

**Press-Release № \_\_**

**The base rate reduced to 9.00%**

July 20, 2020 Nur-Sultan

The National Bank of Kazakhstan has made a decision to reduce the base rate to the level of **9.0%** per annum with the narrowing of the corridor to **+/- 1.5** percentage points. Consequently, the rate for the liquidity provision standing facilities is 10.5% and for the liquidity withdrawal standing facilities is 7.5%.

The decision on reducing the base rate was made in response to the weakened inflationary risks and stronger economic contraction in the first half of 2020 than expected in the forecast round of May-June of this year. The measures taken on tightening quarantine will have an additional disinflationary effect.

At the same time, core inflation (trimmed mean) and median inflation in June 2020 demonstrate more moderate dynamics – 6.1% and 4.4%, respectively. Worth noting a gradual acceleration since the beginning of the year (in December 2019 – 5.2% and 4.3%, respectively), but at nonetheless, core inflation indicators have grown slower than overall inflation, signaling a more moderate growth in the monetary component of inflation.

The risks of dollarization growth have significantly decreased; it has expanded the potential for rate cuts. As a result of prompt measures to protect tenge-denominated assets, following the results of 6 months of this year, dollarization of deposits fell from 43.1% to 40.0% according to preliminary data, which also favors the possibility of lowering the base rate.

The narrowing of the corridor is dictated by the stabilization of the situation in the financial markets and the gradual adaptation of the economy to new conditions. This decision will bring money market rates closer to the base rate, will reduce the volatility of money market rates and will help to create more stable expectations among market participants.

The new level of the base rate will, to a certain extent, compensate for the increased credit risks by reducing the cost of loans. The current decision will mitigate the impact of the consequences of tightening quarantine measures on the economy of Kazakhstan and support the recovery of growth in the economy.

**The annual inflation gets formed in accordance with the estimates.** In June, 2020 it amounted to **7.0%**. The main contribution to the inflation was made by the increased prices of the food goods, which was **11.1%** in the annual term. However, the monthly food inflation has slowed from 1.9% to 0.5% in June of the current year. The highest annual growth as of June is observed in fruits (23.0%), pasta products (15.3%), meat and meat products (14.0%), bakery products and cereal (13.5%), fish and seafood products (11.7%).

The growth in prices for other components of inflation remains moderate. Nonfood inflation gets formed on the level below the forecasted estimates and amounted to **5.4%.** The monthly dynamics of the price increase is stable and doesn’t exceed 0.5%. The restrictive impact on the nonfood inflation will be made by the suppressed consumer demand under the conditions of the quarantine measures and the decrease of the households’ purchasing power due to the fall of the real cash income. Inflation of paid services amounted to **3.0%** in the annual terms in June.

**Inflationary expectations remain relatively stable**. In June 2020, the quantitative estimate of inflation for the year ahead **was 5.4%.** The share of respondents expecting continued or accelerated price growth over the next 12 months dropped to 43% (in May – 54%).

In general, the actual dynamics of annual inflation at the end of June 2020 is in line with the forecast estimates. In the following months, further acceleration of annual inflation is expected within the forecast path **of 8-8.5%** at the end of 2020.

The increased disinflationary effect from measures to tighten quarantine, as well as a more significant decline in GDP in the 1st half of this year compared to forecasts, will ensure a gradual slowdown in inflation towards the upper limit of the target band of **4-6%** in 2021.

The main risks to inflation growth in the current year are the impact of the fiscal and quasi-fiscal impulse on inflationary processes, the decrease in supply caused by the disruption of supply chains under quarantine conditions and an increase in import prices against the background of the depreciation of tenge.

**At the end of the first half of 2020, Kazakhstan's GDP decreased by 1.8% in annual terms, while the forecast was -1.5%.** This is due to the downturn in the services sector, in spite of the easing the quarantine measures and the opening of trade and catering facilities from mid-May 2020. The positive contribution to the GDP dynamics was made by the information and communication (9.0%), health, education and public administration industries. The production growth of the mining (2.2%) and manufacturing (4.8%) is being observed. Economic activity is also supported by the expansion of construction work (by 11.2%) and an increase in gross agricultural output (by 2.4%).

The business activity index, calculated by the National Bank based on surveys of enterprises, is in the negative zone, but after falling to historic lows in April of this year (**37.2**) it has increased in June of this year to **46.8**. In the context of industries, the slowdown is mostly observed in the services and industrial sectors.

**The decline in consumer and investment activity puts pressure on aggregate demand.** The introduced quarantine measures had a negative impact on the income of the population, affecting the decrease in consumer activity. The main factor was the slowdown in the growth of real wages of employees. In addition, the closure and suspension of activities of certain industries led to a deterioration in the situation in the labor market.

**Fixed capital investment is declining**, including reflecting suppressed domestic demand due to declining real incomes of the population. The volume of investments in fixed assets according to the results of the first half of this year decreased **by 2.9%** in annual terms. The main impact on the dynamics of investment activity was due to the decline in investment in the mining industry by 11.6% (January-June 2020 to January-June 2019), due to the suspension of construction work at the Tengiz oil field.

Aggregate demand is supported by an increase in government spending on social security and social assistance. The expenditures of the republican budget in this area in January-June 2020 increased **by 19.9%.**

**The situation in the external sector remains uncertain**. In June 2020, as a result of the partial lifting of quarantine restrictions, an improvement was noted in the global industry and services sector. However, the risks of a re-outbreak of the COVID-19 pandemic remain high, adding to the uncertainty of the continued recovery of business activity in the global economy in the following months. Weak external demand and a lack of stimulus measures could limit the expected growth of the global economy, despite the recovery of the Chinese economy. On the further prospects for the development of the world economy also lie a social unrest in the world, a possible deterioration in economic relations between the United States and China, low inflation persisting for a long time in developed countries, high unemployment and an increase in debt in some countries.

**The estimates for the growth prospects of the trading partners of Kazakhstan in 2020 are revised downward.** According to Consensus Economics' expectations, the Russian economy in 2020 will contract **by 5.2%**. Due to the deterioration of the situation with consumer demand amid the coronavirus pandemic, the forecast for the growth of the EU economy for this year has been reduced **to 8.4%**. Forecasts for China's economy for 2020 are unchanged. China's GDP growth in 2020 will be **1.4%**. In this regard, it is necessary to revise the forecasts of the main macroeconomic indicators.

**The current situation in the world oil market is relatively positive**. The relaxation of quarantine measures in many countries is stimulating a recovery in demand and positively affecting the price of oil. After the lockdown was lifted in the world, and, accordingly, the restart of the industrial sector, oil consumption increased significantly. According to the EIA, in June 2020, in comparison with the previous month, world oil demand increased **by 5.3 million** barrels per day. An increase in oil consumption was recorded in all major oil importing countries with the exception of China.

At the same time, oil production continues to decline gradually, which is facilitated by the OPEC+ agreement and weaker oil production in the United States and Canada. As a result, world quotations for Brent crude have been holding above **$ 42** per barrel since early July 2020.

In the second half of 2020 and in 2021, oil demand is expected to grow. The expected acceleration in oil consumption will help reduce the accumulated oil reserves since the beginning of 2020. Oil production this year will decline in non-OPEC countries (especially the United States, Canada, Mexico) and under the OPEC+ agreement. The acceleration in oil production is expected in 2021, which will be associated with the recovery in oil prices and the overall stabilization of the situation in the global economy.

**Despite the positive current account of the balance of payments at the beginning of this year, the National Bank expects deterioration in the external sector statistics.** Low oil prices in the second quarter of 2020, a decrease in its production rates and a decreasing demand for key export goods compared to 2019 will lead to an expansion of the current account deficit (in 2019, the deficit amounted to USD 6.5 billion). At the same time, the reduction in imports will be less significant due to the implementation of government programs and initiatives to support the real sector. The widening of the current account deficit will remain a risk factor for the weakening of tenge and, as a consequence, a factor of pro-inflationary risks.

**The external inflationary background remains low.** Inflation in the EU amounted to 0.5% in May. The annual price increase in China in June was 2.5%, being below the target. In Russia in June inflation was 3.2%. In the context of declining prospects for economic recovery and a significant increase in disinflationary risks, the Central Bank of Russia on the last decision lowered the key rate by 1 percentage point up to 4.5%.

The current decision was made taking into account the risks of inflation deviating from the forecast corridor, uncertainty about the rate of recovery in the external sector and a more significant contraction of the national economy, which may affect a decrease in consumer demand and give an additional disinflationary effect.

The National Bank will continue to monitor internal and external factors that affect the dynamics of inflation. Further decisions on the base rate will be made taking into account the compliance of the actual inflation dynamics with its forecast, as well as the balance of internal and external risks.

The next planned decision of the National Bank of the Republic of Kazakhstan at the base rate will be announced on September 7, 2020 at 15:00 Nur-Sultan time.

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