was 4.4%, and for 2023 - 3.8%). In Russia, as a result of structural adjustment this year, the economy could shrink between 8 and 12%, the sharpest decline since 1994. Due to the high base of the first quarter of 2022, the Russian economy will also contract in 2023 ((-3.0)-0%).

The deteriorating situation in the external sector has not yet exerted a significant impact on the economic activity in Kazakhstan. The GDP growth in January-April accounted for 4.4%. The following factors help maintain the economic growth above 4%: high prices of oil and metals, growing consumer demand amid high inflationary expectations, the increasing real income of the population (by 7.7% in the first quarter of this year), the lifting of quarantine restrictions and a credit impulse. Thus, the consumer portfolio of banks keeps expanding, and at the end of this April, the annual growth accounted for 35.6%. The investment activity of the population is supported by mortgage lending, which increased in April of this year to 49.8%. At the same time, according to the National Bank's assessments, because of decelerating business activity in trading partner countries, a scenario-based decline in oil prices as well as disruptions in production and logistics chains, the growth of Kazakhstan's economy by the end of 2022 will somewhat slow down to 2.8-3.8%. In 2023, given the increasing volumes of oil production and exports as well as the declining overall level of uncertainty, the economic growth will accelerate to 3.5-4.5%.

Despite a limited impact on the economic activity, the geopolitical crisis had affected inflationary processes in Kazakhstan to a great extent. Thus, the annual inflation increased from 8.5% in January to 14% in May of this year. Unresolved domestic problems in certain food markets laid on the external inflationary shock. Thus, after their deceleration by the end of last year, prices for socially important foodstuffs ("the SIFs") showed a significant acceleration in growth.

The fiscal policy should be mentioned among the factors contributing to the further persistence of inflation at elevated levels. The fiscal policy will be pro-cyclical in 2022 amid a weak fiscal discipline. Thus, despite high inflationary pressure, high oil prices and the GDP growth above the long-term levels, budget spending for 2022 had been significantly revised when the budget was elaborated.

Heightened inflationary expectations represent another factor that affects the balance between the demand and supply of goods and services and, accordingly, the inflation. They have gone up significantly amid price

hikes for tracer goods and the exchange rate depreciation. Thus, a quantitative assessment of expected inflation one year ahead increased to 11.4% in April of this year.

By the end of 2022, due to the restructuring of import supplies of products, significant external inflationary pressure, high world food prices as well as a positive fiscal impulse, inflation is anticipated to build within a heightened range of 13-15%. In 2023, it is expected to slow down to 7.5-9.5% as the high base of 2022 will be removed from the calculations and external inflationary pressure will gradually subside. In the absence of both external and internal new shocks in 2024, inflation will still be outside the target corridor, while it is projected to slow down to its upper limit.



I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

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1.1. Forecast Assumptions

The recent increased and realized geopolitical risks have provoked a rapid rise in prices for raw materials and goods and exacerbated the existing problems with supply chains and the elevated inflationary background in countries. It is expected that under the pressure of these factors, in the near future the global economy will develop at a slower pace than previously predicted. According to the IMF estimates, in 2022-2023 the global economy will increase by 3.6% (a previous forecast for 2022 was 4.4%, and for 2023 – 3.8%). The growth rates of leading economies, including the UK, USA, China, France, and Italy will be almost half as much as in 2021. In the group of Asian countries, with the exception of China, expectations for the economic growth look more positive. This year, the Russian economy could decline by 8% to 12%, the sharpest decline since 1994. Risks to the global economy under a more pessimistic scenario are elevated, due to uncertainty about the duration of events in Ukraine and high inflation in many countries, a possible negative reaction of the markets to tighter policies of large central banks and the emergence of recurrent outbreaks of coronavirus in China and other countries.

As regards the EU economy, growth prospects for 2022-2023 are being revised downward. Energy dependence on Russia and high commodity prices are among the main explanatory factors. These factors, on the one hand, will limit the growth in industry and investments, and on the other hand, will keep inflation at high levels. An additional restraining effect will come from weak demand on the part of major trading partners – the USA and China – due to an expected slowdown in the economic activity that is stronger than previously forecasted. It is expected that the growth of the EU economy will continue to be supported by high consumer activity and the influx of population from Eastern Europe. The projected improvement of the situation in the labor market will also have a positive impact. An additional push for recovery will come from the EU's Green Economy Transition approach (RePowerEU). According to projections by Consensus Ecs., the EU economy will grow by 2.8% this year. In 2023, the economic growth is expected to account for 2.3% and will be close to its potential (Figure 1).

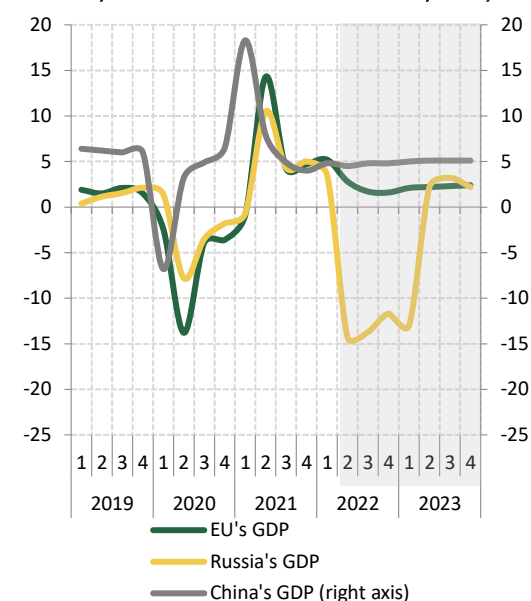
The growth rates of the Chinese economy over the forecast horizon will remain below the pre-pandemic levels. The growth will slow down, primarily as a result of the pursued zero-tolerance COVID-19 policy. It is also expected that the aggravation of geopolitical situation in the world and the widespread rise in prices will have a negative impact on the external demand, which will ultimately constrain the expansion of exports. The recovery of consumer activity, which significantly decreased in March-April 2022 due to expectations of the re-imposition of lockdown, and, accordingly, a possible deterioration in conditions in the labor market and reduction in income, is likely to remain sluggish. On the other hand, the expected tax relief and a stimulative monetary policy should have a positive impact on the growth of investments, demand for loans and the overall economic performance of the country. The risks of a weaker economic development are closely linked to a high level of debt in the real estate sector, further capital outflow from emerging markets given exacerbation of geopolitical events worldwide, as well as possible imposition of secondary sanctions from the West. Consensus Ecs. estimate that China's economy will expand by 4.7% in 2022 and by 5.1% in 2023 (Figure 1).

The prospects for Russia's economic growth are significantly complicated by the aggravation of geopolitical situation. Sanctions imposed by the West will lead to a sharp drop in the industry and investments. Due to the increased uncertainty in the country and limited access to imported goods, domestic private consumption will also decline rapidly. Concurrently, exports of raw materials will also decrease; this, on the one hand, will be associated with the actions taken by the EU countries to limit energy imports from Russia, and, on the other hand, with a possible reduction in consumption by other countries fearing the imposition of secondary sanctions by the West. As expected, the government consumption through implementation of infrastructure projects and other stimulus programs will be gradually increasing, partially mitigating the negative impact of other factors on the economy. In addition, there may be signs of recovery in certain industries and increased investments in these industries due to the development of import substitution in the country. According to projections of Consensus Ecs., in 2022 the Russian economy will contract by 9.0%. In 2023, with adaptation to new conditions, the situation is expected to gradually stabilize. A decline in the economic activity is estimated to contract to 1.4% (Figure 1).

Given the aggravation of geopolitical situation in the world and the uncertainty of its further development, prices for raw materials, agricultural products and many other commodities are likely to remain high throughout the forecast horizon. Recurrent lockdowns in China and the resulting disruption in supply chains could also contribute further to the price growth. In the light of increased pro-inflationary risks, the global inflation will remain high for longer than previously expected.

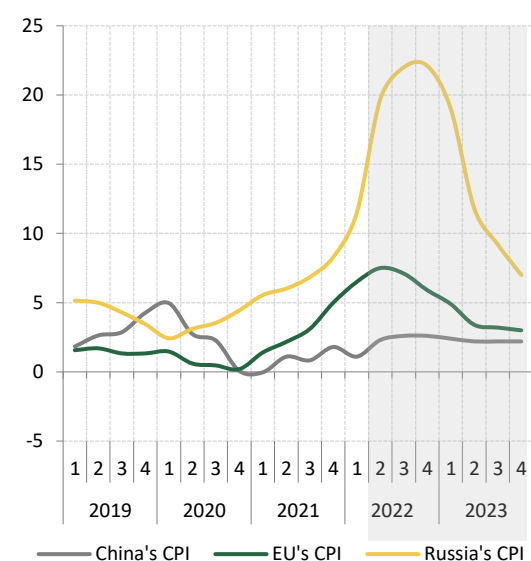
Inflation in the EU, due to anticipated further rise in food prices, high energy prices and a projected certain depreciation of the euro against other currencies will be building way above the target. Inflation is expected to reach its peak in the second quarter of 2022. Later, once the supply in the market grows and energy prices stabilize, inflation will start to decelerate gradually (Figure 2).

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



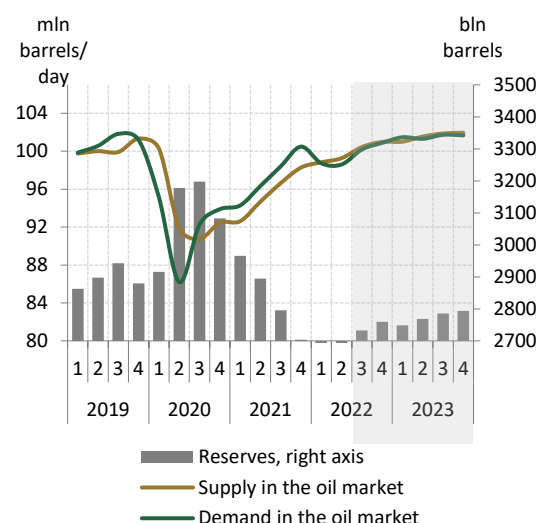
Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs.

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



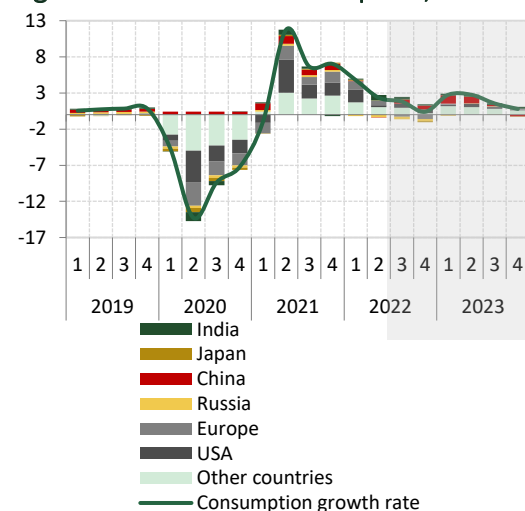
Source: Eurostat, National Bureau of Statistics of China, Rosstat, Central Bank of Russia, Consensus Ecs., European Commission

Figure 3. Dynamics of the Global Oil Market



Source: EIA

Figure 4. Global Oil Consumption, YoY



Source: EIA

Inflation in China will be accelerating. However, according to expectations, as a result of a projected feeble growth of consumer activity, inflation will be rising moderately. By the end of the forecast period, the overall price growth will slow down to 2-2.2% (Figure 2). In turn, inflation in Russia in the near term will be at elevated levels. However, owing to the policy pursued by the Central Bank of Russia, inflation will be gradually going down. Before the end of 2023, the 4% inflation target is not expected to be achieved (Figure 2).

With the increasing inflationary pressure and persisting uncertainty about the duration of geopolitical crisis, the rhetoric of central banks in developed countries remains hawkish.

Given some stabilization in the labor market, coupled with high inflation, the US Federal Reserve is expected to continue the rate hike cycle. Current market expectations boil down to a five-fold increase in the US Fed policy interest rate by the end of this year. In 2023, the interest rate could be raised four times.

Signals from the ECB are also becoming more hawkish. The ECB's policy will be pursued under the scenario of full termination of asset purchases to a two-fold increase of the interest rate for the first time over many years.

Since there is an expectation that high oil prices will be persisting over the entire forecast horizon, the development prospects of the oil market are assessed in a positive fashion.

According to the EIA's projections, during 2022-2023, there will be a minor surplus in the global oil market that will be driven by a more rapid growth of oil supply compared to its consumption (Figure 3).

Forecasts regarding the global demand for oil slightly decreased. In general, compared to 2021, in 2022 oil consumption will go up by 2.2 million barrels a day to 99.6 million barrels a day, and in 2023 – by 1.9 million barrels a day to 101.5 million barrels a day (Figure 4). The main risks of a feeble growth in consumption are associated with the anticipated slowdown of the global economy. Moreover, in connection with the anti-COVID policy pursued by China, the possibility of imposing yet another restrictions during the reviewed period should not be excluded.

Since China is the second largest global oil importer, contraction in the demand on the part of China may put a significant pressure on prices.

Under the current conditions, the global oil production is also associated with uncertainty. Forecasts for oil production in Russia against the backdrop of geopolitical events are being revised downward. At the same time, a strong reduction due to the expected reorientation of markets is not predicted. As regards OPEC+ countries, supply disruptions are also possible because of difficulties in production capacities. The oil shortage may be offset by an expected acceleration in oil production in the USA, Canada, Brazil and other global oil producers. Thus, no sizable oil shortage is expected in the forecast period (Figure 5).

Summarizing the above factors, oil prices in the near future are likely to stay close to current values. Much will depend on the situation around Ukraine. The World Bank expects food and commodity prices to remain high until 2024, due to disruptions in trade and production amid the conflict in Ukraine. As of end-2022, the average Brent oil price will be 100 US dollars per barrel, and in 2023 – 92.0 US dollars per barrel.

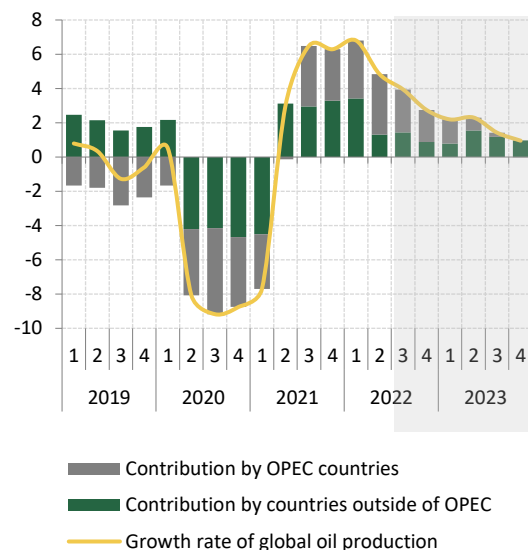
Taking into account projections of international organizations and factors that would/could potentially affect a further path of oil prices, under the baseline scenario for the development of Kazakhstan's economy, Brent oil price will be 90 US dollars per barrel over the forecast period.

Under the optimistic scenario, Brent oil price will be 110 US dollars per barrel, and under the pessimistic scenario – 50 US dollars per barrel.

1.2. Dynamics of the Economic Development under the Baseline Scenario

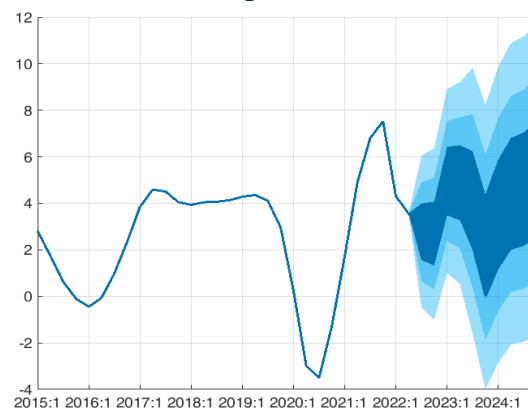
According to the National Bank's assessments, the dynamics of economic activity in Kazakhstan in 2022 will be within the range of 2.8-3.8% (Figure 6). High GDP growth rates will be related to high factual numbers for January-April 2022

Figure 5. Global Oil Production, YoY, %



Source: EIA

Figure 6. GDP, YoY sa, %



Source: NBK's forecast

(a 4.4% growth), a positive fiscal impulse as well as the existing situation in the oil market that is favorable for exporting countries. Meanwhile, an even greater acceleration of the GDP will be restrained by the persisting geopolitical crisis.

A positive contribution to the GDP growth from all components is expected. The domestic demand is expected to show a moderate expansion. The increase in consumer demand will be stemming from the positive dynamics of income of the population as a result of additional increase in the state budget spending for the social sphere (indexation of social benefit payments, arrangements aimed to raise personal income, growing wages in such sectors as healthcare, education, culture and sports, etc.) and the persisting positive dynamics in consumer lending. At the same time, the stronger dynamics of household demand will be restrained by reduction in Russia's GDP given its high share in Kazakhstan's imports (42.1% in 2021). Sanctions and the associated exit of many large international producers from the Russian Federation and, as a result, the disruption of logistics schemes and supply chains, high inflation in Russia, reduction of stocks and a temporary ban on the export of key food products (sugar, grain) will have a restraining effect on more active realization of consumer demand in Kazakhstan.

The investment demand will be also demonstrating positive dynamics given the implementation of the TCO project and other projects in the mining industry, expansion of housing construction and the continuation of government infrastructure programs. Amid the geopolitical crisis, uncertainty about the volume of reserves in the economy remains.

Given a strong fiscal impulse, government consumption will show accelerated growth rates.

A positive contribution is expected from real exports with a gradual decrease to near-zero values by the end of 2022. The positive dynamics of exports will be supported by a favorable situation in the oil market and the reduction of OPEC + restrictions on daily oil production. A more substantial acceleration in exports, despite currently high oil prices, will be held back by a weaker external demand as well as scheduled overhauls in major oilfields.

Due to the positive dynamics of domestic demand, imports will also be in the slightly positive zone and will continue to have a restraining effect on GDP. A negative impact on the dynamics of imports will be provided by the disruption of supply chains and high inflation in Russia because of the geopolitical crisis. At the same time, as economic agents will be adapting to the current realities, the need to search for and find new suppliers and substitute product imports from Russia is growing.

At the same time, yet remaining uncertainty about the duration of geopolitical crisis and the maximum scales of effect of the situation on the dynamics of domestic demand and net exports of Kazakhstan is taken into account as a forecasting risk.

In 2023, the GDP growth rates are expected to accelerate to **3.5%-4.5%**. The economic growth will be supported by the expected normalization of export and import supply chains as well as by an overall reduction of uncertainty in the economy. Along with this, a gradual easing of restrictions under OPEC+ and the expected termination of transaction of oil producing countries will contribute to a significant ramp-up of energy production compared to 2022. This will lead to some acceleration in the growth of exports and the more active investment dynamics. The upward trend in the consumer demand will be persisting against the expected growth in real income of the population, wages and consumer lending. In addition, the positive dynamics of domestic demand will be supported by the ongoing pro-cyclical stance of the fiscal policy.

Given the exhaustion of a negative impact of shocks, in 2024 the economic growth will keep accelerating. Such dynamics will also be supported by a significant increase in production by the TCO. This will primarily have a significant impact on further expansion of export supplies and a more moderate effect on the domestic demand.

In 2022, the output gap path compared to estimates made in the “November-December 2021” forecasting round, had been revised downward, and in 2023 it had not undergone significant changes. The 2022 revision was related to the downward adjustment of the forecasting dynamics of exports and the economic activity as a whole. In 2023, the output gap will be staying close to its potential levels, while in 2024 it will be in the positive zone due to acceleration of exports and the domestic demand.

Given the heightened external inflationary background as well as acceleration of prices in the global commodity markets, according to the National Bank’s estimates, by end-2022 inflation is expected to be building within the range of 13%-15%. The short-term dynamics of inflation will be developing in the light of price growth that was observed against a feverish demand of this March. Moreover, disruptions in supply chains caused by the geopolitical uncertainty may exert additional pro-inflationary pressure.

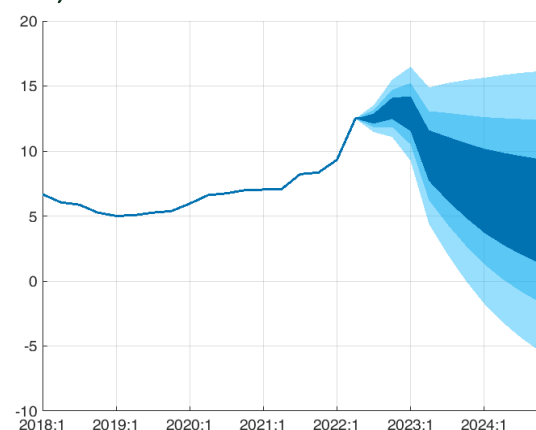
In the context of the CPI components, the highest growth will be observed in the dynamics of food prices. In the short term, the food component will be significantly influenced by external factors, in particular, by the growth of world food prices. Significant pro-inflationary pressure on the food component in 2022 will also be exerted by disruptions in the supply chains of domestic producers using imported raw materials and distributors selling imported products.

It is worth mentioning that in case of effective implementation by the Government of measures to curb the rise of food prices, the dynamics of food inflation will develop near the lower boundary of the forecast. Currently, in order to stabilize prices for socially important foodstuffs, a ban has been put on the export of cattle stock and small cattle abroad, as well as restrictions on the export of wheat until June 2022.

An increase in the annual non-food inflation is expected in the face of disruptions in supply chains, and rising inflation in the trading partner countries. According to estimates, by the end of 2022, some acceleration in the growth of prices for imported non-food products is expected, while the rise in prices for fuel and lubricants and coal that are subject to administrative regulation, will show moderate dynamics.

With a high base of 2021, the inflation of paid services is expected to slow down. The disinflationary dynamics will be facilitated by more moderate growth pattern of prices for regulated utility services. Despite expectations of a low growth in prices of non-market services until the end of 2022, there are significant risks of a surge in their prices (along with fuel and lubricants) in the second half of 2022 due to the end of the moratorium for their increase. In addition, contrary to regulated utility services,

Figure 7. Inflation, Quarterly Average YoY, %



Source: NBK's forecast

prices of market services will be hiking over a short-term horizon due to high inflationary expectations. This, in turn, will be offsetting a disinflationary effect from the dynamics of prices for regulated utility services.

In 2023, amid the structural transformation associated with a forced realignment of production, trade and logistics chains, the annual inflation forecasts have been revised upward. Over the medium-term horizon, external inflationary background will be higher compared to previous estimates. This is due to an upward revision of inflation in Kazakhstan's trading partner countries, higher dynamics of external food prices as well as expectations of weak fiscal discipline in respect of budget expenditures. On the other hand, monetary conditions will offset the negative impact of external factors on the medium-term path of inflation. Inflation is expected to slow down as the high base of 2022 is excluded from calculations and external inflationary pressure gradually eases. According to the National Bank's estimates, during 2023 the annual inflation will be gradually decelerating and will make up 7.5-9.5% (Figure 7) by the end of the year. In the absence of both external and internal new shocks in 2024, inflation will still be outside the target corridor, while it is projected to slow down to its upper limit.

Given the record-high actual levels that formed because of expectations about reduction in export supplies from Ukraine and Russia, compared to previous estimates, short-term forecasts for the FAO Cereal Price Index have been revised significantly upward. At the same time, in the light of a high base of 2022, world food prices are expected to decelerate in the medium term. Along with this, the gradual easing of logistics problems will contribute to normalization of prices in the global food markets.

Deceleration of inflation in the medium-term will occur in the environment of decreasing external inflationary pressure.

Inflation in China is expected to be below the target. However, in the EU and Russia, the annual rise in prices will exceed the corresponding target levels, indicating the formation of a longer pro-inflationary background. It is worth noting that the disinflationary impact from a slowdown in inflationary dynamics in the trading partner countries will be less pronounced compared to previous estimates.

Deceleration of inflation in the medium term will have a more dynamic pace, provided that the Government effectively implements a set of measures aimed at eliminating imbalances in commodity markets and observing the fiscal discipline.

1.3. Alternative Forecast Scenarios

Due to the existence of uncertainty associated with the geopolitical situation in the world and the growth dynamics of the global economy, in addition to the baseline scenario, the National Bank considered alternative scenarios.

As the pessimistic scenario, the National Bank considered the scenario where oil prices would fall to 50 US dollars per barrel and stay at that level until the end of the forecast horizon.

Realization of such scenario can be triggered by a worsening epidemiological situation in the world, by sluggish dynamics of the global economy and the existence of enduring imbalances in the oil market caused by the termination of OPEC+ transaction and the growing production.

In case of the pessimistic scenario, the growth path of Kazakhstan's exports will be more moderate due to the weak dynamics of external demand for raw materials from Kazakhstan. The negative dynamics of revenues in the mining sector compared to the baseline scenario will lead to reduction in production and investments, thus negatively affecting such sectors as construction, transport, trade and other services. Weaker dynamics of personal income and investments will somewhat limit the growth of consumer and investment demand. As a result, the growth of Kazakhstan's economy in 2022-2023 compared to the baseline scenario will be more moderate. **The economy's growth will be below its potential level and will account for 2.3-3.3%.**

In the pessimistic scenario, inflation will continue to form above the target band throughout the forecast period. Despite the disinflationary pressure from the domestic demand, high dynamics of inflationary processes compared to the baseline scenario will be determined by a weaker real exchange rate of the tenge, a possible disruption in the supply of imported products and a corresponding increase in inflationary expectations. In 2022, inflation will account for **14-16%, and in 2023 – for 8.5-10.5%.**

If the **optimistic scenario** is realized, the path of oil prices is supposed to be at **110 US dollars per barrel over the forecast horizon.** Such price path may be driven by the stronger dynamics of the global economy and a more moderate increase in oil production by OPEC+ compared to the baseline scenario. High hydrocarbon 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 be 3.3-4.3% in 2022, and 4-5% in 2023.**

If the situation develops according to the optimistic scenario, inflation will slow down at a faster pace compared to the baseline scenario. This will be supported by the strong dynamics of the tenge exchange rate and lower external inflationary pressure, mainly due to a lower inflation path in Russia. In 2022, inflation will be building within the range of **13-15%**, in **2023 – 6.5-8.5%**.

1.4. Risks in the Medium Term

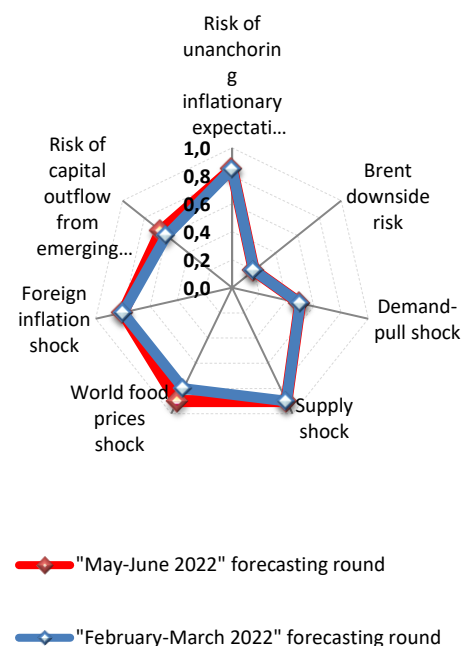
Due to the persisting geopolitical tensions in the world, risks of inflation acceleration remain high (Figure 8).

The global geopolitical crisis brings high uncertainty into the forecast assumptions for macroeconomic indicators of Kazakhstan, thereby causing the formation of risks of inflation significantly deviating from its forecast values.

Thus, the risk of capital outflow from emerging markets to developed economies looks high. First, the elevated inflationary pressure in the world due to rising world prices for food, energy and complicated logistics may force the central banks of developed countries towards a faster path of raising interest rates. Second, the possible strengthening of sanctions rhetoric against Russia may increase the risk premiums of developing countries, which may lead to depreciation of their currencies, including Kazakhstan. In this regard, the risks of inflation acceleration are increasing significantly, especially in the short term.

Besides, the risk of importing external inflation remains high, primarily from Russia due to disruptions in the functioning of business because of sanctions in the form of a shortage of imported production components and difficult logistics. Moreover, a significant risk of importing the world food inflation is persisting due to the recent strong increase in world prices for a wide range of food products. A possible worldwide decline in crops, limited export supplies (especially due to the unstable situation around Ukraine) may lead to the persistence or strengthening of imbalances in the food markets.

Figure 8. Risk Map based on the Expert Judgment



Source: NBK's calculations

The increasing gap between external and domestic prices may subsequently lead to a hike in food prices in Kazakhstan.

Additionally, in view of dependence of the tenge's perceived risk premium on the dynamics of the Russian ruble and high volatility of the Russian currency, the risks of the tenge depreciation remain high. Moreover, the impact of the embargo on exports of Russian oil by the EU may have a negative effect on exports of Kazakhstani oil and lead to reduction in foreign exchange earnings, which may also be a negative factor for the tenge exchange rate. Due to the influence of these factors and high food inflation, the risk of unanchoring inflationary expectations in the medium term remains.

Despite the moratorium on increasing the prices for fuel and lubricants until July 1, 2022, the risk of inflation acceleration from supply factors remains high. Thus, after the lifting of the moratorium, a strong increase in prices for these goods and services is possible due to the need to maintain the profitability of production and to finance investments. Such increase may be reflected in the growth of production costs of other goods and services in Kazakhstan. In addition, supply disruptions due to the possible impact of sanctions against the Russian Federation could also lead to higher production costs and further acceleration of inflation.

Among internal factors, the risk of inflationary pressure from the demand side is less pronounced. This is contingent upon the projected slowdown in Kazakhstan's economy due to a feeble external demand and moderate exports, as well as a lower activity in withdrawal of pension savings.

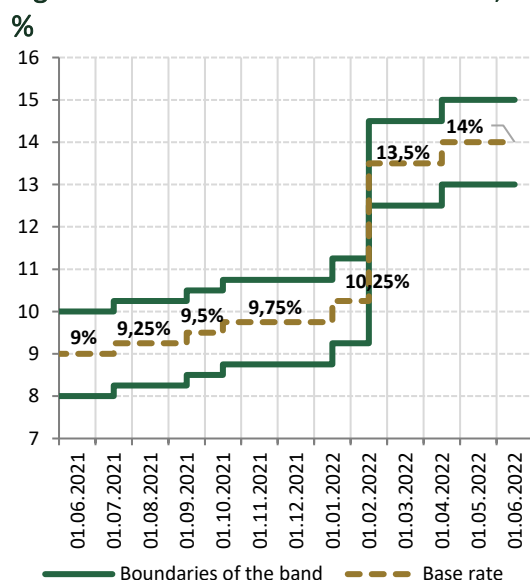
One of the important risks of the inflation forecast is an expansionary fiscal policy. For 2022, budget expenditures were revised upwards, which implies their growth compared to 2021 by 23.6%. In 2023, despite a projected 2.5% reduction in spending, overall spending will be significant given the high base in 2022. Given the low fiscal discipline and periodic upward revisions of government spendings in previous years, it is not excluded that the budget parameters may be further revised in 2022-2023 in the direction of expanding the expenditure side, which may become an additional source of pro-inflationary pressure in the economy.

II. MONETARY POLICY



II. MONETARY POLICY

Figure 9. Base Rate Band in 2021-2022,



Source: NBK

2.1. Decisions on the Base Rate

In April 2022, the National Bank continued to pursue its monetary policy in the environment of inflationary pressure amid the realization of geopolitical risks, growing prices in the world and in the countries –Kazakhstan’s trading partners and their pass-through onto the domestic prices. Significant pro-inflationary pressure was persisting also on the part of positive fiscal impulse, which has been ongoing for the third consecutive year. Given the above factors, from April 26, the base rate was raised by 0.5 pp to 14% (Figure 9). The decision was made based on acceleration of inflation from 8.7% in February 2022 to 12% in March 2022. Prices were rising on all components and for a broad range of goods and services. The significantly increasing core inflation, for its part, indicated persistency of pro-inflationary processes.

In June 2022, the base rate was retained at 14%. The decision was made due to some deceleration of inflationary processes and was based on the National Bank’s updated forecasts for a further development of the economy and inflation in the country.

The monthly inflation, after its surge in March (3.7%), in April and May of this year demonstrated deceleration – 2% and 1.4%, respectively. Some improvement was also shown by inflationary expectations for a year ahead, which accounted for 11.7%. However, the trend for inflation deceleration is not yet steady and its annual values are still high. Thus, inflation reached 14% in annual terms as a result of the growth in prices for all of its components.

There are still risks to inflation from the global acceleration of inflation, uncertainty because of the geopolitical situation in the world and the import of external inflation. Given the current balance of inflation risks, it is expected that retaining the base rate will contribute to a smooth deceleration of inflation by 2024 in the absence of new shocks in the domestic and foreign markets.

2.2. Money Supply

The growth in money supply is slowing down. Except claims on the economy, the contribution of all components to the growth in money supply in the reporting period was in the negative zone.

The money multiplier is increasing, having reached its maximum since the beginning of 2020.

On the year-to-date basis, the money supply in the economy decreased by 1.1 trillion tenge (by 3.7%) and in April amounted to 29.0 trillion tenge (Figure 10). The growth rates of money supply in annual terms decreased to single-digit values accounting for 7.9% in April 2022 (in April 2021 – 20.8%).

Lending to the population and to businesses made positive contribution to the growth in the money supply. Deceleration of the money supply occurred mainly because of reduction in net foreign assets; its contribution moved to the negative zone in April 2022.

The growth rate of reserve money in annual terms slowed down from 12.5% in February 2022 to 0.9% in April due to reduction in gold and foreign exchange reserves, and growth of the government's funds at the National Bank.

As a result of larger contraction in the reserve money compared to reduction in the money supply, the money multiplier (the ratio of money supply to reserve money) increased to 2.9 – the maximum since the beginning of 2020 (Figure 11).

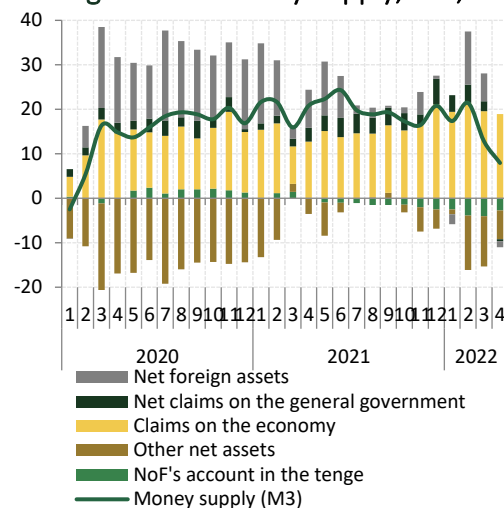
2.3. Money Market

After its significant decrease at the beginning of 2022, the balance on the National Bank's operations went up owing to the increased volumes of liquidity withdrawal via notes and deposit auctions. The money market rates were setting mostly between the upper boundary of the interest rate band and the base rate.

The balance on the NBK's operations compared to February 2022 increased by 11.5% and amounted to 2.5 trillion tenge at May 31 of this year.

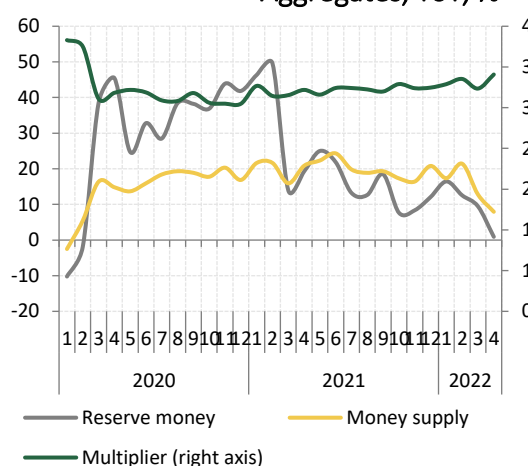
In the structure of the National Bank's balance, withdrawal volumes were growing due to notes and deposit auctions (Figure 12).

Figure 10. Money Supply, YoY, %



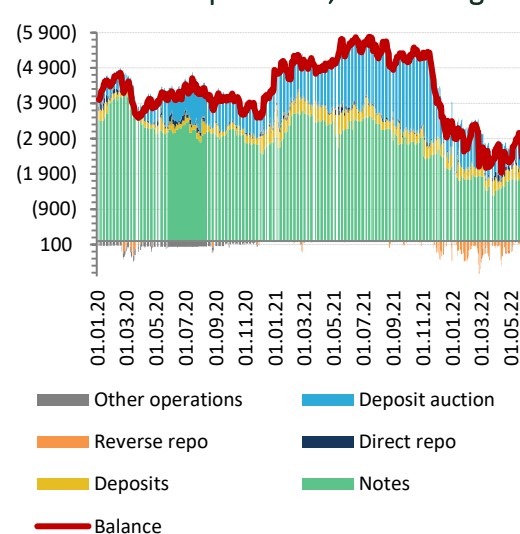
Source: NBK

Figure 11. Growth of Monetary Aggregates, YoY, %



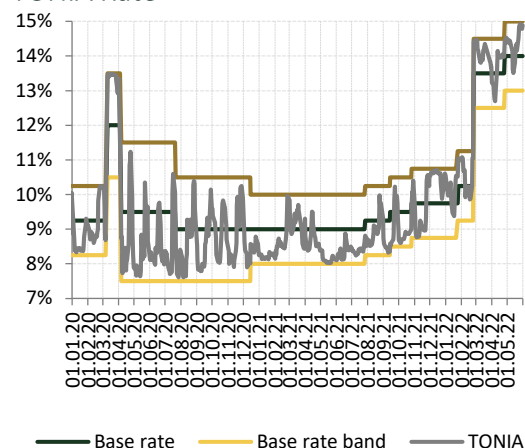
Source: NBK

Figure 12. Exposure on the National Bank's Operations, billion tenge



Source: NBK

Figure 13. Interest Rate Band and TONIA Rate



Source: NBK, KASE

In the reporting period, the volume of liquidity provided by the NBK on reverse repo operations decreased, their average daily volumes in March-May 2022 amounted to 210.3 billion tenge (in December 2021-February 2022 – 298 billion tenge).

The money market rates demonstrated consistent growth following the increase of the base rate at a regular meeting of the National Bank's Monetary Policy Committee in April 2022 (Figure 13).

In the reporting period, the money market rates were staying mainly near the upper boundary of the band going below the base rate in certain periods (in the first week of April and in mid-May). The highest level of TONIA was observed in the period of deteriorating geopolitical situation and volatility in the foreign exchange market: from February 24 through March 3, 2022, when the average TONIA rate was 14.45%, thus virtually approximating the upper boundary of the band. The spread between TONIA and the base rate was 0.95 during that period.

As the situation in the foreign exchange market stabilized, interest rates were decreasing: the spread between TONIA and the base rate on average during three months (March-May 2022) made up 0.37 pp (0.48 in December 2021 – February 2022).

2.4. Foreign Exchange Market

The situation in the foreign exchange market in March-May 2022 was developing under the impact of external and internal factors. Due to accelerated growth in prices for raw materials, supplies and food, central banks of developed countries proceeded to swiftly tighten monetary conditions by increasing the policy rate. This, alongside with deterioration of geopolitical situation, reduced the global appetite for risky assets among investors nurturing appreciation of the US dollar and the increase in yields on treasury bonds. Nonetheless, after reaching its maximum in mid-March, the tenge exchange rate demonstrated appreciation.

Geopolitical tensions entailed high volatility in the financial markets and capital outflow from developing countries. The increase by the US Fed of its policy rate by 50 bp to 0.75-1% cranked up the anticipated tightening of monetary conditions amid the growing inflation.

This led to the growth in yields on treasury bonds from 1.82% at end-February to 2.85% - at end-May 2022 and appreciation of the US dollar, which put pressure on currencies of developing countries (Figure 14).

During the period of March-May 2022, the price of gold was declining, while the exchange rate of the US dollar was appreciating against the majority of currencies. (Figure 15). Spreading of a new wave of coronavirus in China and the emergence of a new viral strain in the North Korea coupled with geopolitical developments in Ukraine served as reasons of volatile oil quotes in March-May 2022 in the range of 98.02-127.98 US dollars per barrel (Figure 6).

The global risk appetite of investors was declining both due to geopolitical tensions and in the light of epidemiological problems in China and the North Korea. Thus, at end-April 2022, foreign investments in government securities of Kazakhstan went down to 485.7 billion tenge (543.8 billion tenge at end-January). As a result, the share of investments into government securities of Kazakhstan by non-residents decreased to 3.2%.

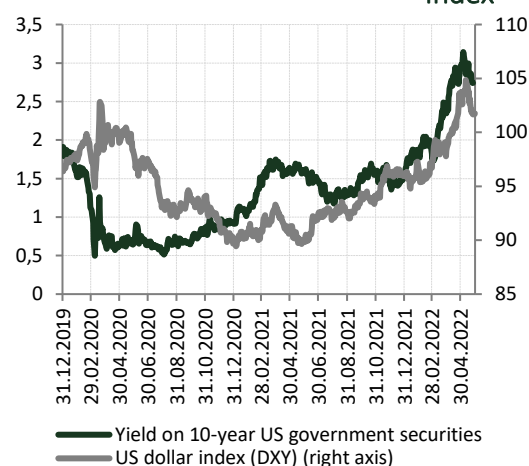
In March 2022, in order to maintain the balance in the domestic foreign exchange market, the National Bank conducted foreign exchange interventions for 990.5 million US dollars or 29% of the total volumes of trading on the exchange. Sales of foreign exchange for providing transfers from the National Fund to the national budget also supported the tenge and amounted to 890.9 million US dollars in March.

In addition, measures taken to limit the outflow of foreign cash and precious metals from Kazakhstan and the increase of the portion of mandatory sale of export proceeds from 50% to 75% help stabilize the foreign exchange market.

In general, in March-May, as a result of high volatility in foreign markets, the tenge exchange rate was moving within the range of 414.79-512.17 tenge. The weighted average volume of stock exchange trading in March-May made up 127.28 million US dollars (in December 2021-February 2022 – 173.4 million US dollars, and in March-May 2021 – 131.3 million US dollars).

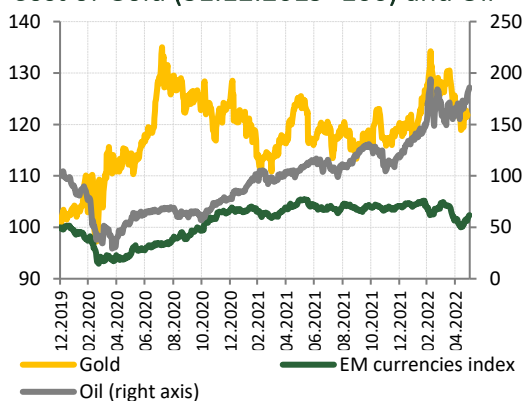
Due to a high oil price and measures taken by the National Bank and the Government to stabilize the foreign exchange market, in February-March the tenge exchange rate significantly appreciated from the maximum of 512.2 tenge per US dollar on March 15

Figure 14. Yield on 10-Year US Government Securities, US Dollar Index



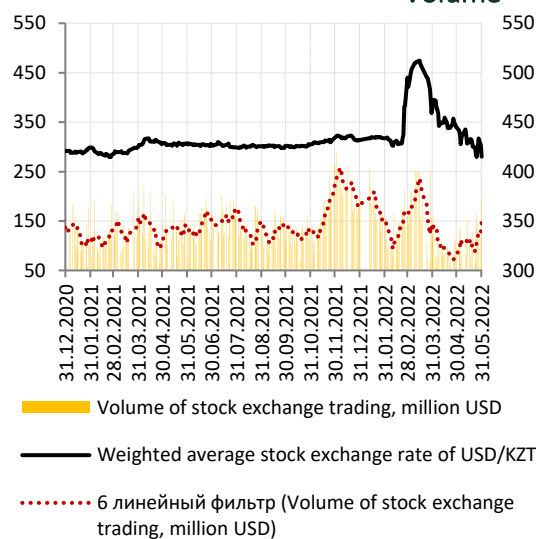
Source: Refinitiv

Figure 15. Dynamics of the Emerging Market Currency Index, and of the Cost of Gold (31.12.2019=100) and Oil



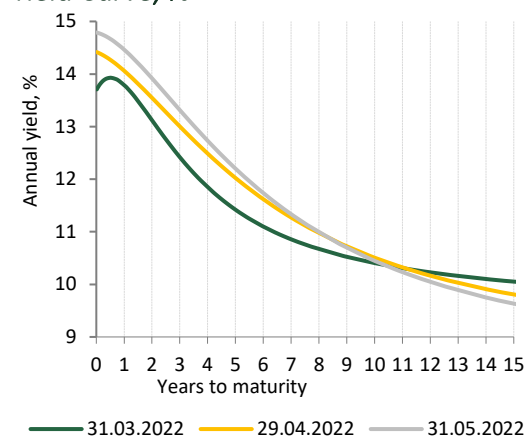
Source: Refinitiv

Figure 16. Dynamics of the Tenge Exchange Rate and the Trading Volume



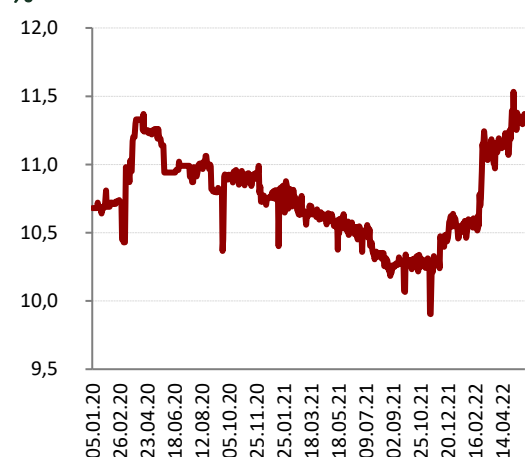
Source: KASE, NBK

Figure 17. Change in the RiskFree Yield Curve, %



Source: NBK

Figure 18. Yield on Corporate Bonds, %



Source: NBK

to 415.16 tenge per US dollar at end-May (Figure 16).

2.5. Stock Market

The geopolitical situation preserves uncertainty in the stock market, equities market in particular.

The National Bank's April decision to raise the base rate resulted in an upward shift of the yield curve in the short- and medium-term segments.

KASE_BMY corporate bond index at the end of the reporting period increased by 62.13 bp to 11.37.

The National Bank's April decision to raise the base rate from 13.5% to 14.0% resulted in an upward shift of the yield curve in the short- and medium-term segments. Yields of the placed government securities of Kazakhstan's Ministry of Finance (MF RK) following the increase of the base rate went up from 10.30-11.10% per annum in January-February to 12.5-14.5% per annum in March-May 2022 (Figure 17).

In March-May 2022, issuance of government securities in the primary market made up 771.9 billion tenge, including 660.5 billion tenge borrowed by the MF RK. The bulk of government securities issue of the MF RK is represented by securities with maturity from 1 to 5 years, their share accounted for 93%. In March-May 2022, local executive authorities attracted 111.4 billion tenge against 0.35-4.24% to finance residential construction as part of the government programs implementation.

In the reporting period, there have been changes in the structure of holders in terms of buyers of government securities. The share of institutional investors increased significantly whereas participation of the second-tier banks decreased dramatically. The share of private investment managers of pension assets that appeared in the market in 2021 is still insignificant in the overall structure and accounts for less than 1%.

The placement volume in the corporate bond market decreased substantially. During March-May 2022, the placement volume amounted to 50.1 billion tenge only (in March-May 2021 – 221.5 billion tenge). The weighted average yield on the placed bonds increased

from 12.21% in February 2022 to 16.35% in April (there were no placements in March) and 15.03% in May 2022. The KASE_BMY index grew by 62.13 bp to 11.37 at the end of the reporting period (Figure 19).

The KASE index from March to May declined by 20.8% (Figure 19) following the global stock exchanges. The main reasons included the increased uncertainty in the global and commodity markets caused by a worsened geopolitical situation as well as by the beginning of the interest rate increase cycle of the US Fed.

During the reviewed period, equities of all companies included in the KASE index representative list demonstrated decline. The largest drop in stock prices was observed in “Kcell” JSC – by 41.6%, “KazTransOil” JSC – by 31.0%, and “Halyk Savings Bank of Kazakhstan” JSC – by 20.1%.

2.6. Deposit Market

Despite their deceleration from the beginning of 2022, annual growth rates of deposits remain in the positive zone.

Appreciation of the national currency after this March as well as an outflow of foreign currency deposits led to a lowered level of overall dollarization to the minimum since 2013.

As a result of increase of the base rate and interest rates on deposits, profitability and attractiveness of the tenge deposits in the banking sector went up.

Since the beginning of 2022, in April growth rates of deposits at depository institutions slowed down accounting for 8% in annual terms (in December 2021 – 22.7%) (Figure 20). Despite the fact that deposits in the national currency of both corporate entities and individuals remain as a key growth driver, their growth rates have notably decelerated. However, since the beginning of 2022, the total volume of deposits contracted, including due to the exit of Russian banks and because of the increased threshold for withdrawal of pension contributions.

Foreign currency deposits in currency equivalent, that is excluding revaluation, decreased by 1.4% in annual terms

Figure 19. KASE Index (Dec.2019=100)

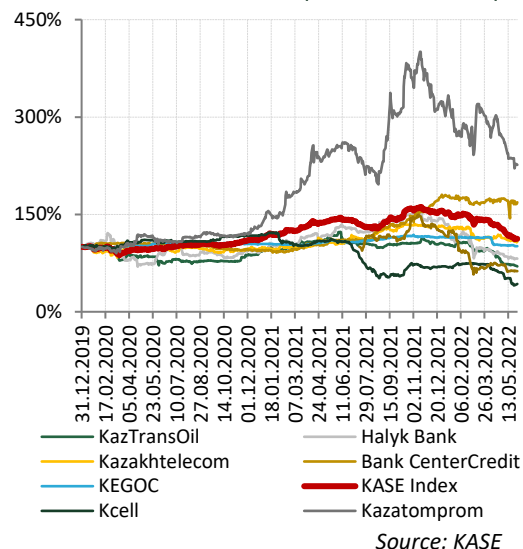


Figure 20. Contribution to the Growth in the Deposit Volume by Components, YoY, %

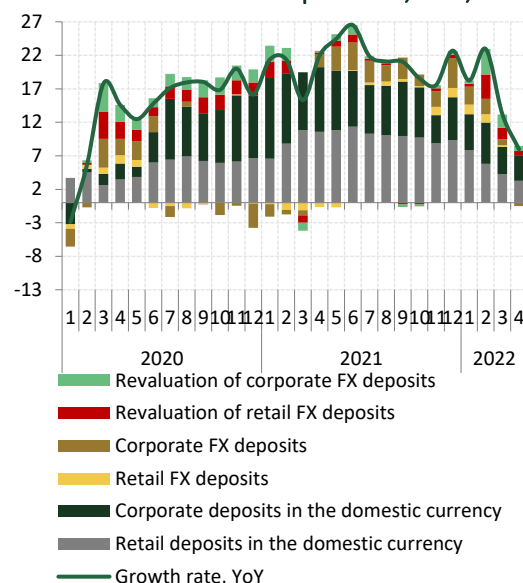
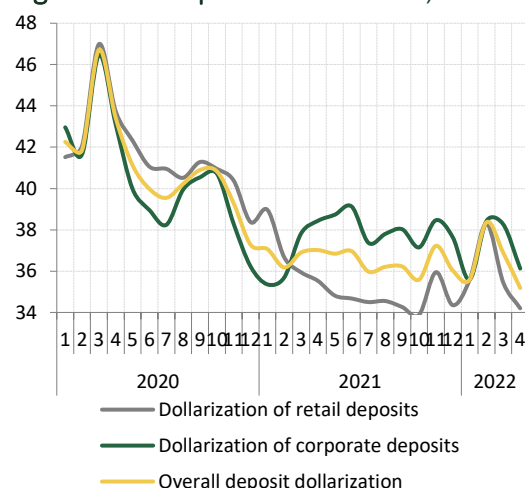
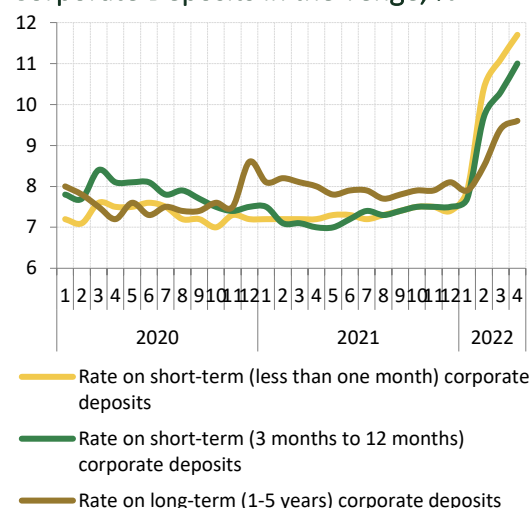


Figure 21. Deposit Dollarization, %



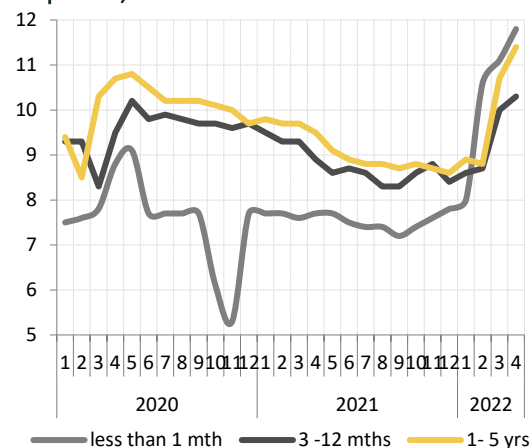
Source: NBK

Figure 22. Interest Rates on Corporate Deposits in the Tenge, %



Source: NBK

Figure 23. Interest Rates on Retail Deposits, %



Source: NBK

(in the tenge equivalent, the growth accounted for 2.6%).

Overall level of dollarization decreased from 36.0% in December 2021 to 35.2% in April 2022. Appreciation of the national currency and outflow of funds in foreign currency were conducive to such reduction. Dollarization of the corporate sector as of end-April 2022 decreased from 37.6% in December 2021 to 36.1%, and of the retail sector – from 34.4% to 34.2% (Figure 21).

Following the increase of the base rate, interest rates on deposits of corporate entities and individuals went up significantly in April 2022. Thus, in the corporate sector, deposits with maturity up to one month, which account for the major portion in attracted deposits (88.1% of all time deposits of business in the tenge) have grown to 11.7% in April 2022 compared to 7.4% in December 2021 (7.2% in April 2021). Deposits with maturity from three months to one year (with a share of 10.2%) also increased from 7.5% to 11.0% in April 2022 (7.0%). Interest rates on long-term deposits with maturity from one to five years (with a share of 0.5%) went up from 8.1% to 9.6% in April 2022 (8.0%) (Figure 22).

Rates on retail sector deposits also demonstrated an upward trend. Deposits with maturity from three months to one year (with a 39.9% share of attraction) have grown from 8.4% in December 2021 to 10.3% in April 2022 (8.9% in April 2021), and rates on deposits with maturity from one to five years (with a share of 43.7%) went up to 11.4% from 8.6% in December 2021 (9.5%). Short-term deposits of up to one month (with a share of 9.2%) also increased to 11.8% from 7.8% in December 2021 (7.7%) (Figure 23).

2.7. Credit Market

The loan portfolio kept growing due to the increased lending to the population and businesses in the tenge. At the same time, consumer loans decelerated while the mortgage loan portfolio accelerated its growth.

Despite the tightening of the monetary policy and the increased cost of borrowing, the loan portfolio of businesses continued to grow.

In April 2022, the loan portfolio of the second-tier banks expanded by 28.5% in annual terms, amounting to 19.4 trillion tenge.

The main contribution to the growth of loan portfolio was made by lending to the retail sector in the tenge. Loans to businesses in the national currency also increased, despite the growing cost of such lending (Figure 25).

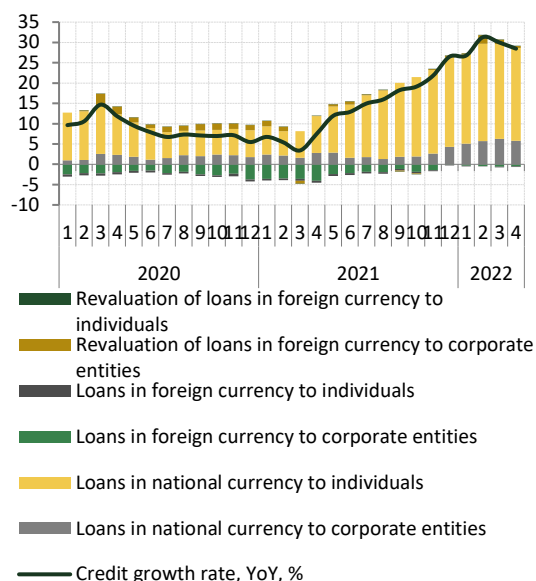
Consumer lending remains as the key driver of retail lending (Figure 25). However, the growth rate of the consumer loan portfolio in April slowed down to 35.6% versus 37.9% in January 2022, whereas the annual increase in mortgage loans accelerated to 49.8% (in January 2022 – 39.3%).

In April, the cost of consumer loans decreased to 18.9% from 19.8% in April of the last year, whereas the cost of mortgage loans remains at 8.2%.

In April, the annual growth of corporate sector loans accounted for 12.1%. Small business loans made the main contribution to the growth in the business loan portfolio, having increased by 60.4% over the year.

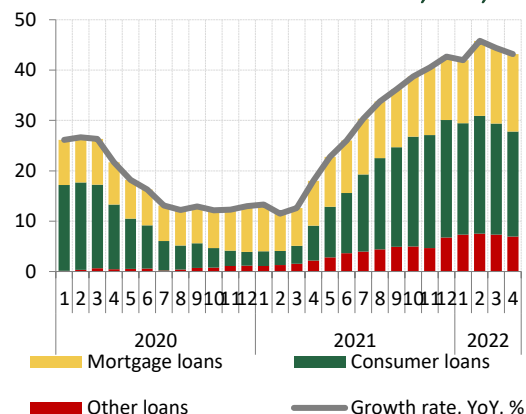
Due to the tightening of monetary policy, the weighted average interest rate on the tenge loans to businesses in the short-term segment went up from 11.2% in last April to 15.1% in April 2022. The cost of long-term loans also increased from 13.3% to 15.4% (Figure 26).

Figure 24. Credits to the Economy, YoY, %



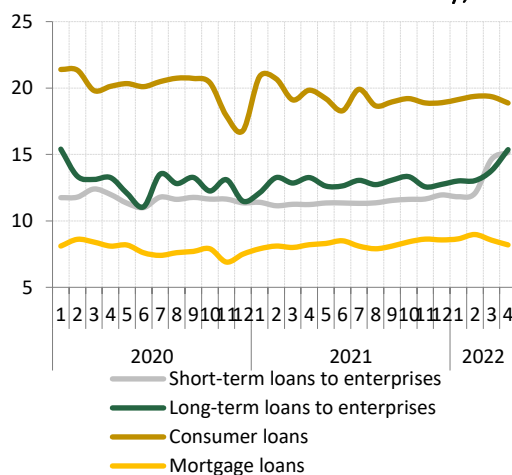
Source: NBK

Figure 25. Contribution by Components to the Annual Growth of Retail Sector Loans, YoY, %



Source: NBK

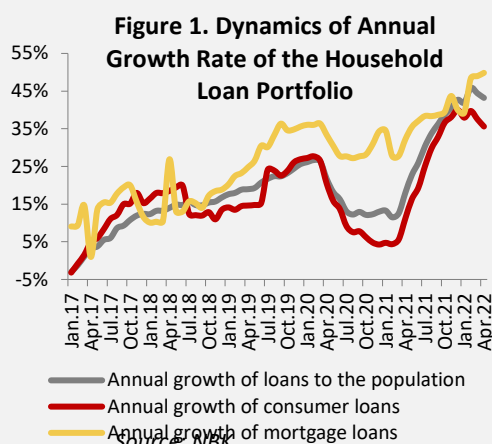
Figure 26. Rates on Loans in the National Currency, %



Source: NBK

Box 1. The Effect of One-Time Pension Payouts on Improvement of Housing Conditions on the Household Loan Portfolio

Since 2017, retail loans have been growing at a double-digit pace. In 2021, the growth of household loan portfolio accounted for 42.7%, demonstrating a record-high increase since 2008. Expansion of consumer and mortgage lending that went up by 40% was conducive to this fact.



Since 2017, consumer loans have been growing amid the increasing real income of the population. The launch of “7-20-25” and “Baspana Hit” concessional lending programs contributed to a swift growth of mortgage lending since 2018. In 2021, this trend was ongoing being additionally supported by the program for withdrawal of pension savings. In 2021, the number of purchases and sales in the housing market almost doubled amounting to 606 056 transactions. Also, during January-March of this year, the number of transactions was 147 743 (a 28.1% growth compared to the same period of the preceding year).

To assess the effect of one-time pension payouts on the mortgage portfolio, it is important to understand the purposes

of using pension savings. Thus, a direct effect on the growth of the loan portfolio may be exerted only by the use of pension savings to obtain a loan, and if the funds were used to repay a mortgage loan, then this, on the contrary, reduces the loan portfolio. If the funds were used to buy a home without a mortgage, then this does not have an effect on lending (Table 1).

Table 1. Paid out pension savings by sub-purposes

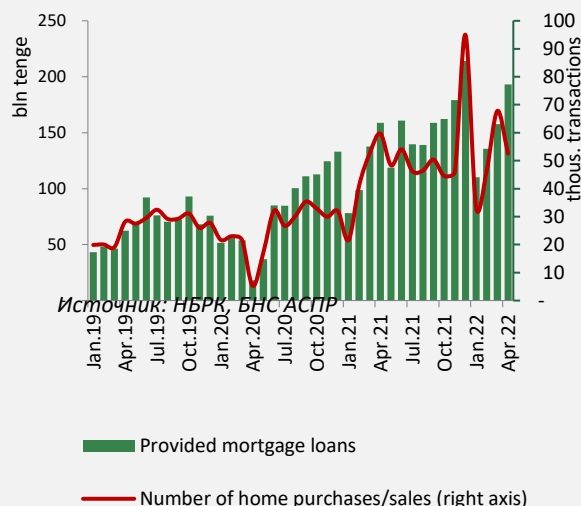
Sub-purposes of the one-time pension payouts for improvement of housing conditions	share	Effect on the mortgage loan portfolio
Acquisition of housing by right of ownership under civil transactions (payment in full)	64%	=
Making a down-payment for getting a residential mortgage loan for home purchase (including as part of financing by an Islamic bank)	4%	+
A partial repayment of debt on a residential mortgage loan (including as part of financing by an Islamic bank)	7%	-
A full repayment of debt on a residential mortgage loan (including as part of financing by an Islamic bank)	1%	-
Obtaining a residential mortgage loan under the housing construction and savings scheme, a residential mortgage loan refinancing	6%	+
A partial repayment of debt on a residential mortgage loan under the housing construction and savings scheme	5%	-
A full repayment of debt on a residential mortgage loan under the housing construction and savings scheme	1%	-
Replenishment of deposit to housing construction savings for further accumulation	8%	=
Other sub-purposes	3%	
TOTAL	100%	

Source: UAPF

The bulk of the amount paid from the UAPF since the launch of the program until April 2022 was used for the purchase of housing under the payment in full scheme, i.e. about 2.0 trillion tenge. The amount of funds that was used as a down-payment for obtaining a residential mortgage loan as well as for getting a residential mortgage loan under the housing construction and savings scheme and the refinancing of a residential mortgage loan amounted to 113 and 202 billion tenge, respectively. The UAPF has paid out about 470 billion tenge for repayment of mortgage loans since the launch of the program to April 2022.

The study of the dynamics of provided mortgage loans and the number of concluded home purchase/sale transactions also shows a high correlation (correlation for the period from the beginning of 2021 through April of this year – 78.3%).

Figure 2. Dynamics of Purchase and Sale Transactions and of Mortgage Loans Provided



The secondary effect of pension savings could cause the growth in the mortgage loan portfolio. When the population repays a mortgage loan, it happens to have spare money, which can be potentially used to purchase a home loan.

Along with the growth in mortgage loans, consumer loans were also growing. Due to home purchases, the demand for durable goods was increasing. Moreover, the process of buying goods on credit/instalment has been simplified owing to digitalization. In general, since 2017, the correlation between mortgage loans and consumer loans has been very high (about 98.7%), meaning that home purchases are accompanied by purchases of durable goods.

In April 2022, the sufficiency threshold was increased, thus reducing the access to withdrawal of pension savings. The news about the increased sufficiency

threshold resulted in a heightened demand for mortgage lending and the largest volume of transactions was conducted in March of this year amounting to 407 billion tenge. Payouts from the UAPF for improvement of housing conditions in April of this year decreased to 7.6 billion tenge or by 33 times compared to 253 billion tenge in April 2021.



III. MACROECONOMIC CONDITIONS

III. MACROECONOMIC CONDITIONS

3.1. External Sector

Quarantine measures in China held back the recovery of business activity (Figure 27)

In April of this year, global the purchasing managers' indices decelerated. On a country-by-country basis, it declined largely in China where in March-April 2022 quarantine restrictions were in force. In other countries, the business activity in the industry and services contracted not so much. Producers reported that production costs and ex-factory prices hiked.

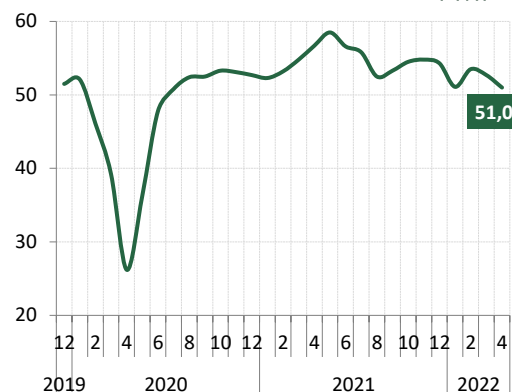
Despite some decline in the prices of energy carriers, in April 2022 the global inflation has been high (Figure 28)

Countries continue to observe the growth of consumer inflation because of rising prices for food, housing and gasoline. In China, acceleration of inflation was accompanied by the increased disruptions in logistics and growing food prices. In the EU, energy carriers keep making the main contribution to upturn in inflation. In the USA, the highest growth was demonstrated by gasoline, housing and food prices.

World oil prices are held on above 100 US dollars per barrel because of the shortage in supplies (Figure 29)

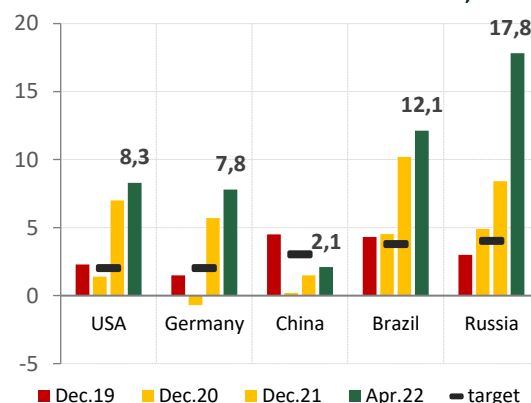
At present, oil prices are supported, on the one hand, by a stronger seasonal demand in the world, and on the other hand, by reduced supplies of oil from Russia due to the geopolitical situation. The zero-tolerance policy pursued by the Chinese authorities in respect of new COVID-19 incidences continues to be a constraining factor for the price growth. The imposition of an embargo on importation of Russian oil by the EU countries remains an open issue.

Figure 27. Global Composite PMI¹



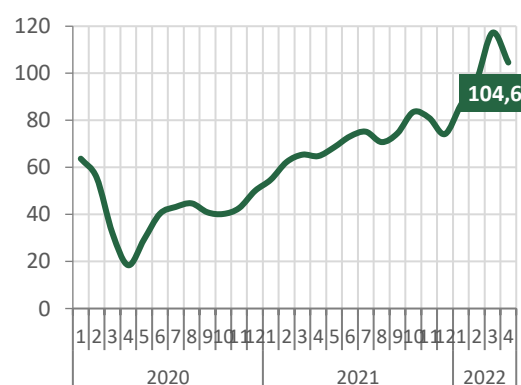
Source: Bloomberg

Figure 28. Inflation in Some Countries of the World, %



Source: national statistical offices

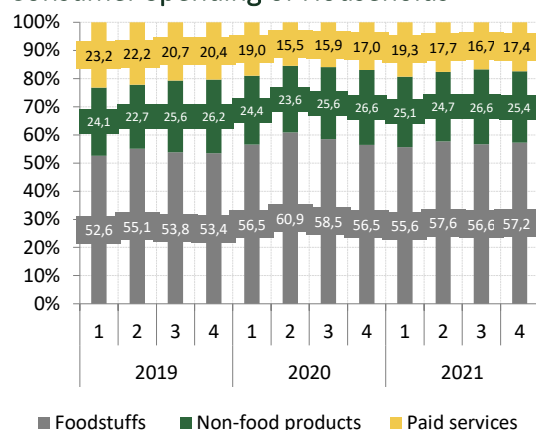
Figure 29. Brent Oil Price, US dollars (monthly average)



Source: Bloomberg

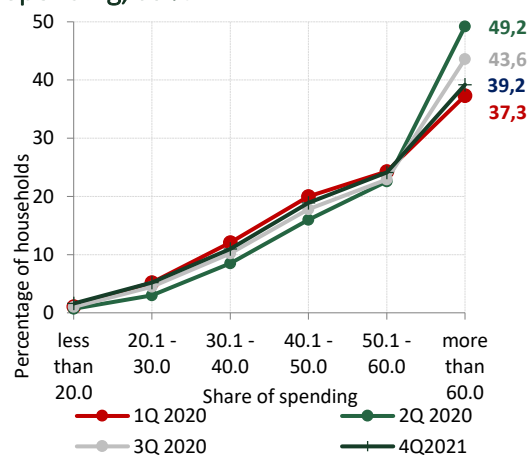
¹ – an index value of more than 50 means an increase in the indicator, less than 50 means decrease, and equal to 50 means its invariability

Figure 30. Structure of Nominal Consumer Spending of Households



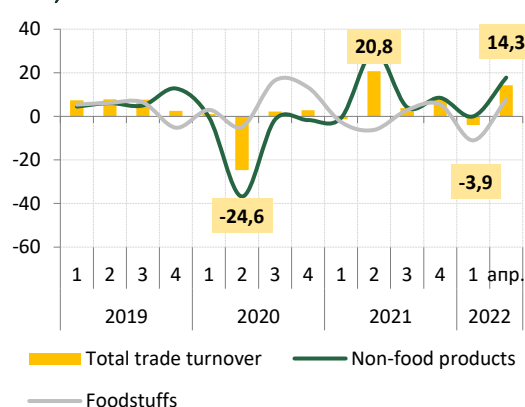
Source: BNS ASPR

Figure 31. Percentage of Household Spending on Food in the Consumer Spending, as %



Source: BNS ASPR

Figure 32. Dynamics of Retail Sales, YoY, %



Source: BNS ASPR, NBK's calculations

3.2 Development of the Domestic Economy

A real consumer demand in 2021 was characterized by the recovering dynamics. The volumes of demand reached pre-pandemic levels in the second half of the last year.

The structure of consumer spending that has changed significantly since the onset of the pandemic has not yet returned to its standard form. In the environment of high food inflation, nominal household spending on foodstuffs still account for more than 55% of all consumer spending (Figure 30).

At the same time, as quarantine restrictions are lifted, earnings recover their growth and, as a consequence, the household consumer activity is reviving, the share of Kazakhstan's population that uses over 60% of its consumer spending on food started to decrease. In the fourth quarter of 2021, the percentage of such population came back to the level of the beginning of 2020 (Figure 31).

At the beginning of this year, the epidemiological situation in the country improved (the number of new coronavirus cases in March was insignificant). This nurtured a further expansion in the consumer demand. At the same time, in the first quarter of this year, the tragic January events in Kazakhstan followed by the imposed state of emergency in most regions of the country had negatively affected the demand. Thus, retail sales in January of this year demonstrated decline, in particular, the food trade turnover contracted by 17.2%, and that of non-food products – by 15.1%. In February-March of this year, after the lifting of the state of emergency, the turnover of non-food products had restored demonstrating considerable growth rates. However, the dynamics of food turnover remained in the declining zone until April 2022. In April 2022, the upturn of food and non-food turnover accounted for 7.7% and 17.8%, respectively (Figure 32).

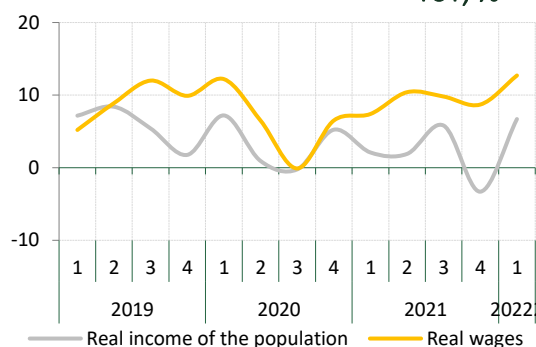
Real income of the population keeps growing due to a two-digit increase in real wages, persistently high budget spending on current transfers and yearly indexation of retirement benefits (Figure 33).

Real wages in the first quarter of 2022 accelerated to 12.7% in annual terms. Such sizable growth was partly driven by the increase of minimum wage to 60 thousand tenge, a 41.2% compared to the previous level of 42,500 tenge.

According to the statistics on employee distribution by wage, the share of employees with wages below 60 thousand tenge in 2021 was about 7.7% (Figure 34). This is the part of employees that should have benefited most from the increase of minimum wage. In the context of sectors, concentration of this category of employees is observed in agriculture; real estate operations; arts, entertainment and leisure; and in the administrative and ancillary service. Generally, the largest portion of employees is distributed within the wage interval from 150,000 tenge to 180,000 tenge.

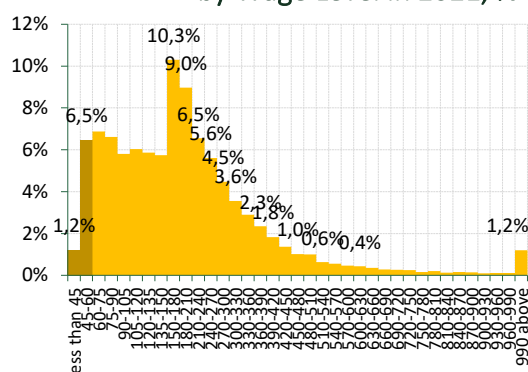
The annual growth in nominal wages in the first quarter of 2022 accounted for 23.7%. The contribution from the growth in minimum wage to the increase in nominal wage in the economy made up 7.5 pp (according to the NBK's assessment). A major effect from the increase was on the sectors of the economy with smaller wages – agriculture, water supply, entertainment, leisure and arts. The smallest effect from the increase of minimum wages was exerted on the sectors of the economy with the highly paid staff – professional scientific and technical activities, the mining industry, finance and insurance (Figure 35).

Figure 33. Dynamics of Real Income of the Population and its Components, YoY, %



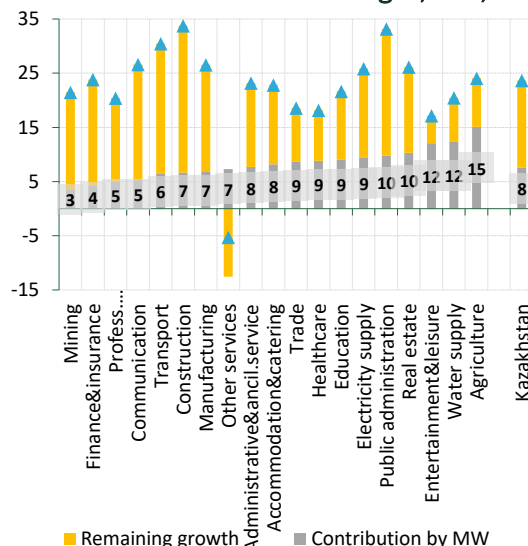
Source: BNS ASPR, NBK's calculations

Figure 34. Distribution² of Employees by Wage Level in 2021, %



Source: BNS ASPR

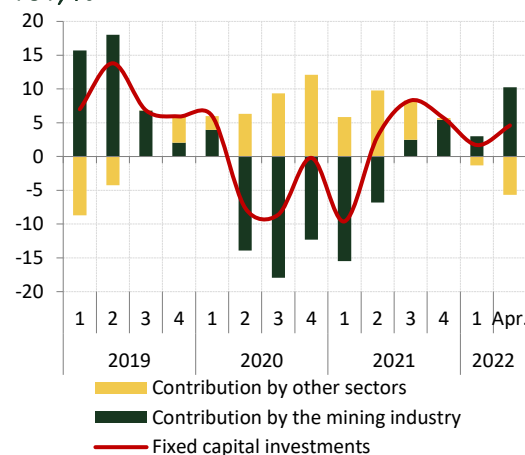
Figure 35. Contribution by the Increase in Minimum Wage to the Growth in Nominal Wages, YoY, %



Source: BNS ASPR, NBK's calculations

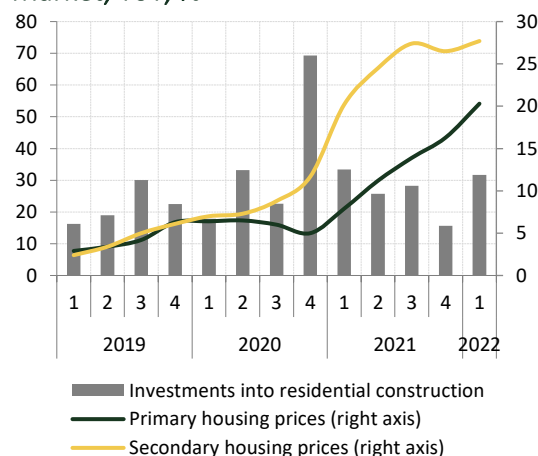
²Data generation and publication is carried out by the BNS ASPR based on actual numbers of full-time employees

Figure 36. Fixed Capital Investments, YoY, %



Source: BNS ASPR

Figure 37. Investments into Residential Construction and Prices in the Real Estate Market, YoY, %



Source: BNS ASPR

In 2022, investment activity in the economy retained its positive dynamics. Investments into construction, major overhaul and scheduled maintenance still constitute the main source of fixed capital investments in the economy. Construction and installation works represent the most stable part in the technological structure of investments and have been making a positive contribution to its growth over the past ten years. At the same time, the least stable part of investments is investment in the renewal of property, plant and equipment. In the first quarter of this year, it made a negative contribution to the growth of investments preserving its volatile dynamics.

The positive trend of investments into the mining industry continued and became the main reason for the growth of investments in the sectoral context (Figure 36). Investments into the manufacturing industry that have been growing over the past two years, in 2022 has been in the zone of significant decline. Investments in other branches of the real sector, with the exception of communication, accommodation and catering services as well as financial and insurance activities, demonstrate growth and make a positive contribution to the increase of investments in the economy.

The investment activity of the population continues to show two-digit growth rates. Investments in residential construction, after a slight slowdown at the end of 2021, accelerated again in the first quarter of 2022 (Figure 37). Acceleration was observed from January to March 2022 from 9.8% to 42% due to a feverish demand associated with a change in the minimum sufficiency threshold within the framework of the use of a part of pension savings from the UAPF. In this light, the upward trend of prices in the primary and secondary real estate markets has persisted. At the same time, the rate of price growth in the primary market exceeded 20% in annual terms, reducing the differential between the rate of price change in the primary and secondary real estate markets.

In January-March 2022, the foreign trade turnover has been at its maximum since 2015, mainly due to the growing export and import prices. Unstable geopolitical situation in the world, surge in prices of raw materials and depreciation of the tenge made a central contribution to the rise in external prices.

Exports at the end of the first quarter of 2022 increased by 65.8% in annual terms and amounted to 19.1 billion US dollars (Figure 38). The key driver for such increase was the expansion in exports of oil in value terms by 98%, while in kind such growth accounted for 11.8%. On a country-by-country basis, physical volumes of oil exports to the following countries increased: to Italy – by 39%, to Korea – by 2.9 times and to Singapore – by 4.7 times (Figure 39).

Among grain cultures, exports of wheat went up by 63.4% as a result of the growing supplies to Uzbekistan within the framework of implementation of measures on ensuring food safety in the neighbouring country, as well as to Iran because of the drought for the second year in a row. At the same time, supplies of rice and barley decreased. In the foodstuff structure, export supplies of flour to Afghanistan and fats and oils to China increased by 41.6% and 2.9 times, respectively.

In the structure of ferrous metals, exports of ferro-alloys decreased and exports of flat rolled metal went up. In the structure of non-ferrous metals, exports of aluminum, zinc and copper increased.

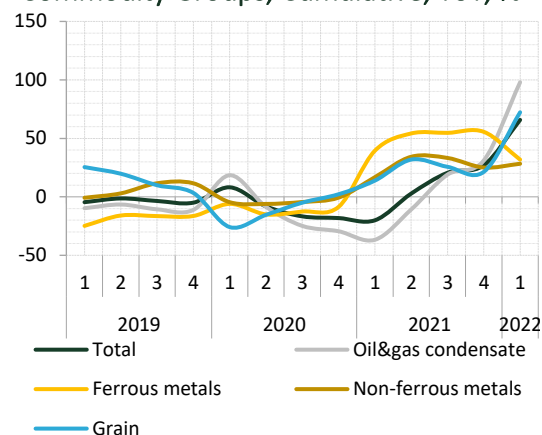
During January-March 2022, imports went up by 16.5% and summed up to 9.5 billion dollars. In terms of countries, imports are growing from China by 22.5%, from Russia – by 11.8% and the EU countries – by 2.4% (Figure 40).

Among foodstuffs, imports of meat in kind decreased while import of milk increased. Imports of sugar dropped because of the reduced supplies from Brazil. Imports of soft beverages went up owing to their larger supplies from Russia.

Among non-food products, imports of medications, telephone sets and home furniture were increasing. Meanwhile, supplies of scouring products and detergents, personal care items and cosmetics decreased. In addition, imports of clothes went down, mainly due to the decreased imports from China. Imports of computing machines, monitors and projectors declined.

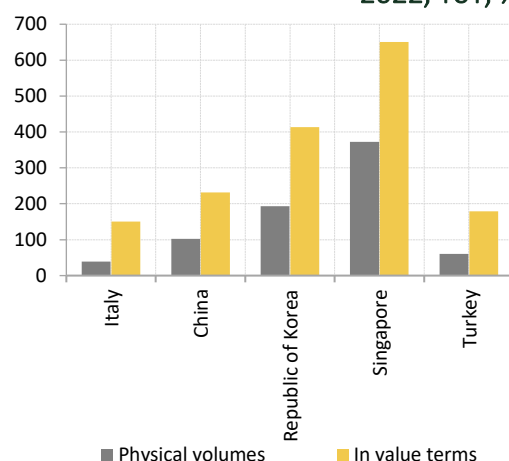
Within interim goods, there was an increase in imports of fertilizers from Russia and tires and covers from China. As for investment goods, supplies of cargo-handling motorized vehicles from China and Thailand went up. On the other hand, imports of natural gas, air pumps and transformers decreased.

Figure 38. Exports by Major Commodity Groups, Cumulative, YoY, %



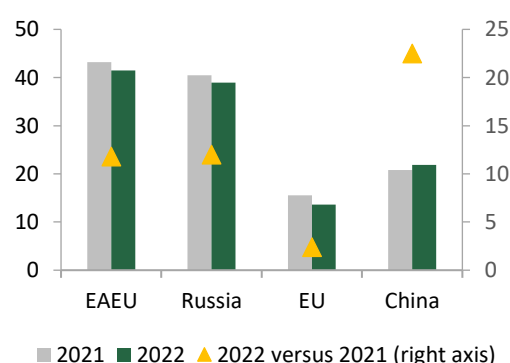
Source: BNS ASPR

Figure 39. Oil Exports on a Country-by-Country Basis in the First Quarter of 2022, YoY, %



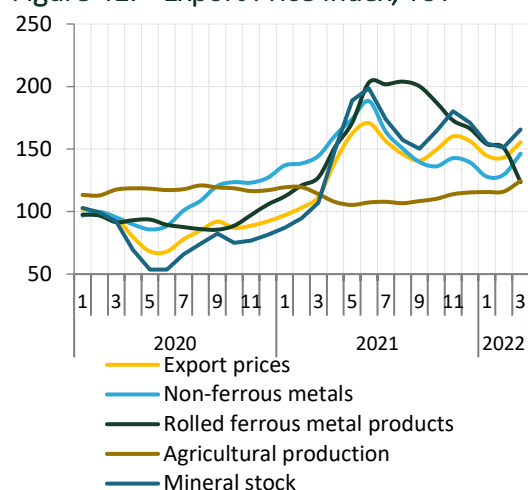
Source: BNS ASPR

Figure 40. Shares of Countries in Imports and the Change in Volumes of Imports in Annual Terms in the First Quarter of 2022, %



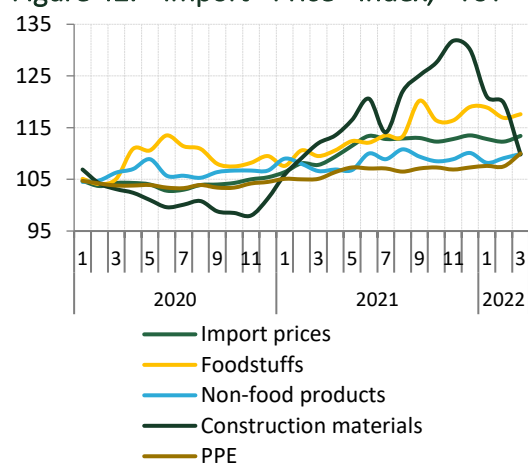
Source: BNS ASPR

Figure 41. Export Price Index, YoY



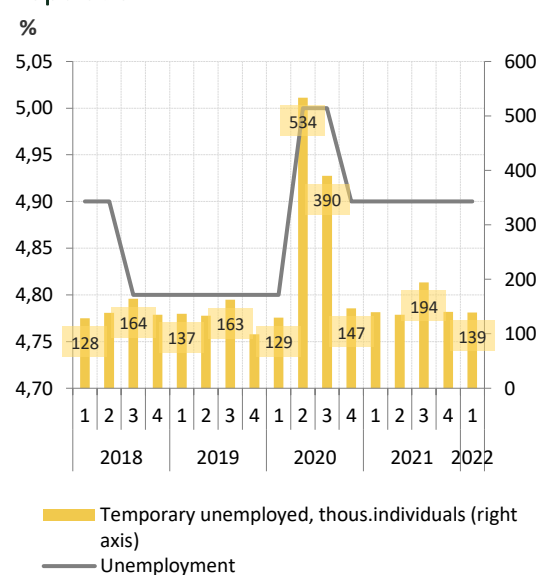
Source: BNS ASPR

Figure 42. Import Price Index, YoY



Source: BNS ASPR

Figure 43. Unemployment Rate and the Temporary Unemployed Population



Source: BNS ASPR

In the first quarter of 2022, the annual price growth of export supplies accelerated significantly from 43.2% in February of this year to 55.5% in March of this year because of unstable geopolitical situation (in March, the growth accounted for 15.7%, MoM). In the agricultural sector, in January-March 2022, the growth in export prices of wheat and rice accelerated a lot, and in the flour and cereals industry prices of flour hiked. Among mineral products, one may point out acceleration of prices for crude oil, hard coal and natural gas. Among metals, prices of copper, aluminum, lead and zinc demonstrated a higher price surge (Figure 41).

Due to depreciation of the tenge, in March 2022 the annual rise in import prices somewhat accelerated to 13.4% (in February – 12.3%). Among foodstuffs, the growth in prices of meat, cheeses, cottage cheese and sugar accelerated. Within non-food products, prices of medications were growing at a faster pace whereas prices of cars decelerated. As for investment goods, prices of construction materials decelerated significantly due to appreciation of the tenge against the ruble (Figure 42).

3.3 Labor Market

In the first quarter of 2022, the situation in the labor market was characterized as neutral. The numbers of labor force increased by 0.4%. In its structure, both the employed population and the unemployed population went up. The unemployment rate remained unchanged and accounted for 4.9% (Figure 43).

The increase in the employed population in the first quarter of 2022 was resulting from the growth of both the self-employed population and employees. The growth in the number of employees was slightly exceeding that of the self-employed.

Despite the growing number of employees in the economy as a whole, on an industry-by-industry basis, decline in the number of employees was observed in half of the economic sectors (Figure 44, group 1). In the sectors of construction, transport and arts, entertainment and leisure, the negative dynamics have been persisting since the onset of the pandemic. At the same time, a sizable increase in the numbers of self-employed population has been observed in these sectors of the economy since the pandemic period; this fact may be the evidence of an overflow of employees to the self-employed category or to other sectors of the economy.

A similar trend is observed in the sector of water, gas and vapor supply.

In the sectors of agriculture, administrative and ancillary service, real estate operations, the rate of employment decreases, both among the self-employed population and among employees.

The improvement of situation with employment in the sectors owing to a rapid growth in the number of employees is noted in sectors of the second group (Figure 44), except for financial and insurance activities as well as information and communication sector where the numbers of self-employed population have been growing for a long time.

Stabilization of the situation in the labor market in most sectors of the economy resulted in the reduced number of temporary unemployed individuals in the country (Figure 43). Given the reduced number of temporary unemployed population, the demand from the labor force for the services of employment authorities in Kazakhstan decreased compared to 2020 and returned to the levels of 2019 (Figure 45).

In the first quarter of 2022, the business activity in the economy was demonstrating a high growth, having increased to 4.4%, against a more moderate increase of employment – by 0.4%. As a result of such outstripping growth in gross value added compared to more modest dynamics of employment, indices of labor productivity in many sectors of the economy reached the pre-crisis levels of 2019 (before 2019, the labor productivity was demonstrating steady growth rates).

However, despite the growing labor productivity in the economy, its growth rates do not exceed the two-digit growth rates of real wages. In addition, in some sectors of the economy a negative trend in the labor productivity is still persisting and is associated with either lagging growth of value added in the sector compared to the employment or with the steady negative dynamics of the business activity.

Therefore, in all sectors of the economy except water supply and provision of other services, the signs of pro-inflationary pressure are observed, being expressed in the outstripping growth of real wages over the increase in labor productivity (Figure 46).

Figure 44. Contribution to the Growth in Employment of the Population by Employees and the Self-Employed by Types of Economic Activities in the First Quarter of 2022, YoY, %

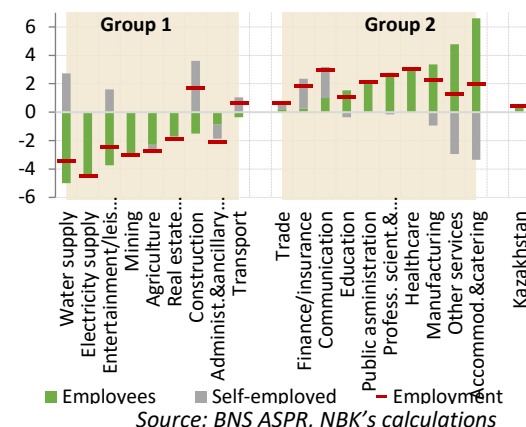


Figure 45. People who Applied to the Public Employment Authorities as Job Seekers, Thousand Individuals

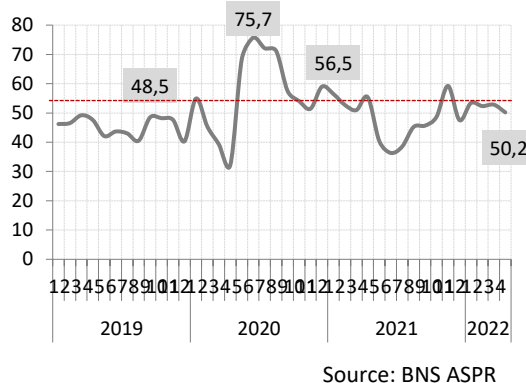
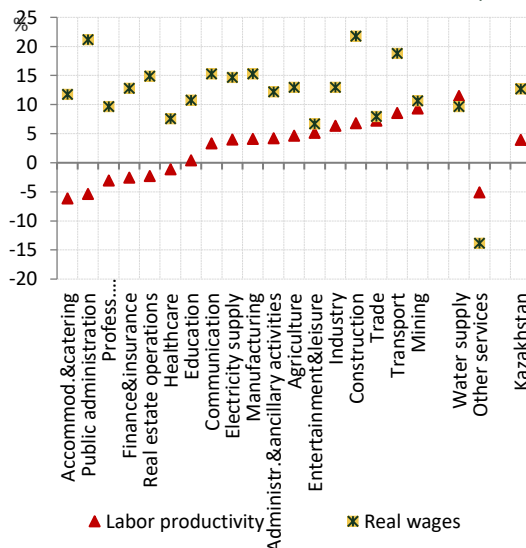


Figure 46. Labor Productivity and Real Wages by Types of Economic Activities in 2021, YoY, %



Source: BNS ASPR, NBK's calculations

Box 2. Geopolitics and the Real Sector of Kazakhstan

To look into the business climate and assess changes in the economic environment, the National Bank conducts quarterly surveys of enterprises in the real sector. The survey questionnaires conducted in April of this year (based on the results of the first quarter of 2022) included questions about the impact of the geopolitical situation on Kazakhstani business that were answered by more than 3,000 enterprises of various industries from all regions of the country.

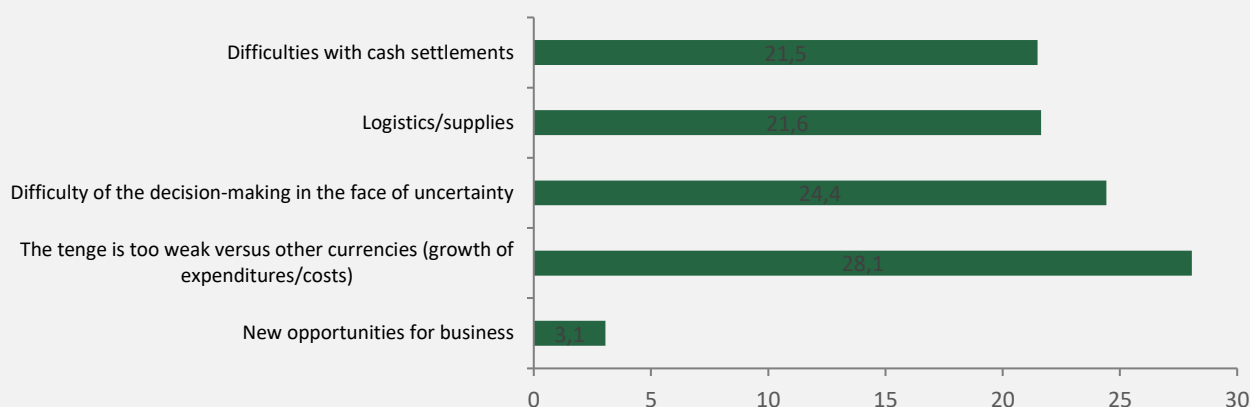
The majority of enterprises (50.3%) stated that the geopolitical situation and the sanctions imposed against the Russian Federation had a negative impact on their operations, 11.5% of which noted that their business was hit very hard. At the same time, 41.2% of respondents mentioned that the geopolitical situation had no effect on their activities. Only 24 enterprises (0.8%) noted positive impact due to the appearance of new business opportunities.

Enterprises in the sector of communication and information services are the least affected by geopolitics, since the majority of them (73.4%) stated that the situation had no impact on their business. The most sensitive was the manufacturing industry, where 62.5% of respondents experienced a negative impact. Among importing enterprises, this share is even higher (70.4%), while the vast majority of them (86.1%) use the Russian ruble in settlements with foreign partners.

Out of the enterprises that noted a negative impact, the majority mentioned an increase in costs due to the weakening tenge in the first quarter of 2022 (28.7%); also respondents noted the difficulty of the decision-making in the face of uncertainty (24.4%), problems with logistics (21.6%), difficulties in making payments (21.5%) (Figure 1).

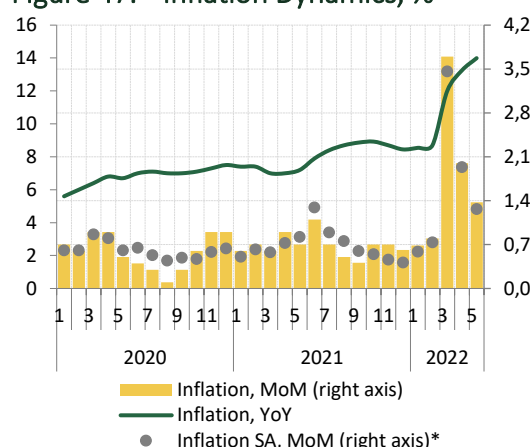
A statistical portrait of the most affected enterprise is a large importing enterprise from the manufacturing industry, which uses the Russian ruble in settlements with partners.

Figure 1. Consequences of the Geopolitical Situation



Source: NBK's data and calculations

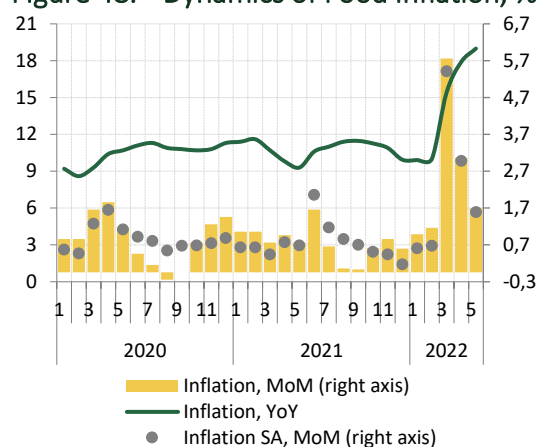
Figure 47. Inflation Dynamics, %



Source: BNS ASPR, NBK's calculations

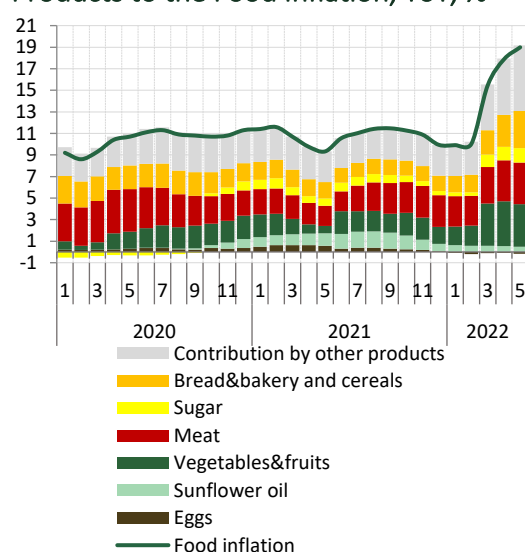
*- Seasonal adjustment was performed by using the X-12-ARIMA method from 2011 until present

Figure 48. Dynamics of Food Inflation, %



Source: BNS ASPR, NBK's calculations

Figure 49. Contribution of Particular Products to the Food Inflation, YoY, %



Source: BNS ASPR, NBK's calculations

3.4. Inflation

As of end-May 2022, the annual inflation accelerated to 14% (Figure 47) due to the rise in prices of all inflation components. The largest contribution to acceleration of the headline annual inflation was made by the growth in food prices, which in May of this year accounted for 19%. The growth in prices of non-food products and paid services also accelerated – to 11.9% and 9.1%, respectively.

The annual increase in food prices as of end-May 2022 made up 19% (Figure 48). Among products, a significant acceleration of prices for bread and bakery and cereals, sugar and confectionery as well as dairy products was observed.

In May 2022, the overall contribution by the rise in prices of fruits and vegetables, meat, sugar, bread and bakery and cereals to the food inflation accounted for 12.9 pp (Figure 49).

Prices of meat kept growing due to the persistently high rise in the producer prices (by 9.5% in April 2022) and a significant increase in the price of forage crops. In April 2022, the FAO Meat Price Index reached its record-highs since its very establishment, having made up 16.8% in annual terms. Given the above factors, as well as the decline in grain crops and pulses in 2021 by 18.4% and stocks by 15.8 YoY as at May 1, 2022, risks of a further rise in meat prices are persisting.

Due to deceleration of producer prices in March 2022, a slump in the feverish demand and the seasonal price changes, in May of this year consumer prices of vegetables in annual terms slowed down to 29%. It is worth mentioning that despite a 8.6% monthly decline of vegetable prices in May, a 19.7% monthly price increase in March 2022 exceeded the shocking growth of June 2021, resulting in that the annual numbers remain high. The March rise in prices was caused by the increase in prices of field vegetables (potatoes, beetroots, onions, carrots, and cabbage) in the first instance.

In the spring of 2022, a spike in sugar prices (by 47.7% during the period from March to May), the annual price growth in May 2022 reached 59.9%.

The main reason for such dynamics had been the accelerating growth of world prices amid the persisting shortage of supply and the increasing global demand.

In April 2022, the annual growth of the FAO Sugar Price Index accounted for 21.8%. A significant pro-inflationary pressure is also exerted by a ban on sugar exports by the Russian Federation – the largest importer of sugar to Kazakhstan – that was imposed for the period from March 15 through August 31 of this year. Apart from that, in May 2022 the Government of India – one of the largest sugar producers – announced a ban on exports of sugar outside the country given a dramatic acceleration of domestic prices.

The annual growth of consumer prices for flour and cereal products in May 2022 accelerated to 28.6%, while producer prices in April accelerated to 29.8%. Besides, world prices remain high (the FAO Cereal Price Index in April of this year went up by 34.3% in annual terms), stocks of grain crops and pulses are decreasing, given a low harvest of 2021. In this environment, the pressure in this market remains at an elevated level. At the same time, it should be noted that a reduced supply of grain crops and pulses may have a negative effect on the price dynamics of a broad range of foodstuffs where they are used in production, including meat, dairy products, bread and bakery and eggs.

The annual growth in prices of **non-food products** in May 2022 accelerated to 11.9% (Figure 50). Due to disruptions in the logistics supply chains as well as because of uncertainty about the impact of geopolitical situation, a spike in prices of imported products occurred. Nonetheless, administrative regulation of prices for fuel and lubricants keep exerting a disinflationary effect on the non-food component.

In May 2022, the contribution of the rise in prices for solid fuel, cars, fuel and lubricants, clothes and footwear to the annual non-food inflation made up 4.9 pp (Figure 51). In March 2022, prices were growing in virtually all commodity groups of the non-food component, which was largely driven by depreciation of the tenge against the backdrop of deteriorating geopolitical situation in the world as well as the resulting feverish demand.

Figure 50. Dynamics of Non-Food Inflation, %

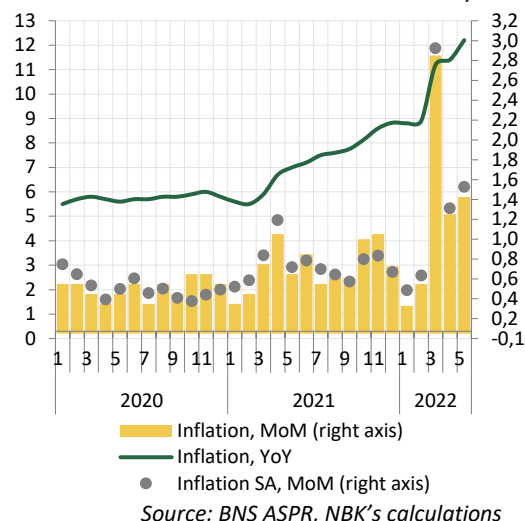


Figure 51. Contributions by Non-Food Products, YoY, %

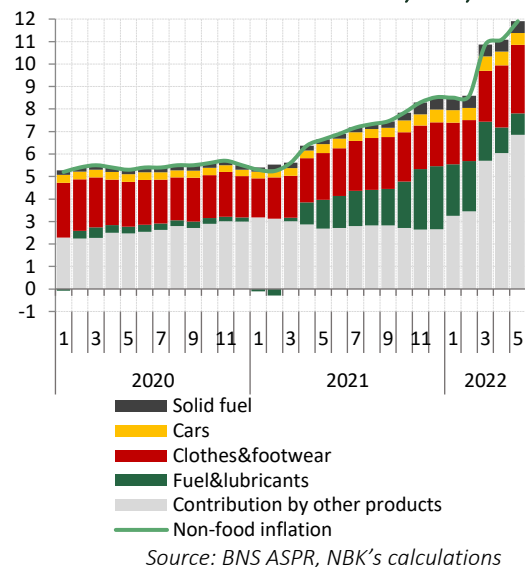
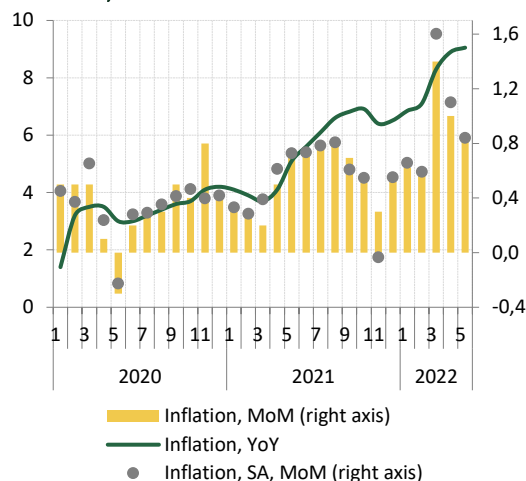


Figure 52. Dynamics of Service Inflation, %

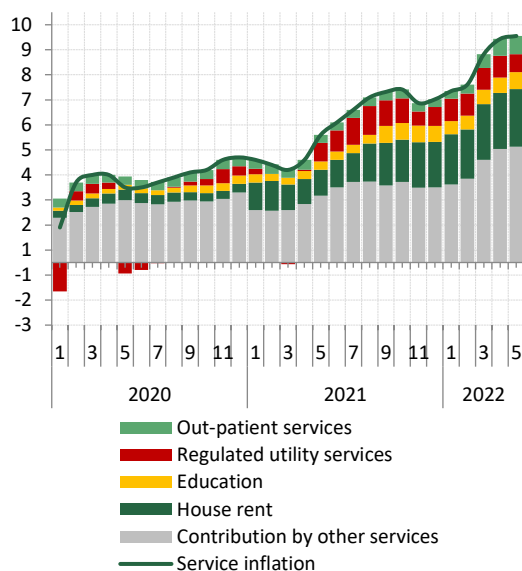


Source: BNS ASPR, NBK's calculations

In May 2022, annual growth rates of prices for **paid services** accelerated to 9.1% (Figure 52). The contribution by the growth in prices for out-patient services, education, house rent and regulated utility services to the annual service inflation made up 4.4 pp (Figure 53). At the same time, prices for gas and communication services are decelerating.

The imposition of a moratorium on the increase of prices for regulated utility services at the beginning of 2022 keeps putting a disinflationary pressure on the service component. The annual rise in prices for this category of services slowed down to 3.5% in May of this year after a boost in May-August of the last year. In April 2022, the growth in producer prices for services related to the supply of electricity, gas, vapor, hot water and conditioned air decelerated to 9.8%.

Figure 53. Contributions to the Paid Services Inflation, YoY, %

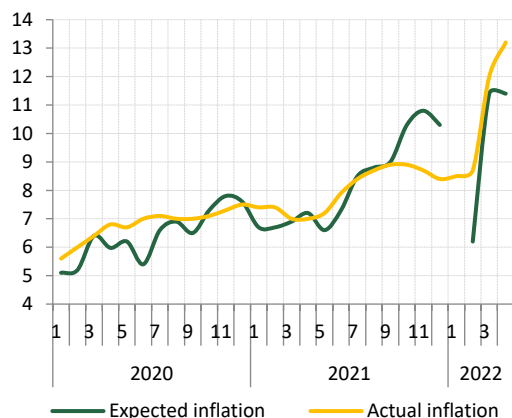


Source: BNS ASPR, NBK's calculations

As a result of persistently heightened demand as well as the increased cost of comfortable housing and construction materials, the growth of rental payment in April of this year accelerated to 24% YoY in annual terms, and in monthly terms the growth accounted for 1%.

The improving epidemiological situation, the restoration of normal operation of organizations and enterprises, coupled with the growing consumer demand, contributed to the increase in the cost of services of restaurants and hotels by 14.4%, hairdresser services – by 11.6%, passenger air transport – by 28.2%

Figure 54. Inflation and Expected Inflation, YoY, %



Source: CS MNE, FusionLab

Inflationary expectations of the population in March-April of this year remained heightened. A quantitative assessment of inflation (quantification) for a year ahead in March-April 2022 was 11.4% (Figure 54). Half of the respondents expect the price growth to accelerate or retain the current rate of growth in the next 12 months (53%). Respondents who expect prices to rise over a one-year horizon mainly associate this with the change in the exchange rate, the increasing prices of food, and external developments.

Perceptions of inflation have remained at a high level in recent months. Changes in external conditions, surges in the price of certain foodstuffs amid feverish sentiment were reflected in the deteriorating sentiment and perception of inflation in March, which also remained at an elevated level in April. The population mentioned the rise in prices of not only foodstuffs (sugar, fruits and vegetables, bread and bakery) but also clothes, footwear, home care products, cars and spare parts, services of transport, cafes and restaurants.

Box 3. Volatility of Inflation

Inflation targeting, in addition to achieving the inflation target in the medium term (1-2 years), implies the anchoring of inflation expectations, which themselves are an important factor in the formation of inflationary processes. At the same time, in case if inflation stays close to certain values for a long time, inflationary expectations are also formed around these values over time. In this regard, it is important to monitor the deviation of inflation from its target and have a description or an idea about such “instability”.

As a measure of inflation volatility, we may consider the deviation of inflation from the target and the variance of this deviation (since the target inflation rate is a constant, the variance of inflation deviation will coincide with the variance of inflation itself). The mid-point of the 6-8% band was taken as a target for the 2011-2017 period, in 2018 – the mid-point of the 5-7% band, and from 2019 on – the mid-point of the 4-6% band, which corresponded to the official inflation targets in Kazakhstan. The variance of values for a particular month was considered as a moving variance over the last 24 months in order to continuously represent volatility over time. Due to the impracticability of a detailed consideration of pairwise covariances for a large number of components of this or that index, all covariances were combined into one component and calculated as the difference between the variance of the index and weighted by the squared weights of the variances of the index components.

For the analyzed period of January 2011 - April 2022 and its sub-periods of January 2011 – September 2015, October 2015 – December 2016, January 2017 – April 2022, mean and standard deviations of differences between the target and the annual inflation, food inflation, non-food inflation and paid services inflation were calculated (Table 1). The choice of sub-periods was dictated by the transition to a free-floating tenge exchange rate in 2015 and a significant deviation of inflation from the target and its high volatility in the period from the end of 2015 – 2016.

Table 1. Mean and Standard Deviation of the Difference between Inflation and its Target for the Period, as %

Period	Mean				Standard Deviation			
	Goods and services	Foodstuffs	Non-food products	Paid services	Goods and services	Foodstuffs	Non-food products	Paid services
Jan. 2011 - Sep. 2015	-0.8	-0.4	-2.2	0.3	1.5	3.1	1.6	2.2
Oct. 2015 - Dec. 2016	7.1	5.2	15.3	1.6	3.3	2.4	6.6	1.5
Jan. 2017 - Apr. 2022	1.4	3.4	1.5	-1.3	1.7	3.0	1.3	1.9
Jan. 11 - Apr. 2022	1.1	2.0	1.5	-0.3	3.0	3.7	5.8	2.2

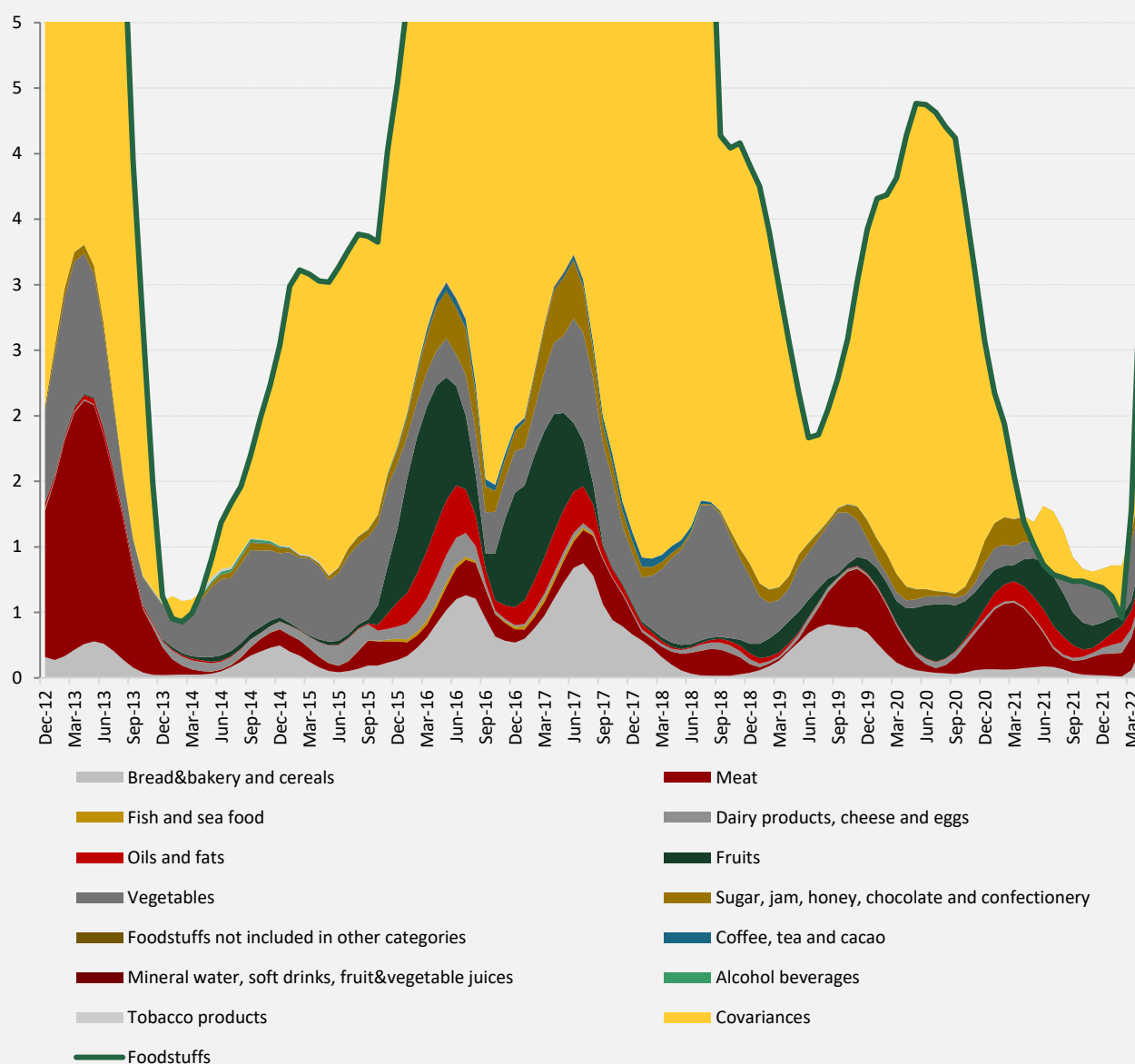
Source: NBK's calculations based on the data from the BNS ASPR

As the results show, foodstuffs deviate from the target to the largest extent and have the highest variance. At the same time, despite the fact that paid services after 2016 have the smallest deviation from the target, they have a heightened volatility.

If we consider the structure of foodstuffs, then from the point of view of deviation from the target, the “leaders” after 2016, in descending order, are tobacco products (because of the policy to increase excise taxes), oils and fats, meat, fish, and vegetables. At the same time, in terms of volatility of this parameter over the historical period, based on the weights, vegetables, bread and bakery and cereals, meat, fruits are the “leaders” (Figure 1). In addition, the dynamics of total contribution of all covariances are determined by the joint response to various shocks and go up during the periods of either a sharp slowdown in prices or their spike.

Among non-food products, after 2016, the purchase of cars, electrical appliances, footwear and fuel and lubricants deviate more strongly from the target. At the same time, fuel and lubricants and solid fuel became the most volatile.

Figure 1. Decomposition of the Variance of Annual Food Inflation by Main Components, as %



Source: NBK's calculations based on the data from the BNS ASPR

The main contribution to the deviation of paid services from the target is made by thermal energy, electricity and other utility services, transport services as well as the actual housing rent. These components are also the most volatile in general.

Thus, the most volatile components of inflation are those that are usually excluded from the calculation of core inflation for this reason. The results showed that prices for a number of consumer goods and services demonstrate heightened volatility, thereby increasing the risk of headline inflation deviating from the target. Given the above, it is necessary to implement measures to reduce price volatility on a wider range of foodstuffs (not only socially important products), to pursue a more balanced fiscal and quasi-fiscal policy that does not lead to excess consumer demand and the formation of "price bubbles" in certain markets (car purchase and house rent as a consequence of rising prices for real estate), to assess the feasibility of administrative price regulation (fuel and lubricants, regulated utility services) in order to bring price increases to a level close to the targeted inflation.

Box 4. Sugar: Sector's Specifics and Prospects

Sugar is one of the most demanded products worldwide due to its broad use both in the food industry and in the chemical industry. Nowadays, the global per capita consumption of sugar reached 40 kg a year, taking into account its content in most foodstuffs.

In Kazakhstan, white sugar is a socially important product. Therefore, special attention has always been paid to the development of its production. Despite subsidizing and supporting the industry, the country still has a high dependence on sugar imports.

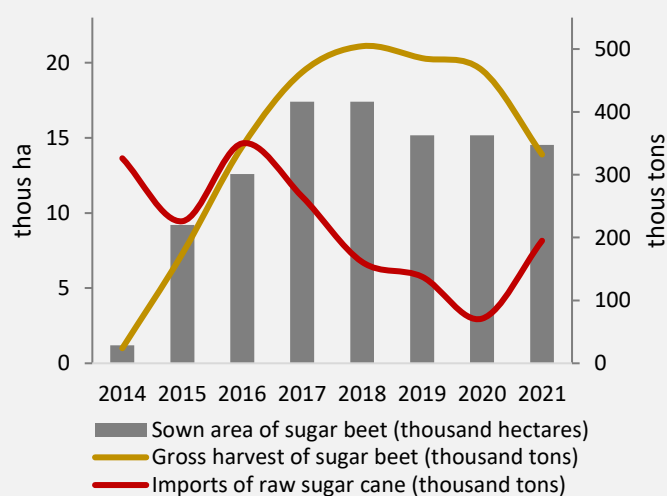
To analyze the specifics of sugar production in Kazakhstan, below we present a simplified value chain of this product (Figure 1).

Figure 1. Value Chain of Sugar



The production of feedstock is at the beginning of value chain. Sugar production is mainly based on two types of feedstock – sugar beet and cane raw sugar. Brazil and India are the largest countries cultivating sugar cane while Germany, France and Poland specialize in sugar-beet growing. Kazakhstan, in turn, grows its own sugar beet and imports sugar cane mainly from Brazil and Cuba.

Figure 2. Domestic Market of Feedstock for Sugar Production



Source: NBK, BNS ASPR

In 1992, the planted acreage of sugar beet in Kazakhstan was 85.1 thousand hectares³, in 2021 – 14.5 thousand hectares (Figure 2). The reduction in local planted acreage occurred due to the displacement of sugar beets by cheaper imported cane raw sugar⁴. Speaking about the sugar-beet industry in Kazakhstan, it is worth mentioning its dependence on imports, by 95%, from supplies of foreign-selected seeds. Therefore, swings in the price of seeds may complicate the process of growing this cropper in the country.

Sugar beet is mainly grown in Zhambyl and Almaty regions. Despite a minor reduction in the planted acreage in 2021 (Figure 2), a gross crop of sugar beet dropped because of a shortage of water supply in the beet growing regions. According to producers, it is easier to process raw sugar than beet due to the

shortening of production cycle by 30% as well as a larger product output.

Despite the competitiveness of raw sugar, growing own sugar beet is very important for resistance to global shocks. So, in recent years, raw sugar began to grow in price, and the aggravation of geopolitical situation in the world made it impossible to transport goods through the usual route – the port of Novorossiysk. Of course, this affected the local production of sugar. High prices for transport services along new supply chains will also have an impact on the growth in cost of the final product.

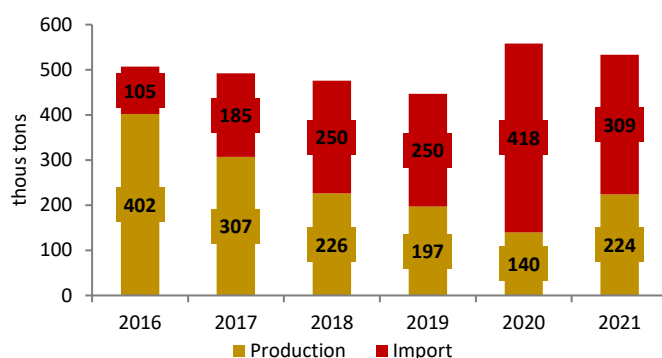
³ According to the data from the BNS ASPR

⁴ A product of sugarcane processing in the form of individual crystals consisting of sucrose and non-sugars. It is a raw material for the production of granulated sugar, refined sugar and liquid sugar.

The obtaining of feedstock is followed by the production of sugar (Figure 1). At present, four large plants are based in Kazakhstan. The Aksu and Koksus plants are located in the Almaty region, while the Taraz and Merken plants are located in the Zhambyl region. The Taraz sugar plant works exclusively with raw sugar. The remaining three plants initially specialized in sugar beet, but over time they launched lines for processing of sugar cane due to insufficient volumes of local feedstock (Figure 1).

According to representatives from the sector⁵, last year, the Aksu and Merken plants were forced to suspend production, while the Taraz plant used only 60-70% of its total production capacity due to a shortage of raw sugar. The Merken plant had processed the beets of the Zhambyl region in just 75 days. Thus, in terms of sugar production, there is a sufficient amount of capacity against a shortage of feedstock.

Figure 3. Domestic Sugar Market



Source: NBK, BNS ASPR

Another important reason for the decline in sugar production in recent years is the growth of imports, in particular from Russia and Belarus (Figure 3). When the market is saturated with sugar from the partner countries of the Eurasian Economic Union, the domestic production becomes unprofitable.

As can be seen from Figure 3, in 2021 the share of Kazakhstani production in the domestic sugar market was 42%. According to the Ministry of Agriculture of the Republic of Kazakhstan, the share of sugar made from

the local feedstock was only 7%⁶. Thus, the sugar market is 93% import-dependent, let alone the import of seeds for growing sugar beet.

A ban on sugar exports from Russia until August 31, 2022 had caused a feverish demand in the domestic market and had driven the price growth. A disruption in logistics chains because of the geopolitical crisis postponed deliveries of raw sugar to the local plants and led to a rise in prices of feedstock.

To ensure the country's food security, it is necessary to reduce import dependence at all links in the value chain of sugar. Kazakhstan has a sufficient amount of capacity against a shortage of feedstock. Therefore, one of the main strategic goals should be to increase the volumes of sugar beets. Efficient distribution of funds to support farmers through improved infrastructure, updated farming techniques and the purchase of seeds should lead to structural changes in sugar production. The existing problems of the industry can become an incentive for the development of domestic production and reduction of import dependence on sugar in the long term.

⁵ Sugar producers described the situation in the sector //Center of Business Information Kapital.kz - 2021./ [Electronic resource]. – Available at: URL: <https://kapital.kz/economic/96720/proizvoditeli-sakhara-rasskazali-o-situatsii-v-otrasli.html>.

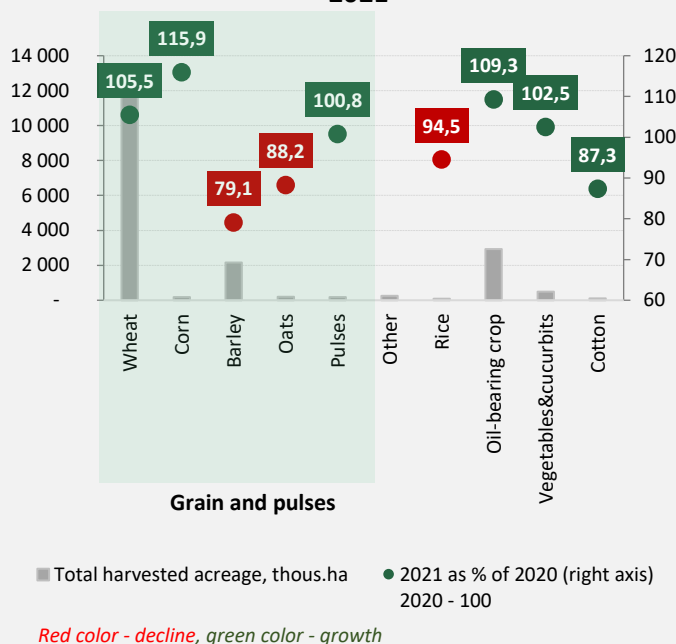
⁶ Smayl M. Kazakhstan is self-sufficient in producing sugar by 7% only //TENGRINEWS. – 2022./ [Electronic resource]. – Available at: URL: https://tengrinews.kz/kazakhstan_news/kazakhstan-obespechivaet-saharom-lish-7-protsentov-glava-msh-467307.

Box 5. Crop Productivity and Situation with Prices in Horticulture: from Grain to Cucurbits Crops

Agriculture plays an important role in Kazakhstan's economy. The stable development of agriculture has a positive effect on the country's food security, since most of the food consumed in Kazakhstan is produced domestically. At the same time, crop and livestock products are used both for the production of final goods and as a forage in animal husbandry and feedstocks in the food industry. In the structure of agricultural crops production in Kazakhstan, wheat occupies the largest part and is sold not only in the domestic market but is also exported to foreign markets. According to the FAO, Kazakhstan is one of the leading producers and exporters of wheat in the world. In addition, the production of crops such as rice, corn, barley, oats and buckwheat is also well-structured in Kazakhstan.

At the same time, the dynamics of yield in crop production has a direct impact on the dynamics of inflation, in particular, on its food component.

Figure 1. Harvested Acreage of Main Crops in 2021



Source: BNS ASPR

In 2021, the total harvested area of agricultural crops in the country as a whole amounted to 22.9 million hectares (a 1.5% growth). Planted acreages of wheat, corn, oilseeds, vegetables and cucurbits increased. The acreage of barley, oats, rice and cotton have decreased (Figure 1).

Meanwhile, despite the increase in planted acreage, the harvest of some agricultural crops in 2021 decreased, which was primarily due to adverse weather conditions.

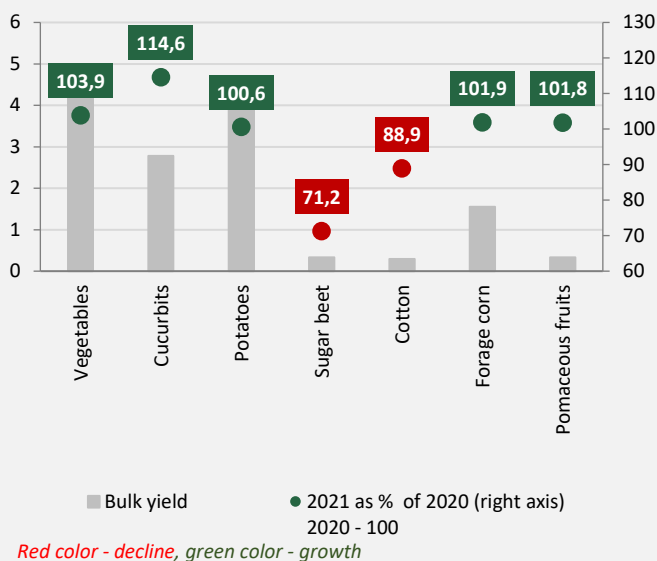
Thus, in 2021, because of abnormal drought, the gross output of plant production in annual terms decreased by 6.7%. Bad weather conditions had a significant impact on the gross harvest of grains and pulses (Figure 2). Last year, 11.8 million tons of wheat were harvested, which is by 17.1% less than in 2020. At the same time, there was an increase in cereal prices in the world food market (in December 2021, the FAO Index went up by 20.7% YoY).

Apart from wheat, in 2021 the crop of cereals also decreased. The yield of barley and oats was lower by 35.3% and 24.1% compared to 2020. Poor crop harvest rates have a negative effect on livestock production where grain forage is used as a feed.

Due to reduction of planted acreage, bad weather conditions, the bulk yield of rice and cotton decreased by 5.5% and 12.7%, respectively.

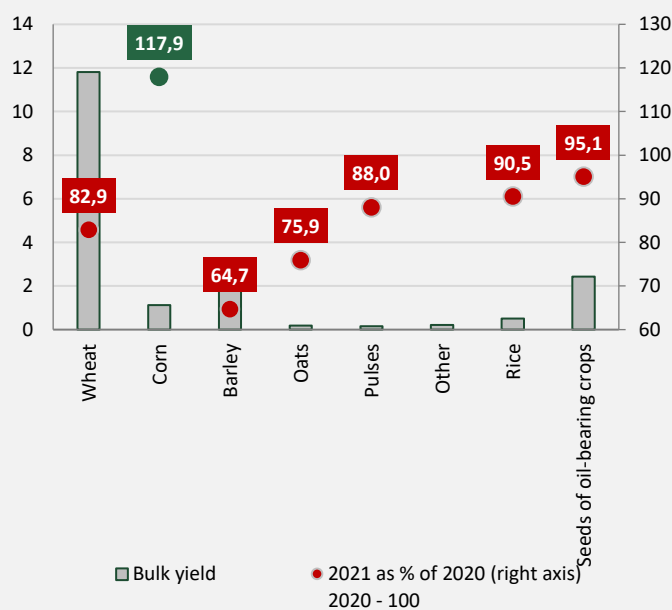
In 2021, the bulk yield of vegetables, cucurbits, potatoes, corn (forage) and pomaceous fruits increased, except sugar beet and cotton, where the reduction accounted for 28.8% and 11.1%, respectively (Figure 3). The main reason for the reduction in the bulk yield of sugar beet is the insufficiency of irrigated land for cultivation as well as problems with water supply to beet-growing regions. Most of the refined sugar in Kazakhstan is imported from the CIS countries, namely from Russia (the share accounts for more than 50% as of end-2021).

Figure 3. Bulk Yield of Vegetables, Cucurbits, Corn, Cotton, Pomaceous Fruits



Source: BNS ASPR

Figure 2. Bulk Yield of Grain and Pulses



Source: BNS ASPR

A decline in the yield of certain types of agricultural crops in 2021 along with the growing world food prices, which has been observed since last year (in 2021, the FAO Food Price Index grew by 23.1% YoY, in April 2022 – by 29.8% YoY) exerted a negative effect on the domestic food prices in 2021. Thus, in 2021, prices for flour, bread, macaroni products, cereals, meat and meat products, dairy products, fruit and vegetable production, and sugar were hiking.

This year, a negative impact of these factors was exacerbated by deterioration of the geopolitical situation in the world, which caused the disruption in logistics supply chains. This is reflected in higher growth rates of prices for a number of food products (bread and bakery, meat, dairy products, fruit and vegetable production, sunflower oil, sugar).

These products constitute a significant share of the consumer basket and are socially important foodstuffs. At the same time, in order to support agriculture, in 2021 the nation-wide project on the development of agro-industrial complex of the Republic of Kazakhstan for 2021-2025 was approved. Based on the project implementation, it is planned to provide the country with the main locally produced foodstuffs, to increase the level of import substitution and build up the export potential.

3.5. Fiscal Policy

As at the end of the first quarter of 2022, the budget deficit was low due to a significant growth of the revenue side of the budget that exceeds expansion in the expenditure side.

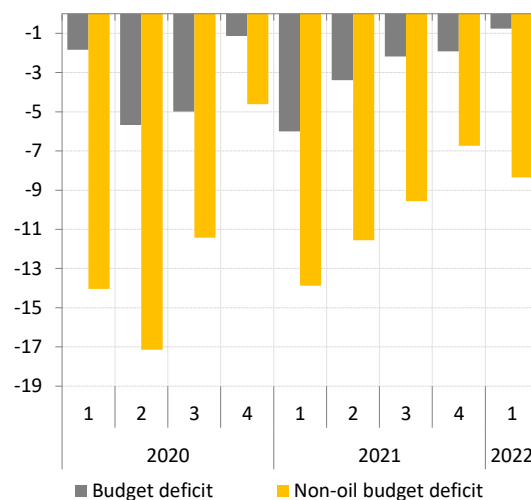
During January-March 2022, the national budget showed up a deficit of 143.9 billion tenge, having decreased by 85.0% compared to the corresponding period of 2021 (in the first quarter of 2022 – 0.8% of GDP). Reduction in the budget deficit, in the first instance, was caused by an outstripping growth of revenues over spending (the growth by 50.3% and 13.5%, respectively). It is worth mentioning that in May of this year parameters of the republican budget for 2022 were specified, whereby the expenditures were significantly increased by 23.6% compared to 2021 (upward revision compared to the previous plan – by 18%). The main expenses will be directed to the following items: defense, public order, health care, social assistance and social security and housing and communal services. At the same time, the social orientation of fiscal policy and support for the development of the real sector and regions have been strengthened.

The adjustment of fiscal parameters implies expansion of the revenue side of the budget by increasing the earmarked transfer from the National Fund (from 2.4 trillion tenge to 4.03 trillion tenge). In a more detailed breakdown, the financing will be directed to support the social sphere (indexation of social benefits, developing the labor market and supporting the younger generation), promote defense security, implement government programs, ensure regional development, for construction and renovation of the national and local roads, and to support the small and medium-sized business.

During January-March 2022, 1 223 billion tenge of official transfers were received to the revenue side of the budget, where the guaranteed transfer from the NOF RK amounted to 985 billion tenge, earmarked transfer – to 50.7 billion tenge, and transfers from the subordinated government authorities – 187.3 billion tenge.

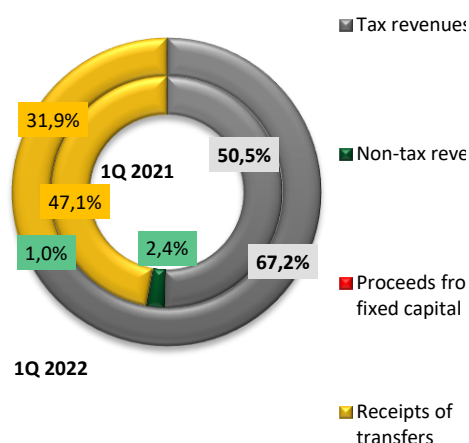
During the first quarter of 2022, non-oil budget deficit (the budget deficit excluding transfers from the National Fund and export customs duties for crude oil), according to the National Bank's assessment, amounted to 1 569.6 billion tenge (8.4% of GDP), which is by 29.1% less than in the corresponding period of 2021 (Figure 55).

Figure 55. Overall and Non-Oil National Budget Deficit, as % of GDP



Source: MF RK

Figure 56. Structure of National Budget Revenues



Source: MF RK

During January-March 2022, national budget revenues increased compared to the corresponding period of 2021 by 50.3% and equaled 3.8 trillion tenge. The main reason for the growth in revenues is a two-fold increase in tax revenues (the share in budget revenues made up 67.2%) due to the easing of quarantine restrictions, recovering economic activity and increase in prices for major export commodities. The largest growth in taxes on an industry-by-industry basis is observed in the mining industry, manufacturing industry and wholesale and retail trade. Revenues from corporate income taxes increased in the structure of tax revenues due to additional tax liabilities payable by large mining and metallurgical companies as well as from the value added tax given the growing turnovers from realization of goods, works and services. Alongside with that, during the first quarter of 2022, receipts of official transfers increased by 1.8% (the share in budget revenues accounted for 31.9%) owing to a 50.9% growth of transfers from subordinate government authorities.

A 40.4% reduction in non-tax revenues is associated with smaller receipts of other non-tax revenues to the national budget. However, receipts from administrative penalties, fines and sanctions imposed by the government authorities are growing.

Shortfalls of proceeds from fixed capital sale are related to the absence of sales of tangible assets from the state stockpiles (Figure 56).

During January-March 2022, the national budget expenditures amounted to 3.9 trillion tenge, having increased by 13.5% compared to the corresponding period of 2021. The main contribution to the growth in the national budget expenditures was made by education – the increase by 34.3% (the share – 11.1%), debt servicing – by 21.9% (the share – 10.3%) and defense – by 23.1% (the share – 4.8%). Along with that, spending on social welfare and social security went up by 8.6% (the share – 26.9%).

BASIC TERMS AND DEFINITIONS

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.

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.

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 accordance 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 stability.

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.

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

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

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

MF 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

Fed – Federal Reserve System