NATIONAL BANK OF KAZAKHSTAN

MONETARY POLICY REPORT

February 2024

CONTENTS

Monetary Policy Report is a quarterly publication of the National Bank, which contains the analysis of key macroeconomic factors affecting inflation as well as the forecast of macroeconomic parameters in the short- and medium-term horizon.

The Report is published in an electronic form on the official Internet resource of the National Bank in the Kazakh, Russian and English languages.

The forecast and analysis of macroeconomic indicators was prepared on the basis of statistical information as at **February 23, 2024**

STATEMENT BY THE GOVERNOR OF THE NATIONAL BANK OF THE REPUBLIC OF KAZAKHSTAN ON THE BASE RATE DATED FEBRUARY 23, 2024

The Monetary Policy Committee of the National Bank decided to lower the base rate to 14.75%.

The decision is based on analysis of actual data and updated forecasts. Along with updating our macroeconomic forecasts, we also adjusted our assessment of inflation risks.

Annual inflation is decelerating. At the same time, the rate of its deceleration decreases. This is in line with our forecasts. A positive signal is the decline in inflation expectations of the population during three consecutive months. However, indicators of the steady part of inflation accelerated, which confirms the need to continue measures to ensure price stability.

The effect of pro-inflationary factors within the economy remains. These include robust consumer demand, fiscal stimulus and still-high inflation expectations.

In the external environment, we see a continuing deceleration in global inflation, which is facilitated by countries' contractionary monetary policies, as well as lower energy and food prices. Concerns are caused by problems with logistics in certain regions and some acceleration of inflation in Russia and China.

The trends we monitor in domestic demand indicators, inflation expectations, as well as the uncertainty of fiscal policy parameters and the external environment continue to require that we maintain moderately tight monetary conditions.

The main task to confidently reduce inflation to 5% in the medium term remains.

Determinants for the decision taken are as follows.

FIRST. DYNAMICS OF INFLATION AND INFLATION EXPECTATIONS.

Inflation continues to decline as a result of the monetary policy pursued, government measures, weakening global inflationary pressures and other factors. At the same time, the rate of decline expectedly slowed down given an almost complete dissipation of the high base of 2023.

In January, the annual price growth was at 9.5%. Prices for food products in January rose to 8.2%, which is lower than in the previous month. Annual non-food inflation fell to 8.6%, which is also below December 2023 levels. The rise in prices for paid services has decelerated slightly but remains high.

Monthly inflation in January was 0.8%, which exceeds its historical average (about 0.6%). Core and seasonally adjusted inflation rates increased slightly, being well above the medium-term target. This indicates the persistence of inflationary processes in the country. Accordingly, it is still too early to say about the formation of a pronounced, sustainable trend towards reducing inflation.

At the same time, the positive shift in the dynamics of inflation expectations over recent months is of particular note. Expected inflation for the next 12 months dropped significantly to 14.4% in January. Let me remind you that in December 2023 it was 16.4%. In the short term, it is important to create a trend for deceleration of inflation expectations and ensure their return to average historical levels.

SECOND. TRENDS IN THE DOMESTIC ECONOMY.

The economy of Kazakhstan boosted by 5.1% on a year-on-year basis in 2023. The expansion of business activity occurred in all major sectors of the economy. At the end of January 2024, GDP grew by 3.9% YoY. Business expansion continues.

The sectors of construction, transport, information and communication demonstrate the highest growth rates. Business activity in the manufacturing industry has accelerated, particularly in the chemical, mechanical engineering, metal products and metallurgy sectors. As a side note, I would like to mention that after a decline due to a poor harvest in 2023, agricultural production entered the growth zone.

Domestic demand remains strong, putting pressure on prices. This is reflected in the data on retail trade turnover, imports of certain consumer goods and catering and accommodation services. Domestic demand is supported by the growth in real wages and consumer lending.

Investment activity is expanding. The growth of fixed capital investments is observed in almost all sectors of the economy.

THIRD. EXTERNAL ECONOMIC ENVIRONMENT.

In the external sector, we continue to observe a downward trend in global inflation. This is driven by the positive dynamics of food prices, contractionary monetary policies of central banks, as well as lower energy prices. At the same time, certain factors putting pressure on inflation remain.

World food prices continue to decline amid falling prices for cereals and meat and a moderate rise in sugar prices. The decline in cereal prices is stemming from an increase in supply due to a rich harvest.

However, in developed countries, due to concerns about how sustainably inflation is slowing, central banks are keeping rates unchanged.

Annual price growth in the EU at the end of 2023 somewhat accelerated to 3.4% after reaching a minimum in November. Achieving the 2% target requires the ECB to maintain high interest rates for a long time.

A similar situation is observed in the United States, where inflation is still stable. According to the Fed's rhetoric, policy easing will likely begin this year, but if necessary, the regulator says that high rates will be maintained for a longer time.

China continues to experience deflation in annual terms. However, in January of this year an increase in monthly inflation was observed.

In Russia, annual inflation in January 2024 was 7.4%. The growing domestic demand coupled with high inflation expectations remain as the main growth driver. The return of inflation to the target in 2024 and its further stabilization around the target of the Central Bank of Russia imply a long period of maintaining tight monetary conditions.

Our forecast for the global food market assumes a slight increase in prices until mid-2024, followed by stabilization and a gradual decline.

The assumptions reflect, on the one hand, the risks of possible logistics problems in the Red and Black Seas, and on the other hand, the expectations of international organizations regarding crop prospects and the growth of grain reserves in the world at the end of the 2024 season.

International organizations expect that this year prices in the oil market will stabilize at around US$80 per barrel. The main factors driving the price upward are the extension of OPEC+ production cuts, moderate production growth in the United States, as well as the uncertainty regarding military operations in the Middle East.

Given that, the price of Brent oil in the baseline scenario is set at US$80 per barrel in 2024-2025, followed by its reduction to US$77 per barrel in 2026.

Furthermore, let me dwell on forecasts of macroeconomic indicators.

The inflation forecast for the current year has not changed. Price growth is expected to range from 7.5-9.5%. The forecast for 2025 was kept at 5.5-7.5%. In 2026, according to our estimates, inflation will build within 5-6%, approaching our target.

The rate of decline in inflation continues to slow down given a complete dissipation of the last year’s high base in February of this year and the presence of price pressure factors within the economy.

The decline in inflation will be nurtured by moderately tight monetary conditions and further improvement in the situation with rising prices in the external environment.

The main risks of the forecast include the lack of certainty regarding fiscal policy parameters, the current fiscal stimulus, persistence of inflation with unanchored inflation expectations, as well as a possible increase in sanctions pressure against Kazakhstan's main trading partners.

The forecast regarding the economic growth in Kazakhstan for 2024 was increased to 3.5-4.5%, for 2025 it was kept at 5.5-6.5%. The GDP growth in 2024 will be driven by domestic demand amid an improving situation with business activity. In 2025, we predict that higher economic growth will be largely driven by government measures and the planned ramp-up in oil production due to increased production at the TCO. In 2026, with a scenario-based decline in oil prices and current forecast assumptions, the growth rate will be 3.5-4.5%.

Here I would like to emphasize that these forecasts are based on the Forecast of the Socio-Economic Development of our country and other available government program documents. At the same time, the Government and other government authorities are currently elaborating new policy measures to increase economic growth rates. As these measures and policies are formulated and implemented, our inflation and GDP forecasts may be revised.

Governor of the National Bank of the Republic of Kazakhstan
Timur Suleimenov

PROSPECTS OF ECONOMIC DEVELOPMENT

I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

1.1. Forecast Assumptions

Compared to the pre-pandemic period, the global economy will be developing more moderately. At the same time, the risks of recession are assessed as low due to stable economic growth in a number of large countries, weakening inflationary pressure and some improvement in the situation in the labor market.

The IMF updated forecasts look somewhat more optimistic[1]. The forecast for global economic growth this year has been raised from 2.9% (YoY) to 3.1% (YoY); in 2025, global economic growth is expected to be 3.2% (YoY). The improvement in forecasts has been driven by upward revisions to forecasts for the US, China, Russia, India and other developing countries. European countries are still expected to have a moderating effect on the global economic growth.

Under the baseline scenario, the IMF expects that energy prices in 2024-2025 relative to prior years will be slightly lower. It is also expected that the world's largest central banks will gradually move towards normalizing their monetary policies. Among the constraining factors, the IMF identifies geo-economic fragmentation, deterioration of the geopolitical situation in the world, as well as the sustainability of core inflation.

Weaker economic growth in the EU will be offset by higher economic growth in China and Russia. At the same time, higher inflation in Russia will offset the effect of weaker price growth in China and the EU.

In comparison with the forecast round "November 2023", estimates for economic growth for the short-term period have been increased for the economies of China and Russia; for the EU, the estimate has again been revised towards feebler growth (Graph 1) (Table 1). It is expected that the planned fiscal policy measures and looser monetary policy will provide significant support to the Chinese economy. The automotive industry will become one of the key drivers for the Chinese economy. The forecast for economic growth in Russia has been raised due to the stronger private and public demand. The pace is expected to slow down in the future, being driven by a tight monetary policy, labor shortages, as well as the budget deficit.

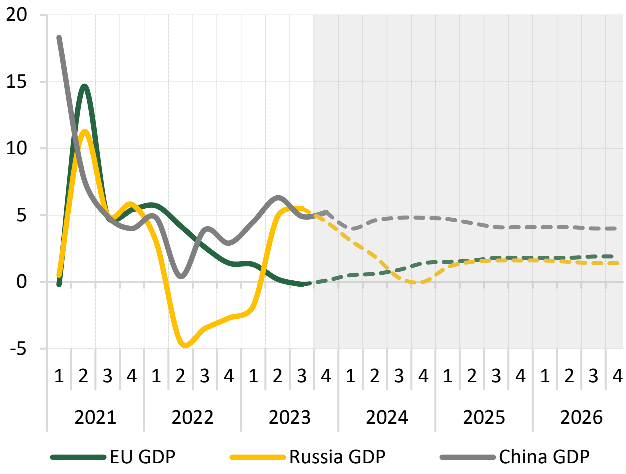
Inflation in the EU is expected to slow under the pressure from a tight monetary policy. According to forecasts, in China, on the contrary, price growth will accelerate slightly, but will not exceed the target. Inflation in Russia will be slightly higher than previously expected, in conditions of strong consumer demand, rising import prices and supply shortages. The achieving of the 4% target has been shifted to the second half of 2025 (Graph 2) (Table 1).

Inflationary pressure in the world continues to gradually weaken. Against this background, a number of developing countries, from the end of 2023, began to gradually move towards normalizing monetary policy. The largest central banks, due to the risks of premature easing of their policies, are keeping interest rates unchanged for now. However, the rate cut cycle is expected to begin this spring.

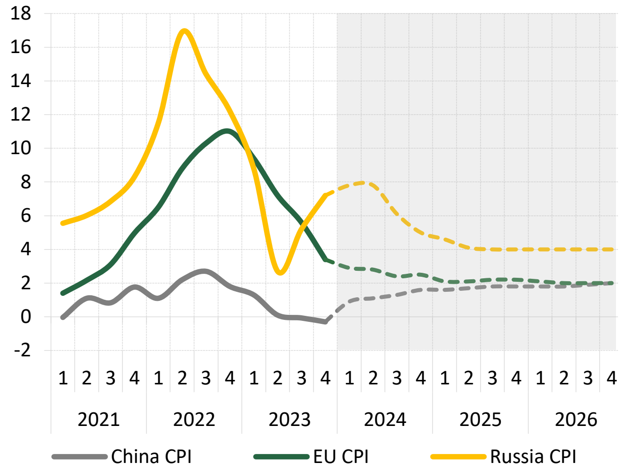
External monetary conditions have improved compared to the previous forecast round. At the last meeting, the US Federal Reserve kept the rate unchanged due to doubts about the sustainability of the slowdown in inflation in the context of economic growth and tension in the labor market. Meanwhile, it is expected that from May of this year the US Federal Reserve will begin to gradually reduce the policy rate. Thus, by the end of 2026, the rate is expected be lowered to 2.5% per annum. Expectations for the ECB rate cuts are aimed towards the end of 2024.

[1] *IMF World Economic Outlook. January 2024*

Graph 1. GDP Growth Rates, YoY, %



Graph 2. Inflation, YoY, %

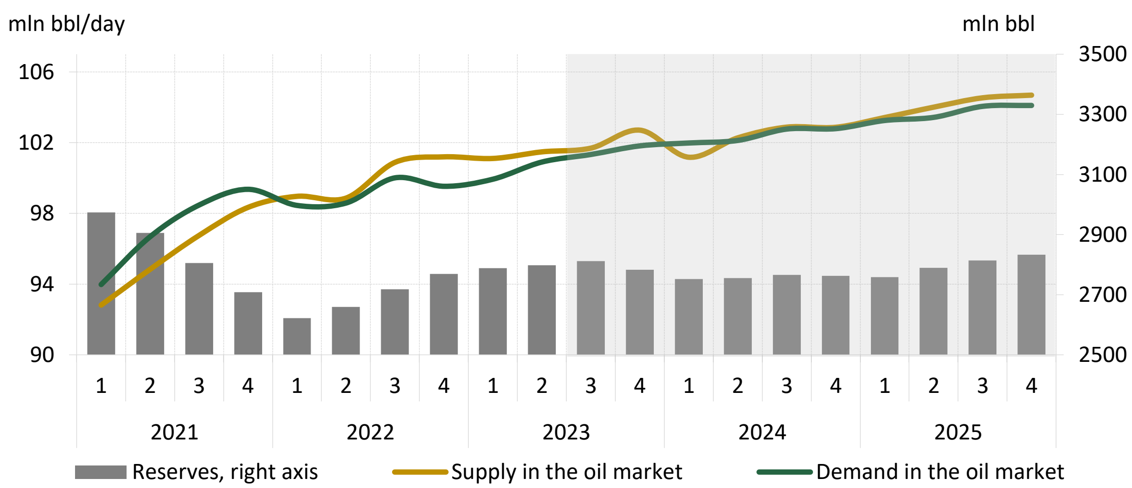


Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs., CB RF, NBK estimate

The current dynamics of world oil prices are taking place in the context of predominance of oil supply in the global market. The United States has historically record crude oil production of over 13 million barrels per day. Along with this, the geopolitical crisis in the Middle East has not yet had the expected upward impact on oil prices. In the medium term, global prices for Brent oil are expected to continue declining because of the increased global oil production by non- OPEC+ countries and more moderate economic growth in the world.

In comparison with the previous forecasting round "November 2023," estimates for the world Brent oil price were revised downward owing to the increased oil supply from non- OPEC+ countries. It is expected that from the beginning of this year, oil prices will be set at US$80 per barrel. This will be promoted by extension of the agreement to reduce oil production by 2.2 million barrels during the first quarter of 2024 reached between Saudi Arabia and other OPEC+ countries[2]. This will lead to the formation of a slight oil shortage in the global market in the first quarter of 2024. From the beginning of 2026, a gradual decline in oil prices is expected due to the anticipated increase in oil production by non-OPEC+ countries and forecasts for more moderate development of the global economy (Graph 1).

Graph 3. Dynamics of the Global Oil Market



Source: EIA

[2] *https://www.opec.org/opec_web/en/press_room/7267.htm*

The baseline scenario assumes that the Brent oil price will remain at US$80 per barrel until the end of 2025 and then will gradually decline to US$75 per barrel by the end of 2026.

At the same time, due to uncertainty regarding the development of the global economy, in addition to the baseline scenario, alternative scenarios for the dynamics of world oil price were also considered.

Thus, reduction in geopolitical tensions, a significant increase in world trade and a global easing of monetary conditions could lead to a strong growth in the global economy and an increase in oil demand. This factor, while maintaining moderate global oil production, will cause an increase in world oil prices. As a result, the optimistic scenario assumes that the world oil price will rise to US$100 per barrel in September of this year and remain at this level until the end of the forecast period.

On the other hand, there is a risk of lower energy demand given China's weak economic performance. Despite the IMF revising its growth forecast for China's economy upward in 2024[3], demand in the economy remains weak. Consumer prices in China continue to decline, amounting to (-)0.8% in annual terms in January 2024. In the case of weaker global oil demand, a pessimistic scenario is considered, which assumes a decrease in the world price of Brent oil to US$60 per barrel in September this year and remaining at this level until the end of 2026 (Table 1) (Graph 4).

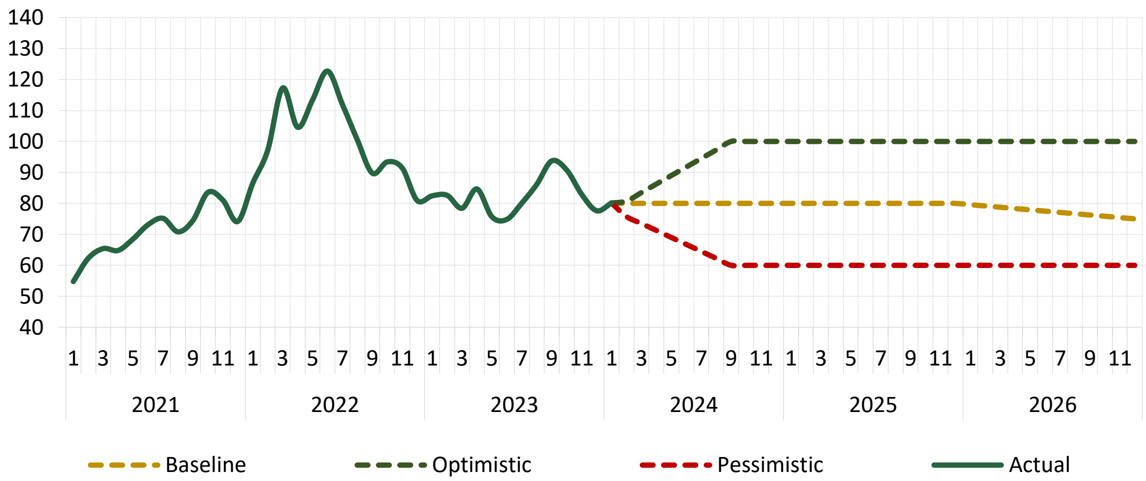
Table 1. Forecast Assumptions Regarding the Oil Price

	2024	2025	2026
Pessimistic Scenario	**66.8** (64.6)*	**60.0** (60.0)	**60.0**
Baseline Scenario	**80.0** (85.0)	**80.0** (80.0)	**77.0**
Optimistic Scenario	**91.8** (98.4)	**100.0** (100)	**100.0**

Source: NBK computations

** the preceding forecast as part of the "November 2023" forecasting round is shown in the parenthesis*

Graph 4. Scenarios Regarding the Brent Oil Price, US$/BBL



Source: EIA, NBK computations

Due to persisting logistical difficulties in the world, a short-term rise in cereal prices is expected until mid-2024, followed by a gradual decline in prices thereafter.

[3] *https://www.imf.org/en/Publications/WEO/Issues/2024/01/30/world-economic-outlook-update-january-2024*

The FAO Cereal Price Index has continued to decline in annual terms since February 2023, due to the presence of significant export supply of wheat and corn in the global market. At the same time, from the end of 2023 to mid-2024, prices are expected to rise due to possible logistical difficulties in the Black and Red Sea. The expected growth in cereal prices could also be driven by the impact of El Niño that, in turn, could lead to dry conditions in the Asia region, which accounts for more than half of global rice production. El Niño can also cause drought in the tropical regions of Brazil and Australia, thereby reducing the yield of wheat and other crops in these regions. The World Bank estimates that the El Niño effect will begin in the winter of 2024 and gradually weaken in the spring of 2024[4]. Beginning in mid-2024, cereal prices are expected to gradually decline as global supply increases.

1.2. Prospects of the Development of the Economic Situation under the Baseline Scenario

As at the end of 2023, Kazakhstan's economy grew by 5.1%. As expected, business activity is expanding in all major sectors of the economy, but feeble growth is observed in the mining industry and contraction is seen in agriculture. According to forecasts, the GDP growth will be 3.5-4.5% in 2024, 5.5-6.5% in 2025, 3.5-4.5% in 2026 (Graph 5) (Table 2).

In 2024, the main contribution to the GDP growth will come from domestic demand. The increase in household expenditures will be supported by budget spending on the social sphere, the restoration of positive dynamics of real wages against the slowing inflation and positive dynamics in the origination of consumer loans.

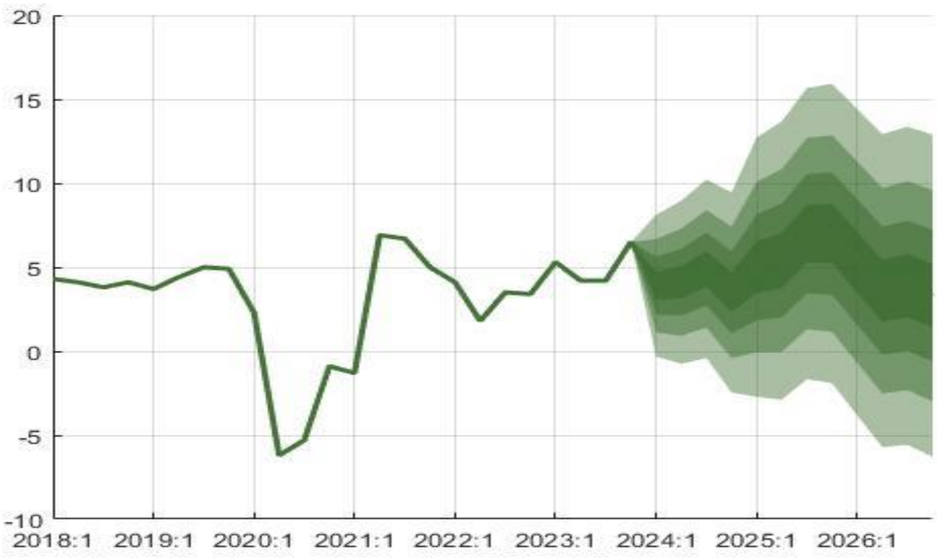
Gross accumulation will grow due to implementation of investment projects in various sectors of the economy (industry, agriculture, energy, transport and other sectors). Positive dynamics of domestic demand will stimulate the growth of imports, which will have a restraining effect on the GDP growth. Positive dynamics in government spending are also expected, which will be driven by increased spending on employee salaries and spending on goods and services. At the same time, it is anticipated that export dynamics will be influenced by such factors as the postponement of the implementation of the FGP/WPMP project at the TCO to 2025 and moderate grain exports due to a poor harvest in 2023. **Overall, the updated forecast regarding the economic growth for 2024 is 3.5-4.5%.**

In 2025, fiscal stimulus will somewhat weaken, but a more modest fiscal impulse will be offset by accelerated exports owing to the launch of the FGP/WPMP project, which will significantly increase oil production at the TCO field. Exports will be supported by external demand, which will remain stable over the forecast horizon. Due to a faster growth of exports over the dynamics of domestic demand and more moderate imports, **the GDP growth in 2025 will be 5.5-6.5%.**

In 2026, exports will show weak dynamics against a reduction in oil production due to the maintenance works at the main fields. In addition, as fiscal stimulus fades, the domestic demand will approach its trend values. These factors will help bring the economic growth closer to its long-term values. Consequently, **the GDP growth in 2026 is expected to be 3.5-4.5%**.

[4] *https://blogs.worldbank.org/developmenttalk/risks-global-food-markets-0*

Graph 5. GDP, YoY, %



Source: NBK forecast

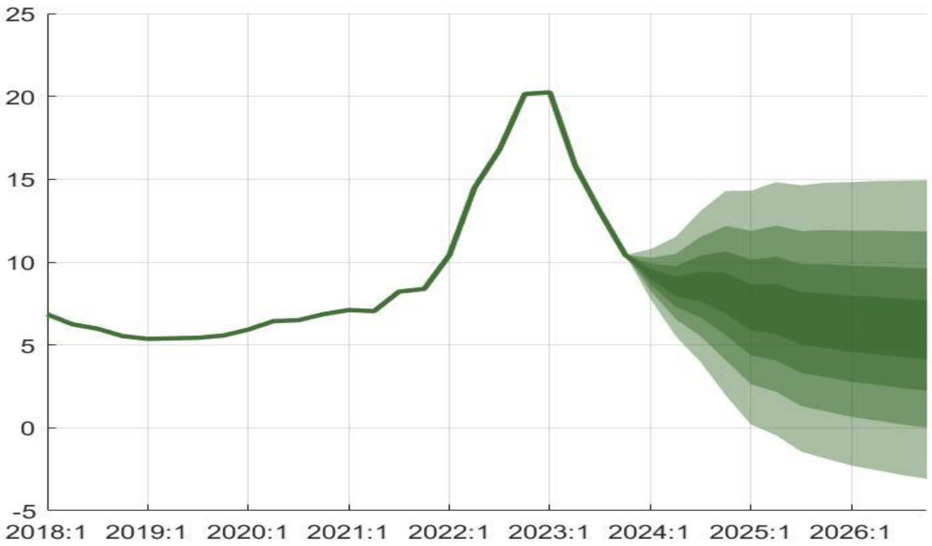
The output gap will remain positive throughout the forecast horizon with a gradual closing throughout 2026. The positive domestic demand gap will slowly narrow by 2026. Imports, as a function of domestic demand, will show similar dynamics. A near-zero export gap is expected in 2024 with a significant increase in 2025. A slight positive gap in 2024 tending towards zero in 2026 is expected for government consumption. Overall, the output gap will move towards closing, but at a slower rate compared to past forecasts due to fiscal stimulus.

The current dynamics of inflation in recent months have been developing according to the forecasts of the National Bank. In 2025-2026, inflation will continue to slow down; the prerequisites and path of forecast dynamics have not undergone significant changes. Thus, inflation in 2024 will be 7.5-9.5%%, in 2025 – 5.5-7.5%, and in 2026 – 5.0-6.0% (Graph 6) (Table 2).

In the first quarter of 2024, high dynamics of monthly food inflation is expected due to the seasonal increase in prices for fruits and vegetables. At the same time, in the coming months, food inflation will be largely exposed to a disinflationary effect of lower producer prices in agriculture and world food prices (oils and fats, sugar and cereals).

A slight slowdown in inflation will be driven by pro-inflationary pressure from rising real wages and consumer lending, which will continue to support stable domestic demand for non-food goods and market services. Prices for regulated services will continue to rise, leading to an acceleration of the service component of inflation. Growth of regulated utilities is expected at 20-25% in 2024, and its contribution to inflation is estimated at the 2023 levels.

Graph 6. Inflation, YoY, %



Source: NBK forecast

In 2025-2026, annual inflation will continue to decline, although at a slower pace. Thus, moderately tight monetary conditions, declining inflation expectations, a return of inflation in Kazakhstan's trading partner countries to their target values, and a general trend towards lower food prices in the world will help reduce inflation in Kazakhstan. At the same time, fiscal stimulation and ongoing reforms in the field of tariffs for utility services will not allow inflation to quickly return to its target level of 5%. As a result, inflation will be in the range of **5.5-7.5%** by the end of 2025 with a decrease by the end of 2026 to **5-6%**.

It should be noted that the forecasts are based on the Forecast for Socio-Economic Development of Kazakhstan (FSED) and other existing government program documents. Meantime, the Government and other government authorities are drafting new policy measures to increase the economic growth rates. As these measures and policies are formulated and implemented, the National Bank's inflation and GDP forecasts may be revised.

Table 2. Forecasts under the Baseline Scenario

	2024	2025	2026
GDP, *YoY, %*	**3.5-4.5** (3.2-4.2)	**5.5-6.5** (5.5-6.5)	**3.5-4.5**
CPI, *Dec. to Dec. of the preceding year, %*	**7.5-9.5** (7.5-9.5)	**5.5-7.5** (5.5-7.5)	**5-6**
Brent oil, *in US$/bbl, yearly average*	**80** (85)	**80** (80)	**77**

Source: NBK forecasts

1.3. Alternative Forecast Scenarios

Based on the risks regarding the development of the global economy in a changing geopolitical environment, the National Bank, in addition to the baseline scenario, also considered other alternative scenarios – pessimistic (Table 3(a)) and optimistic (Table 3(b)), when making a decision on the base rate.

If the pessimistic scenario is realized, oil prices are expected to gradually decline to US$60 per barrel and remain at this level until the end of 2026. This scenario will correspond to a possible slowdown in the global economic growth due to an unfavorable geopolitical situation, the expansion of trade restrictions between countries, the termination of the OPEC+ deal regarding oil volumes produced and a strong increase in oil production outside of OPEC.

In case of developments according to the pessimistic scenario, the demand for Kazakhstan's export commodities, primarily oil, will be weaker than under the baseline scenario. This factor, coupled with a lower oil price, will limit business activity in the extractive industries, which will also negatively affect related sectors of construction, transport, trade and other services, and overall investment in the economy. Weaker economic activity will lead to lower household income and a corresponding weakening of consumption. As economic agents adapt to the new level of oil prices and the low base effect, as well as the preservation of the premise for increasing oil production at the TCO, the economic growth in 2025-2026 will approach the values of the baseline scenario. As a result, **the GDP growth rates will be 3-4% in 2024, 5-6% in 2025 and 3.5-4.5% in 2026**.

Under the pessimistic scenario, inflation will slow down at a slower pace than under the baseline scenario. Despite feebler economic activity, the weaker real effective exchange rate of the tenge and higher inflation expectations will lead to increased inflation pressures. **In 2024, inflation will be 8-10%, in 2025 – 6.5-8.5%, in 2026 – 5.5-6.5%.**

If the world economy develops according to the optimistic scenario, it is assumed that oil prices will gradually increase to US$100 per barrel and remain at this level until the end of the forecast horizon. Increases in oil prices in particular and for commodities in general will be fueled by faster growth of the global economy against some reduction in geopolitical tensions, restoration of active trade relations and easing of monetary conditions due to a faster slowdown in inflation in developed and developing countries while maintaining moderate global oil production.

High world prices for raw materials and strong external demand will have a stronger impact on business activity in Kazakhstan than under the baseline scenario. **The economic growth in 2024 will be 4-5%, in 2025 – 6-7%, and in 2026 – 3.5-4.5%.**

Under the optimistic scenario, inflation will decline to target values faster than under the base scenario. This will be nurtured by strong dynamics of the tenge exchange rate and lower external inflationary pressure. **In 2024, inflation will be in the range of 7-9%, in 2025 – 5.0-6.5%, and in 2026 – 5-6%.**

Table 3 (a). Forecasts under the Pessimistic Scenario

	2024	2025	2026
GDP, *YoY, %*	**3-4** (2.5-3.5)	**5-6** (5-6)	**3.5-4.5**
CPI, *Dec. to Dec. of the preceding year, %*	**8-10** (8.5-9.5)	**6.5-8.5** (6-8)	**5.5-6.5**
Brent oil, *in US$/bbl, yearly average*	**66.8**	**60**	**60**

Table 3 (b). Forecasts under the Optimistic Scenario

	2024	2025	2026
GDP, *YoY, %*	**4-5** (3.5-4.5)	**6-7** (5.8-6.8)	**3.5-4.5**
CPI, *Dec. to Dec. of the preceding year, %*	**7-9** (7-9)	**5.0-6.5** (5-7)	**5-6**
Brent oil, *in US$/bbl, yearly average*	**91.8**	**100**	**100**

Source: NBK forecasts

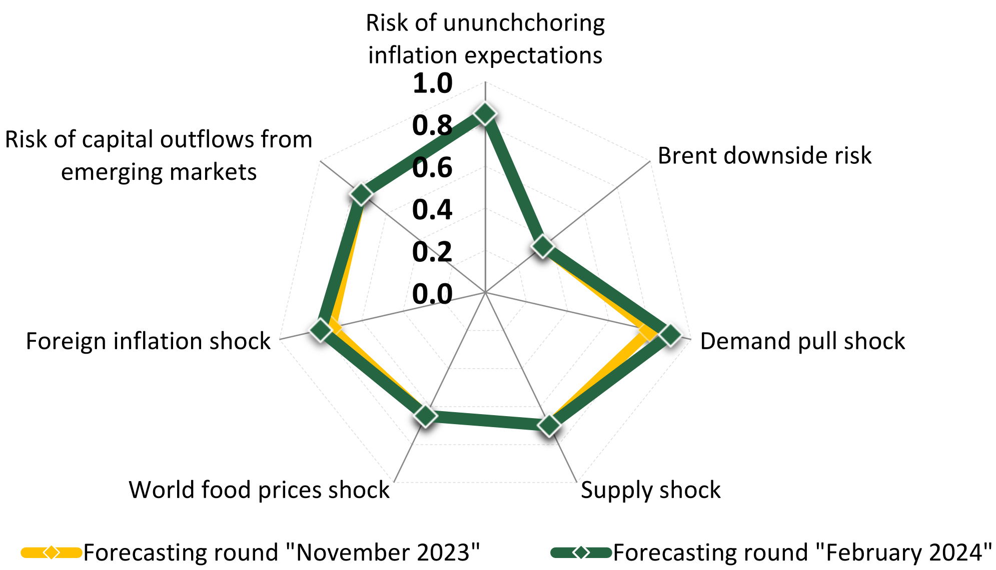
1.4. Risks in the Medium Term

Compared to the preceding forecasting round, the overall balance of risks somewhat strengthened, both from external factors and from internal factors (Graph 7).

Relative to the preceding forecasting round, the risk of heightened external inflationary pressure has somewhat increased. At the moment, the risk of increase in the cost of transportation in the world has intensified given the tense situation in the Red and Black Seas, which may affect the general level of prices in many countries. In this regard, core inflation, which reflects the steady rise in prices in the economy, in many countries may remain above the target for a longer period of time than previously expected. As a result, this factor may lead to high inflation expectations and accelerated inflation in many countries, which will also affect prices in Kazakhstan through the import channel. At the same time, the factor of geopolitical tension on key transport routes, together with restrictions on global trade and a possible reduction in the world harvest due to climate change, causes the risk of importing high global food inflation to be at a high level. These external risk factors, together with the consequences of an unfavorable harvest in Kazakhstan, could cause a significant rise in food prices in Kazakhstan.

The risk of capital outflow from emerging markets in favor of developed ones remains high. If steady inflationary pressures persist or even increase globally, central banks in developed countries will maintain tight monetary conditions for a longer period of time, which could have a negative impact on emerging market currencies. In addition, the risk of increasing sanctions against trading partner countries is still high.

Graph 7. Risk Map Based on the Expert Judgment



Source: NBK computations

Compared to other external risks, the risk of a significant drop in oil prices appears less pronounced. This is due both to the actions of OPEC+ to reduce oil production, the persisting tension in the Middle East, and the continued growth of the global economy. However, the decline in global economic growth against the background of disruptions in the functioning of trade relations and growing problems in the financial sector, especially in China, may cause a decline in prices for oil and other commodities.

As for domestic risk factors for inflation, the risk of fiscal stimulus has increased.

Thus, taking into account the practice of frequent upward revision of government spending in prior years and insufficient tax collection (which causes an increase in the non-oil budget deficit), it is possible that budget parameters may be further revised towards expanding expenditures and/or increasing the budget deficit, which can become an additional source of price growth in the economy.

Risks from supply factors also remain high. Low dynamics of producer prices in the agricultural and manufacturing sectors somewhat reduce the risks of increasing producer costs. However, the effect of these factors may further unfold given the expected increase in prices for regulated utility services, increased transportation costs, and negative consequences of a low harvest in 2023.

The risk of inflation expectations not being anchored at a level close to the 5% target remains high, which is due to their high level, focus on past events and dependence on tracer goods such as food, fuels and lubricants and utilities.

Risks to the GDP forecast stem from uncertainty regarding oil production figures in 2024-2025 and future fiscal policy parameters.

1.5. Forecast of the Current Account of the Balance of Payments

The current account of the balance of payments is expected to remain in the deficit zone in 2024-2026 baseline scenario. Deficit values of the current account in the medium term are a result of a gradual projected decline in oil prices and further growth in imports of goods.

The current account deficit is expected to be at (-)3.9% of GDP in 2024, (-)1.8% of GDP in 2025 and (-)2.8% of GDP in 2026 (Graph 8). The projected dynamics will be determined by the following factors.

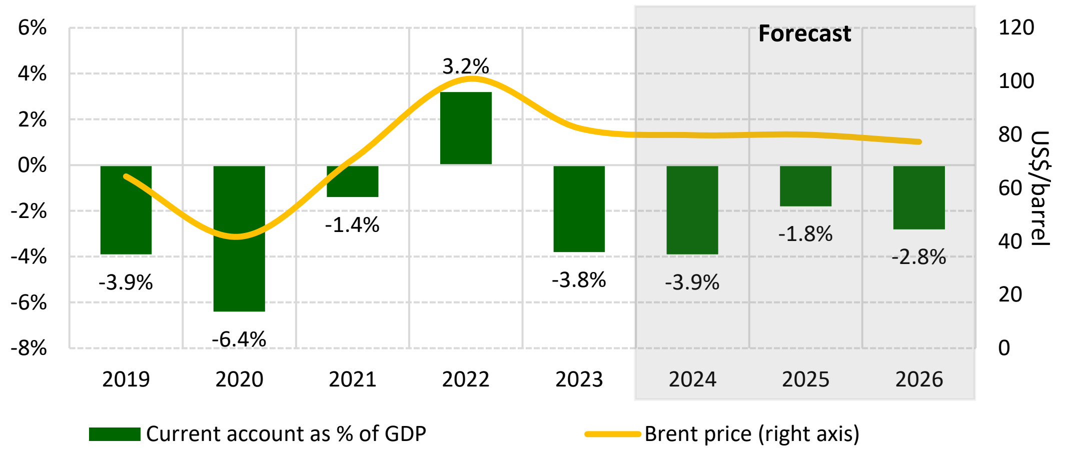
The trajectory of exports will be determined by the oil component. The gradual decline in oil prices to US$77 per barrel in 2026 will be offset by an increase in oil production volumes due to the completion of the TCO’s FGP-WPMP project. Moderate growth in non-oil exports will be supported mainly by the expected rise in uranium prices and moderate growth in supplies of metals and metal ores.

Imports of goods according to the balance of payments methodology will continue to grow moderately – by an average of 3.1% annually during 2024-2026. High levels of imports will be driven by growing demand of households and businesses for foreign goods because of the limited supply of locally produced alternatives, significant share of imported intermediate goods in production chains and implementation of government industrial and infrastructural development programs. In addition, the opening of the Khorgos ICBC will contribute to the growth of shuttle trade volumes to levels exceeding pre-pandemic levels.

The deficit of income balance will remain at high levels and will continue to follow the dynamics of commodity exports. Despite the projected downward oil price trajectory, income payable to foreign direct investors will be significant due to projected growth in metals exports, as well as increased oil production. Accrued interest payable, which reached an all-time high in 2023, will begin to decrease due to the expected reduction in global interest rates from the second half of 2024.

The deficit in the balance of services over the forecast horizon will decrease because of higher growth rates of exports of services compared to their imports: the average annual growth rate is projected at 7.2% and 5.1%, respectively. Exports of services will grow due to the continued growth in the volume of personal non-business travel by non-residents to Kazakhstan, as well as transport services because of the increased transit of cargo through the territory of the country. The growth in imports of services will be mainly driven by an increase in imports of travel due to a significant increase in the volume of tourist flows abroad, as well as an increase in freight due to an increase in imports of goods.

Graph 8. Current Account of the Balance of Payments



Source: NBK forecast

MONETARY POLICY

II. MONETARY POLICY

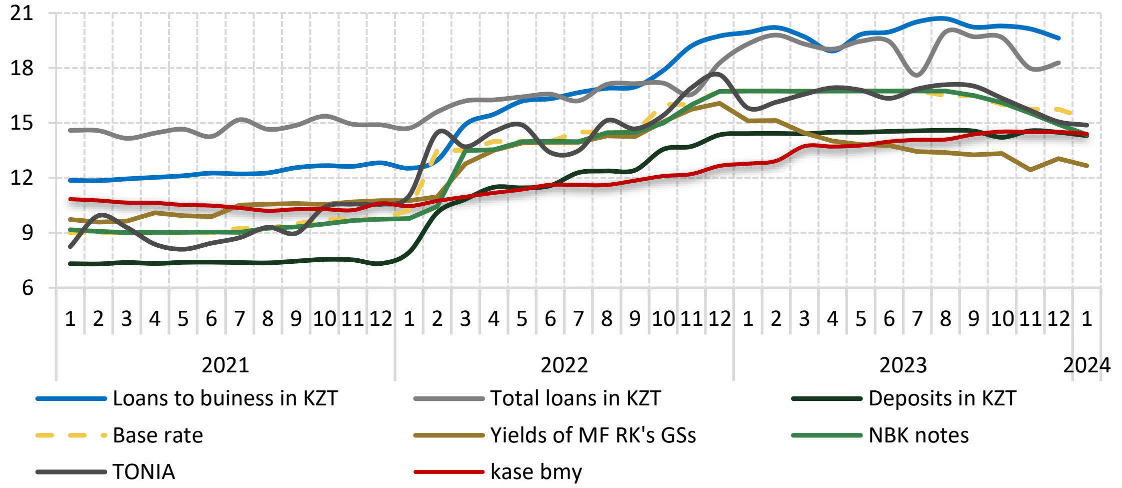
2.1. Monetary Conditions

Yields on government securities continued to decline given the current and expected easing of monetary conditions. In particular, the weighted average yield on government securities of the Ministry of Finance of the Republic of Kazakhstan decreased from 13.33% in October 2023 to 12.67% in January 2024. The yield on issued NBK notes decreased from 16.12% to 14.35% over the same period (Graph 9).

The most recent decisions on the NBK's base rate also affected the cost of loans: the weighted average value of all bank loans decreased by 142 bp during the 4th quarter of 2023, including the weighted average rate on business loans by 60 bp. Seasonal marketing campaigns on consumer loans also helped reduce interest rates on loans to the population.

The spread between the TONIA rate and the general rate on the tenge deposits decreased from 213 bp in October to 57 bp in January 2024.

Graph 9. Dynamics of Change in the Base Rate and Market Rates, %



Source: NBK, KASE

Box 1. Publishing Forecasts for the Central Bank Interest Rate

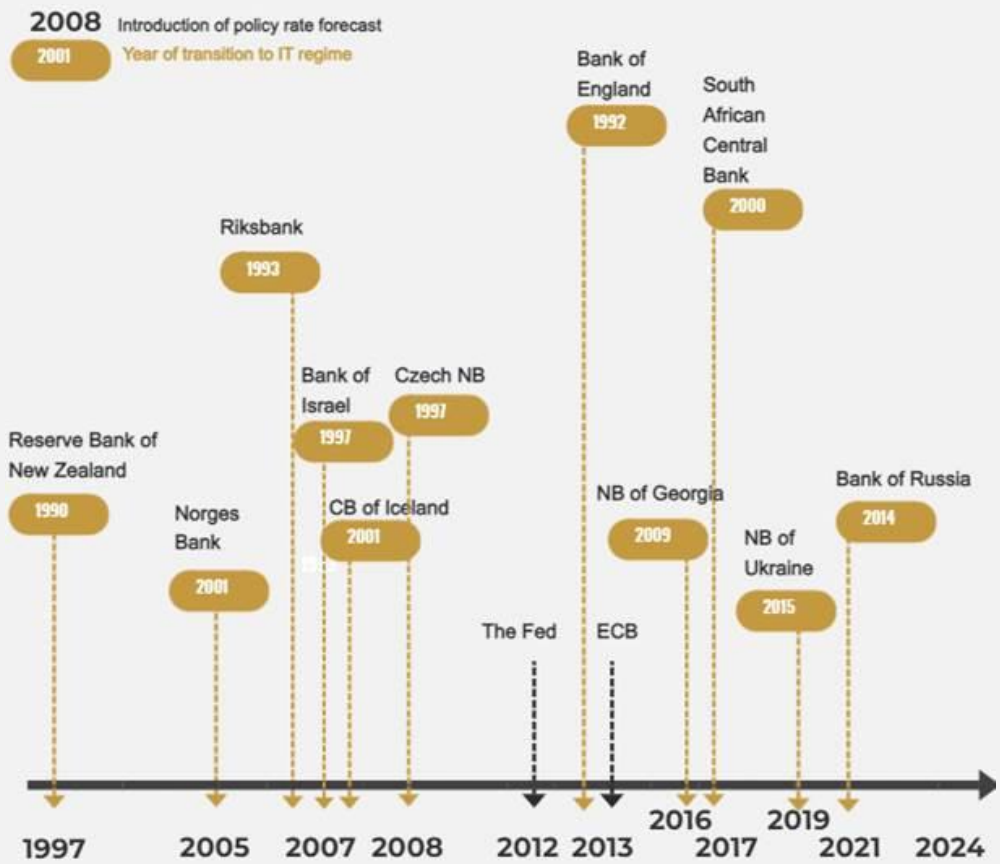
Currently, a small number of central banks in the world practice publishing interest rate forecasts. Longer publication periods are observed in the central banks of New Zealand, Sweden and Norway. Over the past ten years, the National Bank of Georgia (since 2016), the Central Bank of South Africa (since 2017), the National Bank of Ukraine (since 2019) and the Bank of Russia (since 2021) began publishing forecasts (Figure 1).

General Approaches to Publishing the Interest Rate. When forecasting macroeconomic variables, a central bank makes certain assumptions about the path of the short-term interest rate.

Basically, the publication of interest rate forecasts by central banks is carried out according to the following options:

1. Fixed (constant) interest rate (National Bank of Poland, Bank of England);
2. A path implicitly predicted from the yield curve/market expectations (Bank of Iceland, Bank of Israel, Bank of England, ECB);
3. The path of the interest rate projection is determined by the monetary policy committee (US Federal Reserve System, Central Bank of Norway, Sweden, New Zealand, South Africa, Czech Republic, etc.). It represents the endogenous path inherent in the main model, as well as a combination of staff forecasts and expert judgments of members of the MP committee.

Figure 1. International Experience in Publishing the Interest Rate Forecast



Source: compiled by the author based on the information from central banks' web sites
Inflation-targeting countries are highlighted in yellow, the rest represent MP regimes with an implicit nominal anchor

Interest Rate Choice. Most central banks publish forecasts of the key policy rate. Individual banks (ECB, Czech National Bank and National Bank of Poland) publish forecasts for three-month interbank rates. The Central Bank of South Africa, in addition to the nominal key interest rate, publishes a forecast of a neutral interest rate.

Publication Format. In most cases, point rate forecasts are more prevalent than range or probability forecasts. The rate trajectory is forecast for 3 years ahead (12-13 quarters) as a point value on average at the end of the year (for the last quarter) and/or on average for the year. The US Federal Reserve also publishes long-term forecasts separately and presents different forecast formats (median, central tendency, range). The Bank of Russia presents the forecast in the form of a range of the average key rate for the year. Some banks publish graphical forecasts with confidence intervals (Czech Republic, South Africa). Basically, forecasts are presented 4 times a year, as are all key macroeconomic forecasts in general. The Riksbank (Sweden) is one of the central banks that publishes the rate path under alternative scenarios.

The main advantage of the practice of publishing forecasts is the formation of appropriate market expectations about future monetary policy. This allows you to evaluate financial assets more effectively. The main argument against publishing the forecast is the incorrect interpretation of the central bank's signal by financial market participants. If agents do not understand the conditional nature of the forecast, it will complicate rate communication and may cause volatility in the market.

In general, the forecast for the main monetary policy rate is not a strict promise from the central bank to follow this path, but an estimate. An assessment of what rate trajectory is needed for a balanced monetary policy, i.e. policy direction at the time of decision-making, taking into account current macroeconomic conditions and prospects. When new information appears, external and internal conditions change, the rate trajectory may change.

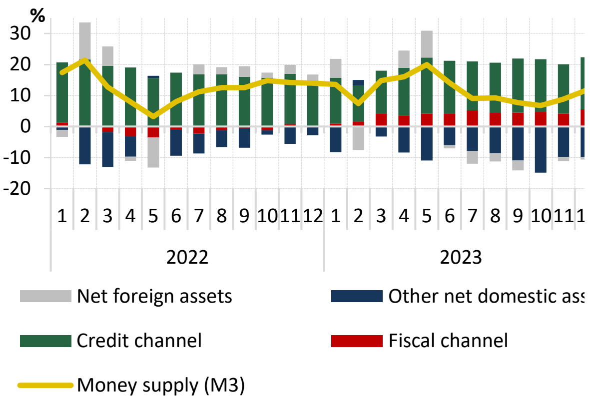
2.2. Money Supply

After a noticeable slowdown in September and October, the annual growth of money supply at the end of December 2023 and January 2024 accelerated. The credit and fiscal channels made the main contribution to the growth in the money supply.

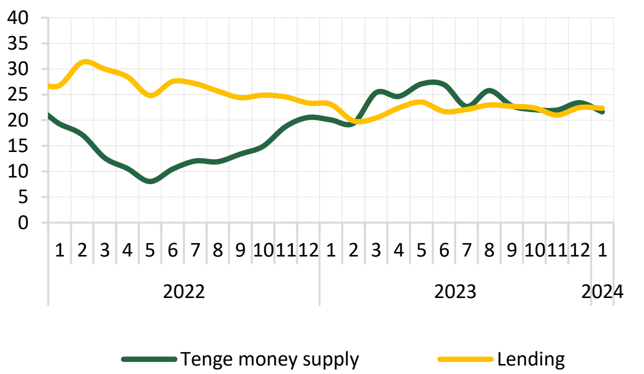
In November 2023, annual growth of money supply began to accelerate, with an increase of 10.5% in January 2024. The total volume of money supply in January amounted to 37.4 trillion tenge (Graph 10). The growth of money supply was ensured by the credit channel, mainly due to retail lending (contribution of 12.4 percentage points) and business (contribution of 3.0 pp), as well as the fiscal channel against the expansion in the issuance of government securities (contribution of 6.9 pp), while foreign assets made a negative contribution.

The growth of **money supply in the tenge** continued to demonstrate high rates, reaching 21.6% in January 2024. As of December 2023, the growth of the tenge money supply outpaced the dynamics of nominal GDP by 8.5 percentage points (the tenge money supply increased by 23.4%, nominal GDP - by 14.9%, YoY).

Graph 10. Money Supply, YoY, %



Graph 11. Tenge Money Supply and Lending Volumes of STBs



Source: *NBK*

2.3. Money Market

In January 2024, the balance of open position (liquidity surplus) amounted to 5.2 trillion tenge Money market rates in November 2023–January 2024 showed volatility amid the quarterly tax week in November 2023 and a persisting high liquidity surplus.

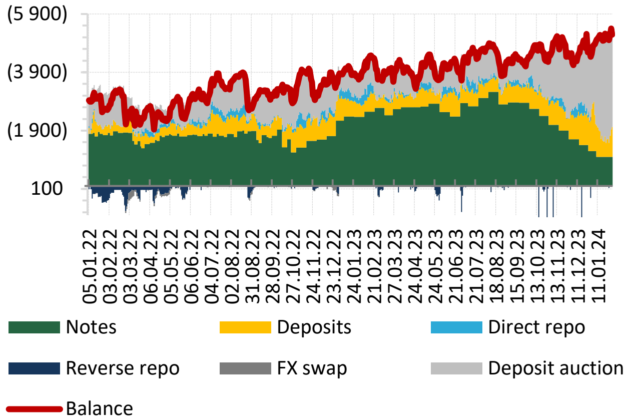
In January 2024, the balance of NBK operations increased by 17% YoY. The main volume of liquidity during November 2023 - January 2024 on average was withdrawn through deposit auctions – 2.3 trillion tenge, notes in the amount of 1.5 trillion tenge and deposits – 0.9 trillion tenge (Graph 12).

In November 2023, the TONIA rate was volatile, setting both near the base rate and near the lower bound being influenced by the quarterly tax week.

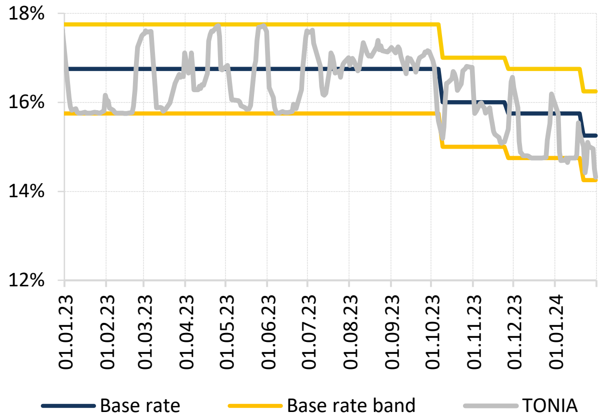
In December (except for the end of the month), given a seasonal significant increase in government spending in monthly terms and an increase in liquidity in the banking sector, the TONIA was setting mainly at the lower bound of the band. In January 2024, following the beginning of the functioning of the NBK's updated system of instruments, which assumes a more market-based formation of the TONIA, the lower bound of the policy rate band was hit at the beginning of the month. At the same time, the TONIA was subsequently within the target corridor.

Given the lowering of the base rate in November 2023 and January 2024, the average TONIA rate in November 2023 - January 2024 was at the level of 15.2% (Graph 13). The spread between the TONIA and the base rate during 3 months was at the level of (-) 0.5 percentage points on average.

Graph 12. Exposure on the National Bank's Operations, Bln Tenge



Graph 13. Interest Rate Band and TONIA



Source: NBK

2.4. Foreign Exchange Market

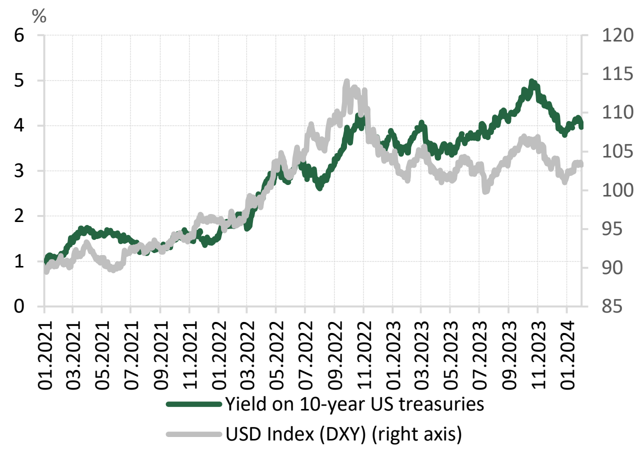
In November 2023 – January 2024, the national currency appreciated by 4.6% to 448.2 tenge per US dollar. The strengthening was supported by the global weakening of the US dollar, seasonal sales of foreign currency by exporters at the end of 2023 and an increase in investments in government securities of the Republic of Kazakhstan by non-residents.

Central banks in developed countries continued to exercise caution, maintaining tight monetary policies to reduce inflation to target levels. Following the results of three meetings in November, December 2023 and January 2024, the US Fed, despite a significant slowdown in inflation processes, decided to maintain the policy rate at 5.25-5.5%. At the same time, at the December meeting, the Fed said that the current cycle of tightening monetary policy is likely over. Against this background, yields on US the Treasury bonds showed a significant decline from 4.9% at the beginning of November 2023 to 4% at the end of January 2024 (Graph 14). As a result, the November 2023-January 2024 DXY US Dollar Index dropped by 5% (Graph 14), while the EM Currency Index increased by 3.2% (Graph 15).

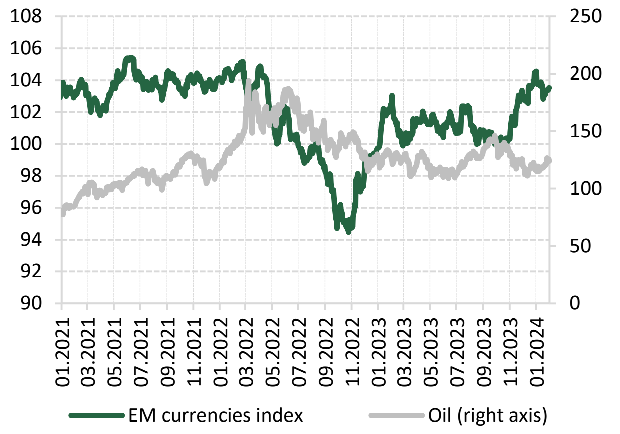
The oil market in November 2023 – January 2024 was influenced by a number of multidirectional factors. Downward pressure on oil prices was exerted by an increase in oil production volumes in non-OPEC+ countries, with ongoing concerns about a decline in demand from its main consumers - the United States and China. While the growth in oil prices was facilitated by an improved forecast for global economic growth in January of this year (compared to October 2023), agreements between OPEC countries regarding additional oil production cuts in the first quarter of 2024, as well as escalating tensions in the Middle East. Taking into account the above, the price of oil in November 2023 – January 2024 decreased by 6.5% from US$87.4 to US$81.7 per barrel (Graph 15).

In November 2023 - January 2024, in the domestic foreign exchange market, the seasonal sale of foreign currency by exporters to pay taxes in November and December, the purchase of shares of NC "KazMunayGas" JSC at the expense of the National Fund of the Republic of Kazakhstan, the weakening factors were the growth of the seasonal demand for currency from the population and a reduction in the National Bank base rate by a total of 75 bp from 16% to 15.25% served as the factors strengthening the national currency.

Graph 14. Yield on the 10-Year US Treasuries, DXY



Graph 15. Dynamics of the EM Currency Index, and of the Price of Oil (31.12.2019=100)



Source: Refinitiv

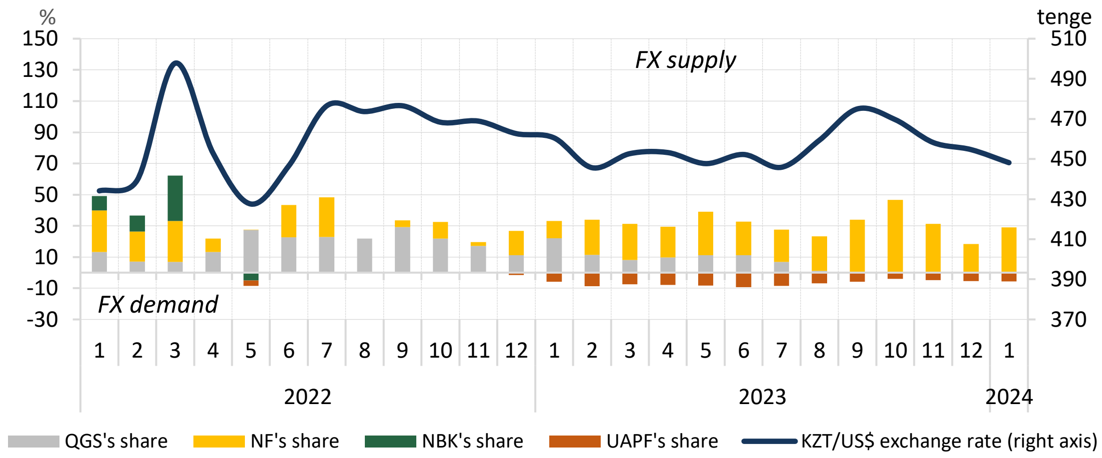
The national currency was supported by sales from the National Fund as part of providing transfers to the national budget. Their share of participation for November 2023 – January 2023 amounted to 26.2% of the total trading volume on average (Graph 16).

As a result of this, the national currency at the end of November 2023 – January 2024 strengthened by 4.6% from 469.6 to 448.2 tenge per the US dollar (Graph 16). At the same time, the range of exchange rate movements did not change significantly, amounting to 445.6-469.8 tenge per the US dollar.

The average daily volume of exchange trading in November 2023 – January 2024 increased by 1.5 times, YoY and amounted to US$180.4 million.

During November 2023 - January 2024, the National Bank operations, including sales from the National Fund and purchases in order to maintain the foreign currency share of the UAPF pension assets at 30%, were performed in accordance with pre-announced volumes. The volume of foreign currency purchases for the UAPF during this period amounted to US$590 million or 5.2% of the total trading volume (Graph 16). At the same time, no foreign exchange interventions were conducted in November 2023-January 2024.

Graph 16. Share of Large Participants in the Currency Purchase/Sale, YoY, %



Source: KASE, NBK

2.5. Stock Market

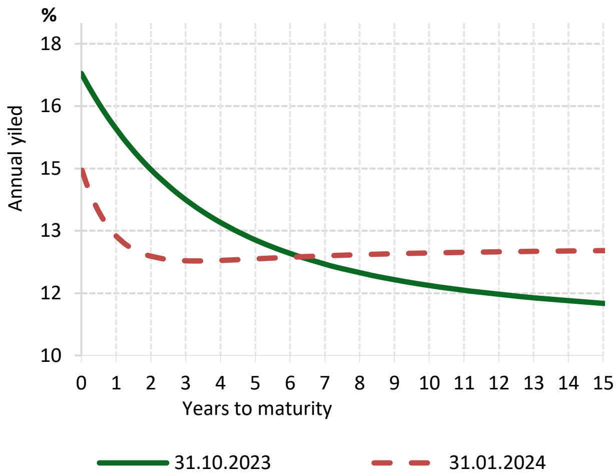
In November 2023-January 2024, the volume of placements of government securities of the Ministry of Finance of the Republic of Kazakhstan in the primary market increased compared to three months earlier, mainly due to significant volumes in January 2024. Trading volume in the secondary market remains high.

The gradual easing of monetary conditions and strong demand have led to a decline in the risk-free yield curve in the short and medium term segments. Against the backdrop of expectations for further easing of monetary policy, it retains its "inverted" form.

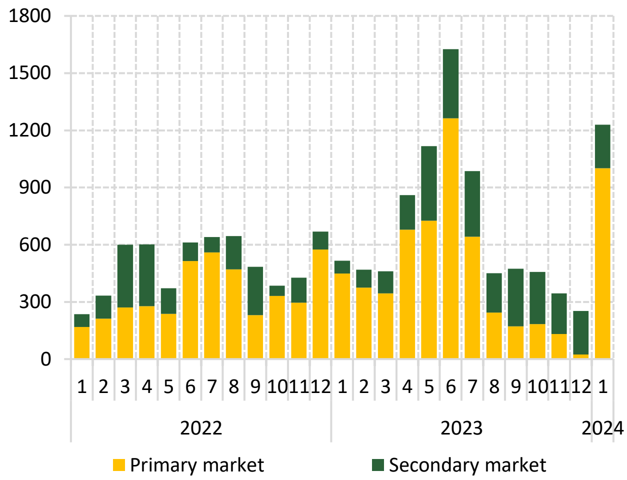
Yields on short-term (up to 1 year) decreased significantly by 258 bp against the background of the expected easing of monetary policy in the coming years, in the medium-term segments (from 1 to 5 years) the decrease amounted to 20 bp (Graph 17).

As of February 1, 2024, government debt (traded on the KASE) amounted to 24.1 trillion tenge. Due to record borrowings in mid-2023, the Ministry of Finance reduced the issuance of new government securities at the end of 2023, which also led to reduction in public debt and trading volumes at the end of 2023 (Graph 18).

Graph 17. Risk-Free Yield Curve, %



Graph 18. Transaction Volume in the GS Market, Bln Tenge

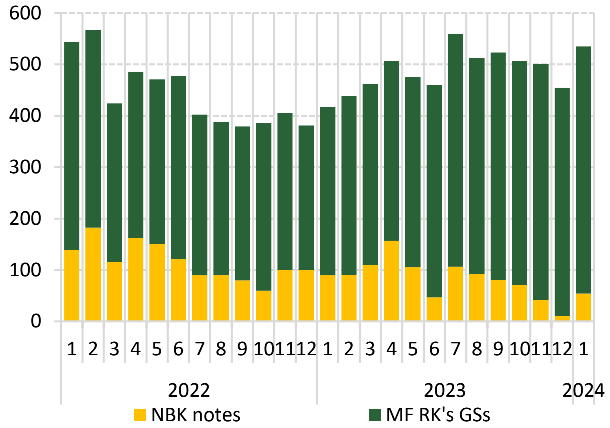


Source: KASE

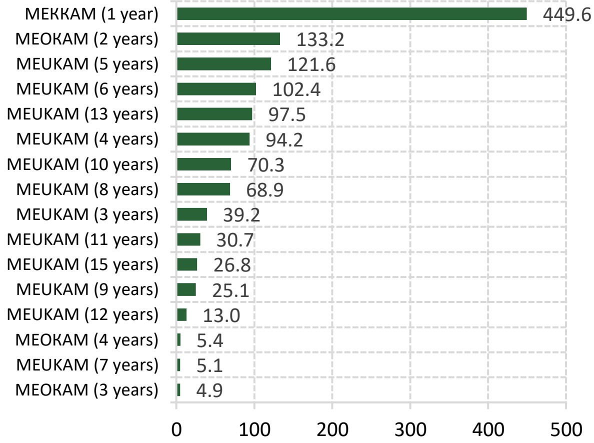
The share of GSs holding by non-residents increased from 2.4% in October 2023 to 2.7% in January 2024, investments of non-residents in government securities of the Ministry of Finance of the Republic of Kazakhstan increased and amounted to 481 billion tenge, while holdings in the NBK notes decreased from 70.5 billion tenge to 54.1 billion tenge (Graph 19). Such decrease in placements in notes by non-residents also occurred against a general reduction in the volume of the NBK note issuance.

According to the plan of the Ministry of Finance of the RK for the issuance of government securities for 2024, it is planned to attract about 5.2 trillion tenge (issue plan for 2023 – 4.6 trillion tenge). At the same time, the placement volume in January 2024 increased significantly compared to January 2023 and amounted to about 20% of the planned volume of issuance for 2024. In turn, the reduction in issuance of the NBK notes led to a significant excess of demand over their supply. The main volume of placements in the primary government securities market during November 2023 – January 2024 fell on the segment of short-term government securities of the Ministry of Finance of Kazakhstan up to 1 year with a yield in the range of 13.0%-13.3%. Medium-term securities with maturities from 1 to 5 years were also actively placed with a yield of 12.0%-14.0%. Long-term securities with maturity of 5 years or more were placed with a yield of 11.5%-13.0% (Graph 20).

Graph 19. Volumes of GSs Holding by Non-Residents, Bln Tenge



Graph 20. Placed GSs of the MF RK, by Remaining Maturities, during November 2023-January 2024, Bln Tenge



Source: *KASE*

During November 2023 – January 2024, the main buyers of government securities in the primary market were second-tier banks with a share of about 70% of the total trading volume. Institutional investors also showed activity, their share amounted to about 25%.

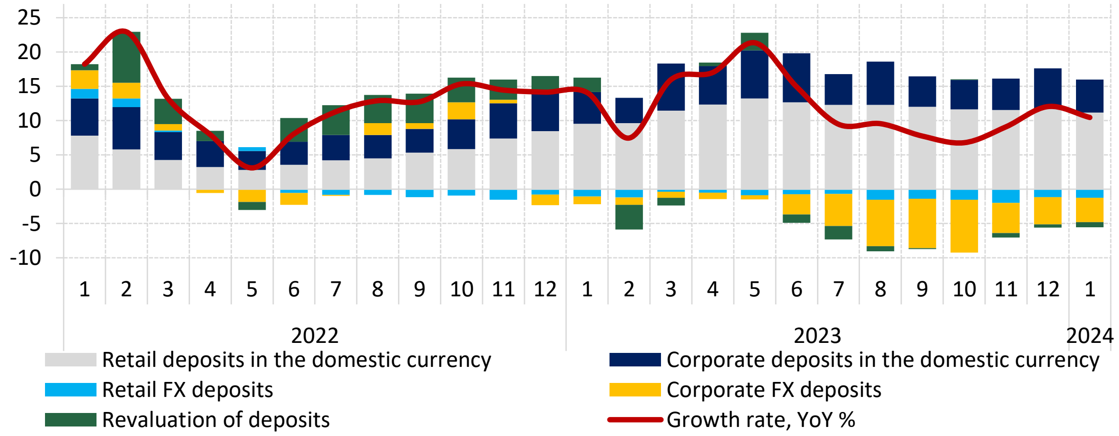
The main players in the secondary market were second-tier banks and other corporate entities (their share was about 90%). The share of participation of non-residents was at the level of 10%.

2.6. Deposit Market

After reaching their all-time high at the end of 2023, in January 2024 total deposits seasonally went down.

In January 2024, deposits at depository organizations increased by 10.5% in annual terms to 33.8 trillion tenge. Deposits in national currency made the main positive contribution, increasing by 23.2%, YoY; the negative contribution is associated with foreign currency deposits showing a 17.8% reduction, YoY (Graph 21).

Graph 21. Deposits of Residents at Depository Organizations, YoY, %



Source: NBK

Tenge deposits increased both owing to deposits of individuals (31.3% YoY) and corporate entities (14.6% YoY). The main factor in the growth of the tenge deposits of individuals is high rates on deposits, enabling to cover the level of inflation, as well as the persistently high differential between the tenge and foreign currency deposits' rates.

Deposits in foreign currency decreased mainly due to the "outflow" of deposits (in foreign currency equivalent, the overall decrease was 15.5%). The decrease in foreign currency deposits was mainly influenced by the low rates on foreign currency deposits, which ultimately leads to a partial flow into the tenge assets, as well as alternative financial investment instruments that allow generating higher returns compared to foreign currency deposits. The exchange rate revaluation of deposits due to the strengthening of the national currency during the year also had a minor effect on the reduction in foreign currency deposits. Against this background, foreign currency deposits of individuals in foreign currency equivalent reached an 11-year minimum in October 2023 and those of corporate entities – a 15-year minimum in September 2023. However, after a period of prolonged decline, foreign currency deposits (in foreign currency equivalent) showed a recovering growth in the 4th quarter of 2023 on the quarter-over-quarter basis (the growth of 73.1%), but decreased in January of this year due to seasonal factors.

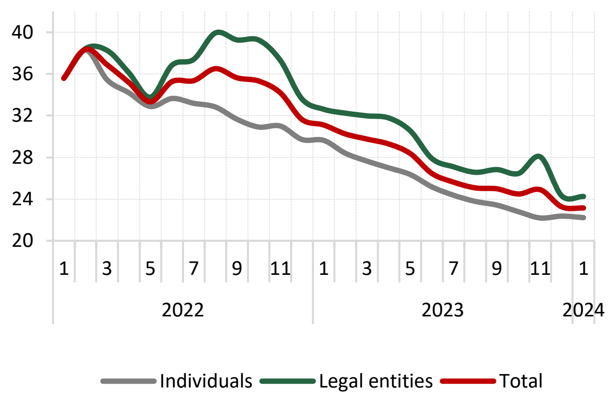
In the structure of retail deposits (including non-residents), non-term deposits[5] accounted for a significant part of the tenge deposit base in January 2024 – 59.7% (in January 2023 – 55.4%), the share of savings deposits increased to 11.1% (in January 2023 – 9.9%). The annual growth in the volume of non-term deposits in the tenge amounted to 42.3%. Savings deposits also showed significant growth (48.3% YoY).

The high rate differential between the tenge and foreign currency deposits, as well as bilateral exchange rate volatility, have led to the lowest degree of dollarization in the banking system over the past 26 years.

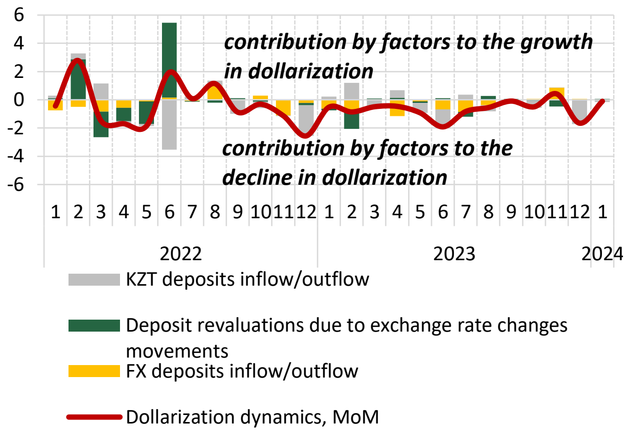
As of February 1, 2024, dollarization of deposits decreased to its lowest level over the past 26 years and amounted to 23.1% (in October 2023 – 24.5%) (Graph 22). Dollarization of deposits of corporate entities reached a 16-year minimum (24.2%, in October 2023 – 26.5%), of individuals – a 26-year minimum (22.2%, in October 2023 – 22.8%). It is worth mentioning that the decline in dollarization was accompanied by both a "net inflow" of new tenge deposits and a "net outflow" of foreign currency deposits (Graph 23).

Dollarization of deposits of individuals (including non-residents) decreased in almost all segments in terms of amount.

Graph 22. Deposit Dollarization, %



Graph 23. Factors Causing the Change in Dollarization in the Banking System, MoM, %



Source: NBK

[5] *According to the KFIF methodology determining and setting cap rates on retail deposits*

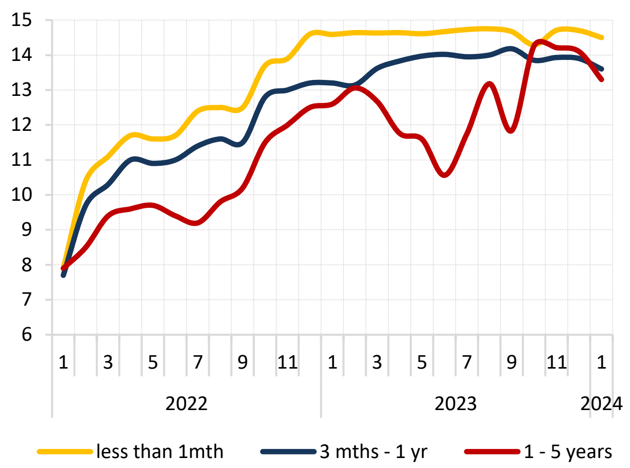
Also in January 2024, the share of the saving population[6] has gone up to the highest value (27.0%) since 2016, signaling an increase in the saving behavior of the population's sentiment.

Interest rates on long-term deposits went down following the lowering of the base rate.

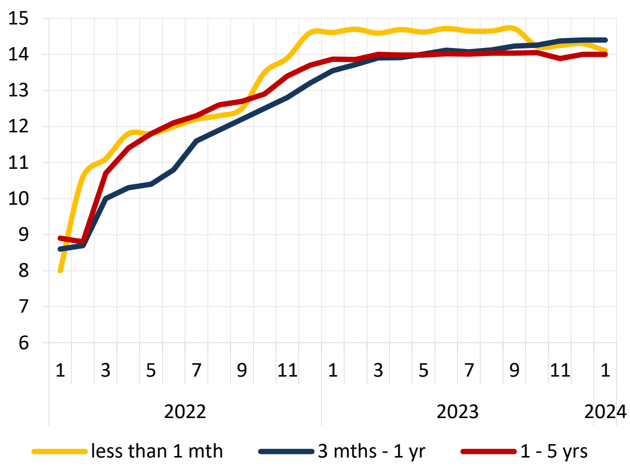
The easing of monetary policy led to a corresponding change in interest rates for corporate entities on longer-term deposits: compared to October 2023, in January 2024 the weighted average rate on corporate deposits with maturity of 1 to 5 years decreased by 97 bp to 13.3%, with maturity from 3 months to 1 year – by 25 bp to 13.6%. Rates on deposits with maturity of less than 1 month did not respond to the easing of monetary conditions, increasing slightly by 0.2 pp to 14.5% (Graph 24).

Rates on deposits of individuals with maturity of less than 1 month and from 1 to 5 years decreased by 12 bp and 5 bp, respectively, while the rate on deposits from 3 months to 1 year increased by 14 bp (Graph 25).

Graph 24. Interest Rates on Corporate Deposits, %



Graph 25. Interest Rates on Retail Deposits, %



Source: NBK

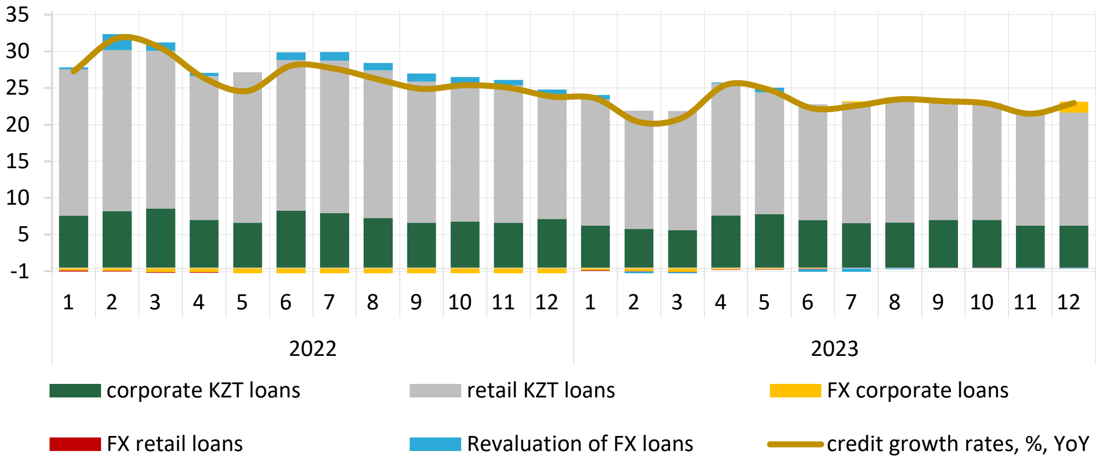
2.7. Credit Market

Lending by STB to the economy (balances) increased in the fourth quarter of 2023 given the accelerated growth in loans to businesses and consistently high growth rates in retail loans.

The annual growth of STB loans to the economy (balances) remained almost at the same level, decelerating slightly from 22.7% in September to 22.4% in December 2023 (Graph 26). The main contribution to the growth in total lending, as before, was made by retail loans. At the same time, the contribution of business loans increased in December against strong growth in loans to small businesses.

[6] *Based on the results of the survey on inflation expectations*

Graph 26. Bank Credits to the Economy (the Balance), YoY, %



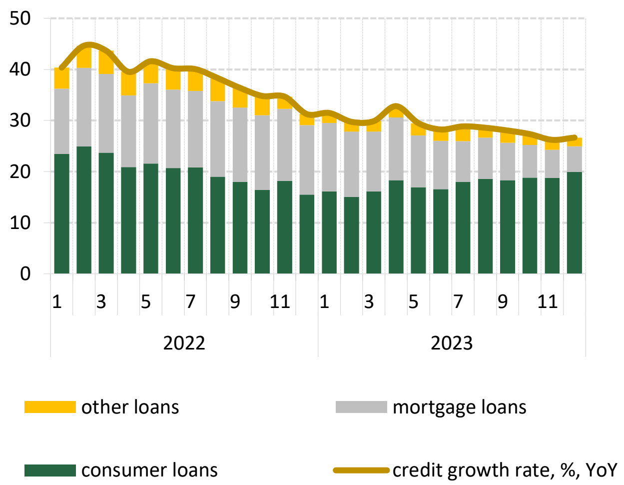
Source: NBK

Loans to households, despite the slowdown in growth rates in the fourth quarter, continue to remain the main driver of overall growth of lending. In the structure of retail loans, there is a significant slowdown in the growth rate of mortgage loans amid normalization of demand in the real estate market. At the same time, the dynamics of consumer lending indicate an acceleration in growth rates against the widespread adoption of installment plans and accelerated digitalization of financial services.

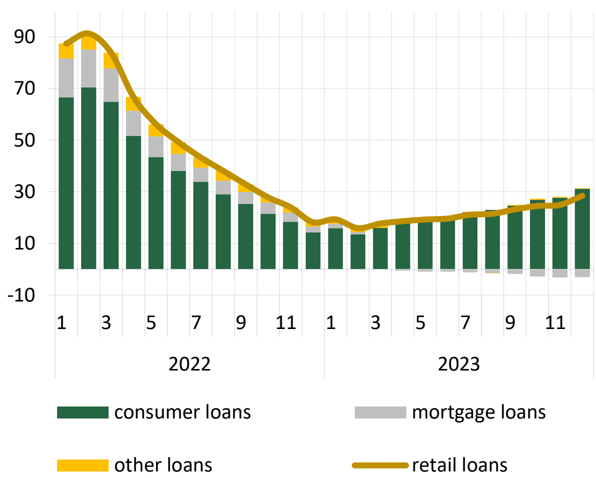
The growth of loans to households (balances) in annual terms slowed from 28.0% in September to 26.7% in December 2023, primarily due to lower growth rate of mortgage loans – from 21.2% to 14.2% (Graph 27). At the same time, the volume of new mortgage loans issued in 2023 decreased by 17.2%, YoY (Graph 28).

The dynamics of mortgage lending continues to show a significant slowdown in growth given the previously realized demand for residential real estate, reduction in government incentives and tightening of conditions for interim loans from Otbasy Bank. The weighted average interest rate on mortgage loans did not change significantly compared to September, remaining at 10.5% (Graph 29).

Graph 27. Retail Loans from STBs (the Balance), YoY, %



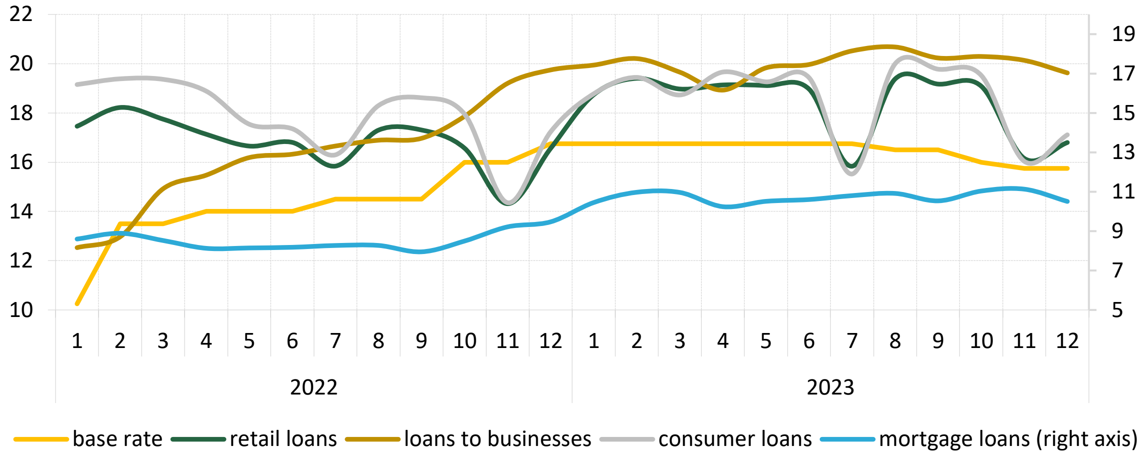
Graph 28. New Retail Loans from STBs, Year-to-Date, YoY, %



Source: NBK

Annual growth in consumer lending accelerated from 31.1% in September to 34.2% in December (Graph 27). This was facilitated by the widespread adoption of installment plans, stimulated by intensive marketing activities of second-tier banks, accelerated digitalization and high inflation expectations.
The volume of new consumer loans issued in January-December 2023 increased by 41.3% YoY (Graph 28). The weighted average rate on consumer loans decreased from 19.8% in September to 17.1% in December (Graph 29).

Graph 29. Rates on Loans in the National Currency, %



Source: NBK

Lending to businesses accelerated to double-digit growth in the fourth quarter of 2023, stemming primarily from small business lending as digitalization drives greater access to banking services. In terms of types of economic activity, loan growth was recorded in all major industries, except construction.

Growth in business loans (balances) accelerated from 15.4% in September to 16.7% in December YoY (Graph 30). Growth was recorded in all major sectors of the economy, except construction (-5.3%). Loans to the industry and trade, which account for the bulk of business loans, have grown over the year by 8.2% and 28.3%, respectively.

In terms of business size, loan growth was observed for all types of business entities. Loans to small businesses are growing especially rapidly – an increase of 26.2%, YoY, in December, including loans to individual entrepreneurs – by 58.6% YoY. In turn, issuance of new loans to individual entrepreneurs increased over the year by 84.6%, and to other small businesses (except for individual entrepreneurs) – by 44.8% (Graph 31).

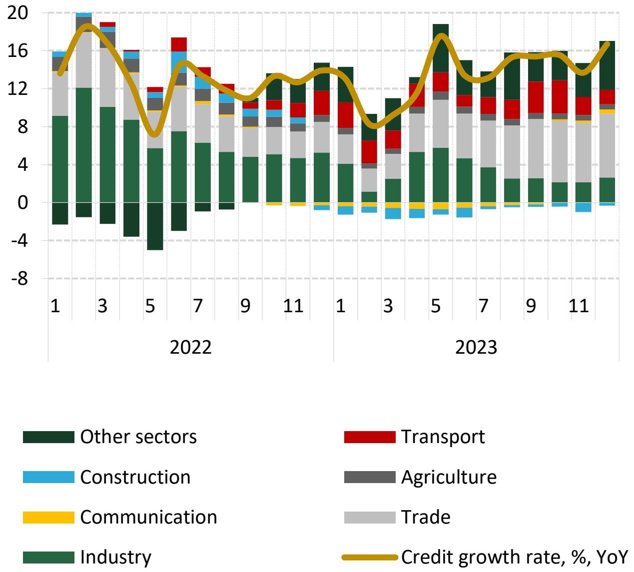
There was also an increase in loans to medium and large enterprises (balances) – by 4.0% and 10.0%, YoY, respectively. Meantime, issuance of new loans to medium-sized businesses increased by 18.0% over the year, large businesses – by 2.2%.

Pricing terms of loans to businesses had demonstrated gradual easing at the end of the fourth quarter of 2023.

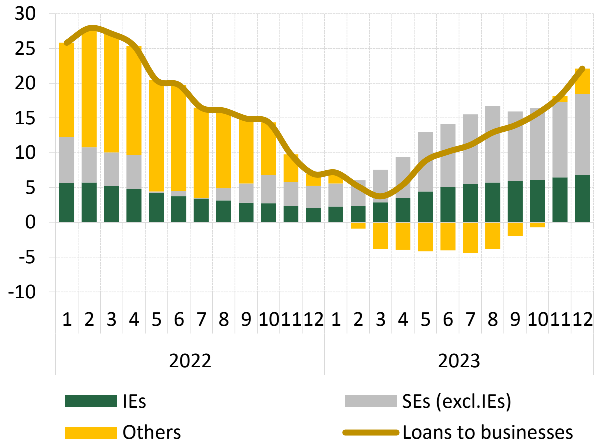
Interest rates on business loans in tenge showed a decline amid easing monetary conditions. As for loans to large businesses, the weighted average rate decreased from 18.9% in September to 18.2% in December, and on loans to medium-sized businesses – from 19.7% to 19.1%, to small businesses – from 21.9% to 21.3%.

Credits to the economy in a broad definition[7] at the end of 2023 increased by 19.7%, YoY, to 34.6 trillion tenge. At the same time, loans to businesses (non-financial legal entities and individual entrepreneurs who received loans for business purposes) increased by 14.1%, loans to the population – by 25.4%. Banking sector loans as of January 1, 2024 increased by 20.3%, YoY, where loans from the Development Bank of Kazakhstan decreased by 4.6%, while loans from second-tier banks increased by 22.4%.

Graph 30. Bank Loans to Businesses (the Balance), YoY, %



Graph 31. New Bank Loans to Businesses, Year-to-Date, YoY, %



Source: NBK

Box 2. Analysis of Monetization in the Economy of Kazakhstan

In general terms, monetization characterizes the level of saturation of the economy with money and is calculated as the ratio of the level of money supply to GDP.

In practice, most countries use the M2 aggregate, which characterizes the money supply only in the national currency, to calculate monetization[8]. In Kazakhstan, the M3 aggregate has historically been used as an indicator of the total money supply, taking into account the money supply in both the national and foreign currencies. The use of a broader definition of the money supply was associated with the peculiarities of the structure of Kazakhstan's economy, which implies a high share of imports in consumer and investment demand, the widespread use of foreign currency as a savings instrument, etc.

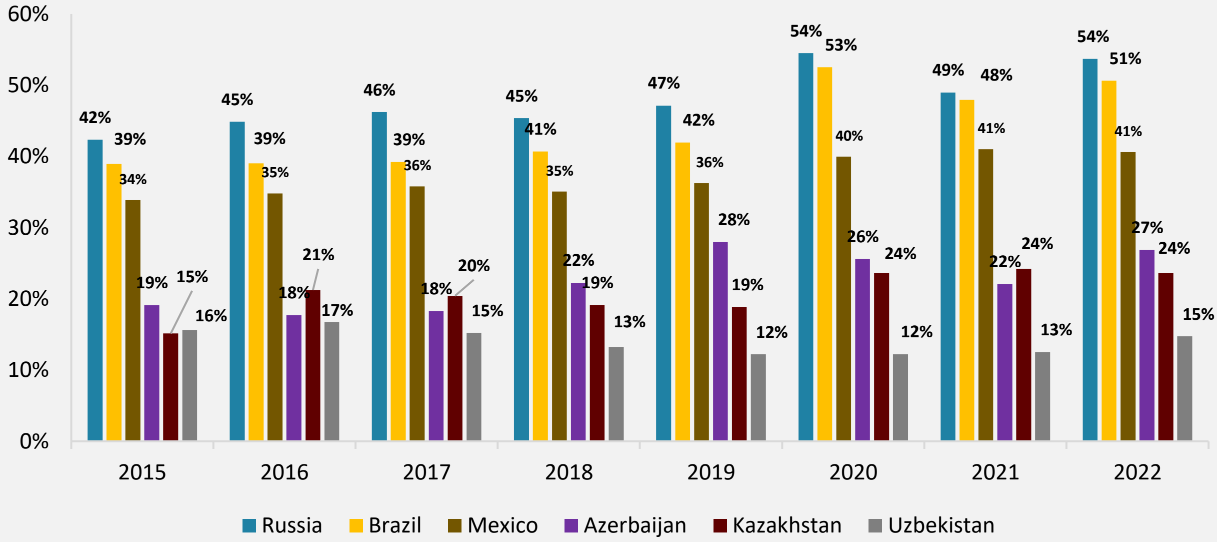
International comparison of monetization levels is fraught with difficulties. Monetization is influenced by the structure of the economy (including the raw material-oriented), the level of financial inclusion, cultural and historical factors, trust in government institutions, and the policies of central banks. Thus, the value and significance of the level of monetization under different monetary policy regimes differs. It is worth mentioning that Kazakhstan changed its monetary policy regime in 2015, switching to inflation targeting and the accompanying floating exchange rate. With inflation targeting, the central bank regulates the cost of money in the economy, not its quantity, keeping money market rates within a given corridor. The volume of money supply and, accordingly, monetization are formed as a consequence of the policies being pursued, so consideration of the values of monetization becomes irrelevant.

[7] Credits to the economy in a broad definition are data on the balances of actual debt on loans from the banking sector, mortgage organizations, other entities of the quasi-public sector (subsidiaries of "Baiterek" NMHC JSC that provide loans to the real sector) and organizations engaged in microfinance activities

[8] In Kazakhstan, the M2 monetary aggregate, along with cash in circulation and deposits in national currency, also contains transferable deposits of individuals and legal entities in foreign currency

In Graph 1, an attempt was made to compare the monetization of countries with a commodity orientation for 8 years from 2015 to 2022. For a more correct international comparison, monetization in Kazakhstan is calculated using not the total but the tenge money supply, i.e. excluding foreign currency. The countries we compare with more diversified economies have the highest level of monetization in absolute terms: Russia, Brazil and Mexico. The higher the level of economic diversification in a country and the deeper the specialization and division of labor, the greater the demand for money and credits to the economy, respectively, the higher the level of monetization in the country can be. Azerbaijan, Kazakhstan and Uzbekistan have low monetization compared to Russia, Brazil and Mexico due to a higher share of the commodity sector in GDP, financed primarily by large international corporations (rather than the banks of the respective countries), as well as the less developed non-resource sector of the economy. At the same time, with the exception of Uzbekistan, all the countries we examined from 2015 to 2022 observed a trend toward increased monetization. In the analyzed period, Kazakhstan and Azerbaijan had comparable levels of monetization.

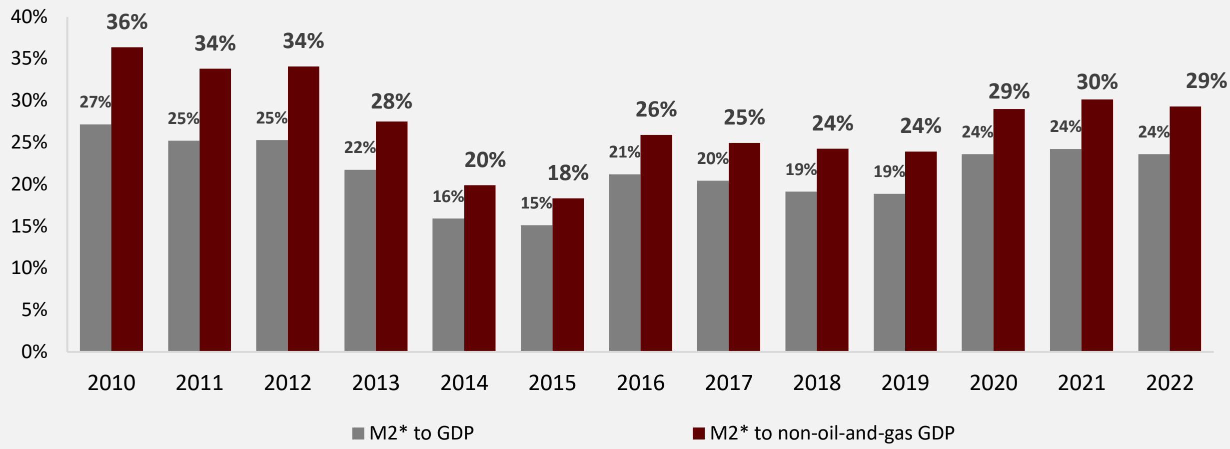
Graph 1. Monetization Coefficients of Countries with Primary Export-Driven Economies, %



Source: NBK, Refinitiv, Central Bank of the Republic of Uzbekistan

As noted above, it is necessary to understand and analyze the quantitative and qualitative factors influencing monetization values in a particular country. Since Kazakhstan is a country focused on the export of hydrocarbons, the country's GDP is formed under significant influence from the activities of the oil and gas industry. When analyzing the level of monetization in oil and gas countries, including Kazakhstan, it will probably be more informative to consider the ratio of the money supply to non-oil and gas GDP (Graph 2). This is due to the fact that high revenues from the oil and gas sector increase the total GDP but do not lead to an increase in the tenge money supply and, accordingly, overall monetization because of the minimal participation of the banking sector of Kazakhstan in financing/lending to the oil and gas industry. The monetization level, calculated as the ratio of the tenge money supply to non-oil and gas GDP was equal to 29.3% in 2022. This value is almost by 6 pp higher than monetization estimated using total GDP (23.6%). It should be noted that before the introduction of the inflation targeting regime, both general and "non-oil" monetization showed a downward trend, but starting in 2015, a gradual increase began to be observed. One of the factors was the influence of inflation targeting on expanding the volume of the tenge money supply through reducing dollarization and increasing confidence in the national currency as a store of value.

Graph 2. Money Supply to Overall and Non-Oil-and-Gas GDP

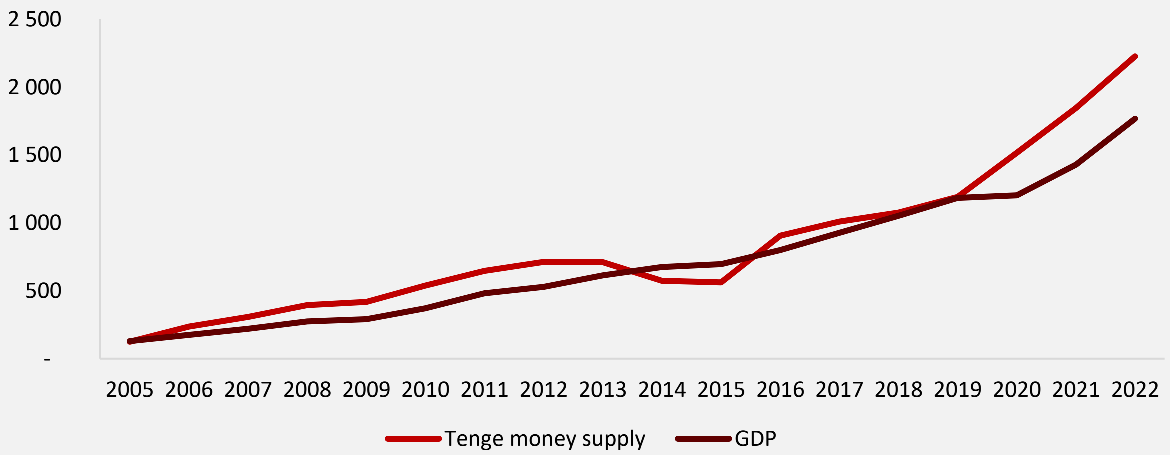


** M2- money supply in the tenge*

Source: NBK

To further expand the understanding of the factors influencing the level of monetization and its dynamics, the tenge money supply should be considered, since it is the main indicator involved in calculating monetization. The tenge money supply in Kazakhstan has shown a five-fold increase since 2015 (since the transition to inflation targeting). It is noteworthy that in most periods, the tenge money supply, starting from 2005, has grown faster than GDP. In 2014 and 2015, in conditions of high dollarization of retail and corporate deposits[9] the indicator showed weak dynamics, having a negative impact on monetization. Since 2020, the growth rate of the tenge money supply began to significantly outpace the dynamics of nominal GDP (Graph 3).

Graph 3. Growth of the Tenge Money Supply and GDP (2004 = 100)



Source: NBK

Thus, despite the fact that the level of monetization of the economy is used to analyze the saturation of the economy with money, its general indicator is not exhaustive for analysis and requires various factors to be taken into account: the structure of the economy (in particular, focus on the export of raw materials), external or internal sources and financing of key industries of the economy, monetary policy regime, factors of money supply growth (lending, purchase of government or corporate securities, etc.), development of financial markets, money turnover, etc. Moreover, even conducting a comprehensive analysis of the dynamics of monetization and constructing various metrics does not provide a basis for developing proposals for expanding the money supply in order to ensure the economic growth. It cannot be unequivocally stated that the volume of money supply in the economy is high or insufficient only based on the level of monetization and/or by comparing the value of the indicator in another country.

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[9] Along with cash in circulation, retail and corporate deposits form a part of the money supply

MACROECONOMIC CONDITIONS

III. MACROECONOMIC CONDITIONS

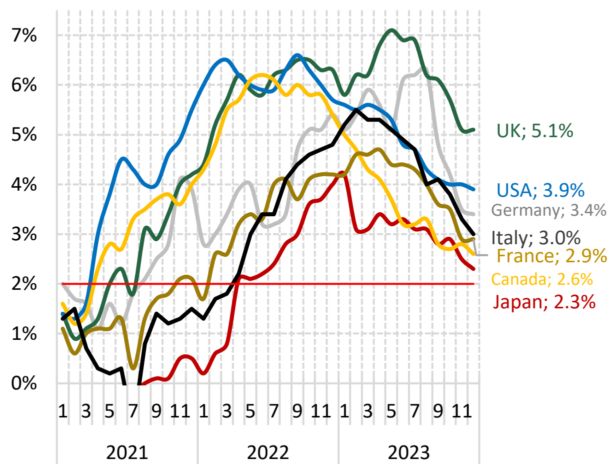
3.1. External Sector

The tight monetary policy pursued, lower energy prices and some improvement in the labor market continue to help reduce the global inflationary background.

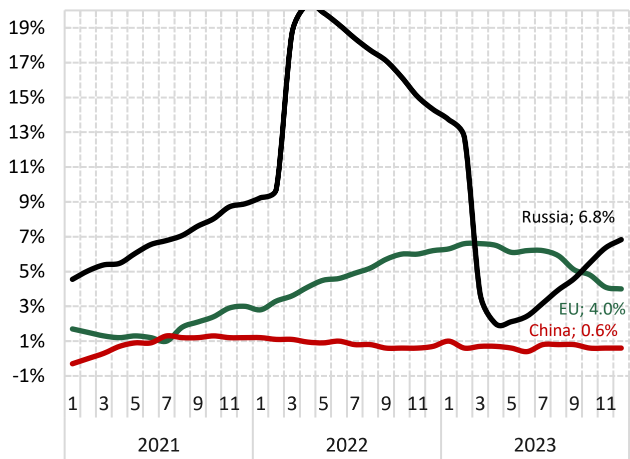
In most countries of the world, the downward trend in inflation continues. In developed countries, core inflation has approached the pre-2022 levels. Among the largest G-7 countries, the highest levels of core inflation remain in the UK, US and Germany (Graph 32). In developing countries, according to the World Bank estimates[10], inflation is currently below the target.

Among Kazakhstan's trading partner countries, consumer prices in Russia still demonstrate high growth rate. In December 2023, annual inflation in Russia was 7.4%, core inflation accelerated to 6.8% (YoY). In the EU, annual inflation accelerated to 3.4% due to rising prices for energy resources, whose growth was driven by the removal of the last year's low base from the calculation. Core inflation in the EU continues to be nearly two times higher than the target. In China, prices have kept declining since October last year amid weak domestic demand. Core inflation in China at the end of December 2023 amounted to 0.6% (YoY) (Graph 33).

Graph 32. Dynamics of Core Inflation, YoY



Graph 33. Core Inflation in the Countries-Kazakhstan's Trading Partners, YoY



Source: national statistical offices

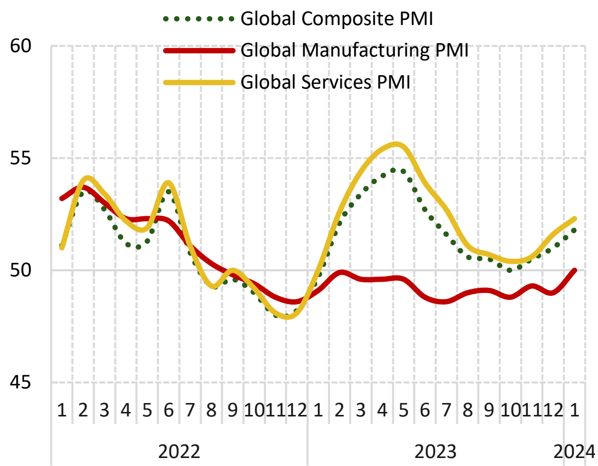
For the first time in a long while, global business activity in the manufacturing industry has recovered. At the same time, the volumes of the services sector continue to grow rapidly.

Business activity in the industrial sector recovered in January 2024 (Graph 34). There is a slowdown in the decline in new orders and a significant improvement in business confidence for the year ahead. Expansion of production volumes is observed in China, Brazil, India and Russia (Graph 35). In Europe's major industrialized countries, activity continued to decline, but at a slower pace.

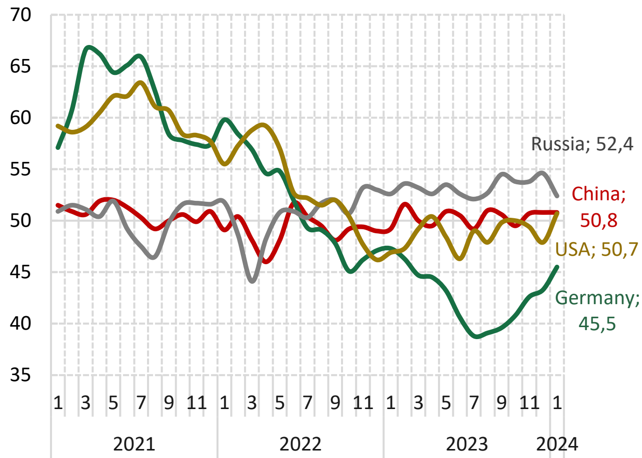
Growth in business activity continues in the service sector. There is an improvement in all sub-components of services, in particular new orders, new jobs, and business optimism. Price pressure, in turn, according to respondents, has decreased slightly.

[10] *Global Economic Prospects, January 2024*

Graph 34. Global Business Activity*



Graph 35. Global Business Activity in the Industry in the Context of Countries



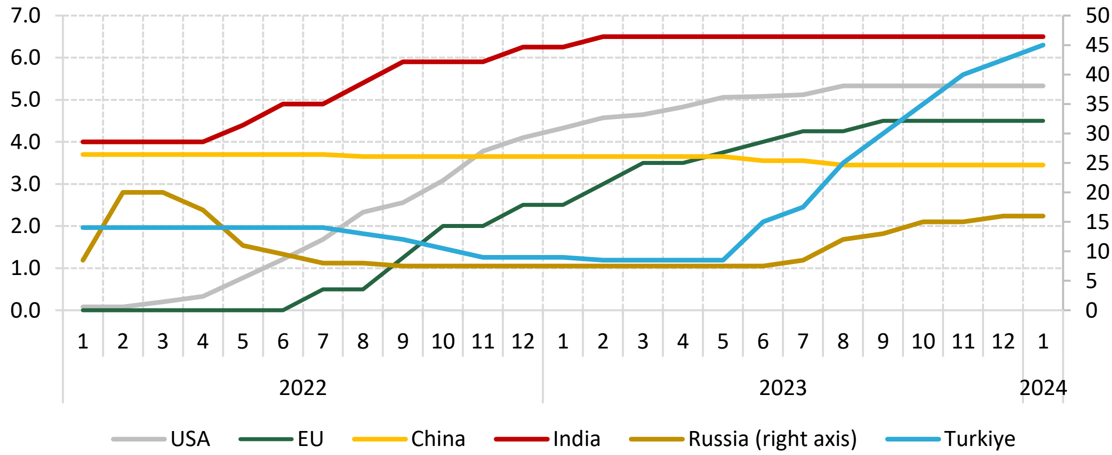
Source: PMI by S&P Global

** The index greater than 50 means the growth of the indicator, less than 50 – its decline, equal to 50 – its invariance*

The increasing number of developing countries started to lower their policy interest rates from the end of 2023. Developed countries so far are "on pause".

The world's largest central banks have kept rates unchanged since the middle of the last year (Graph 36). The rhetoric remains more neutral than harsh. The US Federal Reserve and the ECB kept rates unchanged at recent meetings. Meanwhile, the authorities did not rule out reducing rates this year if disinflationary processes are sustainable. At the last meeting, the CB RF kept the key rate at 16.0% per annum in order to cool the economy and reduce high inflation. The People's Bank of China has kept the rate at 3.45% per annum since last August, while in order to stimulate economic activity; the reserve requirements for banks have been reduced since February of this year.

Graph 36. Key Policy Rates of Some Countries of the World, YoY, %

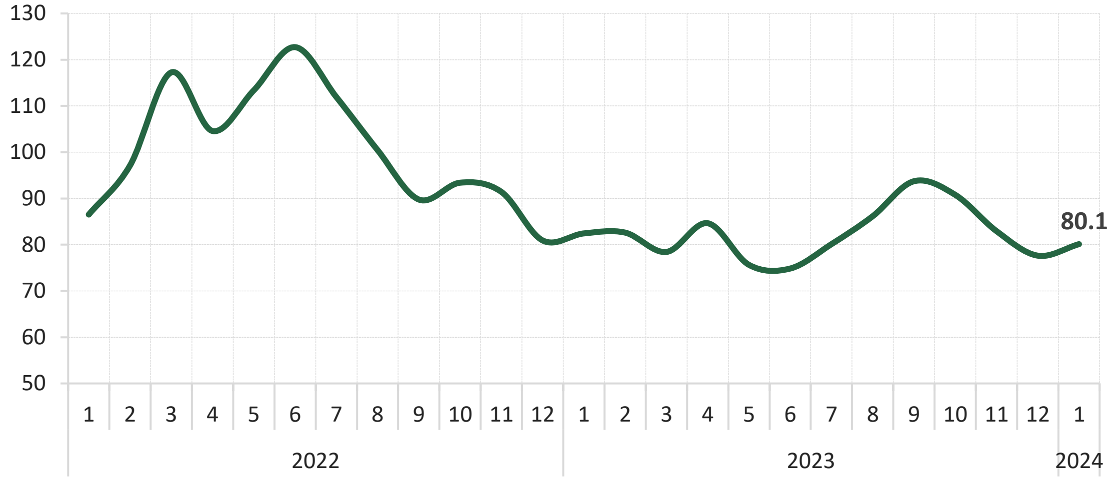


Source: Refinitive

In the fourth quarter of 2023, a downward trend prevailed in the global oil market due to moderate growth in oil production by non-OPEC+ countries. However, the beginning of this year was characterized by a slight increase in oil prices amid the escalation of hostilities in the Red Sea.

At the end of last year, the world price of Brent oil demonstrated downward dynamics. Thus, there was a decline in oil prices from US$90 per barrel on average in September 2023 to US$78 per barrel on average in December 2023 (Graph 37). The decline in prices was mainly caused by increased supply from non-OPEC+ countries. However, the emergence of logistical difficulties against the backdrop of hostilities in the Red Sea led to a minor rise in world prices for Brent oil at the beginning of this year (Graph 37).

Graph 37. Dynamics of Brent Oil Prices, US$/Bbl

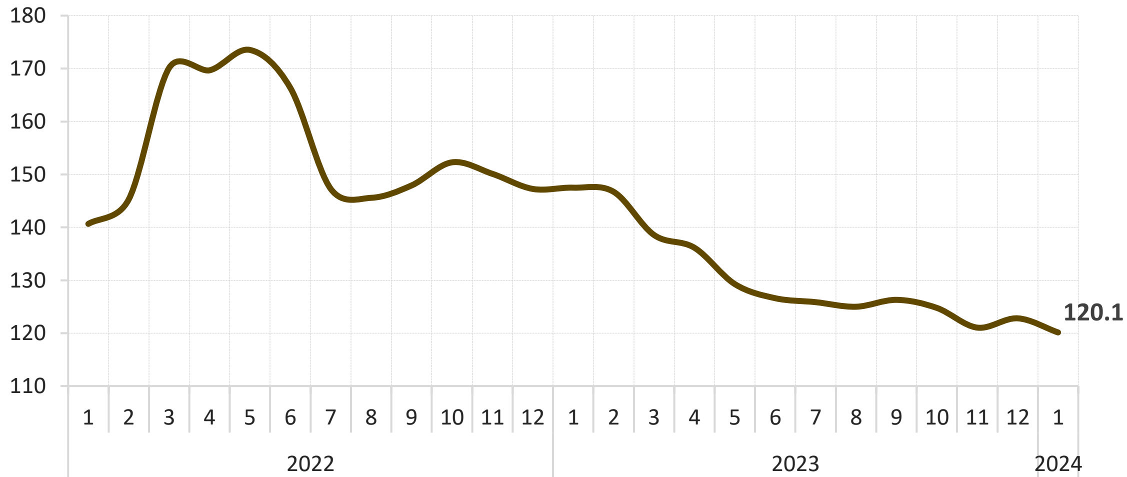


Source: EIA

The decline in cereal prices at the end of 2023 was caused by moderate supply of wheat and corn. However, military actions in the Black and Red Sea region may provoke a rise in prices in the short term.

Starting from 2023, there has been a steady downward trend in cereal prices in the global market due to the abundant supply of wheat and corn in the current 2023-2024 agricultural season. According to the FAO January report[11], grain stocks at the end of the current agricultural season will amount to 895.4 million tons, which is by 2.6% higher than last year's stocks. It is also worth mentioning that because of logistical delays in grain supplies in December 2023, world prices increased by 1.5%, MoM (a 16.6%, YoY, decline). However, given an increasing supply and improving harvest expectations, world cereal prices continued to decline by 2.2% in January 2024, MoM (by 18.6%, YoY) (Graph 38)

Graph 38. FAO Cereal Index, 2014-2016 = 100



Source: UN FAO

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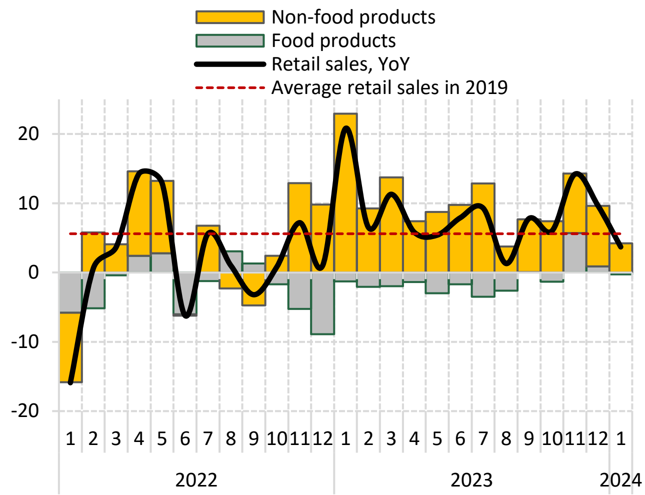
[11] *https://www.fao.org/worldfoodsituation/csdb/ru*

3.2. Internal Sector

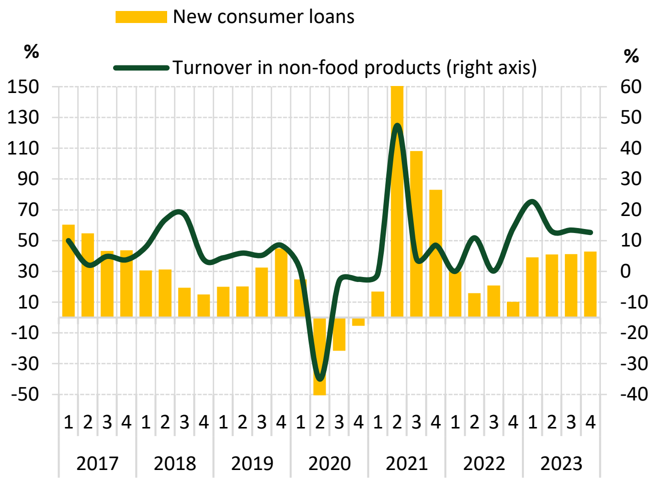
In the fourth quarter of 2023, consumer demand somewhat accelerated given the growing real wages and high growth rates of consumer loan disbursements.

In the fourth quarter of 2023, retail trade turnover accelerated to 10% in annual terms, which significantly exceeds the indicators before the 2020 pandemic. Trade in non-food products made the main contribution to the growth of the industry (growth by 12.6% YoY). Along with this, for the first time since the second quarter of 2022, retail sales of food products increased by 5.7%, YoY. However, in January 2024, retail trade indicators slowed down slightly. Trade in non-food products slowed to 5.8%, YoY, and trade in food products decreased by 0.9%, YoY (Graph 39).
Positive dynamics of consumer demand are accompanied by high growth rates of consumer lending (Graph 40).

Graph 39. Retail Sales, %, YoY



Graph 40. Retail Turnover in Non-Food Products and Consumer Lending, % YoY

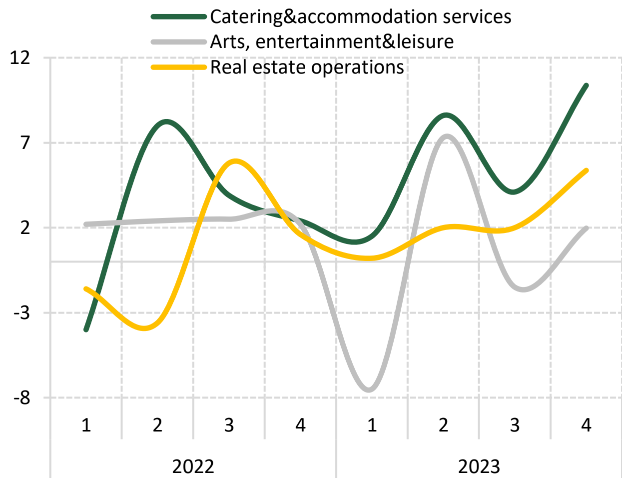


Source: BNS ASPR, NBK computations

The service sector maintained positive growth rates, indicating that consumer demand remains at a sustainable level. The fourth quarter of 2023 marks a significant acceleration in the growth of services.

Graph 41. Public Catering Services (Provision and Supply of Food and Beverages), %, YoY

Graph 42. Providing Various Types of Services, %, YoY



Source: BNS ASPR

Thus, catering services increased by 7.9%, YoY, the growth rate of accommodation and catering services accelerated to 10.4%, YoY. Leisure, entertainment and arts services grew by 2.0%, YoY, after contracting in the third quarter of 2023. Real estate services also show an acceleration to 5.4%, YoY (Graphs 41, 42).

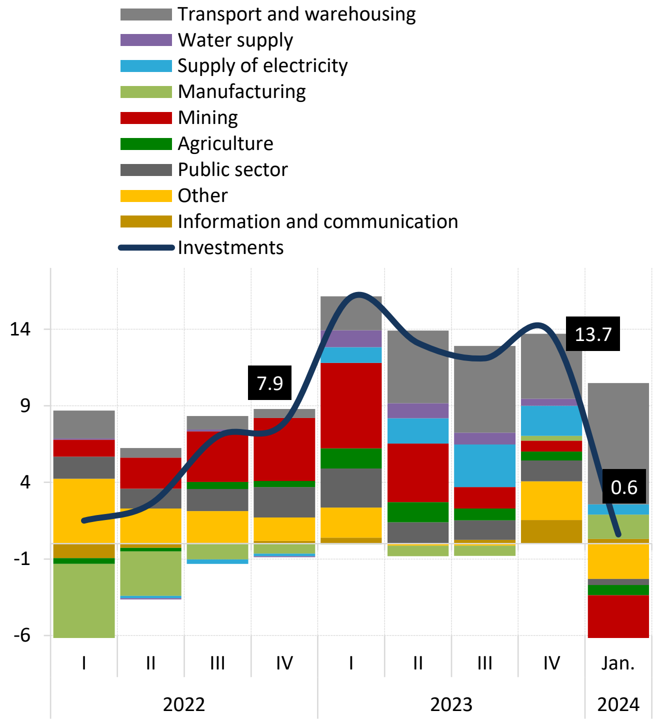
Investment activity accelerated in the fourth quarter of 2023. The implemented infrastructure projects in the fields of transport, communication, utility services serve as the main driver of investment growth. Along with that, the investment activity of the population began to recover and entered the positive zone.

In 2023, fixed capital investments increased by 13.7% in annual terms. Investment growth is observed in almost all sectors of the economy, with the exception of construction and financial and insurance activities (Graph 43).

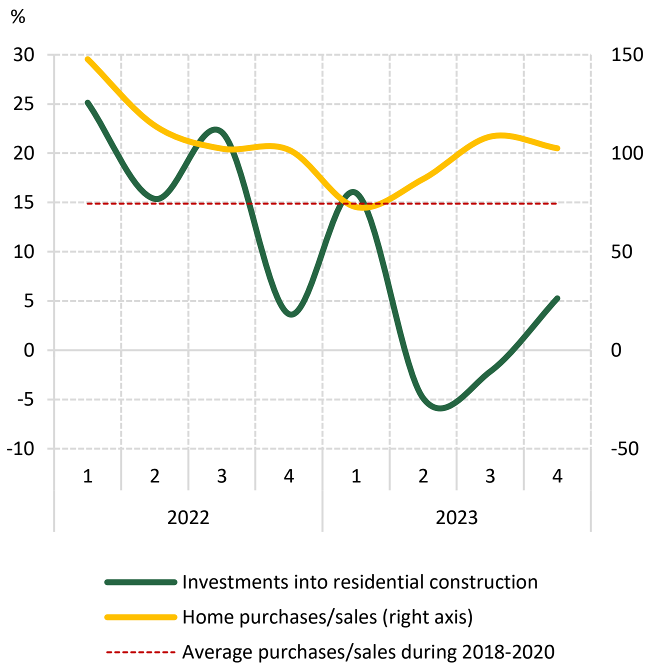
The implementation of the “Tariff in Exchange for Investment” government program in 2023 led to an increase in fixed capital investments in the electricity and water supply sectors by 38.9% and 14.3%, YoY, respectively. Significant growth in investment is also observed in the information and communications, transport and warehousing sectors. At the same time, in January 2024 there was the growth rate of fixed capital investments decelerated to 0.6% in annual terms.

Investment activity of the population began to recover in the fourth quarter of 2023. Thus, investments in residential construction increased by 5.3% YoY. However, the number of home purchase and sale transactions was below the level of 2022, but above the average values for 2018-2021 (Graph 44).

Graph 43. Fixed Capital Investments by Economic Sectors, %, YoY, accumulated total



Graph 44. Investments into Residential Construction and Activity in the Real Estate Market

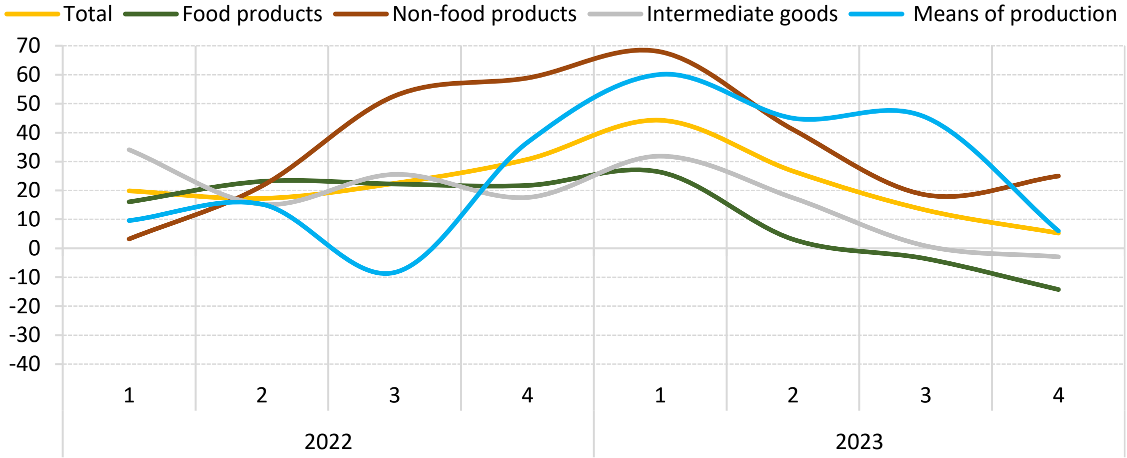


Source: BNS ASPR, NBK computations

As a result of growth in consumer and investment demand, in 2023 a significant increase in imports for all main groups of goods has been observed. At the same time, the structure of imports by country has undergone some changes.

In January-December 2023, imports in value terms increased by 20.1% in annual terms and amounted to US$61.2 billion. An increase in imports in nominal terms is observed among non-food products and production means. Reduction in imports in nominal terms is observed among food products and intermediate goods (Graph 45).

Graph 45. Imports by Major Groups of Goods, %, YoY

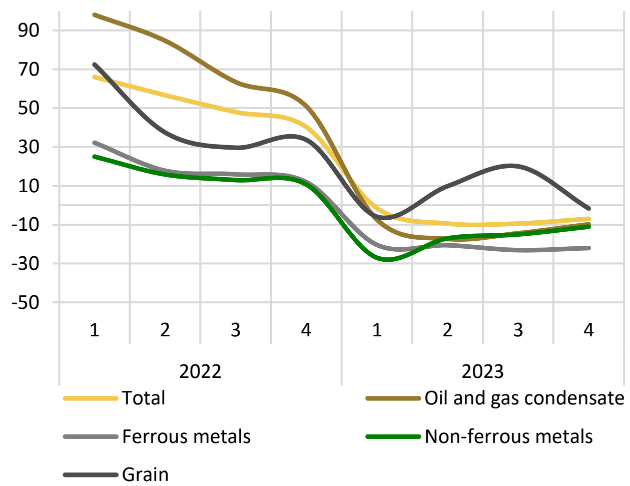


Source: BNS ASPR, NBK computations

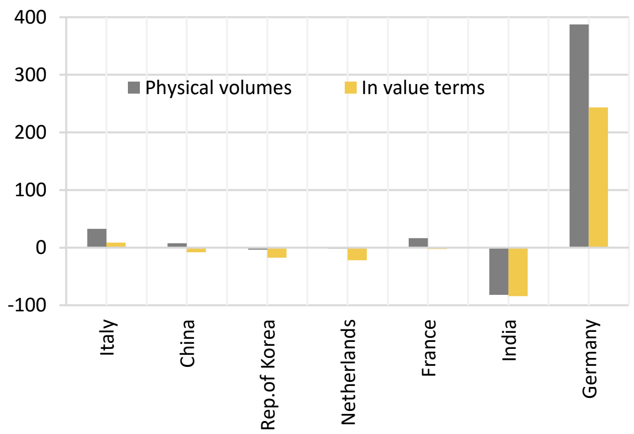
Exports of goods for January-December 2023 decreased by 7.0%, YoY, in value terms and amounted to US$78.7 billion. The decline is observed in all major groups of export goods.

Exports of oil and gas condensate decreased by 9.8%, YoY, in 2023 (Graph 46). The main reason for the decline in oil exports in value terms was lower oil prices compared to 2022. At the same time, the export of physical volumes of oil in 2023 increased against the ramp-up in oil output and the growth in oil supplies in physical terms, including to Germany, Italy, and China (Graph 47).
The export of non-ferrous and ferrous metals declined in value and physical terms. This is due to the decreased external demand and world prices for metals. Supplies of ferrous metals in kind to China and the EU as well as supplies of non-ferrous metals in kind to the EU and Russia declined.
Despite the reduction in world cereal prices, grain exports in volume terms increased in 2023 on the back of a good 2022 harvest. On a country-by-country basis, there is a significant acceleration in grain supplies to the EU and China.

Graph 46. Exports by Major Groups of Goods, accumulated total , YoY, %



Graph 47. Oil Exports by Countries in 2023, %, YoY



Source: BNS ASPR, NBK computations

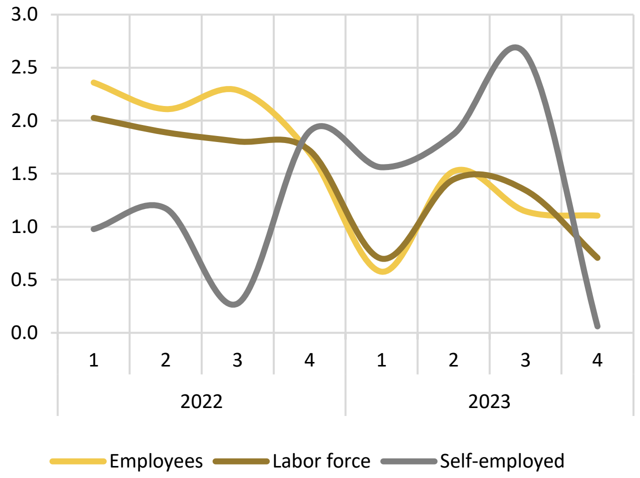
3.3. Labor Market

The labor force in the fourth quarter of 2023 increased by 0.7%, YoY. The growth of the labor force was observed in the context of an increase in the number of hired workers and self-employed people and a decrease in the number of unemployed people.

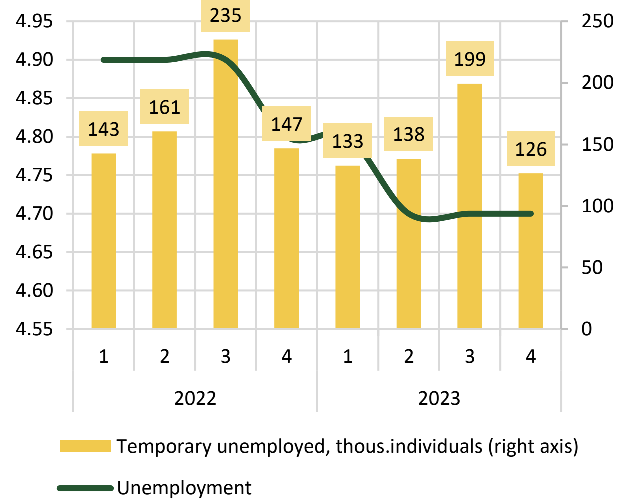
In 2023, employment growth was driven by an increase in the number of both employees and the self-employed (Graph 48).

In the fourth quarter of 2023, the unemployment rate fell to 4.7%. Along with the general unemployment rate, the number of temporarily unemployed people has decreased, which indicates an increase in economic activity in the Kazakh economy in 2023 (Graph 49).

Graph 48. Employees and the Self-Employed, %, YoY



Graph 49. Unemployment Rate and the Temporary Unemployed Population, %, YoY

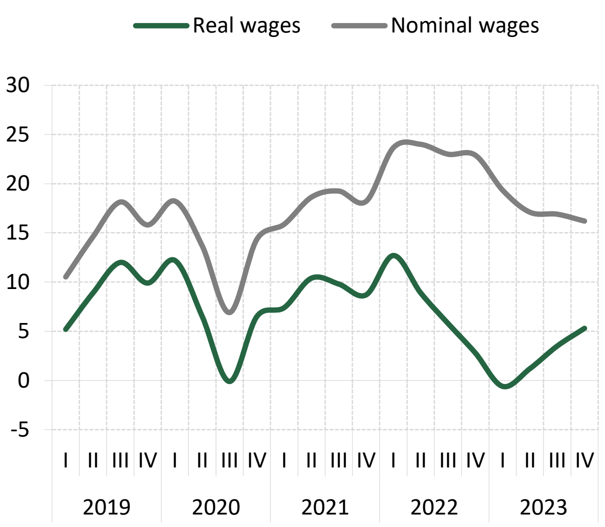


Source: BNS ASPR

The rate of wage growth in real terms continued to recover. In the fourth quarter of 2023, real wage growth accelerated to 5.3% in annual terms. This is due to slowing inflation and high growth rates of nominal wages (Graph 50). In the context of economic sectors, real wage growth is observed in almost all sectors, with the exception of construction and the provision of accommodation and catering services.

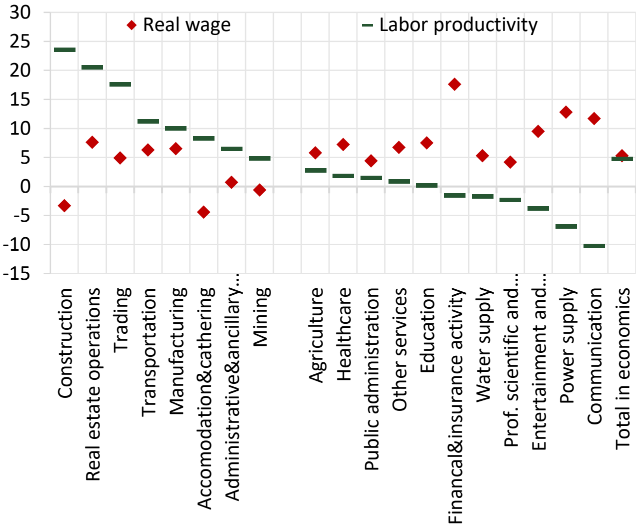
In the fourth quarter of 2023, real wage growth exceeded the growth rate of labor productivity, which may generally create pro-inflationary pressure in the economy. At the same time, multidirectional dynamics are observed across economic sectors. Low labor productivity indicators in certain industries have stemmed from both a decrease in gross value added and an excess of employment growth rates over the growth rates of gross value added (Graph 51).

Graph 50. **Dynamics of Wages in the Economy, %, YoY**



Source: BNS ASPR, NBK computations

Graph 51. **Labor Productivity and Real Wages by TEA in the Fourth Quarter of 2023, %, YoY**



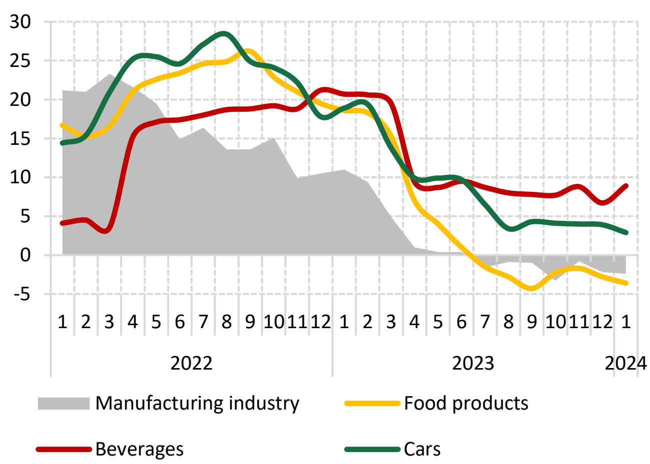
3.4. Production Costs

The trend towards lower prices for manufacturers of manufacturing products and a slowdown in price growth in agriculture continued against the backdrop of lower prices for food and grain crops.

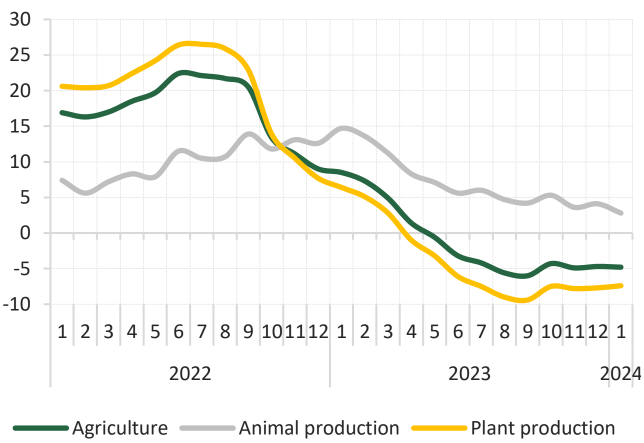
Year-on-year manufacturing price declines continued for the seventh month in a row as a result of lower food producer prices. In January of this year, food producer prices decreased by 3.6% YoY. In particular, there has been a decrease in producer prices for meat, flour and cereal products, oils and fats, canned fruits and vegetables. The growth in prices for producers of dairy products and bakery and pasta products has slowed down. At the same time, prices for beverage producers have increased.

In the structure of non-food products in January 2024, the annual rate of growth in producer prices for machinery and equipment, textile products, and finished metal products continued to slow down (Graph 52).

Graph 52. Producer Prices in the Manufacturing Industry, %, YoY



Graph 53. Producer Prices in Agriculture, %, YoY



Source: BNS ASPR

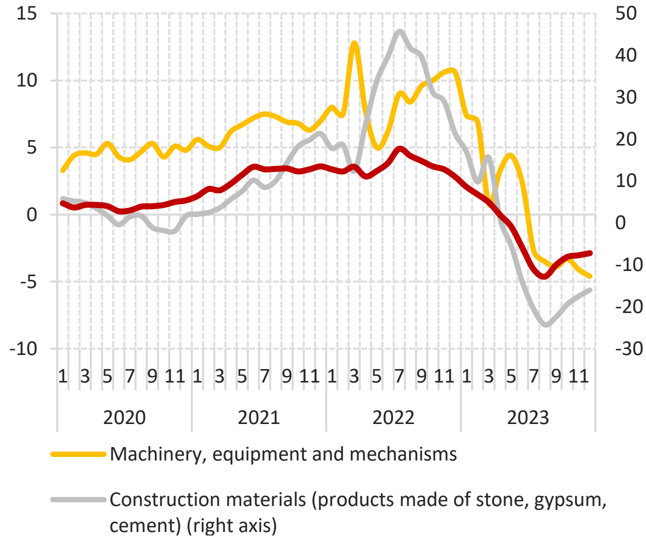
From the second half of 2023, prices for agricultural products decreased, which is due to a decline in prices for crop products and a slowdown in price growth for animal products. In January of this year, producer prices in agriculture decreased by 4.8% YoY (Graph 53). In crop production, the annual growth rate of prices for fresh vegetables, in particular tomatoes and onions, has slowed down. At the same time, there is a decline in prices for certain types of grain crops. In livestock farming, annual growth in prices for live cattle and milk slowed down, and the cost of poultry went down in annual terms. There is a decrease in producer costs in the context of falling prices for feed crops. At the same time, the growth in prices of egg producers continued against the rising prices for imported components, in particular vitamins and vaccines.

Since August 2023, the decline in import prices in annual terms has slowed down due to rising prices for textiles, precious stones, prepared foods, as well as monthly increases in prices for mineral products and construction materials (Graphs 54, 55).

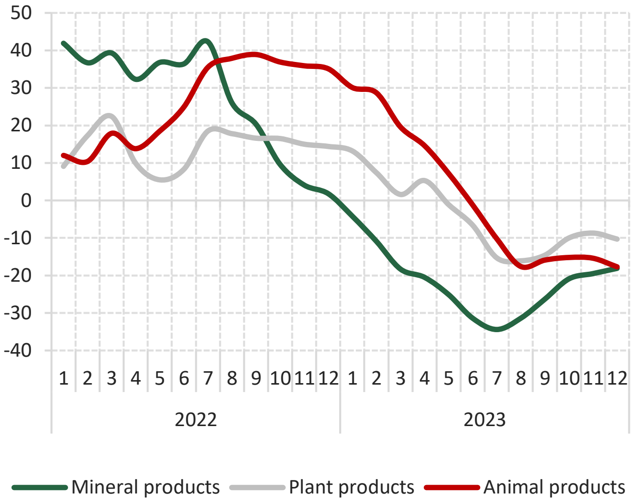
The annual decline in import prices for building materials slowed down against rising producer prices for construction products in Russia, which accounts for the bulk of imports of building materials (January-December 2023 - 38.2%).

Import prices for plant products also slowed their pace of decline. The structure shows an increase in prices for vegetables. At the same time, import prices for flour and cereal products slowed their decline in annual terms. Since September 2023, there has been a monthly increase in import prices for mineral products, in particular coal, oil and petroleum products.

Graph 54. Dynamics of Import Prices for Some Products, %, YoY



Graph 55. Dynamics of Import Prices for Intermediate Goods, %, YoY



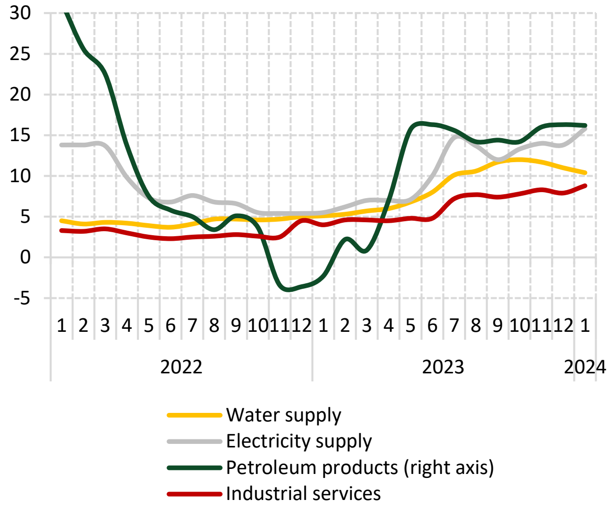
Source: BNS ASPR

Despite the decline in import prices for certain types of investment and intermediate goods, domestic production costs continue to remain high. There is an increase in the cost of utilities, which may put upward pressure on prices for end consumers.

Producer prices of industrial products and services in water supply, electricity supply, industrial services and petroleum products have shown annual growth since the beginning of last year. A significant increase in producer prices for water supply and electricity supply occurs given the implementation of the "Tariff in Exchange for Investment" government program (Graph 56).

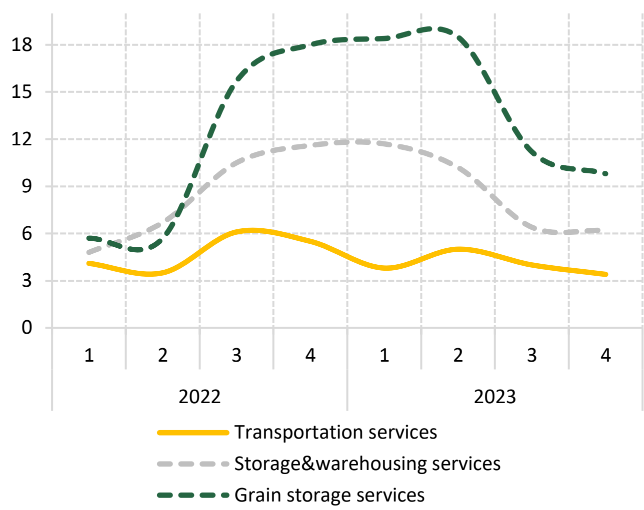
Despite deceleration in annual terms of prices for storage and warehousing services, including grain, the growth rate of the cost of services remains high, exceeding inflation targets. This also contributes to rising production costs (Graph 57).

Graph 56. Producer Prices for Some Types of Industrial Products and Services, %, YoY



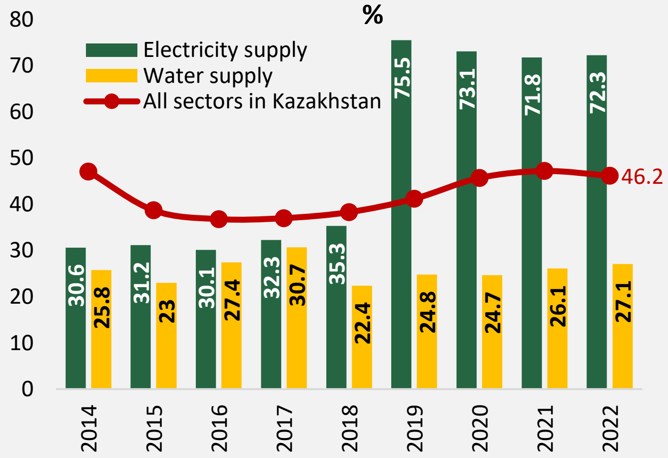
Source: BNS ASPR

Graph 57. Producer Prices for Transportation and Warehousing Services, %, YoY



Box 3. Status and Development Prospects of Kazakhstan's Utility Infrastructure as Part of Implementation of the "Tariff in Exchange for Investment" Government Program

Graph 1. Degree of the PPE Depreciation, %

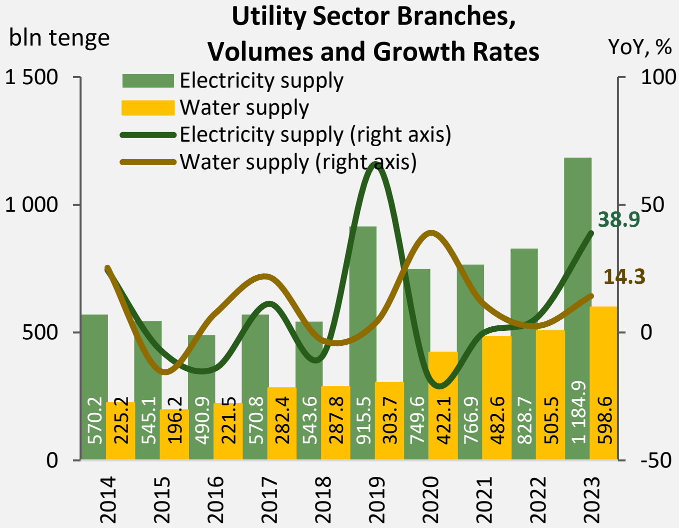


Source: BNS ASPR

The depreciation of PPE of utility services in Kazakhstan is a serious problem faced by many regions of the country. This problem is caused by deteriorating infrastructure, insufficient investment in maintenance and modernization, and a lack of effective management and control of resources. According to the BNS ASPR, the degree of PPE depreciation in the "Electricity, Gas, Hot Water Supply" industry (hereinafter referred to as Electricity Supply) during the period from 2014 to 2022 exceeds 50%, which is higher than the average across the economy (42%). At the same time, a sharp increase in the PPE depreciation in the industry has been observed since 2019. In the "Water supply: collection and treatment" industry (hereinafter referred to as "Water supply"), the level of PPE depreciation is much better than the average in the economy. Thus, over nine years it amounted to 25.8% on average. However, this industry has also seen an increase in the depreciation rate of PPE since 2018, from 22.4% to 27.1% in 2022 (Graph 1). The development of these branches, including the PPE renewal, is limited by a low level of investment, primarily private (Graph 2). In many ways, the low investment attractiveness of the branches stems from the low profitability of enterprises because of low labor productivity and insufficient competition. Thus, the average profitability during the period from 2018 to 2022 in the electricity supply industry is 6.2%, in water supply – 4.7%, while in the economy as a whole this figure exceeds 21%.

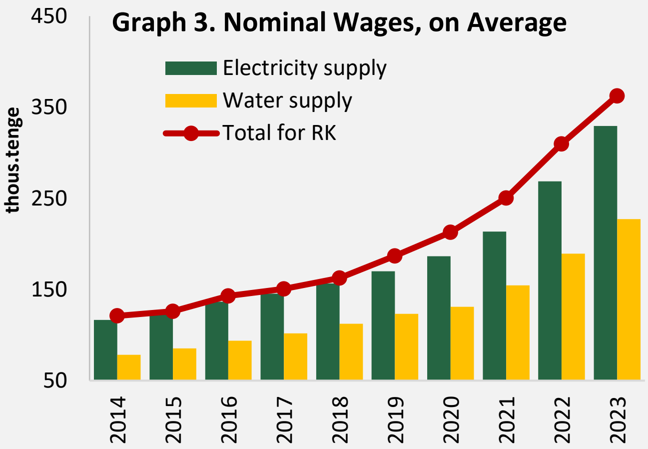
To increase the productivity in the branches of the utility sector, it is necessary to introduce effective resource management systems and new technologies, in particular "smart" meters, monitoring and control systems

Graph 2. Fixed Capital Investments in the Utility Sector Branches, Volumes and Growth Rates



Source: BNS ASPR

Graph 3. Nominal Wages, on Average



Source: BNS ASPR

that help optimize the consumption of energy, water and other resources. In addition, it is necessary to train and improve the qualifications of personnel in the utilities sector to ensure a high level of professionalism and quality of service. At the same time, wages in the branches of utilities sector have historically been below the average in the economy (in the fourth quarter of 2023, wages in the electricity supply exceeded the average in the economy) (Graph 3).

Another factor hindering the development in the branches of utilities sector and limiting the investment opportunities of companies is the administrative regulation of prices and tariffs for the services of enterprises rendering utility services.

Solving the problem of deterioration requires increased investment in updating and modernizing the utility services infrastructure.

This includes the repair and replacement of outdated utility networks, pipelines, water supply and sewerage systems, as well as the renewal of heating systems, etc. Over the past ten years, there has been an increase in investment in fixed assets in the utility sector (Graph 2). At the same time, in the structure of investments in fixed capital, the share of the branches of utilities sector accounts for only about 10% of all investments (according to the data for 2023), which is significantly lower than in other sectors (the mining industry – 26.3%, real estate operations – 17.9%, transport – 14%). This is, among other things, stems from low profitability of the the branches of utilities sector. In this case, as a rule, the bulk of investments are financed from budget funds.

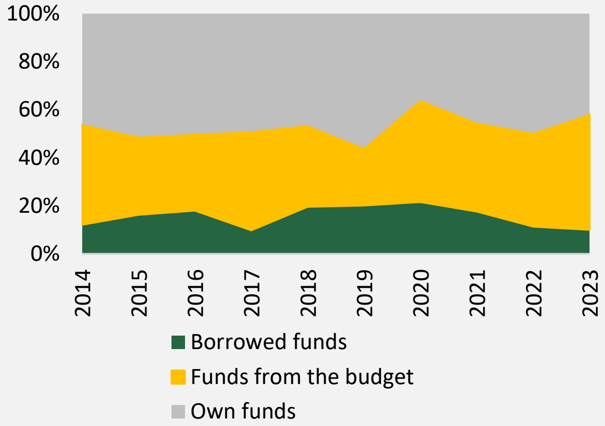
Thus, in water supply, fixed capital is largely renewed with the budget funds (82% on average over ten years). In the electricity supply industry, enterprises' own funds account for a large share of investment financing. Meanwhile, in 2023, the share of budget funds in the structure of investments in the industry reached its maximum value since 2014 (48.1%), which indicates the increased priority of the government policy in the field of renovation and modernization of the utilities sector infrastructure (Graphs 4, 5).

The "Tariff in Exchange for Investment" government program (hereinafter referred to as the Program), adopted in 2023, provides for the possibility of private investors participating in the modernization and development of the country's utilities sector. The Program provides for an increase in tariffs for regulated utilities.

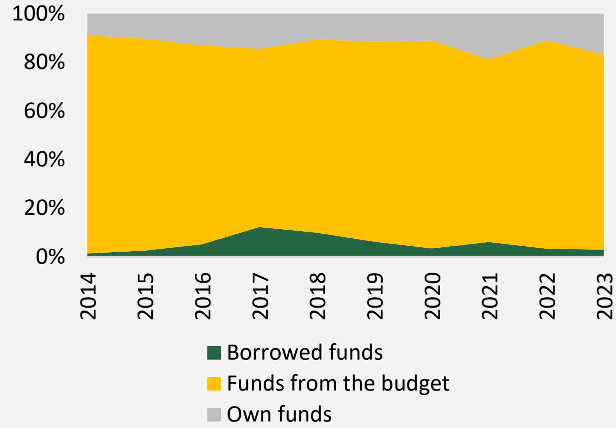
The implementation of this program may lead to the raising of prices and tariffs in regulated markets in the short term. However, in the medium term, this can significantly improve the infrastructure, renew PPE, increase the efficiency of enterprises and improve the quality of services provided.

Fixed Capital Investments, by Funding Sources

Graph 4.Electricity Supply,
share as % of total investments into the sector



Graph 5. Water Supply
share as % of total investments into the sector



Source: BNS ASPR

3.5. Inflation

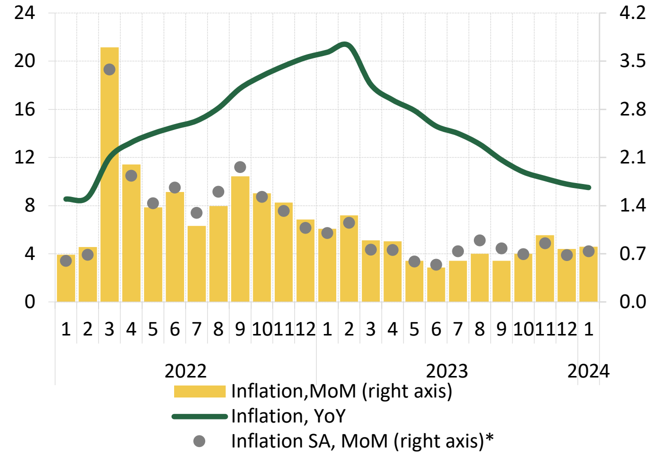
Inflationary processes are slowing down, but the sustainable part of inflation is accelerating. Annual inflation continues to slow, but is still well above the target. The rise in prices for services makes the main contribution to inflation.

In January 2024, annual inflation continued to decelerate and amounted to 9.5% (Graph 58). The slowdown in annual inflation is driven by the removal of the last year's high monthly inflation values from the calculation, by the weakening global inflationary pressure, a steady decline in world food prices, as well as by the monetary policy pursued. There is a decrease in production costs and lower growth rates of import prices, which contributes to a more moderate rise in prices in the country.

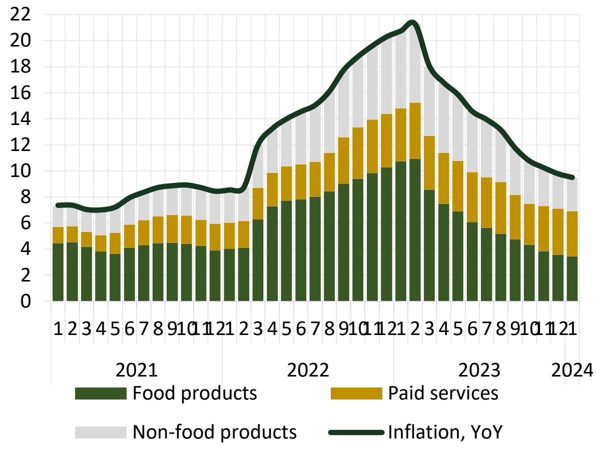
Within the structure of inflation, the annual rate of price growth for all main components of inflation decelerated. Since February 2023, there has been a gradual decrease in the contribution of food and non-food components to overall inflation. At the same time, the contribution of the service component to inflation has been increasing since November 2023 due to the growing tariffs for regulated utilities, as well as rising prices for market services. In January 2024, the rise in prices for paid services for the population made the main contribution to consumer inflation (3.5 percentage points), exceeding the contribution of food inflation (3.4 percentage points) (Graph 59).

The monthly rate of price growth remains high. In January of this year, monthly inflation was at the level of 0.8%, which exceeds the historical average (0.6% on average in 2017-2021). Seasonally-adjusted monthly inflation accelerated slightly in January 2024 to 0.73% (December 2023 – 0.68%) as a result of growing prices for bread and bakery and cereals, fruits and vegetables, dairy products and eggs amid rising producer prices.

Graph 58. Dynamics of Inflation, %



Graph 59. Dynamics of Inflation and Contributions of its Key Components, % PP



Source: BNS ASPR, NBK computations

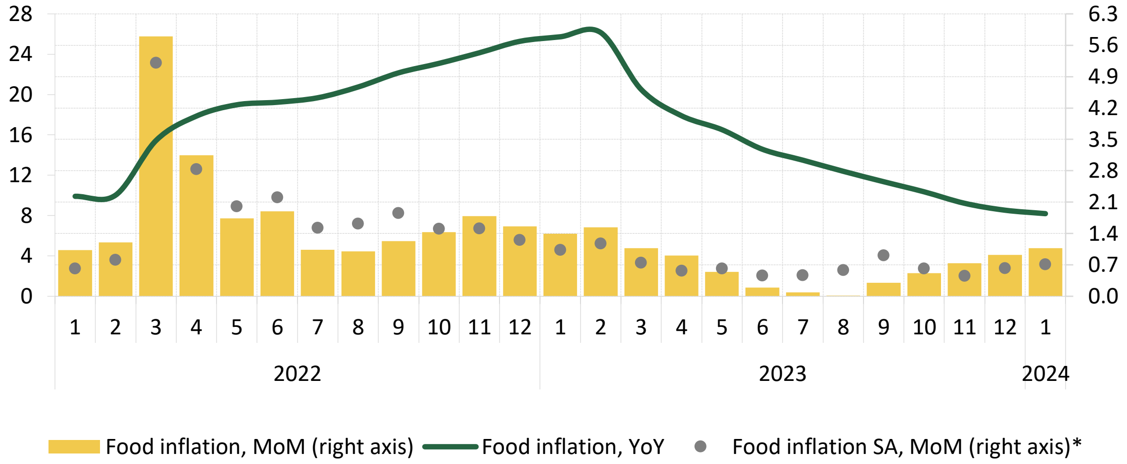
** Seasonal adjustment was performed by using X-12-ARIMA method from 2011 until present*

The annual increase in prices for food products continued to slow down in the context of a decline in world food prices, domestic producer prices in the manufacturing industry and agriculture against the increase in the supply of certain types of crops.

Annual food price growth slowed to 8.2% in January 2024 (Graph 60). Both external and internal factors contribute to the slowdown in food inflation. The decline in world prices for grain crops, coupled with the strengthening of the nominal exchange rate of the tenge at the end of 2023, contributed to reduction in import prices for plant products. Food producer prices have continued to decline since July 2023 in annual terms. In agriculture, the annual cutting of prices for grain crops, in particular wheat, buckwheat, and oilseeds, continued. This contributed to a decrease in consumer prices for cereals and oils.

Despite the slowdown in annual food inflation, monthly price growth continued to accelerate and reached 1.1% in January 2024, which is higher than the historical average for 2017-2021. The main factor that put pressure on inflation was the seasonal increase in prices for fruits and vegetables against the backdrop of rising producer prices for fresh vegetables in agriculture and higher prices for imported vegetables. At the same time, in January 2024 the increase in prices for food products excluding fruits and vegetables amounted to 0.6%.

Graph 60. Dynamics of Food Inflation, %



Source: BNS ASPR, NBK computations

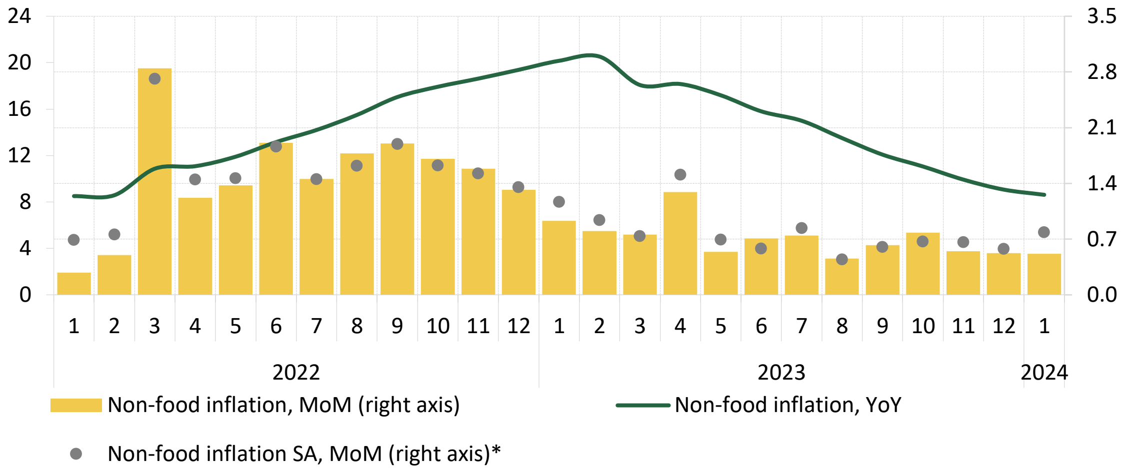
** Seasonal adjustment was performed by using X-12-ARIMA method from 2011 until present*

Annual non-food inflation is slowing down due to the dissipation of high monthly inflation values of last year, lower import prices because of the slowing inflation in trading partner countries and a stronger real exchange rate of the tenge, as well as lower producer prices for certain non-food products.

In January of this year, the annual increase in prices for non-food products slowed to 8.6% (Graph 61). In the structure of non-food products, there is a significant slowdown in prices for clothing and footwear, textiles, detergents and cleaning products. At the same time, prices for household appliances continued to decline in annual terms for the fourth month in a row. A faster slowdown in non-food price growth was offset by robust demand amid the recovering real wage growth and high growth rates in consumer loans.

The monthly increase in prices for non-food products has stayed at 0.5% since November 2023. However, seasonally adjusted price growth accelerated to 0.79% in January 2024. Acceleration of price growth is observed among solid fuels, cars, electrical appliances.

Graph 61. Dynamics of Non-Food Inflation, %



Source: BNS ASPR, NBK computations

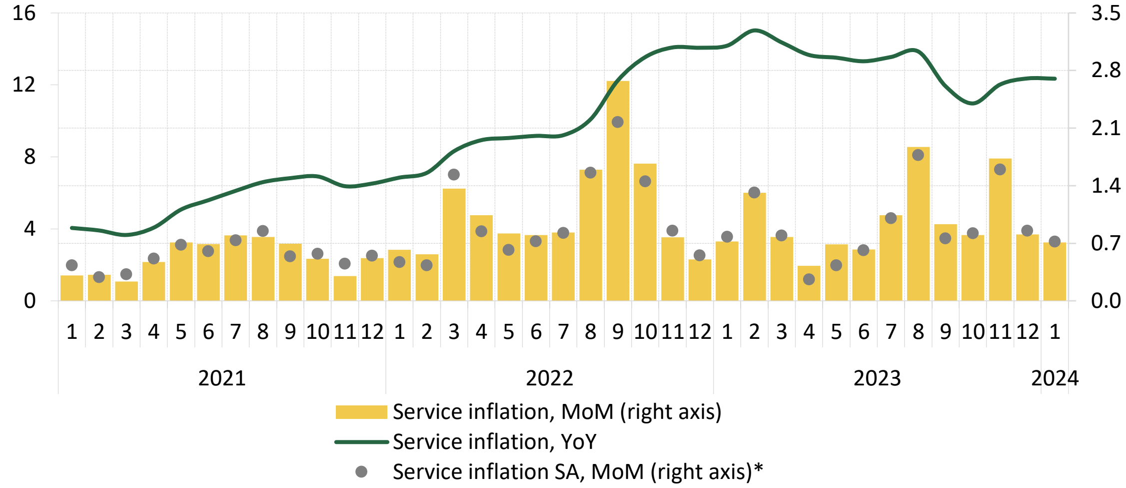
** Seasonal adjustment was performed by using X-12-ARIMA method from 2011 until present*

The raising of utility tariffs keeps exerting pro-inflationary pressure on the service component of inflation.

In January 2024, the annual increase in prices for paid services to the population amounted to 12.3%. At the same time, compared to October 2023, there is an acceleration in price growth for the service component. In monthly terms, price growth was 0.7% in January 2024 (Graph 62).

Increased pressure on the rise in prices for paid services was exerted by the continuing raising of tariffs for regulated utilities in the context of implementation of the "Tariff in Exchange for Investment" program. Thus, since November last year, there has been an acceleration in the annual growth of prices for regulated utility services, amounting to 20.5% YoY in January 2024. The growth in rental payment for comfortable housing also accelerated from 4.5%, YoY, in October 2023 to 7.9%, YoY, in January 2024. The rise in prices for market services is supported by income growth and consumer lending to the population.

Graph 62. Dynamics of Service Inflation, %



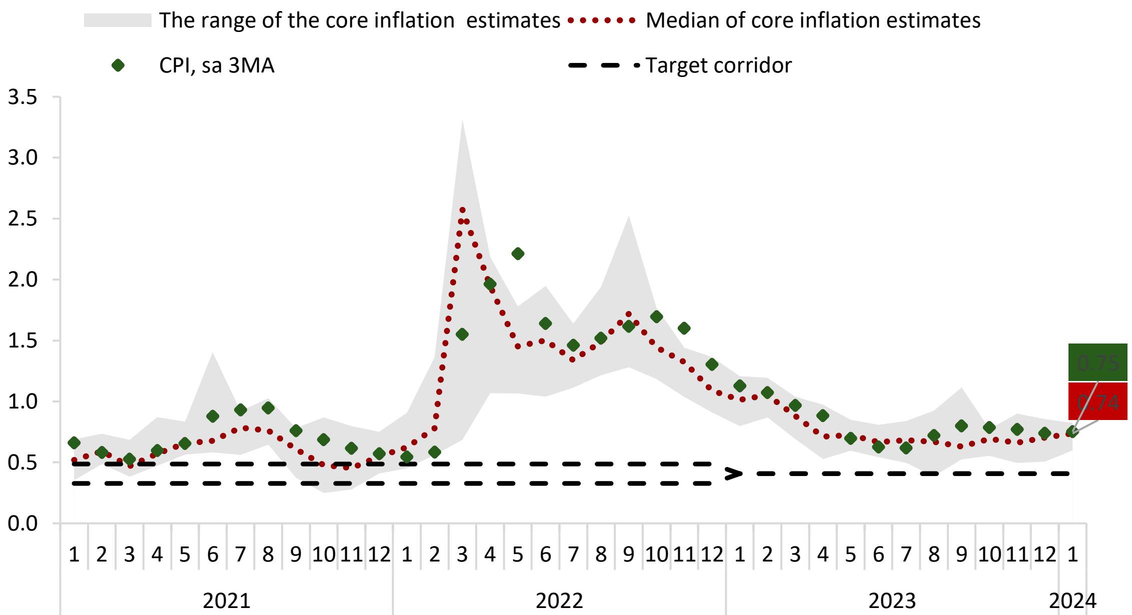
Source: BNS ASPR, NBK computations

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

Estimates of seasonally adjusted and core inflation continue to trend above target, reflecting continued price increases in the sustainable portion of inflation.

The median estimate of seasonally adjusted core inflation accelerated from October last year to 0.74% in January 2024 (9.2% in annualized terms), which could indicate an acceleration in price growth across a broad range of goods and services in the sustainable portion of inflation (Graph 63). Along with this, seasonally adjusted inflation, smoothed out over three months, after a slight slowdown in October-December 2023, in January 2024 showed an acceleration to 0.75% (in annualized terms – 9.4%), also indicating the persistence of a fairly high growth in prices for goods and services above the target value and average value in January 2017-2021.

Graph 63. Seasonally-Adjusted Consumer Price Index and Core Inflation Estimates, %

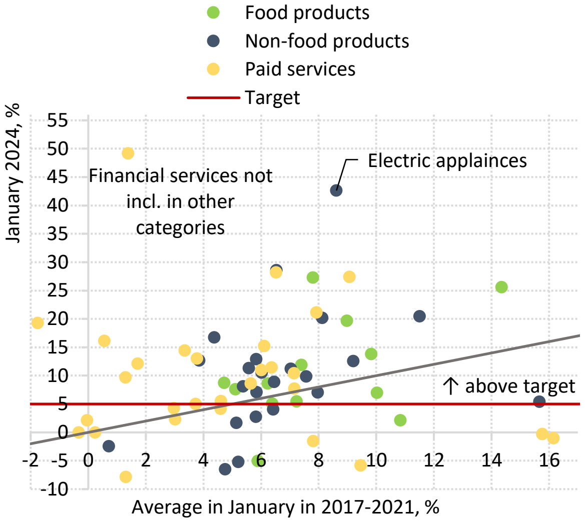


Source: BNS ASPR, NBK computations

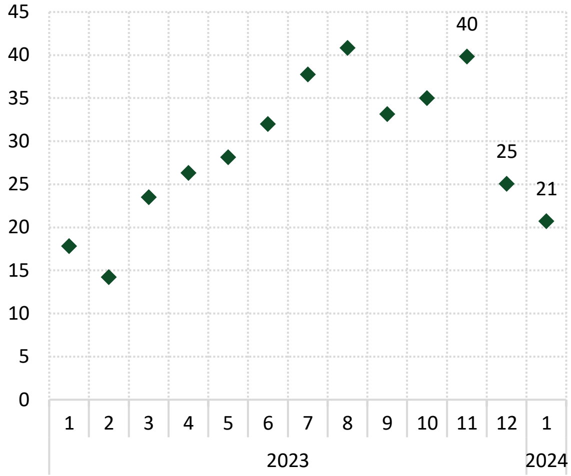
Prices for most goods and services keep rising above their historical averages as well as above the inflation target.

In January 2024, seasonally adjusted annualized price growth for 40 of 66 subgroups of goods and services exceeded the target and historical average growth in the months of January in 2017-2021. Prices for electrical appliances, financial services, card services and money transfers in particular, demonstrated the greatest increase in prices among goods and services (Graph 64).
At the same time, since November 2023, fewer and fewer goods and services (by their weight in the CPI structure) have shown the price growth below the target value, which indicates an acceleration in price growth for most consumer goods and services (Graph 65).

Graph 64. Growth in Prices for Various Groups of Goods, MoM, Annual., %



Graph 65. Dynamics of Weights for Goods and Services Whose Prices are Growing At or Below the 5% Target, MoM, Annual., %

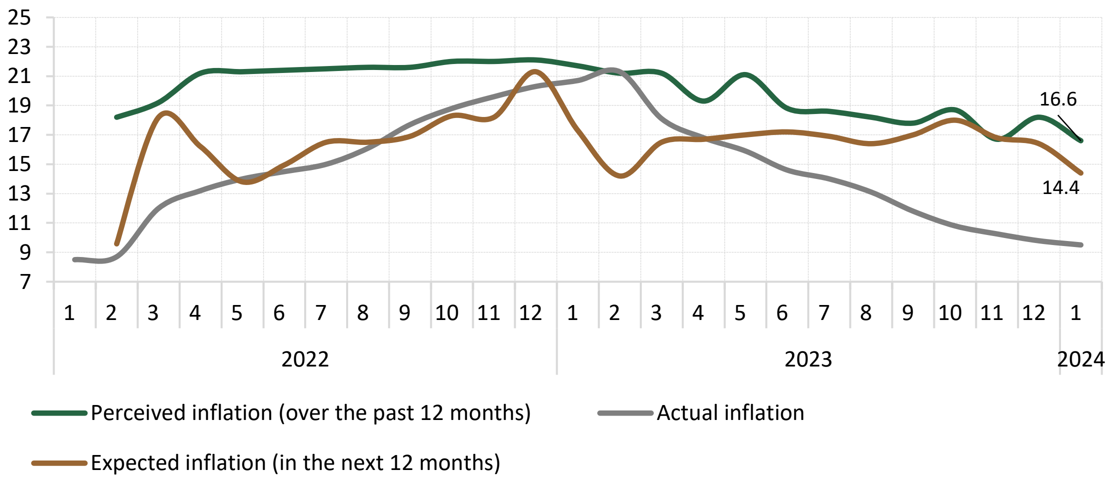


Source: BNS ASPR, NBK computations

Inflation expectations of the population declined. However, rates of deceleration in inflation expectations remain below the rates of deceleration in annual inflation.

The median estimate of expected inflation has shown deceleration since November last year, reaching 14.4% in January 2024. Estimates of perceived inflation also slowed to 16.6% in January 2024 from 18.2% in December 2023 (Graph 66).

Graph 66. Median Estimates of Expected and Perceived Inflation, YoY, %



Source: BNS ASPR PK, FusionLab: public poll

Among consumer goods and services, respondents continue to point to a significant increase in prices for food products, in particular for dairy and meat products. In January 2024, the number of respondents who noted a seasonal increase in prices for fruits and vegetables and eggs increased. At the same time, in January of this year, the number of respondents who noted an increase in prices for bread and bakery products decreased after a sharp increase in October 2023. At the same time, respondents continue to note an increase in prices for utility services, which is due to the growth in tariffs as part of implementation of the "Tariff in Exchange for Investment" government program. January 2024 marks an all-time high in the number of respondents who noted an increase in prices for utility services, as well as for Internet and cellular services.

Among other unregulated services, in January 2024, compared to October 2023, the proportion of respondents who noted the growth in the cost of medical and household services, and passenger transport services increased. Meantime, in the structure of non-food products, the share of the population who noted an increase in prices for medicines and medicines, household chemicals, clothing and shoes decreased slightly.

Box 4. Deceleration of Annual Inflation in 2023-2024 and Evaluation of the "Base Effect"

As a follow-up of the analysis of the impact of various inflation indicators and the "base effect" on deceleration of annual inflation, which was set upon in the "Inflation" section of the Monetary Policy Report for November 2023, this Box describes in more detail the differences and purposes of their use. To analyze the dynamics of price growth in the economy, various alternative inflation indicators are used.

Some of the most informative are monthly inflation indicators, including seasonally adjusted and core inflation. Monthly inflation indicators allow drawing conclusions about the current inflationary background in the economy, identify the main factors of price growth and construct a forecast inflation path for the short and medium term.

Annual inflation is calculated by accumulating monthly data for the last 12 months. Accordingly, annual inflation is determined by current monthly inflation, as well as price volatility in prior periods, the so-called "base effect".

Thus, in January 2024, annual inflation slowed to 9.50% from 9.78% in December 2023. The slowdown amounted to 0.28 percentage points, which corresponds to the difference in monthly inflation in January 2023 of 1.06% and in January 2024 of 0.80%[12]. Thus, to calculate annual inflation in January 2024, monthly inflation in January of the last year (base effect) is excluded and monthly inflation in January of the current year is included.

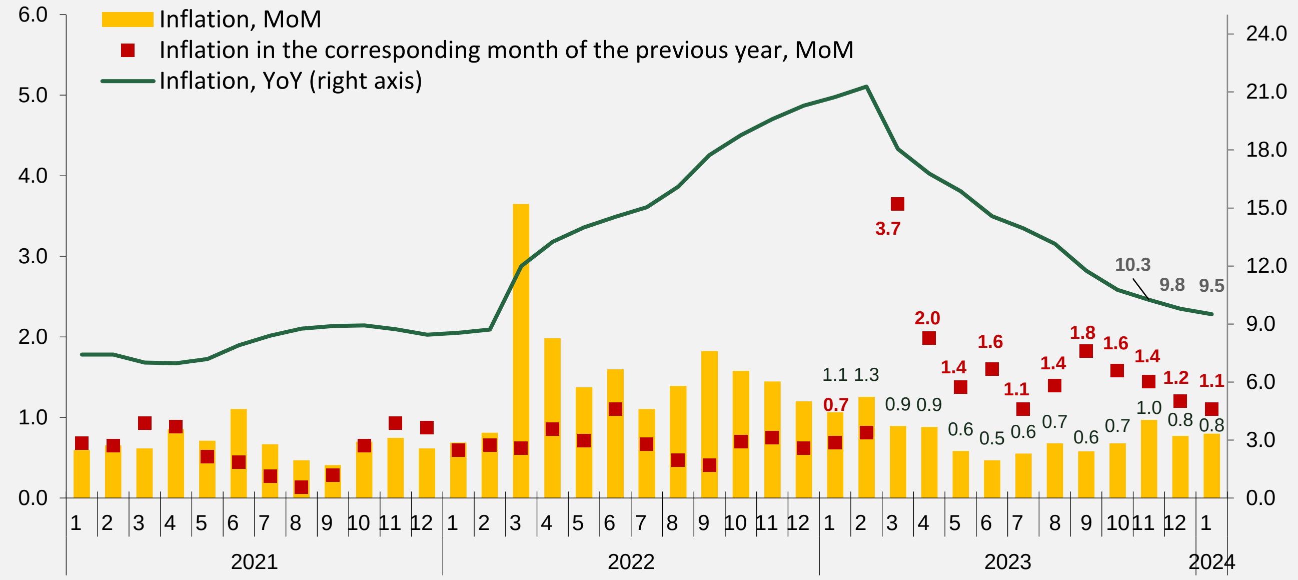
A slowing trend in inflation has been observed since March 2023. Annual inflation has slowed from a peak of 21.3% in February 2023, when monthly price growth in the current period (yellow bars) was lower than the monthly price growth in the corresponding month of the previous year (red squares) (Graph 1).

The removal of the high base that formed in 2022 from the calculation of annual inflation, coupled with lower monthly inflation values in 2023, led to a slowdown in annual inflation by the end of 2023. At the same time, along with such factors as deceleration in global food inflation, inflation in trading partner countries, the rate of growth in domestic producer prices in various industries, the tightening of monetary conditions since February 2022 contributed to the creation of a lower inflationary background in 2023 and in January 2024 compared to the corresponding figure of the previous period.

Thus, in 2023, the contribution of the base effect to the slowdown in annual inflation amounted to an average of 1.6 percentage points per month or 65%. In January 2024, the contribution of the base effect to the slowdown in annual inflation equaled 1.1 percentage points or 57.0% (in January 2023 – 39.2%) (Graph 2).

[12] The difference between inflation values in January 2023 and 2024 was 0.26 percentage points. A small statistical discrepancy (0.02 percentage points) is due to the fact that to calculate annual inflation, monthly inflation indices for the last 12 months are multiplied rather than added.

Graph 1. Correlation Between Monthly and Annual Inflation Rates, %



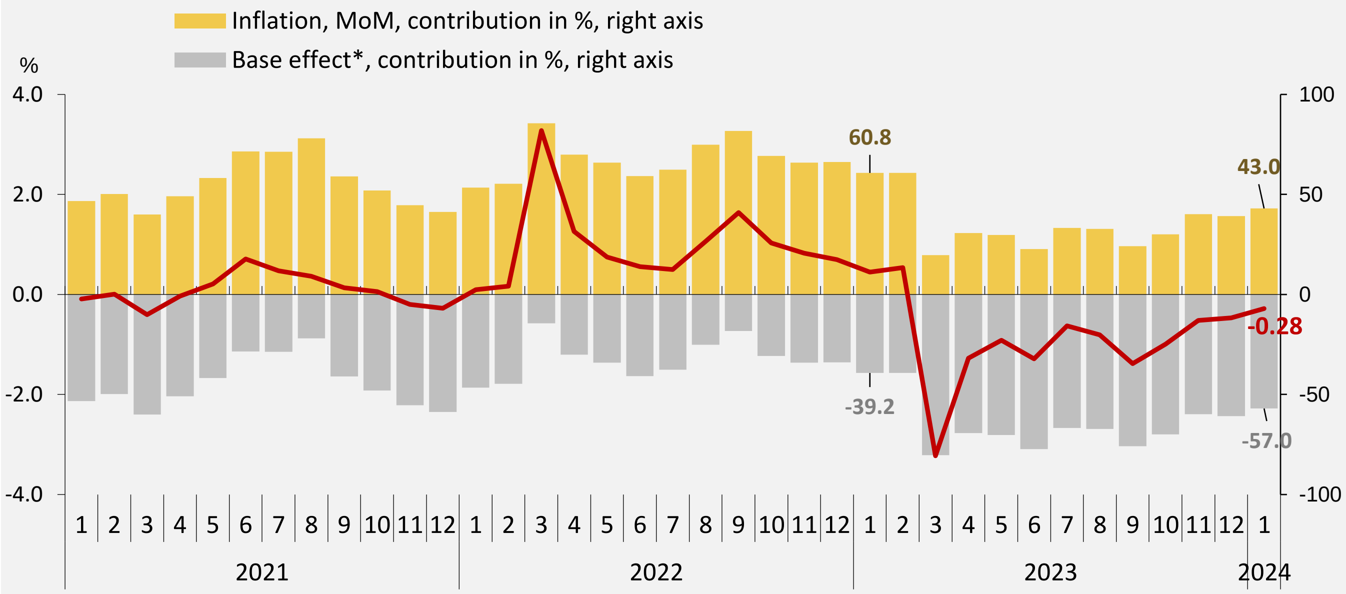
Source: BNS ASPR, NBK computations

It is worth mentioning that despite lower price growth rates in 2023 both in annual and monthly terms compared to 2022, monthly inflation is still above historical averages. Therefore, it also exceeds the target significantly.

The base effect had a significant impact on slowing annual inflation in 2023 and January 2024. Meanwhile, given that monthly inflation was high at the beginning of 2023, the base effect will persist in annual inflation until the end of the first quarter of 2024. In addition, it is worth taking into account the high inertia in inflationary processes, i.e. inflation "fades" slowly.

Starting from the second quarter of 2024, deceleration in annual inflation may be limited by the easing of the NBK's monetary policy (lowering of the base rate from August 2023). Annual inflation will decelerate at a slower pace.

Graph 2. Contribution of the Base Effect to Annual Inflation



Source: BNS ASPR, NBK computations

** monthly inflation in the corresponding period of the last year Inf_{t-12} (when calculating annual inflation in the current month, monthly inflation for the current month Inf_t is included and monthly inflation for the corresponding month of the last year Inf_{t-12}, is excluded, i.e. the base affect). The contribution of the base effect is calculated under the following formula:*

Contribution of the base effect $= \frac{Inf_{t-12}}{Inf_t + Inf_{t-12}}$

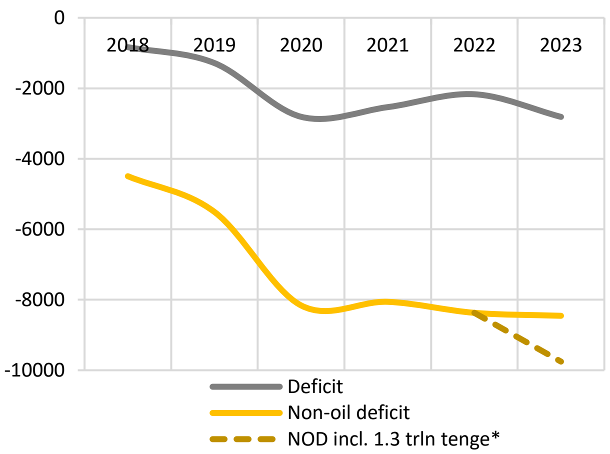
3.6. Fiscal Policy

The state budget deficit has aggravated

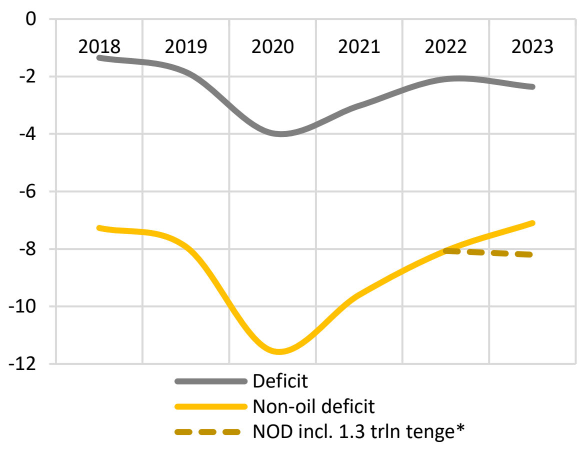
The state budget deficit at the end of 2023 amounted to 2.8 trillion tenge (Graph 67) or 2.4% to GDP (Graph 68), which is by 29.6% higher than the level of 2022 (2.1% to GDP). This is caused by higher growth rates of costs compared to income and increased acquisitions of financial assets.

Given the persistently heightened fiscal stimulus due to the active attraction of funds from the National Fund (over the past five years, the average share of oil revenues of total revenues is 31.6%), the level of non-oil deficit continues to remain high. Thus, the non-oil state budget deficit in 2023 amounted to 8.4 trillion tenge (9.7 trillion tenge, taking into account the purchase of shares of the NC "KazMunayGas" JSC for the National Fund, received as dividends to the national budget) (Graph 67) or 7.1% of GDP (8.2% of GDP) (Graph 68). The increase amounted to 83 billion tenge (1.4 trillion tenge) compared to 2022.

Graph 67. State Budget Deficit, Bln Tenge.



Graph 68. State Budget Deficit, as % of GDP



Source: МФ РК, NBK computations

** purchase of shares of the NC "KazMunayGas" JSC in 2023 in the amount of 1.3 trillion tenge were credited to the National Fund in the form of dividends to the national budget, which is recorded under the "Non-tax revenues" item; for analytical purposes, this amount, by analogy with transfers from the National Fund, was excluded when calculating the non-oil deficit.*

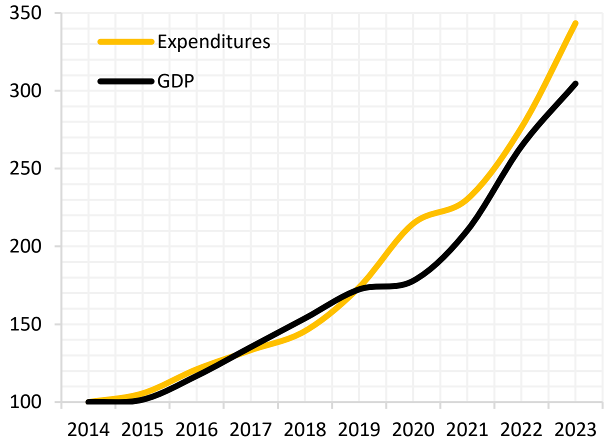
Tax revenues went up by 27.4% in 2023. Within the tax structure, all major types of revenue are growing at double-digit rates. The largest contributors to growth are value added tax (VAT), corporate income tax (CIT) and personal income tax (PIT). The increase in taxes was caused by the improved administration, growth in the economic activity, non-oil foreign trade, domestic trade, the general price level and the expansion of the payroll fund. Revenues under the "Payment for the use of radio frequency spectrum" item increased by almost 160 billion tenge due to payments made by cellular operators for radio frequencies for 5G. In addition, the registration fee for conducting business and professional activities, as well as the state duty for legally significant actions and the issuance of documents credited to the local budget, increased by more than 80 billion tenge. This fact may be associated with the relocation of professionals and businesses from neighboring countries.

Underfulfilment of obligations to pay taxes amounted to over 700 billion tenge, with the largest deviation from the plan being observed in corporate income tax and value added tax.

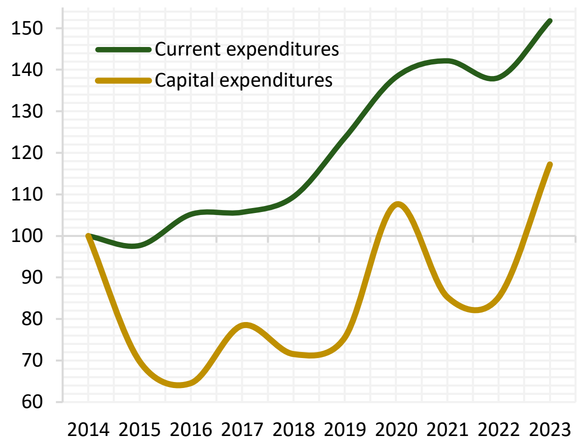
In terms of expenditures, operating expenses are mainly increasing.

The increase in costs during January-December 2023 amounted to 24.3%. In addition to spending on defense and the industry, other sectors are growing at an impressive pace. The main contribution to the increase in costs comes from education costs because of increased salaries for teachers, scholarships for students, and the number of grants for training; social security against the increase in pensions, benefits and targeted social assistance; utility services due to rising costs for infrastructure development. In addition, given the increase in the Government domestic debt, its servicing is growing.

Graph 69. Growth Rates of State Budget Expenditures and GDP, 2014=100



Graph 70. Growth Rate of State Budget Expenditures in Real Terms, 2014=100



Source: MF RK, NBK computations

Since 2020, costs have been growing at a faster pace than the economic growth, which indicates the stimulating nature of fiscal policy (Graph 69). With economic activity declining in 2020, the fiscal policy has been countercyclical, with sharp increases in spending justified. However, in subsequent years, the fiscal policy became pro-cyclical, which creates space for pro-inflationary processes.

In the cost structure in real terms, current expenditures are mainly growing (Graph 70). This shows the social focus of the fiscal policy and indicates stimulation of consumer demand by the government. As for capital expenditures, including the PPE acquisition, their repair and development costs, it is worth noting a significant increase in 2020 during the period of large-scale fight against coronavirus, as well as in 2023 against a significant increase in investments in the utilities sector.

BASIC TERMS AND DEFINITIONS

The base rate is a key monetary policy instrument of the National Bank that allows regulating nominal interbank interest rates in the money market. By establishing the base rate level, the National Bank determines a target value of key interbank money market short-term interest rate 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.

Reserve Money includes cash issued into circulation by the National Bank, other than cash at the cash departments of the National Bank, transferrable and other deposits of banks, transferrable deposits of non-bank financial organizations and current accounts of government and nongovernment non-financial organizations in the tenge at the National Bank.

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 individuals in the national 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 national 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 over time in the average price level of a fixed basket of goods and services purchased by the population for personal consumption. The consumer basket in Kazakhstan for computation of inflation reflects the structure of household spending and includes goods and services, which have the largest relative share in consumption of the 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 preceding (base) period. The index is calculated by the Bureau of National Statistics of the Agency for Strategic Planning and Reforms 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 term 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 as well 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 national 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.

Real Exchange Rate refers to a relative price of a commodity produced in two countries: the proportion of commodity exchange between countries. The real exchange rate depends on the nominal rate, on relation between exchange rates of currencies, and prices of goods in the national currencies.

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, whereby monetary policy instruments influence final macroeconomic indicators such as the economic growth, inflation.

LIST OF KEY ABBREVIATIONS

bp – basis point
BNS ASPR – Bureau of National Statistics of the Agency for Strategic Planning and Reform
GDP – gross domestic product
TEA – types of economic activities
GSs – government securities
EIA – Energy Information Administration
EM – emerging markets
EU – European Union
ECB – European Central Bank
CPI – consumer price index
SRC MF RK – State Revenue Committee of the Ministry of Finance of the Republic of Kazakhstan
KASE – Kazakhstan Stock Exchange
KDIF – "Kazakhstan Deposit Insurance Fund" JSC
KSF – "Kazakhstan Sustainability Fund" JSC
NBK – National Bank of the Republic of Kazakhstan
NFRK – National Fund of the Republic of Kazakhstan
OPEC – Organization of Petroleum Exporting Countries
PPE – property, plant and equipment
pp – percentage point
Rosstat – Federal State Statistics Service of the Russian Federation
MAEC – Mangistau Atomic Energy Complex
IMF – International Monetary Fund
MW – minimum wage
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
FGP/WPMP – Future Growth Project/ Wellhead Pressure Management Project
trln – trillion
thous. – thousand
TCO – Tengizchevroil
CBRF – Central Bank of the Russian Federation
FAO – Food and Agriculture Organization of the United Nations
US Fed – US Federal Reserve System