



NATIONAL BANK OF KAZAKHSTAN

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On the base rate

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Almaty

The National Bank of Kazakhstan has decided to reduce the base rate to 12% with a corridor of +/- 1 percentage points. The decision reflects the downward trend of inflation in line with the forecast, continuing pace of de-dollarization of bank deposits, and reduced inflation expectations of households. Increased uncertainties in the global markets, which may be followed by the slowdown in the process of reallocation of foreign currency assets into the national currency, as well as the sensibility of the economy and the financial sector to external shocks, require a cautious approach to further reduction in the base rate. Should the economic situation is significantly improved and persistent signs of stabilization in the financial market are present, further cuts are possible.

The decision on the base rate was made with the account of the following factors.

For 10 months of 2016 inflation amounted to 6.2%, which corresponds to the historical trend. Possible deviations of the annual inflation from the target at the end of 2016 will be determined by the factors that are outside of the influence of the National Bank. At the same time, according to the estimates of the National Bank, the annual inflation will be sustainably within the target range of 6-8% throughout the whole year of 2017 in the absence of negative shocks.

Inflation expectations of households show a moderate pattern. The recent poll showed that in October the share of respondents expecting the current growth rates of prices during the next 12 months has increased insignificantly. Hence, the households' perception of inflation is improving, which contributes to the decrease in their pro-inflationary behavior.

Fluctuations in oil prices and in the exchange rates of a number of currencies of developed and developing countries, as well as a short-term market reaction to the election results in the United States, in fact had almost no effect on the downward trend of the devaluation expectations of market participants. The number of respondents, assuming stability or appreciation of tenge, continues to increase.

Deposit market indicators suggest resumption of de-dollarization and currency preferences of investors shifting toward tenge. The share of deposits denominated in foreign currency decreased from 58.3% in September to a level below 57% in October 2016, according to preliminary data.

The signs of economic recovery remain. In September 2016 the short-term economic indicator, which represents tendencies in the development of main sectors of economy, increased by 2.3% in annual terms overcoming accumulated fall during the previous months (during the 9 months of 2016 growth rate of the indicator accounted for 0%).

However, risks which may deteriorate economic conditions persist. Current situation in the world oil market shows that there is a considerable uncertainty about its future development. An expected by markets rise in the key interest rate of the Federal Reserve and the results of the US presidential elections increase the risk of changes in international capital flows and market quotations. Continued fiscal imbalances in Kazakhstan and in the countries - trade partners, as well as uncertainty about their prompt solution increase the likelihood of the pass-through of the resulting possible economic shocks on Kazakhstan.

The presence of these risks on the background of the declining annual inflation in 2017 restrains the further rapid cuts in the base rate. The risks for price stability and confidence in the tenge at lower levels of interest rates may increase, including the risks performing through the channels and variables that the National Bank is observing with a substantial lag and over which the National Bank has a limited control, especially at the short-term horizon. In such circumstances, the decision to further cut the base rate will require a more cautious approach and a thorough rationale.

The next decision on the base rate will be announced on January 9, 2017 at 17.00 Astana time.

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