



NATIONAL BANK OF KAZAKHSTAN

Inflation Report

The Third Quarter of 2018

Almaty, Kazakhstan

The **Inflation Report** is a quarterly publication of the National Bank which contains the analysis of key macroeconomic indicators 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 of macroeconomic indicators was prepared on the basis of statistical information as at 15.11.2018.

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SUMMARY

Since the publication of the previous Inflation Report for the second quarter of 2018, the National Bank twice made the decision regarding the base rate. In October, the base rate was increased to 9.25%, and was retained at 9.25% in December with the unchanged interest rate band of +/-100 basis points.

The inflation rate in October and November 2018 had built up at 5.3%, coming close to the lower boundary of the target range of 5-7%. The annual decline in prices of fruits and vegetables, gasoline as well as the reduction in tariffs for regulated services as compared to September were the main contributors to the deceleration of inflation. However, the ongoing rise of the core inflation from 5.9% in August to 6.8% in November of this year points at a persistently high inflation background.

Inflation expectations remain adaptive and are sensitive to one-time events. If in September and October inflation expectations were above the actual inflation, at end-November they subsided to the actual inflation rate – 5.3%. Thus, the effect of negative developments of September and October associated with the dynamics of the exchange rate of the tenge diminished. The long-term trend for deceleration of perceived inflation rate is persisting.

According to the National Bank's assessments, under the baseline scenario which assumes the oil price (Brent) to be at USD 60 per barrel, in 2019 the annual inflation in Kazakhstan will start to gradually enter into a new target range of 4-6%, staying near its upper boundary. As compared to the previous "August-September 2018" forecast round, the inflation path was adjusted towards to a minor downward movement, being associated with the decline in prices for services provided by monopolists which is anticipated in 2019. In the first half of 2020, the annual inflation, according to the National Bank's assessments, will continue to gradually slow down.

The National Bank revised its risk profile towards a minor deterioration. As compared to the previous forecast round, among internal factors the risk of inflation pressures on the part of domestic demand intensified given the 1.5 time increase in minimum wages from 2019. In addition, the abatement of personal income tax for low-paid employees as well as the positive dynamics of the consumer lending will contribute to a potential acceleration of the consumer demand.

The key risks of inflation pressures on the part of external demand include uncertainty regarding future oil prices as well as the persisting trend of inflation growth in countries-main trading partners. Volatility in the oil market and the increasing risks of fall in oil prices are nurtured by the growing supply of raw materials, with a possible slowdown in the global demand as a result of trade conflicts.

Risks of the tightening of external monetary conditions which are manifested in the increased US Fed's policy rate are persisting.

According to updated forecasts made by the National Bank, under the baseline scenario the growth of Kazakhstan's real GDP will account for 2.7% in 2019, and in the first half of 2020 – for 2.7%. Assumptions regarding the economic growth had not changed. The main driver for the growth of the economy will be the domestic consumer demand. Positive dynamics of the investment activity will hold up, in the first instance, in the mining industry and in residential construction. The increasing exports of goods and services will be associated with a further scaling up of extraction of oil and gas condensate in the Kashagan oil field.

The National Bank assesses the output gap as positive over the forecast horizon; this will be putting pro-inflation pressure. A positive output gap will be narrowing by the end of the forecast horizon while remaining in a weakly positive zone.

The National Bank will keep the monetary conditions neutral. The current level of the base rate, other things being equal, ensures that inflation will be within a new target range of 4-6% by the end of 2019. Besides, the current interest rate policy of the National Bank also allows leveling down the pressure of external factors on the domestic foreign exchange market. Thereby, the effective formation of the exchange rate of the tenge and reduction of its effect on the domestic prices are ensured.

An important objective in increasing effectiveness of the National Bank's monetary policy is still to improve the short-term predictability of the targeted TONIA rate within the boundaries of the targeted corridor, also by bringing close the money market rates and the base rate.

I. MACROECONOMIC ENVIRONMENT AND THE FINANCIAL SECTOR DEVELOPMENT

1. EXTERNAL MACROECONOMIC ENVIRONMENT

1.1 Situation in the Global Commodity Markets

1.1.1 Oil Market

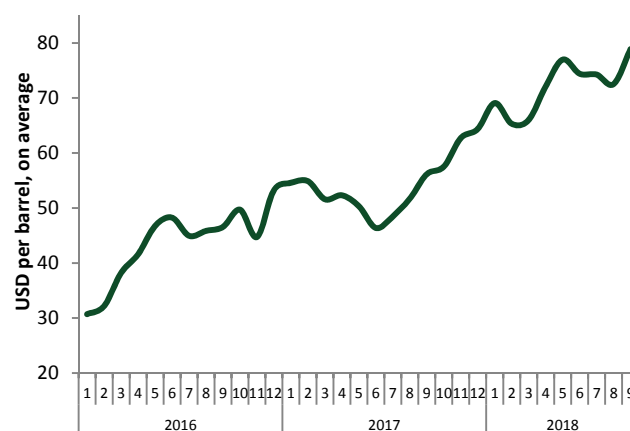
In the third quarter, the average price of oil (Brent) had been at USD 75.2 per barrel (Figure 1), which is by 44.4% higher than in the third quarter of 2017.

One of the main fundamental reasons for such rise in oil prices is the reduction in the world reserves as a consequence of the rapidly and steadily growing global demand for oil (Figure 2).

Global oil consumption increased by 1.5% as compared to the corresponding quarter of the previous year (Figure 3). Acceleration of the global consumption was caused by the growing market concerns about a further rise in oil prices as well as by expectations about reduction in supplies from Iran due to the US sanctions. The situation in Venezuela also provides an additional support to the demand. Given the effect of the above listed factors, the increase in consumption was observed in China, India as well as in the USA where the growth in industrial output and cargo transportations had an additional impact on the upturn in demand.

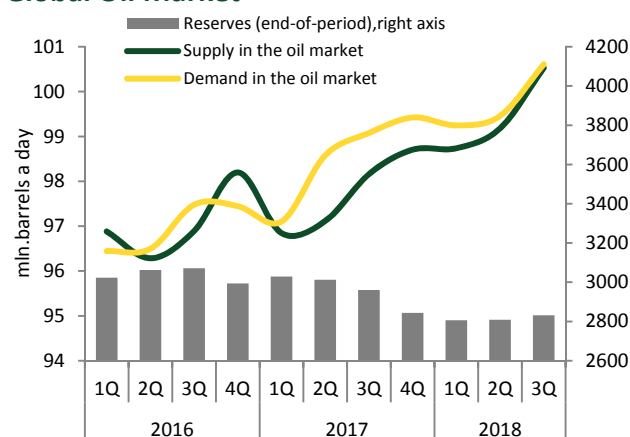
Global oil production went up by 2.2% (Figure 4). The main contribution to the growth is secured by countries outside of OPEC, where the overall oil extraction increased by 4.7%. In the environment of favorable price performance, a significant ramp-up of oil extraction was observed in the USA as well as in Latin American countries. According to some analysts, oil extraction in the USA and Canada would have been much larger if it were not for the problems associated with limited production capacities. Oil extraction in OPEC+ countries decreased by 2.3% as compared to the corresponding quarter of 2017. Along with that, the main contribution to such reduction was secured by Iran (minus 7.5%) and also by Venezuela (by 35.3%). The rise in production was observed in Saudi Arabia, Russia, African countries and in the UAE.

Figure 1. Price of Oil (Brent)



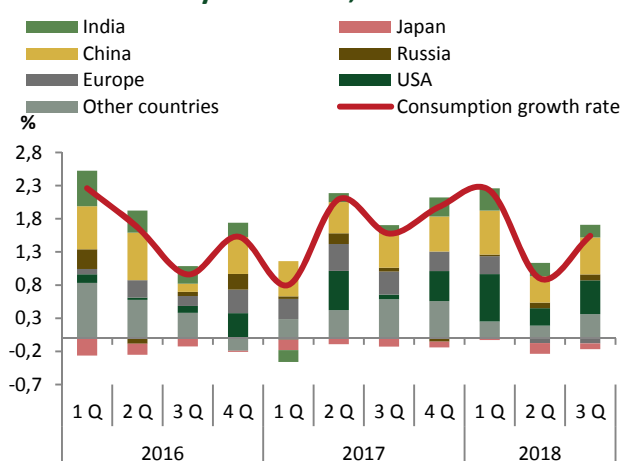
Source: U.S. Energy Information Administration (EIA)

Figure 2. Demand, Supply and Reserves in the Global Oil Market



Source: U.S. Energy Information Administration (EIA)

Figure 3. Global Oil Consumption and Contribution by Countries, YoY



Source: U.S. Energy Information Administration (EIA)

1.1.2 Non-Ferrous Metals Market

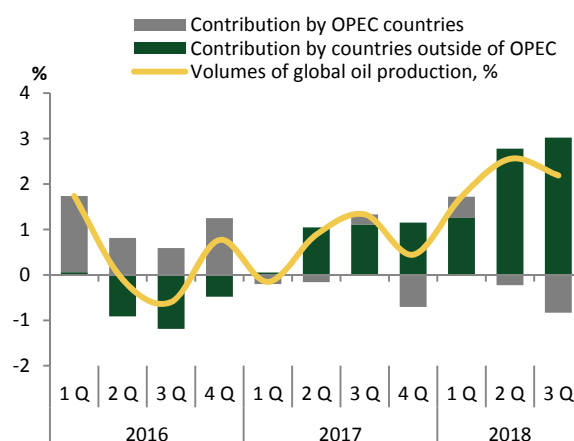
Negative dynamics was prevailing in the non-ferrous metals market that was caused by the tightening of monetary policy by the USA and by central banks of developing countries as well as by appreciation of the US currency and escalation of trade wars worldwide. An anticipated deceleration of the global economy's growth and, consequently, a slowdown in the global demand for metals had put an additional pressure on prices causing their decline.

Given the above factors, the decline in prices of all non-ferrous metals was observed in the reporting period. As a result, according to the National Bank's assessments, in September 2018 as compared to September 2017, the arithmetic mean price index of copper, aluminum, zinc and lead demonstrated the 12.8% reduction (Figure 5).

In the aluminum market, price quotations decreased by 9.4%. The fall in prices of the metal was occurring under the impact of several factors. First, the US Department of the Treasury once again postponed the imposition of sanctions against Rusal and En+, thus reducing the risk of the metal shortage in the market. Second, there was an upsurge of production as a result of a launch of a new plant in India. Third, a downturn in the global production of aluminum is also a consequence of the reduced availability of aluminum oxide which is used to produce aluminum, as well as of the growth in prices of electricity. In the reporting period, the prices were supported by: workers strike at a plant of Alcoa Inc. (the world's third largest producer of aluminum) in Western Australia, reduction in volumes of aluminum oxide production by the Aluminium Corp. China because of high prices of bauxites and low prices of aluminum oxide as well as the plans of the Chinese government regarding a large-scale development of infrastructure projects in the country.

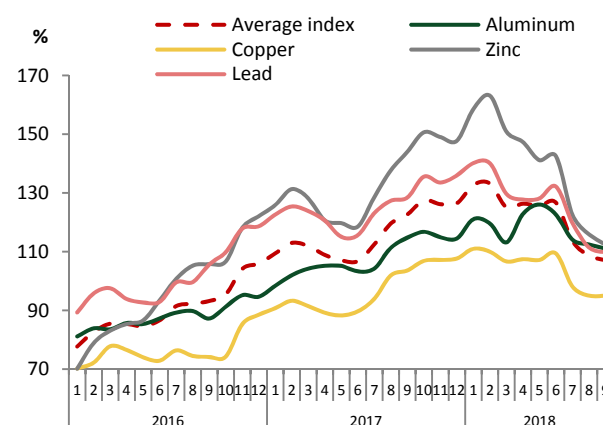
In the copper market, prices went down by 13.1%. Analysts point to market expectations about the drop of the metal consumption given trade dispute between the USA and China as the main constraining factor. Decline in the

Figure 4. Global Oil Production, YoY



Source: U.S. Energy Information Administration (EIA)

Figure 5. Price Index of Copper, Aluminum, Zinc and Lead (January 2015=100 %)



Source: NBRK's calculations based on data from Bloomberg

price of this metal also reflected the increased supply by Chile and Indonesia, despite the necessity to settle labor disputes. The beginning of the holiday season and a minor recession in trade activity also had an impact on reduction of the metal consumption in Europe and the USA. Drivers for the growth in price of the metal included the shutdown of the copper smelter in India because of environmental problems as well as maintenance works at a Glencore plant in Philippines as a result of a large typhoon in September.

In the lead market, the price drop was the greatest, accounting for 21.2%. Such a dramatic fall in prices of the metal occurred, first of all, as a result of a faster growth in the metal production versus its consumption worldwide. Appreciation of the US Dollar served as an important factor that affected reduction in quotations. In addition, the drop in prices of the metal was accompanied by the growing market expectations regarding the upcoming cutback on consumption in China given implementation of the government winter program for environmental protection.

Worldwide trade wars and political tension resulted in that prices of lead fell significantly, with the drop accounting for 17%. At the same time, the shortage of supplies and a seasonal high demand in the coming winter period continued to support the metal market.

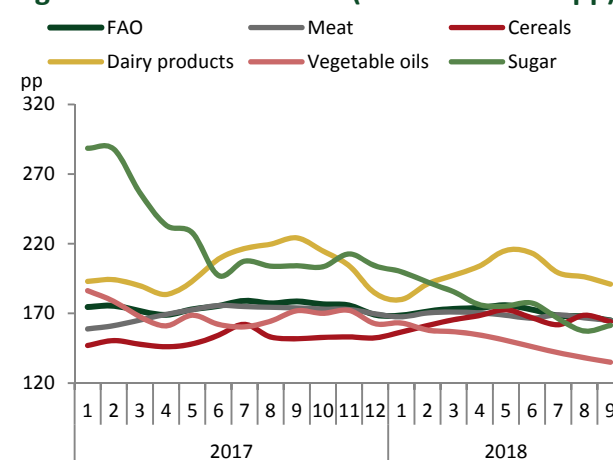
1.1.3 Food Market

According to the Food and Agriculture Organization of the United Nations, in September 2018 the FAO Food Price Index made up 164.9%, having decreased by 7.6% as compared to September 2017 (Figure 6). The drop of the index was caused by the decline in prices of all components.

The cereal price index has demonstrated a minor decline which is explained by the fall in prices of corn, rice and wheat amidst a plentiful harvest of corn in the USA and large volumes of wheat supplies from Russia. In annual terms, cereal prices went down by 7.6%.

Prices of vegetable oils have been declining for eight months in a row and have reached their three-year minimum. The price of palm oil,

Figure 6. FAO Price Index (2002-2014=100 pp)



Source: UN FAO

soy-bean oil and sunflower oil is going down given the information of the increase supply on the part of their producers. Vegetable oil price index had decreased by 22% over the year.

Over the third quarter, the price of meat products had not virtually changed. The decline in prices of poultry and beef as a result of a large supply on the part of the USA was offset by the growth in prices of lamb and pork meat given the increased demand on the part of China.

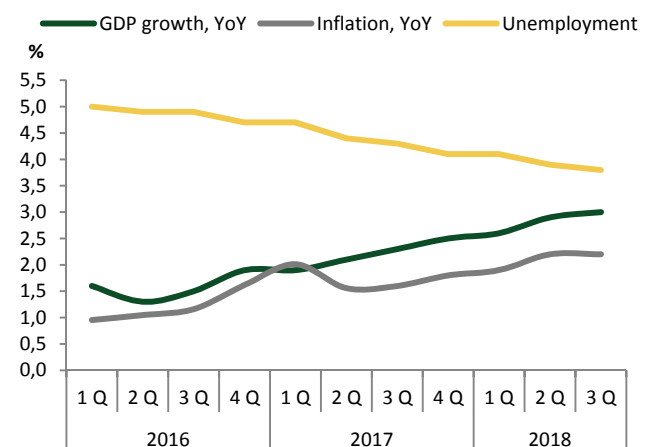
The dairy price index has been decreasing for the fourth quarter in a row losing 10.4% of its value over the quarter. Reduction of the market activity and good prospects for production in New Zealand happened to be the reasons for a fall in prices of dairy products. As compared to September 2017, prices declined by 15%.

In September, sugar prices demonstrated growth given the information about adverse weather conditions in Brazil, India and Indonesia – the main exporters. Despite this fact, over the year sugar prices dropped by 21%, which was driven by depreciation of local currencies of Brazil and India.

1.2 Economic Situation in the USA and the Fed's Rate

At the end of the third quarter, the economic growth in the USA accelerated and made up 3.0% (Figure 7). Acceleration of the economy was accompanied by escalation of the US protectionist policy and also by a strong support of economic entities via an eased fiscal policy. According to the U.S. Bureau of Economic Analysis of the United States Department of Commerce, an additional support to the economic growth was secured by the expansion of consumer spending on goods and services as well as by gross domestic private investments, primarily in the intellectual property products. The consumer spending was expanding against the increasing hourly wages, government social security benefits and earnings from residential lease. Other positive factors included a further deceleration of unemployment and also the growing number of people employed in the healthcare sector, transport services and other services.

Figure 7. US Economic Performance



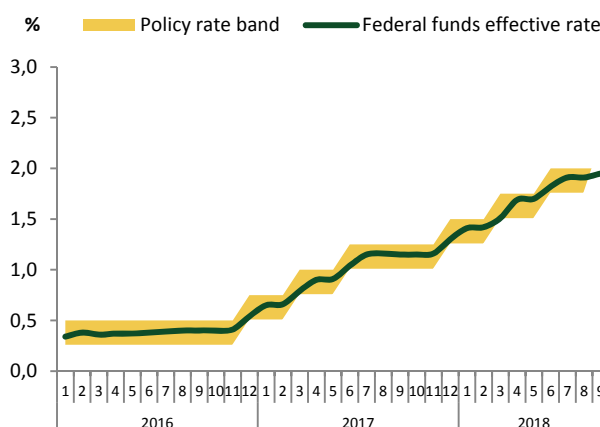
Sources: U.S. Bureau of Economic Analysis (BEA), U.S. Bureau of Labor Statistics (BLS)

In the reporting period, a significant decline in the exports of goods was recorded along with reduction of investments into equipment; this, in the aggregate, had a constraining effect on the economy's further growth.

Annual inflation in the USA accelerated. Acceleration of inflationary processes was induced by a significant rise in prices of gasoline, durable goods (such as cars, computers, bicycles, etc.) and certain services amidst the growing real income of the population.

In September 2018, the US Fed for the third time since the beginning of the year made the decision to raise its policy rate by 25 basis points to 2.00-2.25% (Figure 8). The decision was made given the attainment of the long-term inflation goal as well as a further improvement of performance in the labor market and high rates of economic activity.

Figure 8. Rates in the USA



Source: Reuters

1.3 Economic Situation in Countries – Kazakhstan's Trading Partners

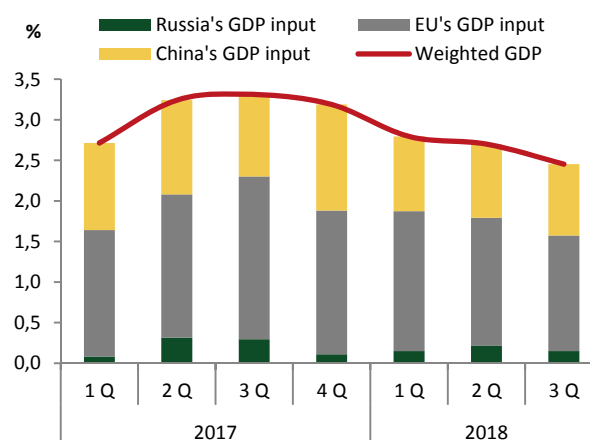
1.3.1 Aggregate External GDP

Aggregate external GDP which is calculated on the basis of the data about Kazakhstan's international trading structure and is characterizing the demand for Kazakhstani exports has been decreasing for the fourth quarter in a row (Figure 9). In the reporting quarter, the growth rates of the indicator have slowed down due to deceleration in the growth rates of economies in all trading partner countries – Russia, EU and China (Figure 10).

Expansion of the Chinese economy decreased to 6.5%; this was a result of the trade clash with the USA, in the first instance, and of escalation in trade barriers in the economy. As a consequence, in the reporting period a slowdown in activity was observed in the manufacturing industry, in the construction sector and trade.

An additional negative influence was stemming from the weakening domestic demand given the decreased consumer spending. The economic growth was supported by strong export performance which increased before implementation of the US customs duties, as well as by the ramp-up in the crude oil extraction (for the first time in three years)

Figure 9. External Weighted GDP , YoY



Source: NBRK's calculations

in the environment of rising world prices of energy carriers.

In countries of the Euro zone, GDP decelerated mainly because of Germany, France and Italy. In expert opinion, such deceleration was affected by many factors, of which the trade war with the USA, political problems in Germany, a high level of government debt in Italy as well as an overall deterioration of the economic situation in the world were the most significant ones. The ECB's intentions to wind up the bond purchase program before the end of 2018 served as an important factor. Brexit continues to produce a constraining effect on a further economic growth.

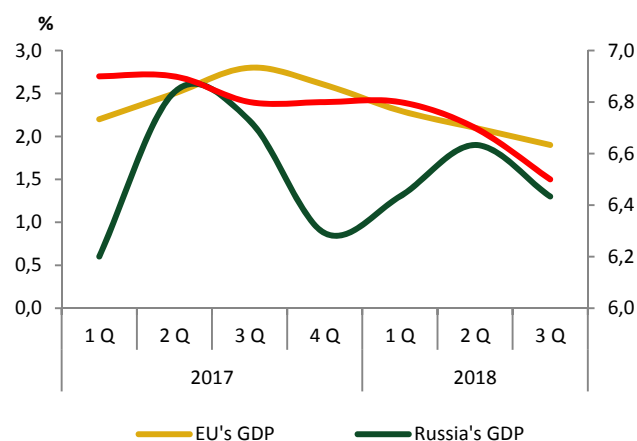
According to the assessment made by the Rosstat, economic growth rates in Russia in the third quarter of 2018 slowed to 1.3% (1.9% in the previous period). The decelerating production activity was recorded in the majority of economic sectors, including in agriculture (-6.1% YoY), and in the construction sector (-0.4% YoY). Such dynamics in agriculture is explained by the diminished yield of cereals and pulses given the high base of the last year. It should be noted that a negative contribution to the GDP growth by the agricultural sector made up 0.5 pp in the third quarter.

1.3.2 Aggregate External Inflation

Aggregate external consumer price index which is calculated based on the share of main trading partners in Kazakhstan's imports, accelerated in the third quarter of 2018 (Figure 11). Such acceleration is explained by an upswing of inflation in Russia and in China (Figure 12). Acceleration of the indicator clearly illustrates that external inflation pressure on consumer prices in Kazakhstan is increasing.

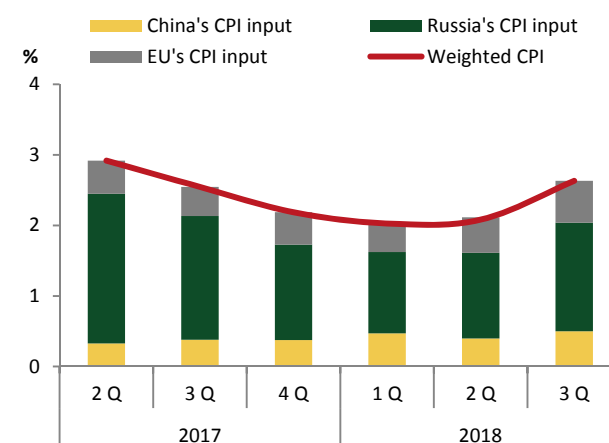
Annual inflation in China in September 2018 accelerated and reached 2.5%. The largest contribution to the growth in annual inflation was made by the increased energy prices. An additional pressure was put by the rise in prices of some foodstuffs, especially fruits and vegetables, lamb and eggs. In the structure of services, the price of educational services, healthcare services and house rent went up.

Figure 10. Real GDP Growth in China, EU and Russia, YoY



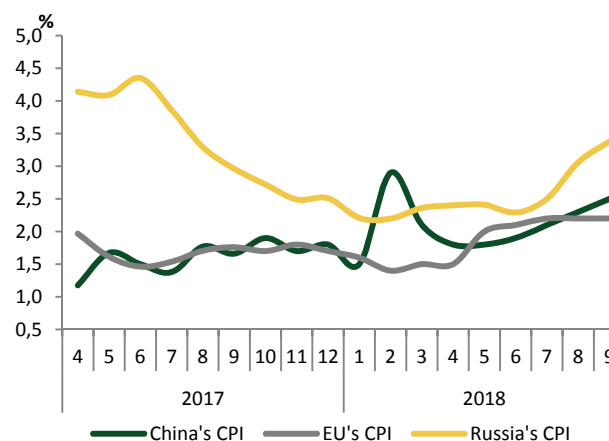
Source: Bloomberg, Eurostat, Rosstat

Figure 11. Weighted External CPI, YoY



Source: NBRK's calculations

Figure 12. Inflation in China, EU and Russia, YoY



Source: National Bureau of Statistics of China, Eurostat, Rosstat

Apart from those, prices of local and imported medications also increased.

Inflation in the EU member countries in September 2018 accounted for 2.2% in annual terms. High gasoline prices have significantly influenced the acceleration of inflationary processes. In addition, there was a rise in price of some seasonal food products such as fruits and vegetables as well as alcohol and tobacco.

Inflation in Russia continued to accelerate in the third quarter and in September 2018 accounted for 3.4%. The dynamics of inflationary processes was building up under the influence of depreciation of the ruble, acceleration of growth in prices of the food component against a high base of the last year and an outstripping rise in prices of goods by some producers in anticipation of the VAT rate hike.

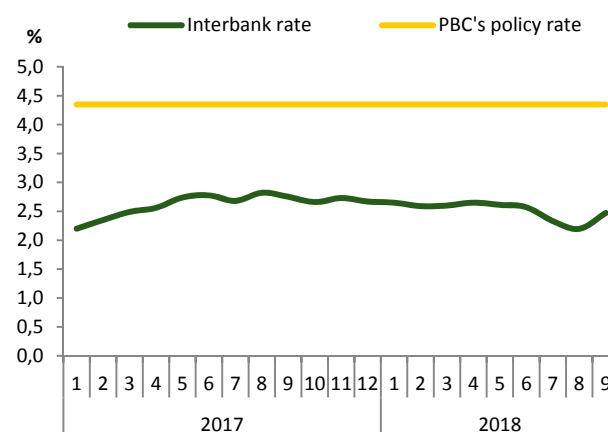
1.3.3 Money Market Rates

The People's Bank of China retained its policy rate unchanged in the third quarter of 2018 (Figure 13). Meantime, the average monthly over-night SHIBOR also demonstrated a minor growth from 2.20% in August to 2.47% in September 2018.

The ECB, during its most recent session, retained its official interest rates at the minimum level despite expectations in the market. Moreover, the ECB once again declared its intention to retain the rates at the existing level till the end of summer of 2019 (Figure 14). The regulator also confirmed that net asset purchases will be stopped by end-December 2018.

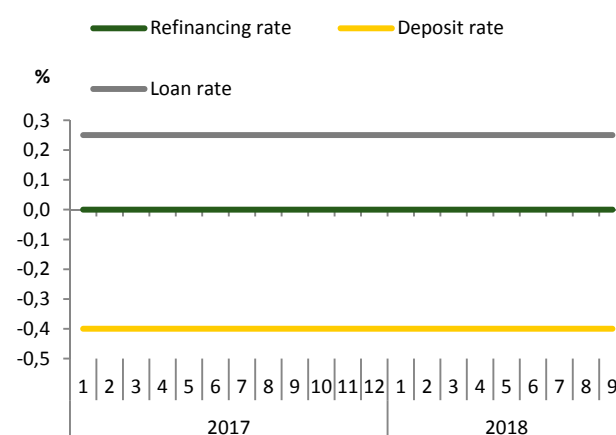
Given the price growth, the Central Bank of Russia revised its inflation forecasts upwards. So, according to the CBR's forecasts, at the end of 2018 the annual inflation will make up 3.8-4.2% instead of 3.5-4% as declared earlier. In 2019, a short-term acceleration of inflation rate to 5-5.5% is anticipated, followed by a gradual fitting into the 4% target in the first half of 2020 (Figure 15). To that end, in order to limit inflation risks, in September 2018 the Bank of Russia made the decision to increase its key rate by 25 pp to 7.50%.

Figure 13. Rates in China



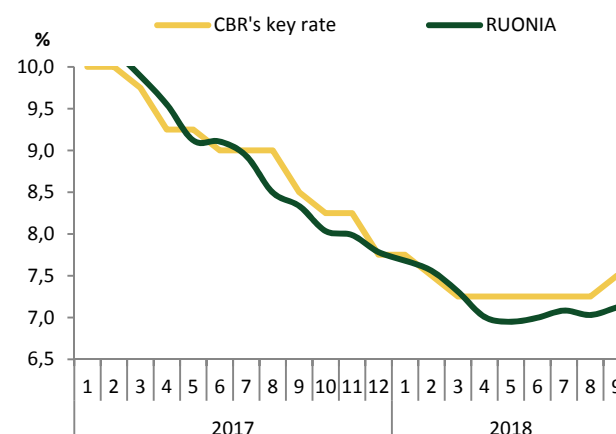
Source: Reuters

Figure 14. ECB's Rates



Source: Reuters

Figure 15. Rates in Russia



Source: CBR

3.4 Foreign Exchange Rates

The average monthly exchange rate of the Yuan against the US Dollar depreciated from CNY 6.71 in July to CNY 6.85 per 1 USD in September 2018 (Figure 16).

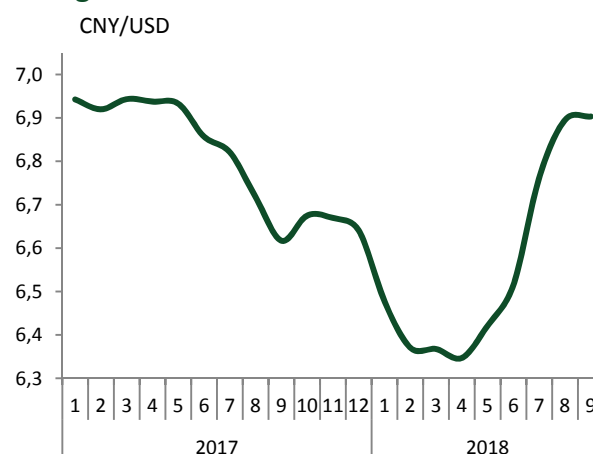
Depreciation of the Chinese local currency was caused by several factors, where escalation of conflict with the USA was the most significant factor. The pressure on the Chinese currency was also made by the measures taken by the Chinese central bank to reduce reserve requirements for a number of banks. Some analysts, among other reasons for depreciation of the domestic currency, point to the attempt of the Chinese authorities to support local producers-exporters through depreciation of the Yuan.

During the reviewed period, quotation of the European currency after a long-time depreciation slightly appreciated from USD 1.168 on average in July 2018 to USD 1.166 per 1 EUR on average in September 2018 (Figure 17). An insignificant appreciation was occurring against the achievement of arrangements of the EU authorities with the USA regarding a temporary suspension of imposition of increased customs duties for steel and aluminum from Europe.

The exchange rate of the Russian ruble against the US Dollar throughout the third quarter demonstrated a depreciation trend. Such trend was to a larger extent determined by imposition of the new US sanctions against Russia; this resulted in an outflow of non-residents from the federal bond market (Figure 18). The percentage of non-residents in the FBM in September decreased to 25.8% from the peak of 34.5% in March 2018.

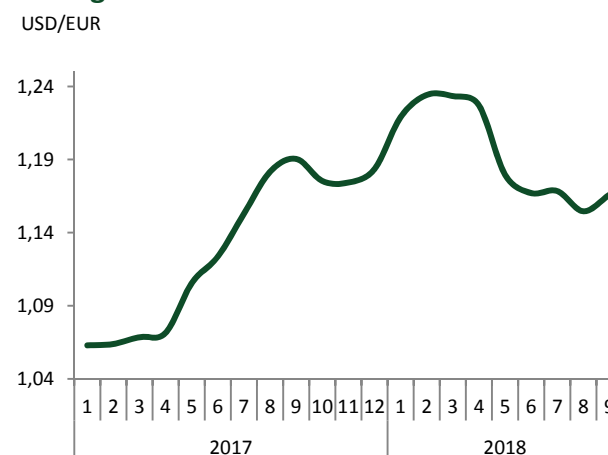
In September, the average monthly exchange rate of the ruble depreciated versus June 2018 by 7.8%, making up RUB 67.7 per 1 USD.

Figure 16. CNY/USD Exchange Rate, Monthly Average



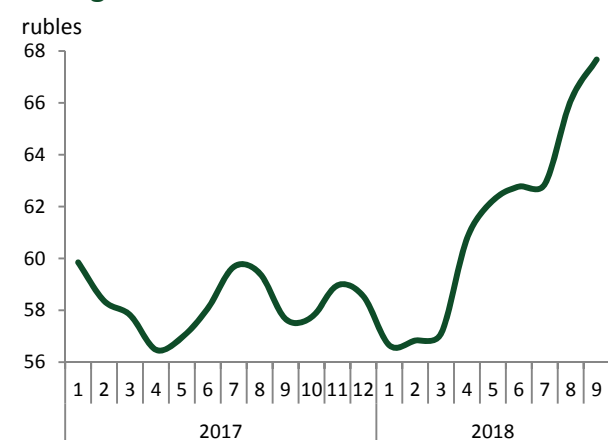
Source: Reuters

Figure 17. USD/EUR Exchange Rate, Monthly Average



Source: Reuters

Figure 18. RUB/USD Exchange Rate, Monthly Average



Source: CBR

1.4 Kazakhstan's Balance of Payments

In the environment of rising world prices and the increased production of oil and gas condensate, in the second quarter of 2018 the balance of payments was improving.

In the second quarter of 2018, the current account deficit went down by more than eight times as compared to the same quarter of the previous year, to USD 0.2 bln. A high level of returns earned by foreign direct investors serves as a constraining factor for reduction in the current account deficit (Figures 19 and 20).

Exports of goods increased by 21.5%, mainly owing to mineral products (by 34.6%) and grain (by 31.9%).

The growth in imports of goods (by 3.2%) was observed among all major commodity groups (imports of consumer goods increased by 5.8%, of interim industrial products – by 2.8%, and of investment goods – by 6.1%).

Higher growth rates of exports of goods versus their imports helped to increase a balance of trade surplus by more than 1.5 times (Figure 20).

The deficit on the balance of international services decreased as compared to the second quarter of 2017 by 9.1% due to the growth in exports of services along with a less significant rise in the imports of services. The run up in the exports of services was secured by the growing revenues of local airline companies as well as by growing expenditures of non-residents related to trips to Kazakhstan.

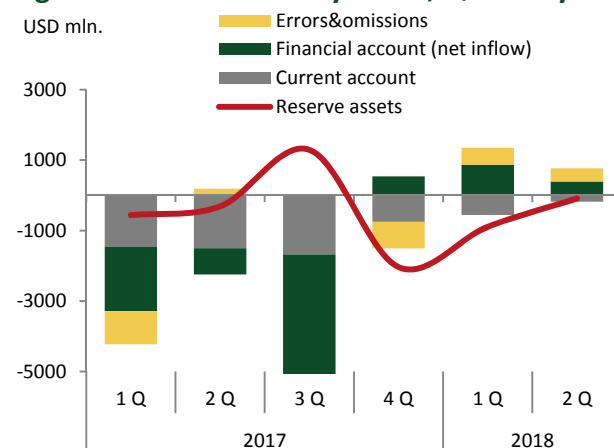
A rise in the imports of services was caused by the growing volumes of business services which are associated with the involvement of non-residents in implementation of large infrastructure projects in Kazakhstan (Figure 21).

As the exports of raw commodities were growing, returns earned by non-residents on foreign direct investments went up by 29.4%. A part of returns was used by non-residents to finance their Kazakhstani subsidiaries in the oil and gas sphere.

The financial account (excluding reserve assets) showed up a net capital outflow of USD 0.4 bln.

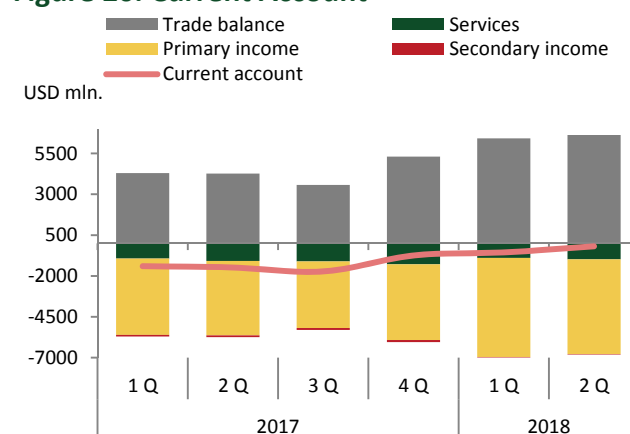
A net capital inflow on foreign direct

Figure 19. Balance of Payments, Quarterly



Source: NBRK

Figure 20. Current Account



Source: NBRK

Figure 21. Exports and Imports of Goods and Services



Source: NBRK

investments was offset by a net outflow on portfolio and other investments.

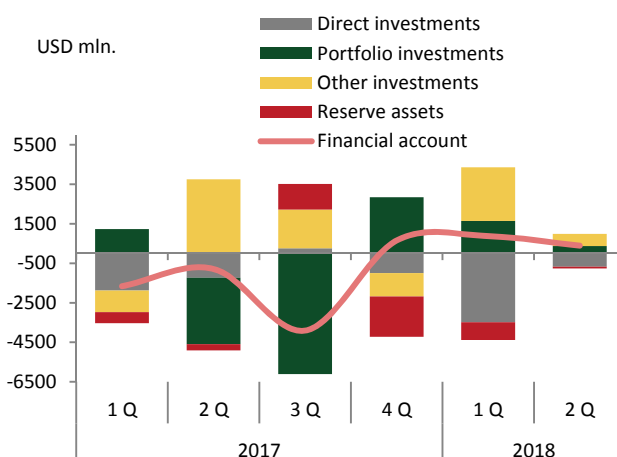
Foreign direct investments showed up a net inflow as a result of reinvestment of returns earned by non-residents from participation in Kazakhstani enterprises.

A surplus (a net outflow) on portfolio investments occurred as a result of a significant reduction in liabilities of residents within portfolio investments with a less significant decline in assets on such investments.

A surplus on other investments occurred as a result of the increase in receivables of non-bank organizations and in foreign cash in hand (Figure 22).

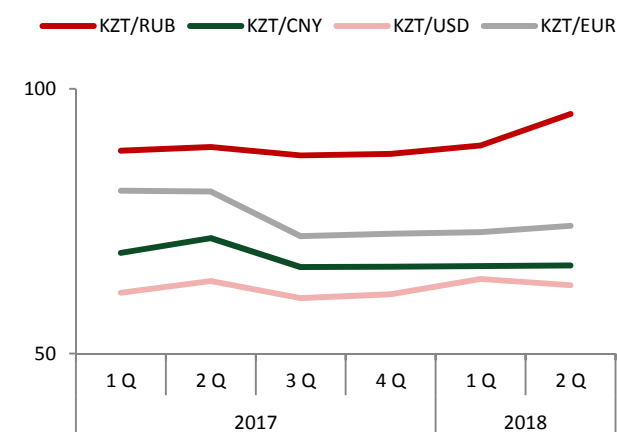
At the end of six months of 2018, the real effective exchange rate index of the tenge appreciated by 2.5% versus December 2017 and made up 79% of the benchmark competitiveness index of December 2013. Indices of bilateral real exchange rates of the tenge against currencies of countries – main trading partners were demonstrating a divergent trend. In June 2018 versus December 2017, the tenge appreciated in real terms against the ruble by 6.7% and against the Euro - by 1.9%. However, the tenge depreciated against the Yuan by 0.4%, and against the US Dollar - by 0.3% (Figure 23).

Figure 22. Financial Account



Source: NBRK

Figure 23. Real Effective Exchange Rate Index (December 2013 = 100%)



Source: NBRK

2. DOMESTIC ECONOMY

2.1 Monetary Policy and the Financial Sector Development

2.1.1 Money Market and the National Bank's Operations

A structural liquidity surplus was determining the situation in the money market. The National Bank conducted operations to withdraw excess liquidity with a view to hold in the inflation pressure. The bulk of excess liquidity was withdrawn via the short-term notes.

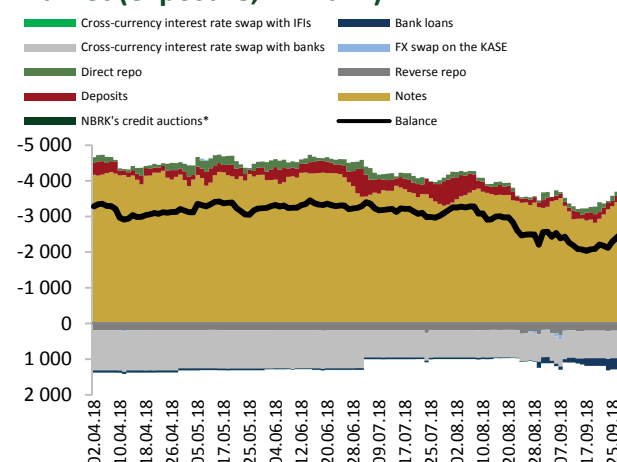
As external monetary conditions were tightening, non-residents exited the market of the National Bank's short-term notes (the share in the overall exposure on short-term notes reduced from 6.33% in June 2018 to 2.85% in September). As a result, in mid-September a negative balance on monetary policy operations dropped to its minimum since the beginning of 2018 (KZT 2 trln.).

With a view to improve transmission of money market rates, the National Bank took measures to approximate yields on short-term notes to the base rate level. In this context, the demand for short-term notes on the part of resident banks increased. As a consequence, a negative balance went up to KZT 2.6 trln. by the end of the quarter. Along with that, as part of a support to safeguard financial stability of the banking sector, loans to certain banks were provided during the quarter (Figure 24).

The base rate was remained at the existing level two times (July 9 and September 3) against the backdrop of a shift in the risk balance in the external sector as well as against a possible intensification of pro-inflationary pressure on the part of the domestic economy. Therefore, monetary conditions were retained at a neutral level. During the quarter, the TONIA rate was building up primarily closer to the lower boundary of the interest rate band (Figure 25). However, due to volatility of the exchange rate of the tenge and the season of tax payments, there were on-and-off upsurges of interest rates to the level of the base rate. At end-period, TONIA made up 8.31%.

In order to increase effectiveness of the implemented policy, since September 10, 2018 the official exchange rate of the tenge against the US Dollar has been set on the basis of an

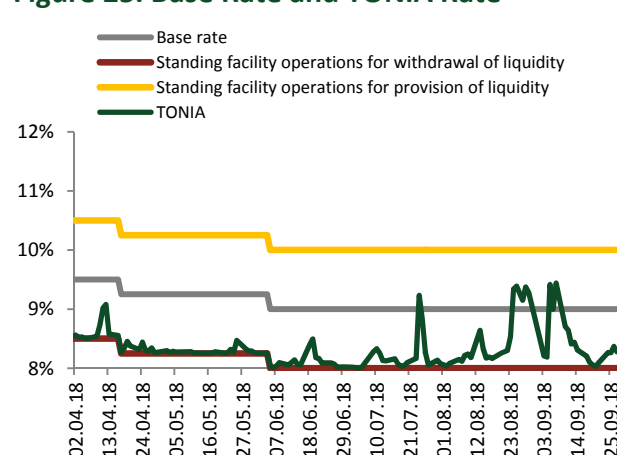
Figure 24. NBRK's Operations in the Domestic Market (exposure, KZT bln.)



* NBRK's securities buy/sell back auction

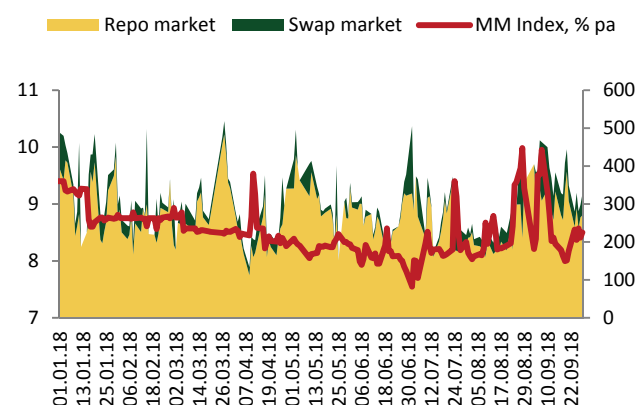
Source: NBRK

Figure 25. Base Rate and TONIA Rate



Source: NBRK, KASE

Figure 26. Changes in the MMI and the Volume of Transactions (KZT bln., right axis)



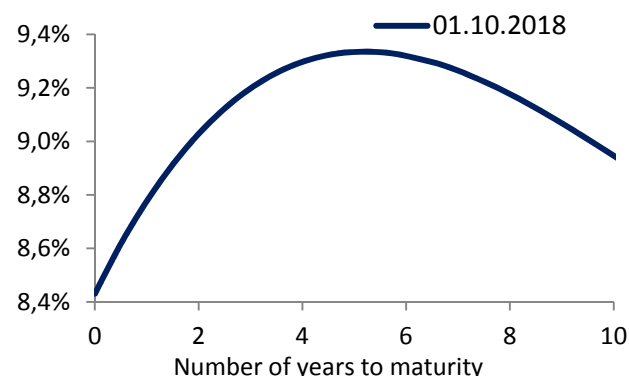
Source: KASE

average exchange rate on the stock exchange based on trading sessions with due dates of T+1; this approach helps to improve the short-term liquidity management and reduce volatility in the money market.

The Money Market Index was moving within 7.55-9.98%. At September 28, 2018 the index made up 8.50% (Figure 26).

A temporary “hump-backed” form of the yield curve was observed, which is an indication of a significant rise in the short-term yield (Figure 27). This situation occurred as a consequence of transactions that were conducted in September by non-residents when one-year notes with the yield above 10% were sold at a low price. Such effect is expected to last till the middle of the fourth quarter of this year.

Figure 27. Risk-Free Yield Curve in the Government Securities Market, %



Source: KASE

2.1.2 Foreign Exchange Market and the National Bank's Foreign Exchange Operations

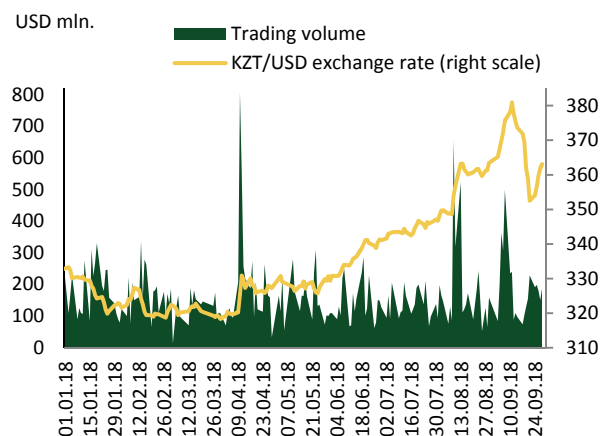
Volatility in the foreign exchange market resulted from a number of external factors.

The rise in oil price which in September 2018 reached its maximum since December 2014 appeared to be a favorable factor. Aggravation of trade conflicts, the US sanctions and protectionist policy had negatively affected the state of the foreign exchange market. These measures as well as the tightening of its monetary policy by the US Fed have driven the change in the direction of capital flows in favor of developed markets and depreciation of currencies in developing economies, including that of Kazakhstan. Depreciation of the Russian ruble amidst the news about stricter sanctions on the part of the USA appeared to be the most significant adverse external factor.

The tenge was fluctuating between KZT 341.62-380.93 against the US Dollar. At the quarter-end, the KZT/USD rate on the stock exchange depreciated to KZT 363.07 or by 6.4% (Figure 28).

In September, with a view to stabilize the foreign exchange market, the National Bank sold USD 520.6 mln. (interventions for the first time since October 2017). An overall volume of trades in the KZT/USD currency pair in the third quarter is comparable with figures for the previous quarter (the 0.9% increase from USD

Figure 28. Exchange Rate Behavior and the Trading Volume in the Foreign Exchange Market



Source: KASE

10.5 bln. to USD 10.6 bln.).

2.1.3 Deposit Market

At end-September 2018, the deposit volume amounted to KZT 17.6 trln., having decreased by 1.1% over the third quarter.

Deposits in the domestic currency went down by 6.6%, foreign currency deposits in the US Dollar equivalent declined by 0.7% (Figure 29).

As compared to prior quarters, foreign currency deposits slowed down their reduction, and, on the contrary, the growth in deposits in the domestic currency gave way to their decline. The drop in the tenge deposits was first of all driven by the exchange rate volatility. As a result, the overall level of deposit dollarization had been at its maximum since the beginning of the year, having reached 47.5% (in June – 44.5%).

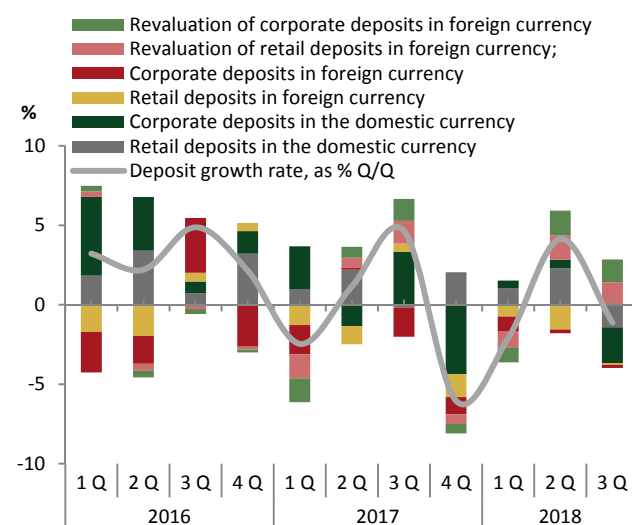
During the third quarter, the weighted average interest rate on deposits in the domestic currency has decreased by 0.3 pp from 7.4% in June to 7.1% in September 2018. The dynamics of the weighted average interest rate is fully determined by the rate on time deposits in the domestic currency which continued to gradually go down. In September, interest rates on corporate time deposits and retail time deposits made up 6.8% (in June 2018 – 7.1%) and 10.8% (11.2%), and in freely convertible currency – 1.2% (0.9%) and 1.7% (1.8%), respectively (Figure 30).

2.1.4 Credit Market

During the third quarter, the volume of bank credits decreased by 1.3% to KZT 12.7 trln., where the volume of credits in the tenge increased by 0.8%, and credits in foreign currency went down by 7.7% in the US Dollar equivalent. Excluding banks whose license was revoked or suspended as well as those that write off their assets as a result of the balance sheet cleanup, the loan portfolio growth in the reporting quarter is assessed to be 7% on a year-on-year basis.

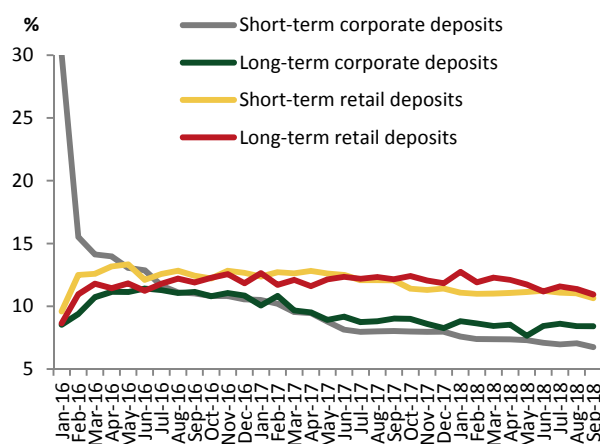
In the corporate segment, the loan portfolio demonstrated a quarterly reduction of 5.3% to KZT 7.6 trln. because of the license

Figure 29. Contribution of Components to the Growth in Deposit Volumes



Source: NBRK's calculations

Figure 30. Interest Rates on Time Deposits, by Currencies



Source: NBRK

revocation of “Qazaq Banki” JSC, “Bank of Astana” JSC, “EXIMBANK KAZAKHSTAN” JSC and the cleaning up of bank balance sheets (“Tsesnabank” JSC). The retail loan portfolio grew by 5.4% owing to loans in the tenge (Figure 31).

Over the quarter, the weighted average interest rate on loans in the domestic currency went down from 15.0% in June to 14.1% in September 2018 (Figure 32).

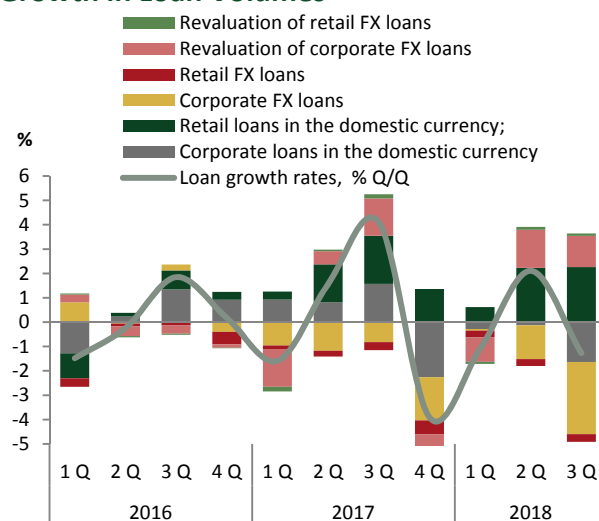
In the structure of interest rates on loans in the domestic currency provided to corporate entities the trend of a gradual reduction of long-term interest rates continued. Rates on such loans decreased from 13.2% to 12.6% while volumes of loans with maturities over 1 year increased by 37.5%.

In the third quarter, according to the poll conducted among banks, liquidity ratios were deteriorating and the cost and risks associated with debt funding were growing, including in the deposit market. Also, loan rates were going up as a result of the increased cost of funding because of enhanced volatility of the exchange rate of the tenge.

According to outcomes of the enterprise monitoring process, the percentage of enterprises which mentioned deterioration of price-related (interest rates on loans, amount of additional fees) and non-price-related (maximum amount and tenor of a loan, requirements to a borrower’s financial standing, requirements to collateral) terms and conditions of lending used to finance their working capital slightly increased. Nonetheless, the number of enterprises that applied for a loan increased, and the number of refusals decreased. Interest rate on retail loans in the tenge is gradually going down owing to the eased terms and conditions in respect of unsecured consumer loans. Interest rates on retail loans in the tenge decreased from 19.1% to 17.6%.

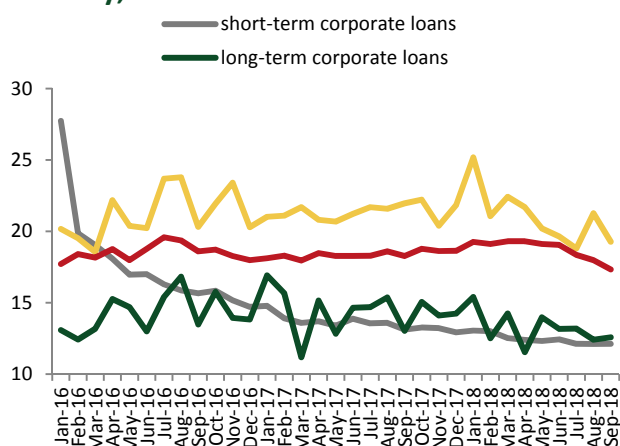
Terms and conditions of mortgage lending were eased primarily by banks participating in the 7-20-25 mortgage lending program. As a result, interest rates were declining, thus producing a positive effect on reduction of long-term interest rates on retail loans in the tenge.

Figure 31. Contribution of Components to the Growth in Loan Volumes



Source: NBRK

Figure 32. Rates on Loans in the Domestic Currency, %



Source: NBRK

2.1.5 Monetary Aggregates

The money supply had slightly decreased (by 1%) over the quarter (or by 3.6% over the year), whereas the reserve money expanded by 7.8% (expansion by 1.9%) (Figure 33).

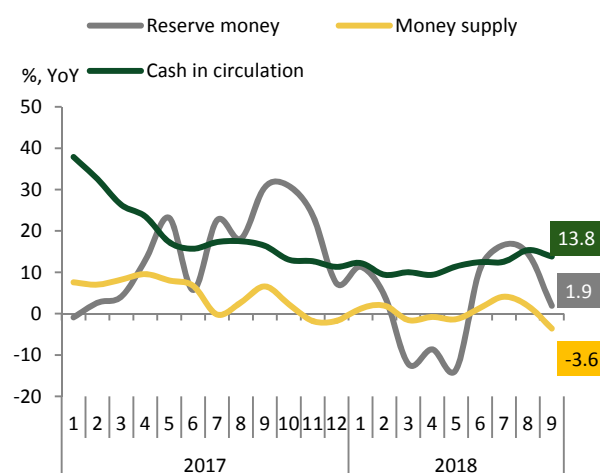
Capitalization of the KSF as part of the framework for rehabilitation of the agrarian sector and for increasing soundness of the financial sector as approved by the Government and the National Bank made the main contribution to expansion in the reserve money.

The KSF's resources were used to purchase bonds of the "Problem Loan Fund" JSC, so that the latter could buy out the portfolio of agricultural loans from "Tsesnabank" JSC.

However, this transaction had a neutral effect on the money supply since the loan write offs were offset by capitalization of the KSF on the banking system's balance sheet.

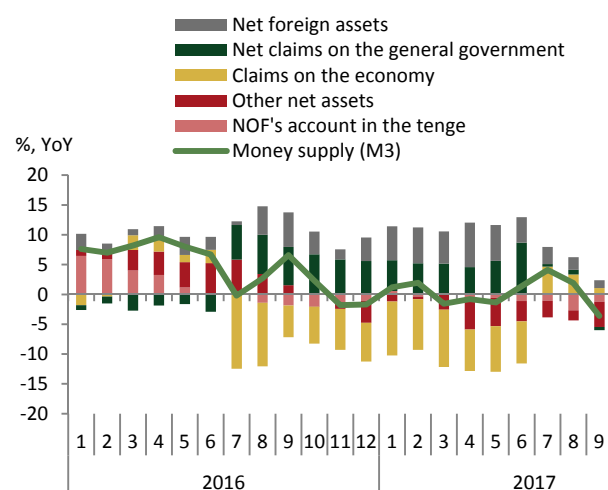
A positive contribution to the money supply was made by the increase in net foreign assets and by the growth in credits to households. The rise in other domestic assets was mainly conducive to reduction in the money supply (Figure 34).

Figure 33. Growth of Monetary Aggregates, YoY



Source: NBRK

Figure 34. Dynamics of Sources to the Formation of Money Supply, YoY



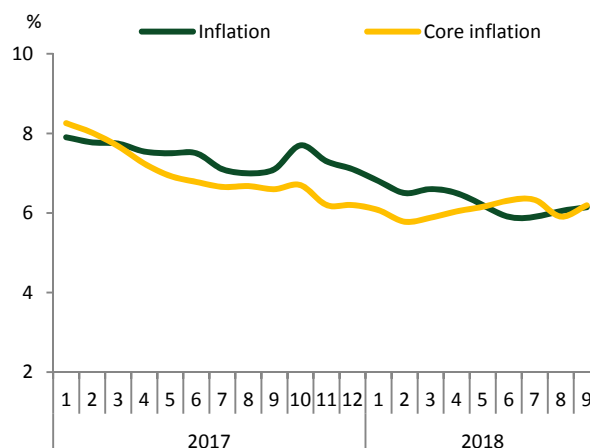
Source: NBRK

2.2 Prices and Inflationary Processes

2.2.1 Prices in the Consumer Sector

In the third quarter, the annual inflation was remaining closer to the middle of the target range of 5-7%. At the same time, it increased slightly from 5.9% in June to 6.1% in September 2018 (Figure 35). Such dynamics was determined by a short-term effect from the supply-side factors. A later harvest of agricultural products caused by unfavorable weather conditions contributed towards reduction in stocks and the growth in prices of cereals. As a result of exhaustion of the excess supply effect that was observed in the same quarter of the previous year, in August-

Figure 35. Annual and Core Inflation Dynamics, YoY



Source: CS MNE RK

September the food inflation accelerated to 5.7%. Such groups as breads and cereals, butter and fats, sugar, and eggs were demonstrating higher growth rates as compared to the third quarter of 2017.

At the same time, the increase in volumes of the domestic production of refinery products gradually leveled down the last year's shocks and was conducive to deceleration of non-food inflation to 7.7% (Figure 36). In addition, the growth rates in main commodity groups (clothes and footwear, household utensils) were slowing down. Prices of household goods, both durable and non-durable, demonstrated some upturn in cost amidst enhanced volatility and depreciation of the tenge.

In the sector of paid services, prices of regulated services slowed down their growth as a result of imposition of temporary compensatory tariffs.

2.2.2 Prices in the Real and External Sectors

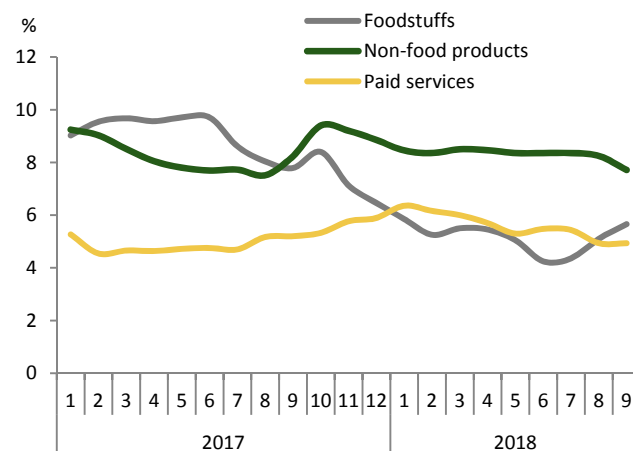
The annual price growth in the industry slightly increased from 22.2% in June to 23.9% in September 2018 (Figure 37). In the mining industry, oil exported to foreign markets appreciated in terms of price. In the domestic market, lower growth rates of prices of the product were observed. In the manufacturing industry, the growth rates of food prices continued to increase. The largest appreciation in terms of price was observed in the production of oils and fats, milling products, and sugar. Besides, prices of beverage producers also increased.

Intermediate products were demonstrating higher price growth rates versus the previous year; this translated into the rise in production costs.

The upturn in price growth rates in the domestic agricultural market occurred because of the rise in prices of plant production. So, prices of cereals have demonstrated growth in annual terms for the first time during the year. This was caused both by the shift in the harvesting season and by the 13% reduction in stocks as compared to the previous year at end of the quarter. However, price growth rates of fresh vegetables continued to slow down.

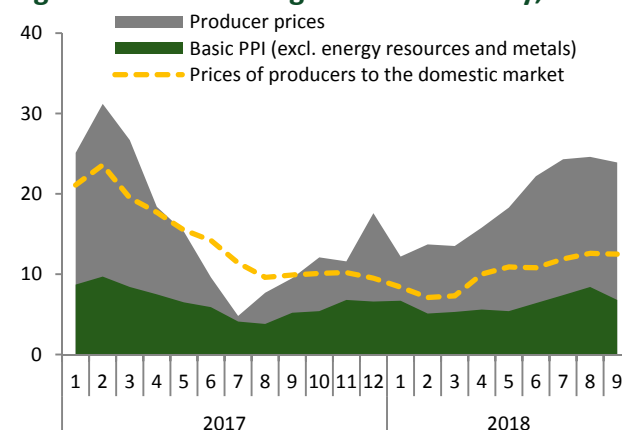
* excluding prices of fruits and vegetables, utilities, railway transport, communication, gasoline, diesel fuel and coal

Figure 36. Dynamics of Inflation Components, YoY



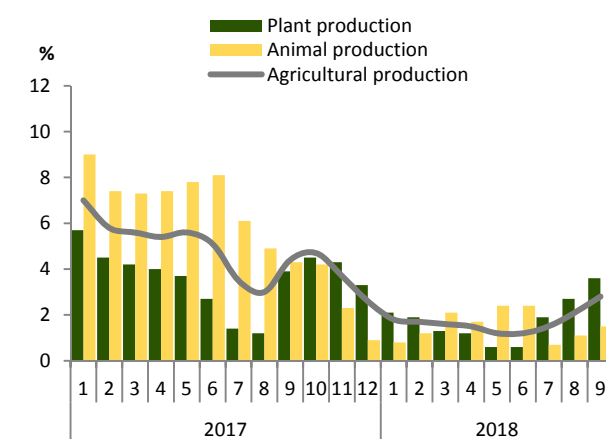
Source: CS MNE RK

Figure 37. Price Changes in the Industry, YoY



Source: CS MNE RK

Figure 38. Price Changes in Agriculture, YoY



Source: CS MNE RK

2.2.3 Inflation Expectations

Inflation expectations of households regarding the prospects of growth in prices of foodstuffs, non-food products and paid services are still sensitive to shocks in the near term.

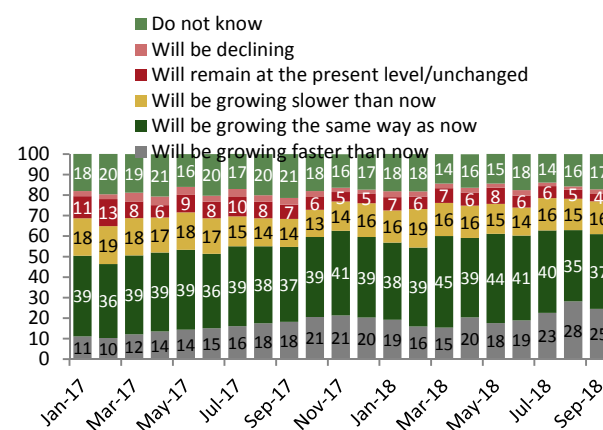
The households' poll outcomes show that in the third quarter inflation expectations were rising in the environment of volatile exchange rate of the tenge. Perceived inflation also slightly increased as compared to the previous quarter.

The percentage of respondents who anticipate that inflation rates will remain unchanged within the next 12 months, decreased accounting for 37% of the total number of respondents at the end of the quarter (Figure 39). Alongside with that, the percentage of respondents who anticipate a more rapid price growth (25% at the end of the quarter) increased. A quantitative assessment of expected inflation¹ for the coming year at the end of the quarter accounted for 6.4% (Figure 40), being above the level of the actual annual inflation.

Perceived inflation², which is generated based on the subjective basket of goods of an individual increased to 16.5%. Nonetheless, perceived inflation is still following its long-term downward trend (Figure 40).

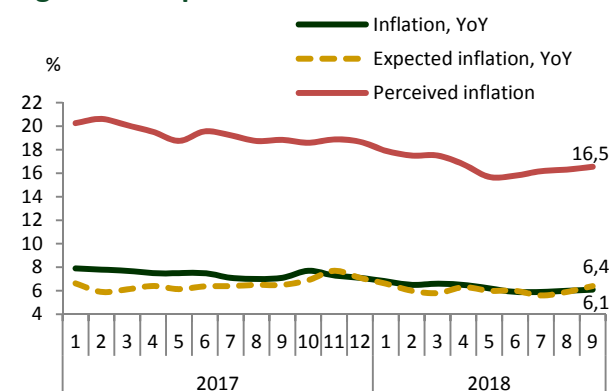
Figure 39. Assessment of the Price Growth in a Year

In your opinion, how much generally will prices of foodstuffs, non-food products and services change in the next 12 months?



Source: GfK Kazakhstan

Figure 40. Expected Inflation



Source: Committee on Statistics of MNE RK, GfK Kazakhstan

¹ The Methodology for calculating the quantification of inflation expectations is posted on the official Internet resource of the National Bank in the "Monetary Policy"- "Inflation and Inflation Expectations" Section

² The median of the results of answers to the question "In your opinion, how much have prices of foodstuffs, non-food products and services grown over the past 12 months?" is used as perceived inflation

2.3 Real Sector Development

2.3.1 Domestic Demand

In the first half of 2018, a positive trend in the economic activity persisted amidst a favorable external pricing environment in the global energy markets. The GDP growth was accompanied by a positive contribution of all key components: net exports, consumer demand and investment demand.

At the end of the first half of the year, GDP by the final use method grew by 4.2% given a significant positive contribution of net exports and consumer demand (Figure 41). Investment demand also demonstrated positive dynamics.

The increase in net exports was accompanied by a significant growth in exports of goods and services (by 8.9%). The overall export volumes were growing against the expansion in exports of crude oil and gas condensate as well as amidst the rising world oil prices. In the first half of 2018, the upturn of average oil prices accounted for 36.7% versus the same period of the last year.

Imports continued to demonstrate a positive trend. The growth in real volumes of imports was observed against the expansion of consumer demand and investment demand.

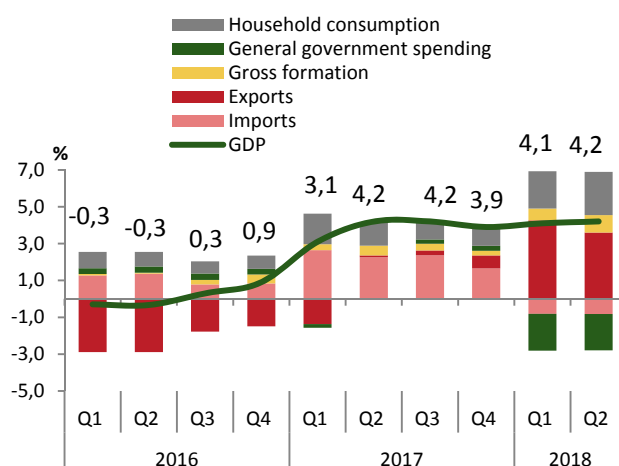
At the end of the first half of the year, the growth rates of consumer demand accounted for 4.5% (Figure 42). Such acceleration in consumer demand was observed as a result of the increasing real cash income of the population, positive dynamics in consumer lending amidst the decelerating inflationary processes.

The 4% increase of gross formation was accompanied by a significant acceleration in the growth rates of fixed capital investments.

In the first half of 2018, the general government spending decreased by 15% due to the Government's plans to cut the state budget deficit.

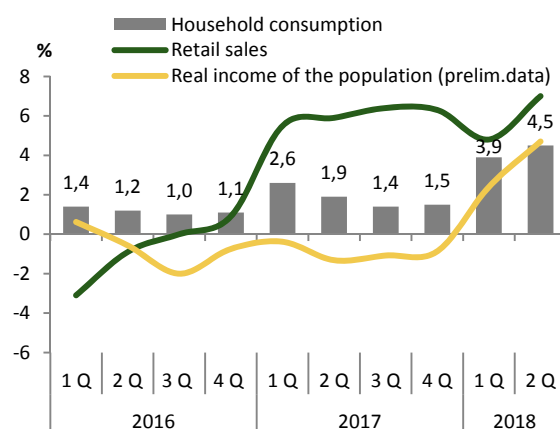
In the second quarter of 2018, nominal consumer household spending grew by 9.3%. Such growth was promoted by the increased positive contribution of foodstuffs and paid services. Meantime, the contribution of non-food products continued to gradually decrease (Figure 43).

Figure 41. Decomposition of the GDP Components by the Final Consumption Method, YoY, year-to-date total



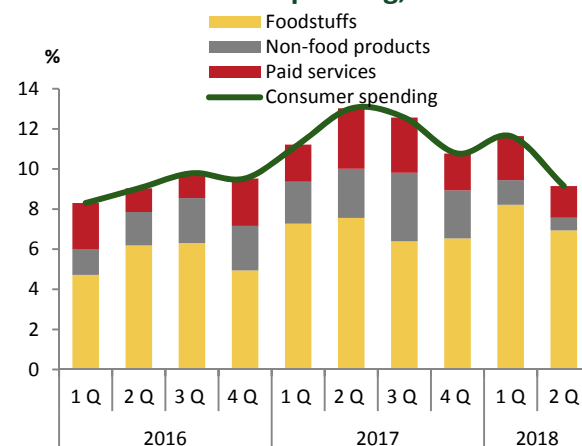
Source: CS MNE RK, NBRK's calculations

Figure 42. Dynamics of Household Consumption, Household Real Income and Retail Sales, YoY, year-to-date total



Source: CS MNE RK

Figure 43. Structure of Growth in Household Nominal Consumer Spending, YoY



Source: CS MNE RK, NBRK's calculations

Income of the Population

In the third quarter of 2018, real income of the population continued to grow, but at a slower pace as compared to the last quarter. It should be noted that a high growth in real income in the second quarter of 2018 is explained by a lower base in the corresponding quarter of 2017 as well as by the increased retirement benefit payments in connection with the change in the methodology of calculation of the base retirement benefit from June 1, 2018.

After the exhaustion of this effect, in the third quarter of 2018 the dynamics of real income came back to its prior path. So, in September 2018 real cash income increased by 2.4% (Figure 44) as compared to the corresponding period of 2017. The structure of nominal income of the population demonstrated growth on all components: income from hired labor – by 4.2%, retirement benefits – by 3.9%, income from self-employment – by 1.3% and other income – by 0.5%. The main reason for a positive rise in real income of the population was the increase in their nominal values. In turn, the increase in nominal income was occurring as a result of higher growth rates of nominal wages which accelerated to 9.3% in the third quarter. Apart from those, deceleration of inflationary processes in the third quarter was also conducive to the increase of income in real terms.

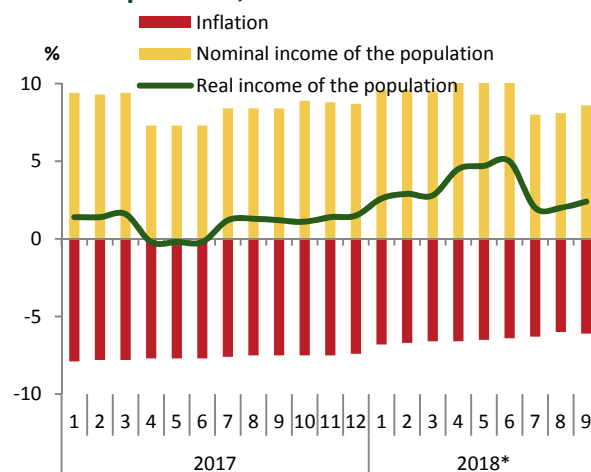
Investments

In the third quarter, the real sector continued to demonstrate a high investment activity. As a whole, during 9 months of 2018 the growth in fixed capital investments accounted for 21.6% in annual terms (Figure 45).

Within the overall structure of investments, their largest portion is directed to the development of the oil and gas sector (42.3%), as well as to real estate operations (13.3%) and transport and warehousing (13.0%).

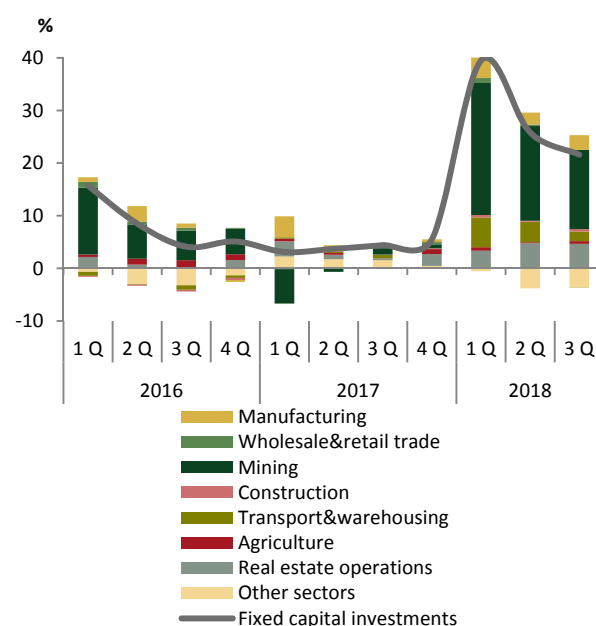
In the industry-based breakdown, a positive contribution to the dynamics of investments was made by the mining industry (the annual growth of 41.4%) as a result of expanded oil

Figure 44. Structure of Growth in Real Income of the Population, YoY



* - preliminary data
Source: CS MNE RK

Figure 45. Fixed Capital Investments, by Types of Economic Activity, Contribution, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

production capacities in major oil fields of the country.

The growth of investments into transport and warehousing accounted for 12.4%.

In the manufacturing industry the 26.4% growth was determined by completion of modernization and reconstruction of Shymkent Oil Refinery.

A positive trend of growth in investments into real estate operations is keeping up (the growth of 38.7%). The growth is associated with implementation of infrastructure and housing projects within the framework of “Nurly Zher” and “7-20-25” government programs.

Other sectors made a moderate contribution to the upturn of investments.

As before, own funds of enterprises still represent the main source of investment financing (73.1%). In the second quarter of 2018, the share of domestic investments in the overall investment volume accounted for 70.6%, and foreign investments – for 29.4%. During the second quarter of 2018, a gross inflow of foreign direct investments amounted to USD 5.6 bln. and grew by 7.7% as compared to the corresponding period of the previous year. The mining and manufacturing industries as well as wholesale and retail trade are still the most attractive for foreign investors.

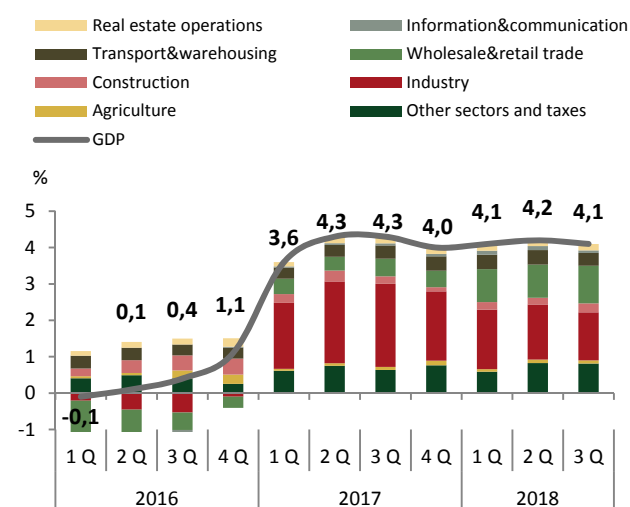
2.3.2 Domestic Production

At the end of nine months of 2018, the real GDP growth by the production method accounted for 4.1% in annual terms (Figure 46).

The main driver for upturn of the economy was the 4.4% increase in volumes of goods production owing to extraction of mineral resources and production of industrial output. A positive contribution was also made by the growth in the service production (by 3.9%) secured by sectors of wholesale and retail trade, transport and real estate operations.

Performance of key economic sectors demonstrates the on-going positive development trends which are driven by the improved external economic environment and by expansion of the domestic demand. During 9 months of 2018, the short-term economic indicator increased by 4.8% as compared to the

Figure 46. GDP Decomposition. Contribution by Economic Sectors to the GDP Growth, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

same period of the previous year (Figure 47).

Sizable extension of crude oil extraction in the country's large oil fields (Tengiz and Kashagan) as well as steady growth rates in the extraction volumes of natural gas, coal and lignite, iron ore and ores of non-ferrous metals triggered a growth of the mining industry by 4.9% at the end of 9 months of 2018 (Figure 48). Meantime, in the third quarter of 2018 some slowdown in the growth rates of the mining industry was observed that was caused by the reduced volumes of oil extraction in August, in the first instance as a result of scheduled maintenance works in the Tengiz oil field.

Retention of production activity in the manufacturing industry was secured both by the increased production of interim products (the metallurgical industry and crude oil refining) and consumer goods.

The growth in the manufacturing industry accounted for 5.1% as compared to the corresponding period of the previous year (Figure 49). The metallurgical industry served as the main growth driver (the expansion of 4.2%). So, the production growth rates in the non-ferrous and ferrous metallurgy accounted for 3.7% and 4.5%, respectively.

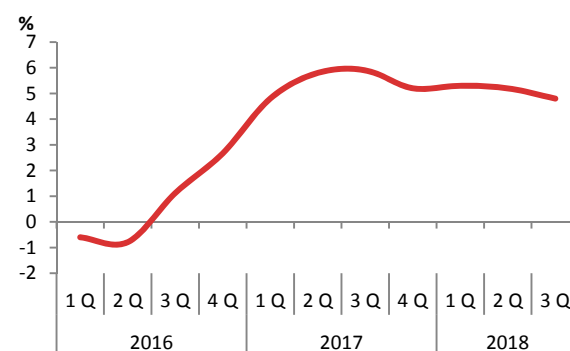
The 7.5% increase in production of petroleum products was furthered by expansion in extraction of feedstock and completion of modernization and reconstruction of Shymkent oil refinery.

The business activity in non-primary sectors of the economy is keeping up its recovery. Production volumes in the light industry increased by 3.4%, food production – by 3.3% and production of tobacco products – by 4.9%.

The engineering industry continues to demonstrate high growth rates which accounted for 14.5% during 9 months of 2018. Such height was secured by the increase in production of motor vehicles (by 50.7%), electric equipment (by 41.7%), and machinery and equipment not included into other categories (by 12.9%).

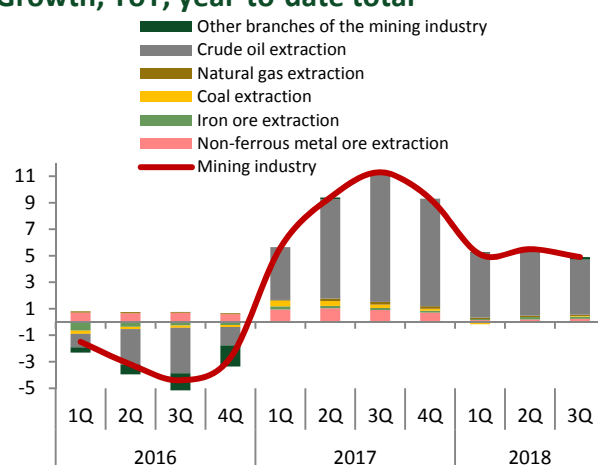
Production of gross agricultural output continues to gradually go down. So, at the end of 9 months of 2018 the growth accounted for 2.0%. Deceleration in the sector is explained by

Figure 47. Short-Term Economic Indicator, YoY



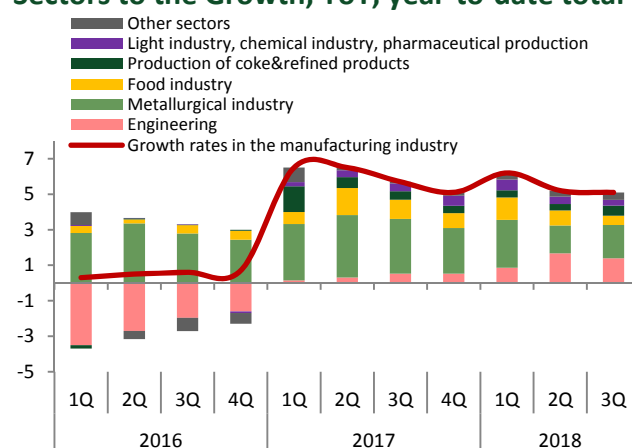
Source: CS MNE RK, NBRK's calculations

Figure 48. Decomposition of the Mining Industry. Contribution by Sectors to the Growth, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

Figure 49. Decomposition of the Manufacturing Industry. Contribution by Sectors to the Growth, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

the decreasing growth rates of plant production (by 0.5%) given the reduced yield of cereals. A positive contribution to the upturn of the sector was made by the animal production (by 4.0%), which increased owing to the growing volumes of cattle and poultry slaughtering on a live weight basis, yield of raw cow milk and in the quantity of delivered chicken eggs.

During 9 months of 2018, production growth rates in the construction sector went up to 4.4%; this is explained by the completion of modernization and reconstruction of Shymkent oil refinery (Figure 50). So, the volume of construction and assembly works increased by 3.2%, the growth in major overhaul and regular maintenance works accounted for 13% and 19.5%, respectively.

The increase in maintenance works is driven by reconstruction of industrial facilities, engineering lines and works related to modernization of oil refineries. In the structure of facilities under construction, the largest shares are taken by transport and warehousing facilities, industrial facilities and real estate; this is aided by implementation of government housing programs and infrastructure projects.

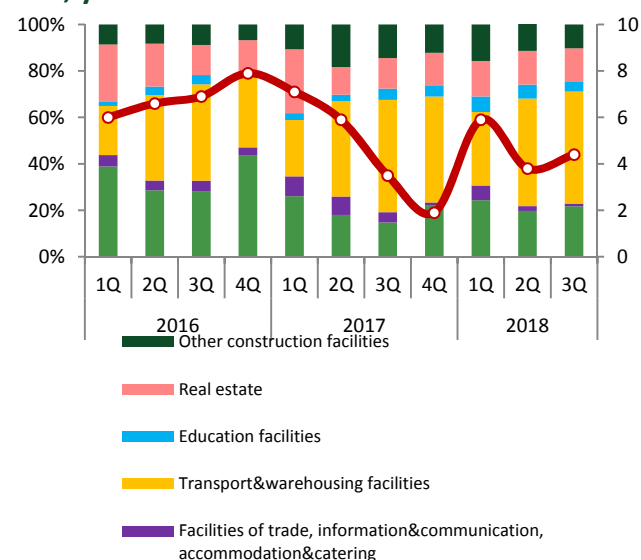
The growth in real cash income of the population was supporting the 7.0% increase in the volumes of retail sales (Figure 51). A positive contribution to the growth in retail sales was made by a significant ramp-up in the sales of non-food products, which indicates the growing consumer demand and employment. However, the sales of foodstuffs decreased by 6.0%.

The 6.4% growth in wholesale turnover stemmed from the increase wholesale trading of foodstuffs.

Owing to positive dynamics in trade and a stable external demand, the volume of transport and warehousing services is growing. So, at the end of 9 months of 2018 the upturn in the sector accounted for 4.6%, with a significant contribution being made by cargo transportations by railways (10.2%), by pipeline transport (8.3%) and motor transport (7.1%).

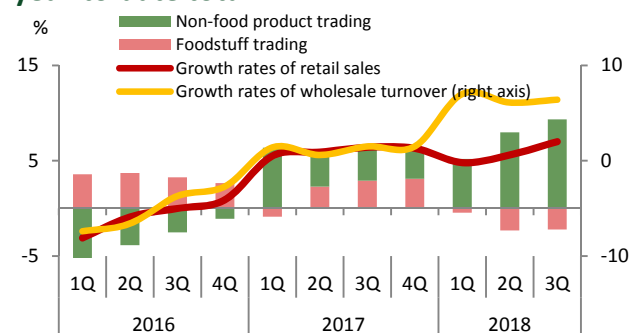
In the reviewed period, the growth in the information and communication sector accounted for 3.9% mainly due to the increased

Figure 50. Growth Rates of Construction and a Relative Share of Facilities under Construction, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

Figure 51. Growth Structure of Retail Sales and Growth Rates of Wholesale Turnover, YoY year-to-date total

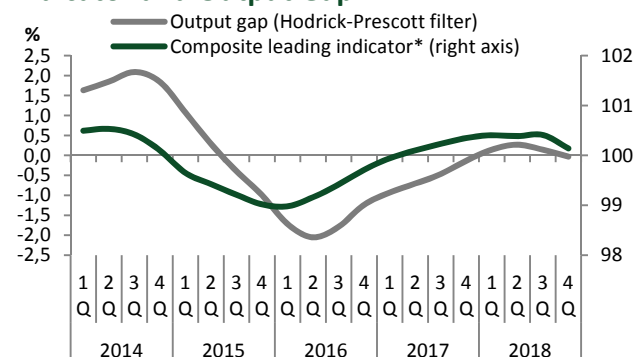


Source: CS MNE RK, NBRK's calculations

volume of telecommunication services (8.7%) and the Internet services (7.0%). Besides, postal and express mail services also increased (3.7%).

The composite leading indicator, which summarizes the assessment of the existing situation as well as expectations of CEOs of companies in the real sector of the economy, in the third quarter of 2018 keeps staying in the positive zone, which indicates that the business activity in the real sector continues to recover. A favorable environment in the global oil market as well as the recovering domestic consumption amidst the growing real cash income generally had a positive effect on the demand for final products. So, the interviewed enterprises (industry, agriculture, transport, trade, and construction) record the increase in the use of production capacities, an improving situation with the investment activity of enterprises, and a slowdown in the price growth for final products as well as for raw materials and supplies. The output gap, for the first time since 2014, has turned positive indicating the existence of a feeble pro-inflationary pressure in the economy (Figure 52).

Figure 52. Behavior of the Composite Leading Indicator and Output Gap



Source: NBRK

* the calculation of a composite leading indicator was revised based on the OECD methodology

2.3.3 Labor Market and Unemployment

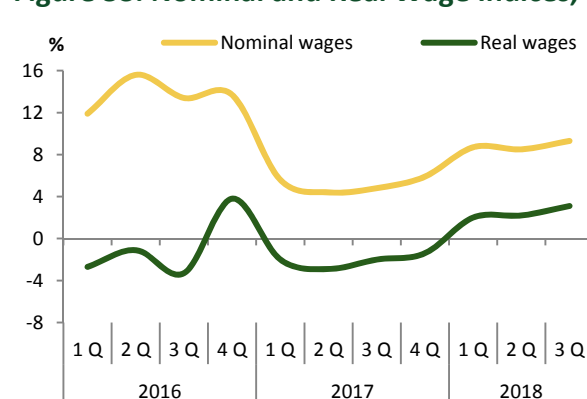
In the third quarter, real wages continued their growth which accounted for 3.1%. The rise in real wages was promoted both by the retention of growth rates of their nominal values (9.3%) and by deceleration of inflation (Figure 53).

In the industry-based breakdown, the growth in real wages was observed in activities in the area of administrative and ancillary service (by 16.2%), financial and insurance activities (by 9.8%), trade (by 5.6%), in the construction sector (by 5%), in the mining and manufacturing industries (by 5.1% and 6.3%, respectively) and in public administration and defense (by 4%).

At the same time, the decline is observed in the healthcare sector (by 4.5%) and in real estate operations (by 10.8%).

At the end of the first half of 2018, the growth in the labor productivity slowed down and made up 3.6%. Such deceleration occurred after a steady acceleration in the labor

Figure 53. Nominal and Real Wage Indices, YoY



Source: CS MNE RK

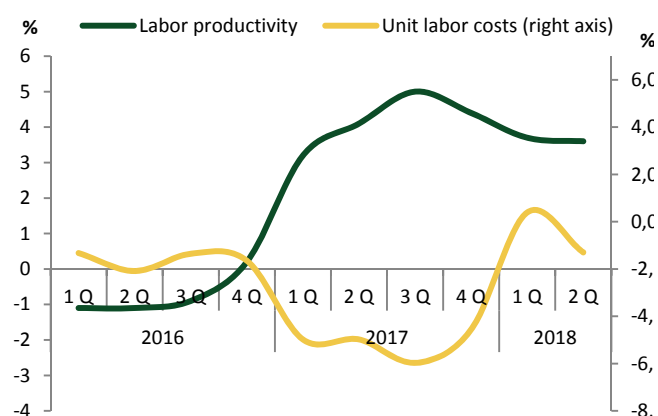
productivity beginning from the third quarter of 2016. Positive dynamics of labor productivity in the economy as a whole were accompanied by retention of significant growth of productivity in the sectors engaged in the production of goods (by 7.9%). In the industry, the labor productivity increased by 5.4% mainly due to the increased productivity in the mining industry (by 9.1%), and the labor productivity in the manufacturing industry decreased by 1.8%. In agriculture and in the construction sector, the labor productivity increased by 4.3% and 9.3%, respectively.

The labor productivity in the service sector in the first quarter of 2018 shifted to a positive zone, after a significant downturn which had lasted since the end of 2014. In the first half of the year, this positive trend persisted and the growth accounted for 1.2%. The growth of labor productivity in the service sector was observed against its increase in the financial and insurance activities (by 10.6%), in the transport sector (by 3.1%), professional, scientific and technical activities (by 3.9%), in the communication sector (by 2.6%), and trade (by 0.7%). At the same time, the productivity decreased in real estate operations (by 27.9%), and activities in the area of administrative and ancillary service (by 8.4%).

The dynamics of unit labor costs, after the shift to a positive zone in the first quarter of 2018, at the end of the first half of the year showed a negative value again. Reduction in unit labor costs accounted for 1.3%. Such decline was observed against the outstripping rates of GDP growth as compared to nominal wages (Figure 54).

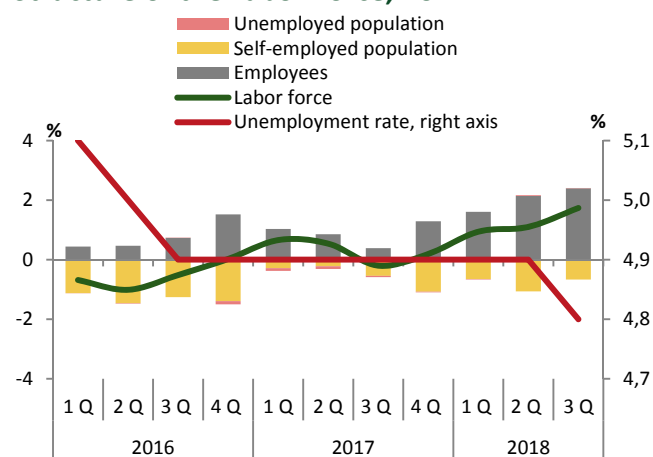
In the third quarter, the labor force grew by 1.7% given the 1.8% increase in the employed population. The growth in the employed population is caused by the increase in the numbers of employees. However, the self-employed population has been decreasing for four years in a row (the decline of 2.8% as compared to the third quarter of 2017), first of all, because of the unproductively employed people. The number of the unemployed population slightly increased, along with that the growth rates of the employed population

Figure 54. Labor Productivity and Unit Labor Costs, YoY, year-to-date total



Source: CS MNE RK, NBRK's calculations

Figure 55. Unemployment Rate, Growth Structure of the Labor Force, YoY



Source: CS MNE RK, NBRK's calculations

are exceeding the growth rates of the unemployed population (Figure 55). In such circumstances, the unemployment rate reduced to 4.8% for the first time since the third quarter of 2016.

The number of employees increased by 1.2% (Figure 56). The growth was observed in the following sectors: accommodation and catering services (by 10.3%), trade (by 3.9%), transport (by 3.3%), education (by 2.3%), communication (by 1.6%), in the manufacturing industry (by 1%), in the healthcare sector (by 0.7%), professional, scientific and technical activities (by 0.2%). At the same time, reduction was observed in such sectors as real estate operations (by 20.4%), financial and insurance activities (by 7.2%) and electricity supply (by 0.5%). The trend of reduction in the number of employees in agriculture (by 0.2%) and in the construction sector (by 3%) has been persisting against the growth in labor productivity in these sectors.

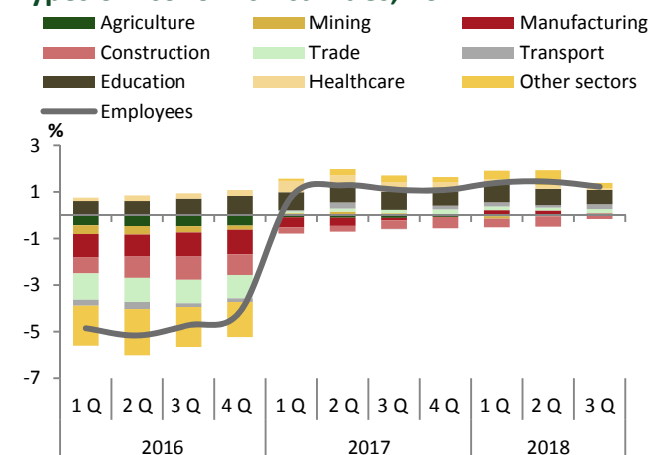
2.4 Fiscal Policy

Given the scheduled reduction of the volume of guaranteed transfer from the National Fund, in the third quarter budget revenues decreased by 19.3% as compared to the same period of the last year and amounted to KZT 3 trln. or 20.3% of GDP (Figure 57).

The growing production of goods and services in key sectors of the economy and the rise in prices of major export items as well as improvements in the tax and customs administration led to the 26.1% increase in tax revenues. Besides, a substantial contribution to the growth in tax revenues was made by the imposition of a higher rate of export customs duty on crude oil exports as a result of a higher oil price.

The state budget spending went down by 35.8% and amounted to KZT 3 trln. (20.1% of GDP). However, excluding a lump-sum amount allocated in the third quarter of 2017 (KZT 2.1 trln.) to support the banking sector, budget expenditures increased by 16%. The main contribution to the growth in expenditures was made by such items as social aid and social security, healthcare and education. Such growth

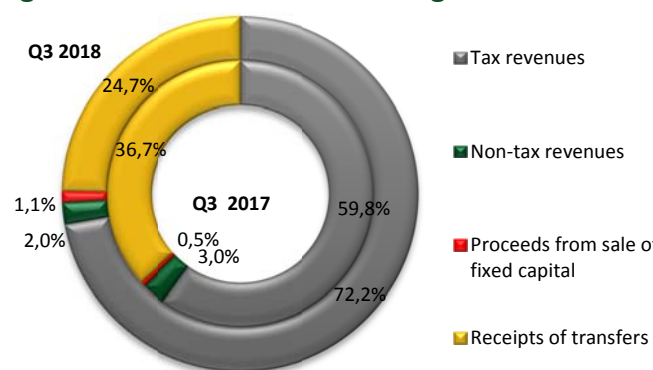
Figure 56. Employee Growth Structure*, by Types of Economic Activities, YoY



Source: CS MNE RK, NBRK's calculations

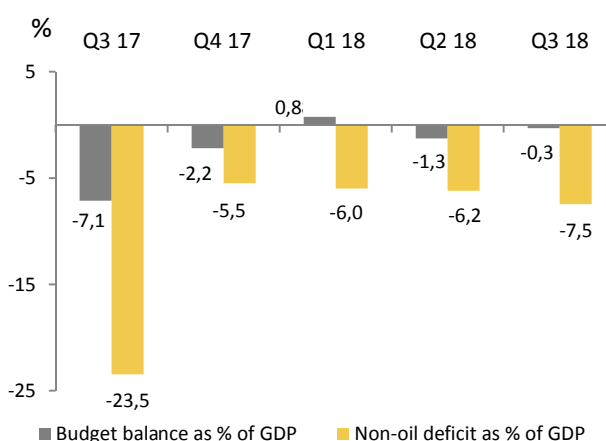
*- excl. small businesses engaged in entrepreneurship

Figure 57. Structure of State Budget Revenues



Source: Kazakhstan's Ministry of Finance

Figure 58. Change in the Overall and Non-Oil Balance of the State Budget



Source: Kazakhstan's Ministry of Finance

was associated with fulfillment of government social obligations and development of the social infrastructure.

As a result, the state budget showed up a deficit of KZT 45.7 bln. or 0.3% of GDP (Figure 58). The main portion of the budget deficit was financed through the issue of long-term government securities.

II. FORECAST OF KEY MACROECONOMIC INDICATORS AND FURTHER MONETARY POLICY GUIDELINES

The forecast of macroeconomic indicators was prepared on the basis of statistical information as at November 15, 2018

In designing forecasts of macroeconomic indicators for the period from the fourth quarter of 2018 through the second quarter of 2020, the National Bank considers three scenarios of the economy's development which differ from each other by the paths of oil prices over the forecast horizon. The baseline scenario assumes the price of oil (Brent) to be at USD 60 per barrel till the end of the forecast period; under the optimistic scenario the price of oil will be at USD 70 and under the pessimistic scenario it will fall to USD 40. The forecast scenarios are designed to include not only external but also internal assumptions. Over the forecast horizon, such factors will be having a significant impact on the dynamics of economic activity and inflationary processes while determining the monetary policy stance.

Internal Forecast Assumptions

Structural factors determine the internal conditions for implementation of the monetary policy in a considerable way. These, first of all, include low diversification of the economy, low competition in some markets of goods and services, prevalence of imports in the markets of non-food products as well as the adaptivity and strong sensitivity of inflation expectations to certain developments in the foreign exchange market and to the supply-side shocks. In addition, the absence of good quality borrowers in the banking sector, subsidization of interest rates for the borrowers by the government weakens the influence of short-term rates on their medium-term values. The overcoming of such structural limitations is a long-term process; this, accordingly, does not enable to factor it into the medium-term forecast. In turn, the monetary policy is focused on smoothing cyclical fluctuations and has quite a limited nature of effect on the above mentioned factors.

Fiscal policy measures play an important role in the monetary policy implementation. The adjustment of fiscal policy parameters, including the amount of resources transferred from the National Fund, and subsequent changing of the expenditure side of the budget may have impact on actual and potential GDP growth rates while determining the nature of impact on prices on the part of demand (pro-inflation/disinflation pressure). To this end, coordination of monetary policy measures and fiscal policy measures is one of the key factors in ensuring long-term price stability.

The change in budget parameters for 2019-2021 which assumes attaining 1.0% of the national budget deficit no sooner than in 2021 as well as the increase in transfers from the National Fund by KZT 150 bln. in 2019 and by KZT 300 bln. in 2020 as compared to the figures which were planned earlier may limit the deceleration pace of inflation over the forecast horizon. The above mentioned revision of transfers along with the increase in salaries and wages in the economy will be putting a pro-inflation pressure on price levels without the respective growth in the labor productivity.

A continued effort of the Government to limit the growth in prices and tariffs for regulated services **is paramount for anchoring the inflation at the targeted levels.** In case if measures to limit the tariffs (or reduce them) for services provided by natural monopolists that are scheduled for 2019 are of a one-time nature, then a corresponding reduction in profitability may be compensated by the growth in tariffs in the years to follow. On the medium-term horizon, a risk of

acceleration in inflationary processes arises; it will be having negative influence on achieving the inflation target level.

A sufficient supply of energy resources in the domestic market in 2019-2020 in order to prevent a significant growth in prices of gasoline and diesel fuel will help to decelerate inflationary processes further. Gasoline and diesel fuel are among the largest components of the consumer basket and represent a considerable cost item of many enterprises and households. If prices of energy resources rise on the forecast horizon, inflation could be accelerating, both directly and also because of the pass-through effect onto prices of other goods and services.

The National Bank believes that an adaptive nature of inflation expectations and their sensitivity to one-time events will be prevailing on the medium-term horizon. The nature of inflation expectations is to a large extent exposed to the effect of volatility in the foreign exchange market, of supply shocks in certain commodity markets as well as of inflation surge in general. When the price growth rates are accelerating, households' inflation expectations may react quite strongly whereas deceleration of inflationary processes may be mild in terms of perception of the price dynamics by the population.

External Forecast Assumptions

There is still a high degree of uncertainty not only in relation to a further development of the global economy as a whole and economies of main Kazakhstan's main trading partners in particular but also on the part of the monetary policy implementation by key economies. These factors will be determining the dynamics of capital flows, exchange rate dynamics in developing countries as well as the pricing in the global commodity market and financial market. Sensitivity of the market participants to the speed at which the US monetary policy is evening out and volatility upsurges in the commodity markets may lead to turbulence in the financial market on the forecast horizon.

The National Bank assumes some deterioration in external forecast conditions over the forecast horizon. Deterioration of external forecast assumptions first of all is associated with the situation in Russia. A possible tightening of sanctions against Russia on the forecast horizon is taken into account; this will have a negative effect both on the exchange rate of the Russian ruble and the economic growth and on inflationary processes in Russia. Russian prices will be translated onto the domestic prices in Kazakhstan via the cost of imported goods.

The external monetary environment will be shaping under the influence produced by the evening out of the US Fed's monetary policy. The increase of interest rates in the USA and a further deterioration of the sanctions regime will promote a revision of risk appetite of the market participants and also a rise in the premium on risky assets and depreciation of currencies in the developing markets, including those of Russia and Kazakhstan. At the same time, it is expected that a potential deterioration in external environment will be more moderate in respect of the exchange rate movements of the tenge as compared to the path of the Russian ruble.

The situation in the global energy markets keeps projecting a significant influence on the Kazakh economy. With due regard of a high share of oil in Kazakhstan's exports as well as the dominant position of the oil industry in the overall volume of fixed capital investments, oil quotations will be having considerable impact on the Kazakh economy not only directly via exports and the industry but also indirectly through assessments by investors of development prospects of the economic growth in Kazakhstan and the risk premium.

1. KEY ASSUMPTIONS FOR EXTERNAL FORECAST PARAMETERS

Expectations of information agencies, international financial institutions and private companies in the market regarding the oil price assume that oil quotations will be somewhere between USD 70 to USD 76 per barrel in 2019 (Table 1). Positive forecasts of the market participants regarding the oil price are associated with reduction of production in Venezuela against the backdrop of the political crisis as well as the US sanctions against Iran. Contingent factors which have an upward effect on forecasts of oil quotations include unfavorable weather conditions as well as the launch of new oil refineries in the USA that serve as an additional source of demand for petroleum products.

However, by mid-November 2018 a significant drop in oil quotations to the levels below USD 70 per barrel was observed (in October 2018 the average oil price was USD 80.5 per barrel). A sizable fall in oil prices occurred against expectations regarding reduction in the global demand in the environment of deceleration in the global economy as well as the buildup of excessive world reserves as a result of a high level of supply. Despite more optimistic forecasts of the market participants, the risk that oil quotations in the medium-term may be at the levels close to USD 60 per barrel while reflecting the balance of demand and supply in the energy market, increased.

Taking into account volatility and high degree of uncertainty about a further path of oil prices, the National Bank also considers other scenarios which assume both the decline and the growth in prices of energy resources in the medium-term.

Assumptions regarding the growth prospects in countries-Kazakhstan's main trading partners that reflect the potential of Kazakhstani exports were adjusted towards slight deterioration. External demand while staying in the positive zone during 2019 will be slowing down by the end of the medium-term

Table 1
Forecasts of Oil Price (Brent) in USD per Barrel

Source:	2018	2019	Date of the Forecast Release
International Monetary Fund	71.6	70.9	October 2018
WorldBank	74.2	76.2	October 2018
ThomsonReuters	74.3	76.0	October 2018
Consensus Economics	73.8	77.6	October 2018
Bloomberg	72.5	62.6	October 2018
Average	73.3	72.7	-

Source: prepared by the NBRK

horizon. External demand will be decelerating, first of all, amidst expectations regarding lower GDP growth rates in the EU as a result of a slowdown in the global economy. In addition, sluggish dynamics of the business activity in Russia and deceleration of the economic growth in China as a consequence of trade wars with the USA is anticipated (Figure 59).

The external inflation background has also deteriorated as a result of the upward revision of forecasts about inflation in Russia as compared to previous assessments (see the Inflation Report for the second quarter of 2018). Expectations about a higher price rise in Russia on the forecast horizon are associated with the growth in VAT rate from the beginning of 2019 and the increase in import prices given depreciation of the Russian ruble.

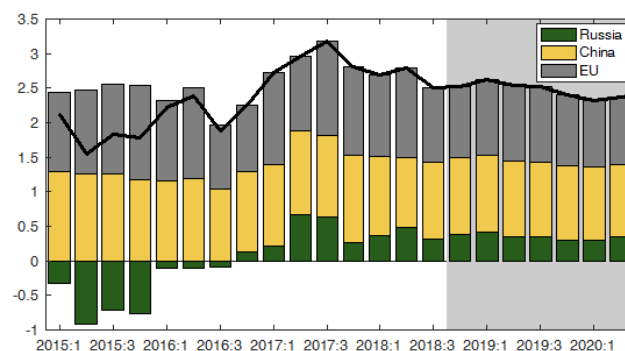
In case if risks of tighter sanctions against Russia diminish, the inflation pressure on the part of import prices will go down thus having a downward effect on inflation in Kazakhstan.

There is an assumption that inflation in the EU and China will be stable over the forecast horizon (Figure 60).

As for the global food market, the demand in the global cereal market will be prevailing over its supply in the short term. Therefore, the world stocks of cereals will be reducing in the cropping season of 2018-2019³. **Prices in the global food market will be demonstrating a smooth upward trend as a result of lower expectations regarding production of cereals on the forecast horizon.** In turn, expectations about the decline in production are associated with worse harvest prospects in Australia. On the forecast horizon, world cereal prices are expected to have a moderately upward influence on the dynamics of food inflation in Kazakhstan.

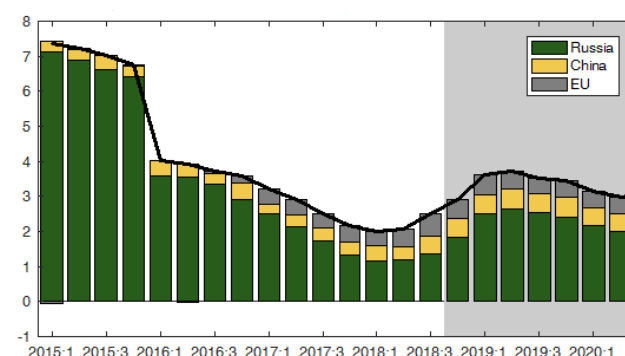
Prerequisites regarding the external monetary environment have not changed; the US monetary policy is expected to gradually even out. This will be manifested in the increase of federal funds rate on the forecast horizon. If

Figure 59. External GDP Decomposition Broken Down by Kazakhstan's Main Trading Partners, %, YoY



Source: NBRK's calculations
Russia; China; EU

Figure 60. Weighted Inflation Broken Down by Kazakhstan's Main Trading Partners by Shares in Imports, %, YoY



Source: NBRK's calculations
Russia; China; EU

³ <http://www.fao.org/worldfoodsituation/csdb/en/>

the US Fed alters its posturing in respect of further plans to change interest rates, the National Bank will be taking into account potential consequences when implementing the monetary policy.

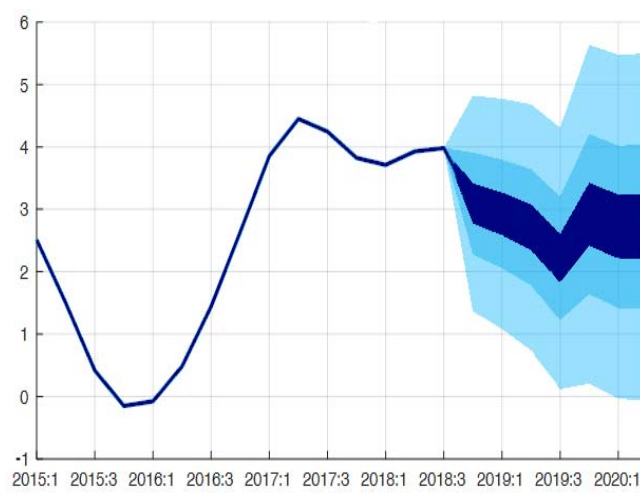
2. FORECAST UNDER THE BASELINE SCENARIO

In 2019, the real GDP growth in Kazakhstan will be 2.7%, and in the first half of 2020 – 2.7% (Figure 61). The consumer and investment demand will act as key growth factors. Positive dynamics of the consumer demand will be observed amidst a positive trend in the consumer lending and the growing real income of the population supported by the increase in minimum wages. The upturn in investment demand will be accompanied both by the larger fixed capital investments given expansion of Tengiz oil field and by positive growth rates of investments into residential construction. The rise in exports will be promoted by the increased extraction of oil and gas condensate in the Kashagan oil field. The government spending on consumption will be demonstrating weak dynamics.

On the forecast horizon, there will be a positive output gap which will be putting a pro-inflation pressure on the pricing processes. By the end of the forecast horizon, a positive output gap will be shrinking while remaining in the weakly positive zone.

In 2019, the annual inflation will be within the target band building up near its upper boundary by the end of the year (Figure 62). Annual inflation forecasts till the end of 2019 were adjusted towards a minor decline as compared to the previous forecast round as a result of anticipated deceleration processes in the dynamics of inflation of regulated services. However, there are some risks that inflation would go above its target rate in 2020 given the expanding domestic demand as a result of increase in minimum wages, abatement of personal income tax for low-paid categories of employees and the increase in transfers from the National Fund as compared to the previously budgeted figures. In their entirety,

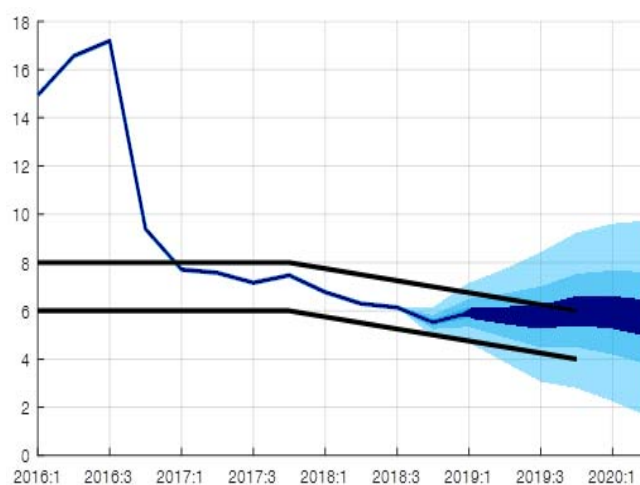
Figure 68. GDP, Quarterly, to the Corresponding Quarter of the Previous Year, %



Source: NBRK's calculations

Figure 69. Инфляция, в среднем за квартал, YoY, %

Figure 62. Inflation, Average for the Quarter, YoY, %



Source: NBRK's calculations

these factors will be having a constraining effect on the processes of price deceleration during the first quarter of 2020. Besides, potential tightening of the sanctions regime in respect of Russia which indirectly affects the risk premium of Kazakhstani assets and the dynamics of the tenge accompanied by deterioration of the external inflation background intensify the risks that the target for 2020 (below 4%) would be exceeded.

3. RISKS IN THE MEDIUM-TERM

The effect of various external and internal factors motivated the National Bank to somewhat revise its assessment of risks in the medium term forecast (Figure 63).

Among internal factors, as compared to the previous forecast round, the risk of inflation pressure on the part of domestic demand intensified given the expected 1.5 time increase in minimum wages from 2019. In addition, abatement of personal income tax for low-paid employees as well as positive dynamics in the consumer lending may potentially speed up the domestic demand.

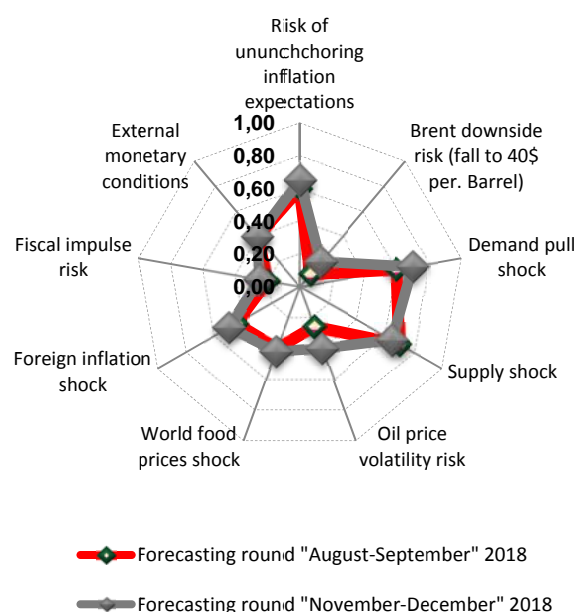
The probability of non-anchoring of inflation expectations has not considerably changed; however, their adaptivity and oftentimes dependence on fluctuations of the nominal exchange rate of the tenge still represent a significant risk factor for ensuring a low and steady inflation rate in the medium- and long-term horizon.

Risks of supply shocks in certain goods markets are still high because of a shortage of domestic production and/or an unexpected growth in the cost of production. Nonetheless, in connection with the Government's plan to increase control over the tariff setting by natural monopolies the probability of such shock occurrences slightly decreased.

The risk of fiscal impulse has not undergone considerable changes as compared to the last forecast round.

Among external factors, a notable deterioration of the situation in the global oil market should be pointed out. At present, due

Figure 63. Risk Map Based on the Expert Judgment



Source: NBRK's assessment

to a high rate of oil production in the USA, Saudi Arabia and Russia as well as to potential slowdown in the global demand for oil as a consequence of trade wars, the risk of the future heightened volatility of oil prices and their continuing decline intensified significantly.

As compared to the previous forecast round, assessment of risks of the global food price growth had not changed; however, it remained high given the projected drop in world stocks and the growth in global consumption.

The probability of deteriorating external monetary conditions also had not undergone substantial changes. However, a tighter posturing of the US Fed regarding the prospects of increasing its policy rate as well as the persisting and aggravating trade tension between the leading global economies (the USA, China and the European Union) may lead to the outflow of financial capitals from developing countries, to depreciation of their domestic currencies and acceleration of inflationary processes, including in Kazakhstan. In addition, the risk of import of external inflation is critical given acceleration of inflation in Russia because of depreciation of the ruble against a possible imposition of sanctions and the increase of VAT rate in 2019.

Finally, in view of intensification of risks pertinent to the oil market, the development of the pessimistic scenario which assumes that the price of oil would fall to USD 40 per barrel becomes more realistic. Should this scenario be implemented, devaluation and inflation expectations will increase significantly and inflation may go above its targets in 2019-2020, and the GDP growth rates may fall to 2.1% in 2019. The National Bank's reaction could be the tightening of its monetary policy, and conditions in which the monetary policy is implemented would be changed from neutral to contractory ones.

In future, in its assessment of the balance of risks, the National Bank will take into account not only external and internal factors described above but also the successfulness of the

Government's structural reforms for diversification of the economy which may have a significant impact on the economic growth and inflationary processes in Kazakhstan.

Annex 1

Forecast of the Balance of Payments Current Account

This Annex presents a forecast of the balance of payments current account for 2018-2019. The forecast has been designed as part of the National Bank's quarterly forecast rounds for the purposes of the decision-making regarding the monetary policy.

Initial forecast assumptions

The baseline scenario for this forecast is the price of oil (Brent) of USD 60 per barrel, starting from December 2018 (*average price in 2018 – USD 71.8 per barrel; in 2019 – USD 60 per barrel*).

Some internal and external forecast parameters have been revised as compared to the previous forecast round.

The forecasts of the economic growth rates in Kazakhstan in the medium term are somewhat better than their prior expectations.

In 2018, the expected volume of oil production will be 90 million tons, in 2019 – 91 million tons (*previous forecast – 91 million and 93 million tons, respectively*). The revision of forecasts is related to the release of new actual data for 10 months of 2018 and the anticipated maintenance works in the Kashagan oil field in the spring of 2019.

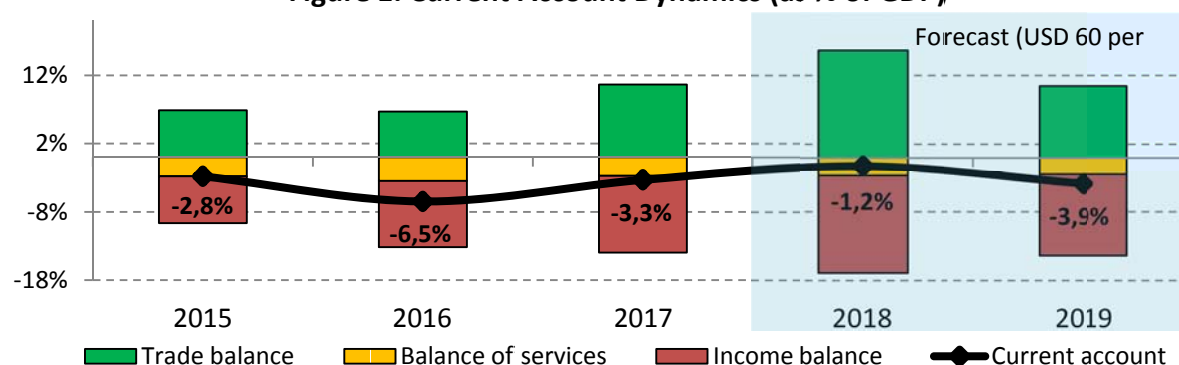
The external demand figures were revised downwards in connection with a slowdown in the growth rates of the EU and Chinese economies.

Forecast

The current account balance in Kazakhstan is determined by the dynamics of trade balance and income balance. The dynamics of balance of services is stable and its effect on the current account performance is limited (*Figure 1*). At the end of 2018, the current account status is expected to improve to (-)1.2% of GDP (*previous forecast – (-)2.3% of GDP*). In 2019, the deficit will go up to (-)3.9% of GDP (*previous forecast – (-)3.8% of GDP*) because of a lower average annual oil price and a smaller production volume as compared to the previous forecast round.

Factors constraining the current account improvement still include the growth in imports of goods required for implementation of infrastructure projects in the oil and gas sector as well as the increasing payouts of returns to foreign direct investors.

Figure 1. Current Account Dynamics (as % of GDP)



Exports of goods in 2018 will increase by 22.2% (*previous forecast – 18.6%*) to USD 60.4 bln. because of a higher average annual oil price. In 2019, exports are expected to decrease by 8.8% (*previous forecast – 1.1%*) to USD 55.1 bln. in connection with an anticipated slowdown of the growth in oil production volumes and the price decline under the scenario.

Imports of goods will increase by 7.8% (*previous forecast – 8%*) to USD 34.4 bln. in 2018 and by 3.3% (*previous forecast – 10%*) to USD 36 bln. in 2019. Lower growth rates of imports as

compared to the previous forecasts are caused by the change in the initial forecast assumptions: some slowdown in the growth rates of new consumer loans is presumed. Nonetheless, a high level of consumer imports will be maintained due to the increase in real income of the population.

The interim and investment imports will continue to grow as a consequence of the recovering revenues of businesses, implementation of government programs⁴ as well as implementation of investment projects⁵, primarily in the oil and gas sector.

Income balance reflects flows of investment returns, payroll and unrequited transfers. A negative income balance indicates that accrued income payable to foreign investors exceeds income receivable by the domestic economic entities.

In the forecast period, the deficit on the income balance is expected to increase to USD (-)23.6 bln. in 2018 and USD (-)22 bln. in 2019. Such dynamics is explained by the growth in returns of foreign investors in the primary sector of the Kazakh economy which, in turn, is secured by the rise in oil production. The current forecast path of the income balance is somewhat better than forecast in the previous review. This fact is related to reduction in the expected oil production.

⁴ “7-20-25”, “Nurly Zher” and others

⁵ TCO’s Future Growth Project - Wellhead Pressure Management Project, investments in Karachaganak (KPC Gas Debottlenecking Project, Karachaganak Expansion Project), “Saryarka” gas pipeline, the integrated gas and chemical complex in Atyrau jointly with Borealis, the fourth oil refinery, BAKAD, LRT in Astana, Fly Arystan lowcosters, “Nomad” and “Baikonur” Hygiene and Epidemiology Center, etc.

BASIC TERM AND DEFINITIONS

Core Inflation – means the inflation which excludes transitory uneven price changes subject to certain factors of administrative, event-related and seasonal nature.

Base Rate is a key monetary policy instrument of the National Bank that helps to regulate nominal interbank interest rates in the money market. By setting the level of the base rate, the National Bank determines a target value of the targeted interbank short-term money market rate in order to achieve the goal of ensuring 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 industrial 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 tangible non-produced assets; and d) expenses in connection with the transfer of title for non-incurred costs.

FX Swap – means a foreign exchange transaction which involves the concurrent purchase and sale of a certain amount of one currency in exchange of another currency with two different value dates.

Gross Domestic Product is an indicator that reflects the market value of all final goods and services (i.e. designated for direct consumption) produced during a year in all sectors of the economy within the territory of the country for consumption, exports and saving, irrespective of the national identity of the used production factors.

Money Base (Reserve Money) includes cash issued in circulation by the National Bank, other than cash at the cash departments of the National Bank (cash outside the National Bank),

transferrable and other deposits of banks, and transferrable deposits of non-bank financial organizations and current accounts of government and non-government 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 legal entities – residents and households in the domestic and foreign currency.

Dollarization of the Economy means the situation where a foreign currency (largely – the US Dollar) starts to be used for transactions within a country or in certain sectors of its economy, pushing out the domestic currency from the domestic money turnover, and acting as the means of saving, measure of value and the legal tender.

Inflation – is an increase in the general price level of goods and services. In Kazakhstan, inflation is measured with the use of consumer price index.

Consumer Price Index (CPI) – the change in the overall level of prices for goods and services purchased by the population for consumption. The consumer basket of Kazakhstan for calculation of inflation reflects the structure of household expenditures and includes goods and services which represent the largest relative share in the consumption of population. The CPI is calculated as the ratio of the cost of a fixed set of goods and services in current prices and its cost in the prices of the previous (base) period. The index is calculated by the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan.

Inflation Targeting – is a monetary policy regime which is oriented at achieving a target inflation rate.

Composite Indicator – is a generalizing indicator which is used to reflect short-term trends in the development of the real sector of the economy. Composite indicator as possessing the forward-looking feature is used to reflect a cyclical change and to identify turning points when recovery and downturns in the economy occur and change. A composite indicator is built on the basis of survey findings among enterprises which participate in the market research conducted by the National Bank.

Short-term economic indicator is calculated with a view to ensure efficiency and is based on the change in the output indices by key sectors: agriculture, industry, construction, trade, transport and communication accounting for over 60% of GDP. The indicator is built without recalculations for the unobservable economy and without other macroeconomic adjustments.

Credit Auctions mean the National Bank's auction for the securities buy/sell back.

Minimum Reserve Requirements (MRRs) mean the mandatory share of bank's liabilities which a bank is to keep in the form of cash in its cash department and monies on correspondent accounts with the National Bank in the domestic currency (reserve assets). The volume of reserved liabilities of banks is regulated by the MRR ratios.

Nominal Anchor for Monetary Policy. It is a certain indicator including a macroeconomic indicator which helps the National Bank to influence the ultimate monetary policy goal.

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 repos with a view to provide the tenge liquidity to banks against the pledge of securities in line 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. Transferable deposits represent a part of the narrow money.

Other deposits primarily include savings and time deposits that only can be withdrawn on expiration of a certain period of time, or can have different restrictions which make them less convenient for use in the ordinary commercial transactions and, mainly, meet the requirements established for saving vehicles. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

Potential Output reflects the level of output in the economy that can be reached subject to full utilization of inputs and full employment. It reflects the volume of production which can be manufactured and realized without creating prerequisites for the change in the price growth rates.

Consumer Basket means a sample of goods and services which characterizes the standard level and the structure of monthly (annual) consumption of an individual or a family. Such sample is used to calculate the minimum subsistence level, based on the cost of the consumer basket in current prices. The consumer basket also serves as a comparative basis for estimated and real consumption levels and also as the basis to determine the purchasing capacity of currencies.

Interest Rate Channel of the monetary policy transmission mechanism is the transmission mechanism channel which describes the impact of the central bank on the economy through the interest rate regulation.

Direct Repo is the sale of a security with the commitment to repurchase it after a specific period of time and at a specific price. The National Bank conducts direct repos with a view to withdraw excess liquidity in the tenge.

Free Floating Exchange Rate. According to the current classification of the International Monetary Fund, 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 intervene in the foreign exchange market in order to smooth out the volatility of the domestic currency exchange rate or to prevent its dramatic changes as well as to ensure the financial system stability.

Output Gap (GDP Gap). 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 frame. Serves as an indicator which reflects the effectiveness of resources utilized in the country. If an actual output exceeds the potential one (a positive output gap), other

things remaining equal, the trend of acceleration in the price growth rates would be anticipated because of the overheating of the economy. The presence of a negative output gap indicates an expected slowdown in the price growth rates due to low economic activity. Output fluctuations around its potential level reflect business cycles in 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, relation between exchange rates of currencies, and prices for goods in the domestic currencies.

TONIA Rate – (Tenge OverNight Index Average) represents a weighted average interest rate on one-day repo opening transactions made on the stock exchange with government securities in the automatic repo sector.

Monetary Policy Transmission Mechanism is the process, by which monetary policy tools influence final macroeconomic indicators such as the economic growth, inflation.

Narrow Reserve Money is the reserve money excluding other deposits of banks at the National Bank.

NDF – non-deliverable forwards used to hedge foreign exchange risks.

LIST OF KEY ABBREVIATIONS

GDP – Gross domestic product
GPIID – Government Program for Industrial and Innovation Development
EU – European Union
ECB – European Central Bank
CPI – consumer price index
CS MNE RK – Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan
KASE – Kazakhstan Stock Exchange
KSF – “Kazakhstan Sustainability Fund” JSC
NBRK – National Bank of the Republic of Kazakhstan
VAT – value-added tax
OPEC – Organization of the Petroleum Exporting Countries
UN FAO – Food and Agriculture Organization of the United Nations
RK – Republic of Kazakhstan
REER – real effective exchange rate
USA – United States of America
FAO – Food and Agriculture Organization of the United Nations
Fed – Federal Reserve System
Bln. - billion
Mln. - million
Thous. – thousand
USD – US Dollars