



NATIONAL BANK OF KAZAKHSTAN

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Overview of monetary policy of the National bank of Kazakhstan

In recent years Kazakhstan has become one of the world's leaders in terms of the economic growth rates. Cumulative GDP growth for last 4 years was circa 50%, including real GDP growth of 9.2% in 2003. These growth rates were the result of both internal (increase in industrial output, ongoing positive trends in agriculture and other sectors) and external factors, like economic recovery in some countries and favorable commodities prices.

In 2003 the National Bank has adopted a new monetary policy framework and price stability has become the primary objective. The National Bank (NBK) announced its plans to introduce inflation targeting regime by 2007. Since 2002 monetary policy guidelines are being defined and made public for three upcoming years, and these guidelines are being annually updated. In the Monetary Policy Guidelines for 2002-2004 National Bank has stipulated that the main goals of the NBK monetary policy for the nearest 3 years are preparation and transition to inflation targeting. This move assumes a gradual change from setting objectives for monetary indicators and gold/foreign currency reserves to attempting to impact inflation through a variety of intermediate actions. While in transition to inflation targeting principles the National Bank seeks advice and cooperation from International Monetary Fund and, potentially, from other multilateral financial institutions.

In 1993, when Kazakhstan has introduced its national currency, tenge, the country had a rampant inflation of 2,165.0% per annum. A number of swift and decisive actions by the National Bank, which were made possible after NBK gained its independent status, have resulted in drastic decline in inflation rates from 60.3% in 1995 to 9.8% in 2000. Starting 2001 the annual inflation went down to single-digit numbers: 6.4% in 2001, 6.6% in 2002, and 6.8% in 2003 (as of the end of the period). Since the beginning of 2004 the inflation is 3.0%.

At the same time the exchange rate of the national currency, tenge, has stabilized and in 2003 for the first time in the history of independent Kazakhstan Kazakh currency appreciated versus US dollar (by 8.0%).

Stable exchange rate and inflation allowed the National Bank to reduce the refinancing rate to 7.0%, the lowest level since Kazakhstan gained the independence. At present, the National Bank uses various monetary policy tools to influence inflation, including but not limited to official refinancing rate, fees for the principal operations of monetary policy, minimum reserve requirements.

Monetary policy was crucial in ensuring high economic growth in non-oil sector of the economy. For last 3 years the level of monetization (money to GDP ratio) has increased from 15.3% to 21.8%.

Significant foreign exchange inflow is driving up the size of the National Bank foreign exchange and gold reserves (USD 6.7bln. as of September 1, 2004) and the National Fund (USD 3.8bln, September 1, 2004).

National Fund, often called Future Generations fund and Oil Fund as well, was established in 2000 in order to accumulate and invest long-term state savings, reduce dependence of the national budget on volatility of oil prices, and ensure intergenerational equity for current and future citizens of the Republic of Kazakhstan.

National Fund is a special account of the Ministry of Finance of Kazakhstan with the National Bank. National Bank advises Ministry of Finance on managing the assets of National Fund. More than half of USD3.8bln is under management of world's leading private financial institutions, like Citibank, UBS, ABN Amro, Deutsche Bank, State Street to ensure transparency and accountability of the process. NBK itself manages about 40% of the assets of the National Fund.

Currently total foreign assets of the Republic of Kazakhstan (the National Bank and the National Fund) are USD 10.4bln. This, when compared to the gross external public debt of USD \$3.6bln or annual imports of USD9.031bln, is a source of a lot of confidence in the ability of the economy of Kazakhstan to absorb adverse shocks.

In order to manage significant inflows of foreign exchange into domestic market, in 2003 the National Bank had to purchase about USD 2.2bln on the Kazakhstan Stock Exchange and interbank market. More than half of this volume was sterilized with issues of short-term notes of the National Bank with the aim of taking excess liquidity from the market and reducing its impact on inflation. As a result, the volume of NBK notes in circulation increased 3.1 times up to KZT 198.6bln (ca USD1.4bln).

This year the situation did not change dramatically: in the first 8 months of 2004 only the volume of net purchases of foreign currency by the National Bank reached USD 1.2bln, which again had to be sterilized by issues of short-term notes of the National Bank. Thus, since the beginning of 2004 the volume of NBK notes in circulation went up by another 62.4% to KZT 322.5bln (caUSD2.4bln) as of the end of August 2004.

The National Bank is planning to continue further use of its short-term notes as major tool in regulating commercial banks' liquidity and, respectively, inflation rates. The emphasis is made on making short-term interest rates more significant and shifting from issuing notes to conducting REPO operations. The plan is to regulate banks' liquidity mostly by dealing in government securities. In an attempt to achieve the above aim the National Bank is beefing up its securities portfolio.

The volume of REPO operations year-to-date is KZT 511.2bln only (caUSD3.8bln). The National Bank regulates short-term liquidity in the banking sector by varying official interest rates, refinancing commercial banks by discounting promissory notes, short-term lending and taking deposits.

The growth of net international reserves of the National Bank became the main reason for the expansion of the monetary base by 52.3% to reach KZT 317bln (USD2.2bln) in 2003. A growth of broad money (M3) same year was 27%; this indicator was equal to KZT 971.7¹ billion at the end of the year. During 7 months of 2004 the monetary base expanded by 20% and reached KZT 380.3 billion due to the growth of net international reserves of the National Bank, while the growth of broad money was 24.9% and made 1213.3 KZT billion due to the increase of both net external and internal assets of the bank system.

¹ Since December 2003 data changed as the accounts of credit partnerships included to the broad money

Further strategy of the National Bank of Kazakhstan is going to be defined by determination to capitalize on the achievements of Kazakhstan's financial sector and build out Kazakhstan's financial industry to compliance with the standards of the European Union.

Main segments of financial sector are dynamically developing in Kazakhstan on the back of improved macroeconomic conditions (see attached table "Main Macroeconomic and Financial Sector Indicators").

The improvement of economic situation in Kazakhstan has been confirmed with assignment of investment grade to the country by both major international rating agencies. On September 19, 2002 Moody's Investment Service upgraded Kazakhstan's sovereign rating to Baa3; Standard & Poor's Rating Services raised its foreign currency credit ratings on the Republic of Kazakhstan to BBB-/A-3 from BB+/B in May 2004.

In November 2003 the Organization for Economic Cooperation and Development improved its assessment of Kazakhstan's borrowing capabilities by moving it to a next level.