

**National Bank
of the Republic of Kazakhstan**

**Inflation Survey
Q2 2007**

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Basic terms and concepts

In section 1. Inflationary processes

Inflation in the Republic of Kazakhstan is calculated based on a consumer price index (CPI) that characterizes the change in the overall level of prices for goods and services acquired by the population for personal consumption in the cities of Astana and Almaty, all the oblast centers, and a sample set of cities and rayon centers. The consumer basket for calculating inflation reflects the structure of household expenditures and comprises 508 goods and services making up the largest proportion in the population's consumption.

Baseline inflation consists of inflation excluding short-term irregular price changes influenced by certain factors of an administrative, one-off, or seasonal nature.

Since 2004 the Republic of Kazakhstan Statistics Agency has been calculating baseline inflation using five different methodologies:

- baseline inflation-1: inflation excluding price increases for vegetables, fruits, gasoline, and coal;
- baseline inflation-2: inflation excluding price increases for vegetables, fruits, regulated services, and energy resources;
- baseline inflation-3: excluding the five maximum and five minimum price increases;
- baseline inflation-4: trimmed mean; and
- baseline inflation-5: median CPI.

In the framework of the **Enterprise monitoring** carried out by the National Bank since 2002, the inflationary expectations of enterprises of the real sector are surveyed. This survey covers qualitative assessments of managers of the surveyed enterprises (“will rise,” “will fall,” and “will remain unchanged”) with regard to production activities of the enterprises, including demand for and prices of finished output and for raw and other materials used in production for the preceding and the upcoming quarters.

The diffusion index is presented as the number of “will rise” responses and half of the “unchanged” responses. This index represents a summary indicator characterizing the dynamics of change in the indicator being examined. An index figure above 50 signifies a positive change in the indicator, and a figure lower than 50 represents a negative change.

In section 2. Fiscal policy

Budget receipts include revenue (tax receipts, nontax receipts, and receipts from the sale of fixed capital), the repayment of budget credits, and receipts from the sale of financial assets of the state.

Budget expenditures comprise expenses (current and capital), budget credits, and acquisition of financial assets.

In section 3. Monetary policy

Base money (reserve money) includes cash released into circulation by the National Bank excluding cash in cash departments of second-tier banks (cash outside the National Bank), transferable and other deposits of second-tier banks, and transferable deposits of nonbank financial and current accounts of state and nonstate nonfinancial institutions in tenge with the National Bank.

Narrow base money represents base money excluding other deposits of second-tier banks with the National Bank.

The M1 monetary aggregate is calculated as the total of cash in circulation and transferable deposits of non-bank legal entities and the population in tenge.

The M2 monetary aggregate is equal to the M1 monetary aggregate plus other deposits in tenge and transferable deposits of non-bank legal entities and the population in foreign currency.

The money stock (M3) is determined based on consolidation of accounts of the balance sheets of the National Bank and second-tier banks. It consists of cash in circulation and transferable and other deposits of resident legal entities and resident households in the domestic and foreign currency.

Transferable deposits are all deposits that: 1) can at any moment be turned into money at face value without penalties or restrictions; 2) are freely transferable using a check, bill of exchange, or draft; and 3) are widely used for making payments. Transferable deposits are part of the narrow money stock.

Other deposits pertain, for the most part, to savings and time deposits that may be withdrawn only at the expiration of a defined time period or are subject to various restrictions that make them less convenient for use in common commercial operations and generally are subject to requirements set on savings mechanisms. In addition, other deposits also include nontransferable deposits denominated in foreign currency.

The ratio of participation of the National Bank in foreign exchange trading on the Kazakh Stock Market (KFB) is calculated as the ratio of net participation of the National Bank (purchases minus sales of foreign currency) to the net volume of trading on the KFB.

The balance of National Bank operations on the money market is calculated as the total of the change in volume of short-term notes in circulation, balances on deposit and correspondent accounts of banks with the National Bank, and net operations for the purchase and sale of government securities.

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1. Inflationary processes

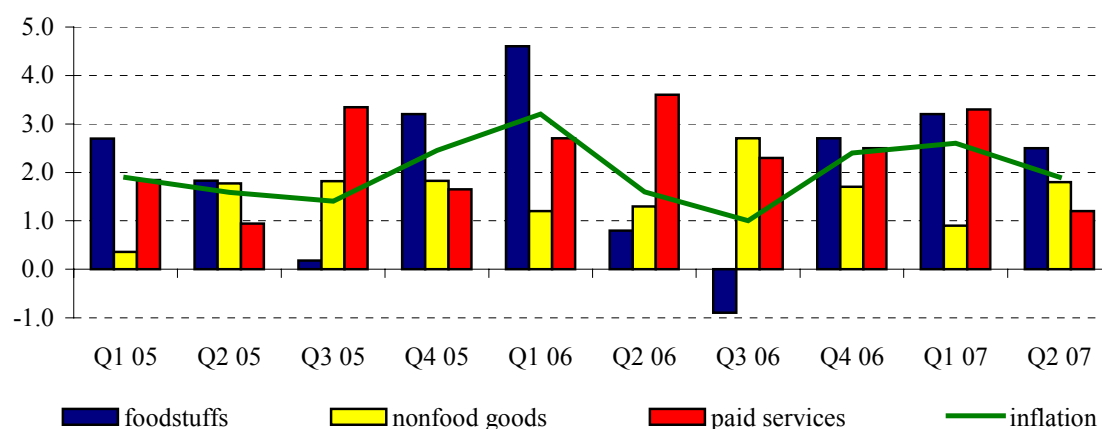
1.1. Consumer prices

In Q2 2007 there was an uncharacteristic increase in prices on the consumer market for the period. Inflation declined by comparison with the previous quarter, but by comparison with the same quarter in 2006 it was higher and comprised 1.9 percent.

June should especially distinguished within the dynamics for inflation in April-June 2007. Inflation was 0.8 percent in June alone; such a substantial increase in prices has not been observed in that period since 2000.

The main reason for the increase in inflation is an increase in the price of foodstuffs, which increased in cost in this period by 2.5 percent, while prices for non-foodstuffs increased by 1.8 percent and prices for paid services increased by 1.2 percent (Figure 1).

Figure 1
Dynamics of quarterly inflation and its components
(as a percentage of the previous period)



Source: Republic of Kazakhstan Statistics Agency

The increase in consumer prices in Q2 2007 was caused by increased prices for certain types of goods and paid services, and the seasonality factor did not contribute to a restraining of inflation.

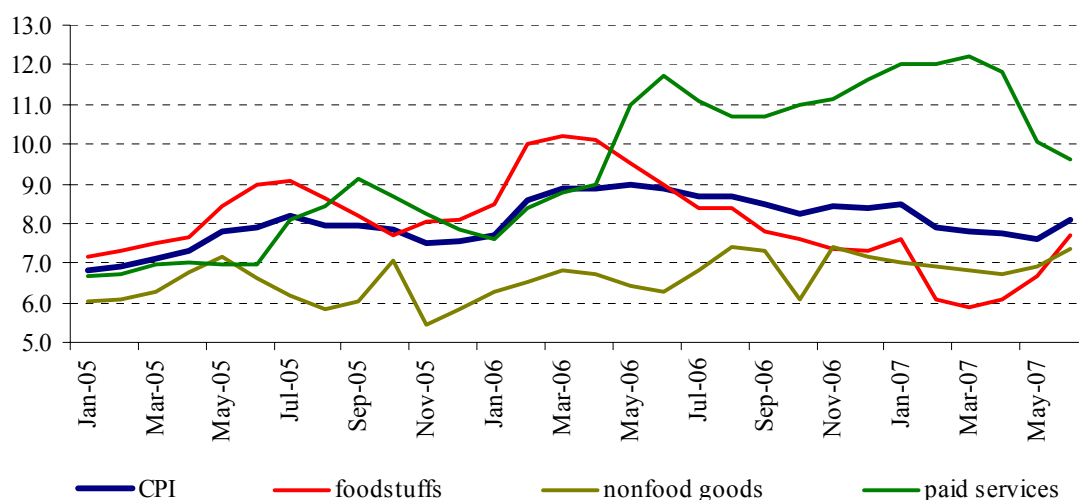
In April-June 2007 the largest prices increases occurred for meat, fruits and vegetables, and fish products (by 5.9, 5.1 and 3.8 percent, respectively), and for medical services—by 5.8 percent, and gasoline—by 3.1 percent.

The contribution of these goods and services to the establishment of inflation in Q2 2007 is estimated at 0.8 percent; in other words, without taking into account the price increases for the aforementioned goods and services, inflation was 1.1 percent.

As a result of the substantial increase in inflation in June 2007, the trend toward a decline in the rate of annual inflation observed at the beginning of the year changed to an increase. Annual inflation for 2006 was 8.4 percent; in May 2007 it was 7.6 percent, but in June 2007 it was 8.1 percent. And although the largest contribution to annual inflation continues to be due to paid services to the population, the annual increase in prices for them is demonstrating a declining trend. At the same time, prices for non-food goods and especially for foodstuffs in annual terms are showing a rising trend (Figure 2). Expressed annually, gasoline, medical and transport services, fruits and vegetables, meat and fish products, and housing and communal services demonstrated the greatest increase in prices.

Figure 2

Dynamics of inflation and its components
(as a percentage of the same month in the previous year)



Source: Republic of Kazakhstan Statistics Agency

1.2. Baseline inflation

The increase in the overall level of prices in Q2 2007 was accompanied by an increase in the baseline inflation indicators as calculated by all the methods by comparison with the same period last year. By comparison with the previous quarter, baseline inflation grew at a slower rate (Figure 3).

In April-June 2007 the rate of increase in overall inflation exceeded the rate of increase in baseline inflation-1, baseline inflation-4, and baseline inflation-5. This situation

was largely due to cost increases in certain types of goods and services that were excluded from their calculation (fruits and vegetables, meat products, gasoline, and medical services).

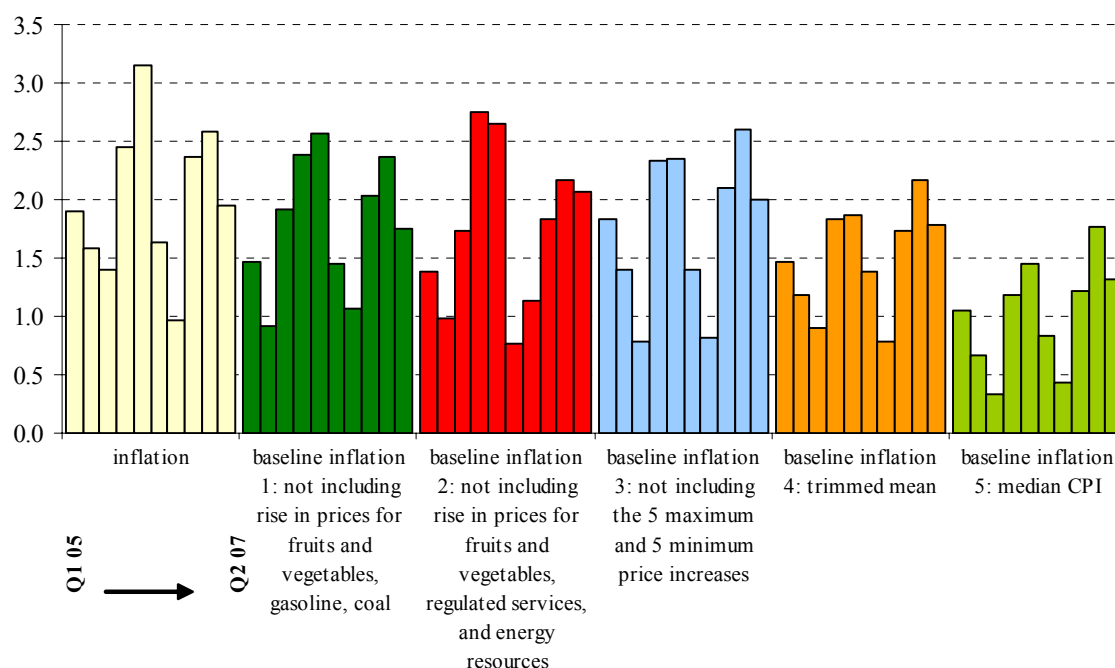
At the same time, the indicators for baseline inflation-2 and baseline inflation-3 increased faster than overall inflation due to insignificant increases in prices and tariffs for certain types of regulated services in Q2 2007.

The acceleration in inflationary trends is also demonstrated by the increase in baseline inflation in annual terms, calculated by all methods (Figure 4).

In addition, baseline inflation calculated by methods 3, 4, and 5, in other words not presupposing the exclusion of a previously defined set of goods and services, has been demonstrating a fairly stable increasing trend over the last 3 years. At the same time, the dynamics of baseline inflation-1 and baseline inflation-2, whose calculation excludes a specific list of components, do not demonstrate unambiguous and clearly expressed long-term trends. Nonetheless, in the current year their annually expressed values are increasing.

Figure 3

**Dynamics of quarterly inflation and baseline inflation
(as a percentage of the previous period)**

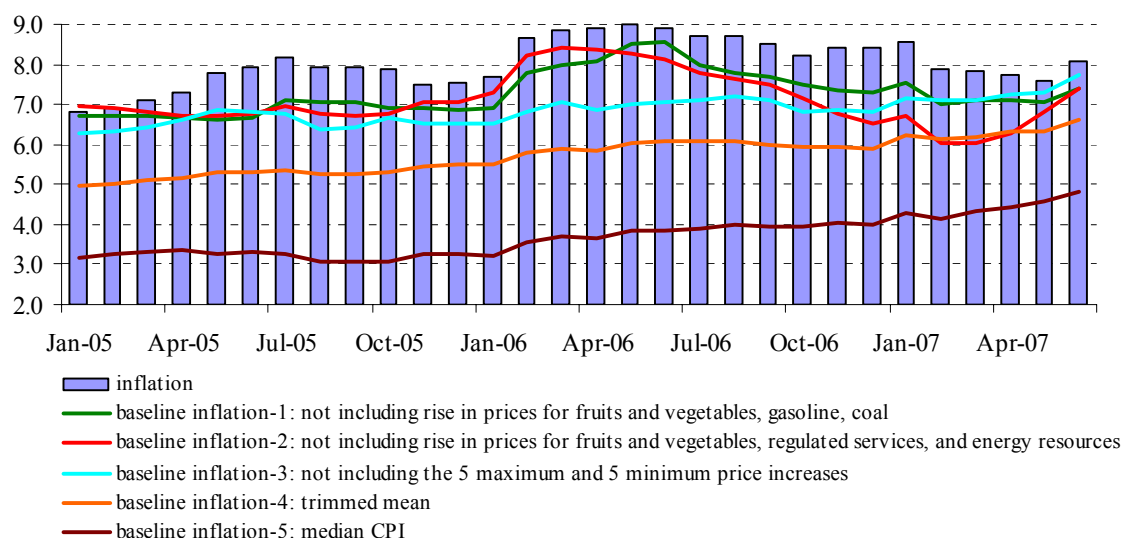


Source: Republic of Kazakhstan Statistics Agency

Figure 4

Dynamics of annual inflation and baseline inflation

(percentage of the same month of the preceding year)



Source: Republic of Kazakhstan Statistics Agency

In all likelihood, the increasing trend in inflation is due not so much to chance factors (shocks) or seasonal factors as, possibly, to more fundamental causes (see 1.4. Inflationary factors).

1.3. Prices in the real sector of the economy

1.3.1. Prices in industry

In Q2 2007 there was an increase in prices of enterprises that are producers of industrial output by comparison with the same period in 2006. The increase in prices was 10.9 percent compared to 8.8 percent in Q2 2006. Produced output was 11.6 percent more expensive, which was first and foremost caused by a 12.9 percent increase in the cost of products of intermediate consumption, whereas prices for consumer goods increased insignificantly, by 0.6 percent. Prices for services of a production nature increased by 1.9 percent, and prices for production resources were unchanged.

Within the structure of economic sectors in Q2 2007, output of enterprises of the extractive industry increased in price by 12.5 percent (in Q2 2006 they increased by 7.7 percent). The increase in prices in the industry was caused first and foremost by an increase in the growth rate of prices for gas condensate by 11.0 percent (in Q2 2006—by 8.4 percent), for oil—by 13.0 percent (by 7.9 percent), for petroleum products—a decline by 2.1 percent (by 8.4 percent), and for natural gas—by 1.9 percent (a decline by 4.1 percent). As a whole, prices of producers of energy resources in Q2 2007 increased by 10.6 percent, whereas in the same quarter of 2006 there was an increase of 7.5 percent.

The increase in prices of producers in the processing industry in April-June 2007 slowed by comparison with the same period in 2006: to 10.0 percent from 11.3 percent, which was primarily influenced by the existing pricing situation for metals. The main increase in prices was registered by rolled ferrous metals—42.5 percent compared to 4.1 percent in Q2 2006, and by non-ferrous metals—19.1 percent compared to 39.1 percent.

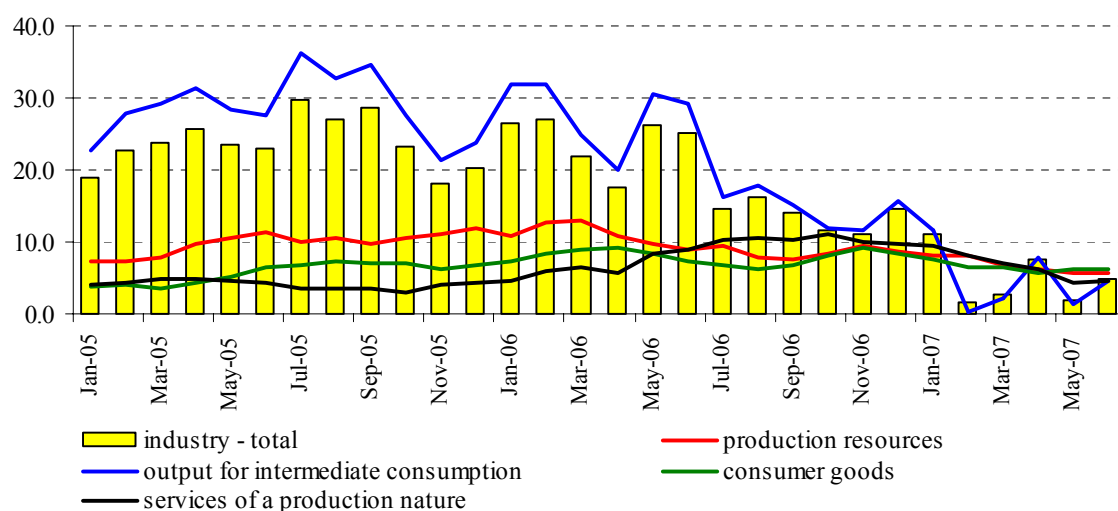
Foodstuffs produced in the Republic increased in price during April-June 2007 by 1.9 percent (by 0.5 percent in April-June 2006). The highest increase in prices occurred for poultry meat—by 10.4 percent and wheat flour—by 2.8 percent.

Prices and tariffs for the production and distribution of electricity, gas, and water in Q2 2007 grew by 1.6 percent (in Q2 2006—by 5.7 percent).

In June 2007 the annual increase in prices in industrial production was 4.8 percent, which increased from 2.8 percent in March 2007. Only products of intermediate consumption increased in prices in annual terms—from 2.1 percent in March 2007 to 4.6 percent in June 2007. The rate of increase in cost of production resources declined during that same period from 6.7 percent to 5.7 percent, consumer goods—from 6.4 percent to 6.1 percent, and services of a production nature—from 6.9 percent to 4.5 percent (Figure 5).

Figure 5

Dynamics of the price index for enterprises that are producers of industrial output (as a percentage against the same month of the preceding year)



Source: Republic of Kazakhstan Statistics Agency

1.3.2. Prices in agriculture

In Q2 2007 sales prices of producers of agricultural output increased by 0.7 percent (in Q2 2006—a decline by 1.3 percent). Price dynamics in agriculture occurred against the

backdrop of a 2.7 percent increase in prices for crop output and a 2.0 percent decrease for livestock products.

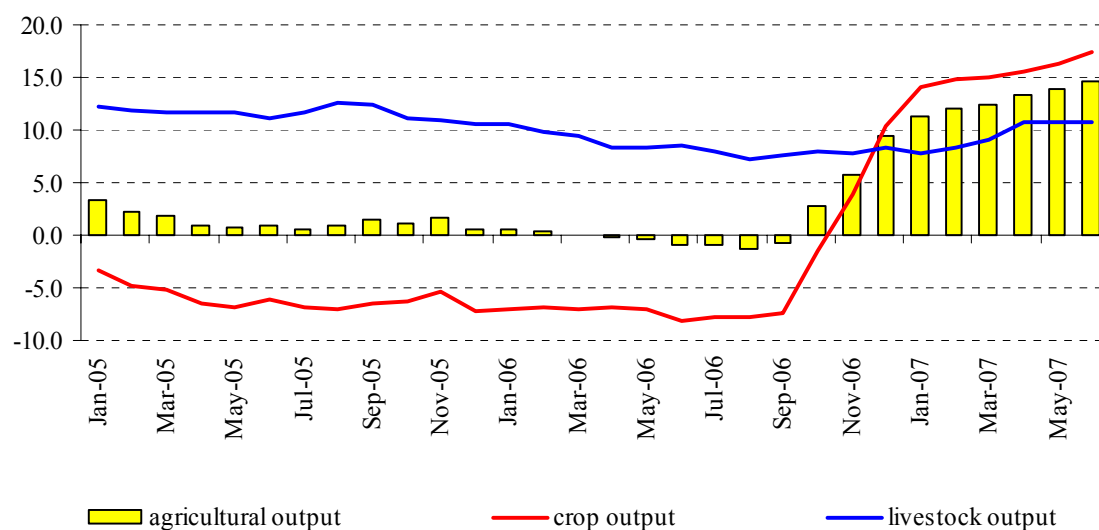
An increase in prices for crop products during the reference period was caused by a 3.1 percent increase in the cost of grain crops, and also an increase in prices for vegetable crops, including a 1.2 percent increase in prices for potatoes and vegetables.

Among livestock products, prices increased the most in April-June 2007 for cattle and poultry meats, even as there was a decline in prices for eggs and milk.

Prices in annual terms for agricultural output continued to demonstrate a trend toward price increases begun in September 2006. In June 2007 the price increase reached 14.6 percent (in March 2007—by 12.4 percent). Prices for livestock products increased by 10.8 percent (in March 2007—by 9.0 percent), and for crop products—by 17.5 percent (in March 2007—by 15.0 percent) (Figure 6).

Figure 6

**Dynamics of the price index for agricultural output
(as a percentage against the same month of the preceding year)**



Source: Republic of Kazakhstan Statistics Agency

1.3.3. Enterprise monitoring

A survey of enterprises demonstrated an increase in demand for finished output of the polled enterprises. Thus, in Q2 2007 by comparison with the previous quarter 37.8 percent of polled enterprises noted an increase in demand for finished output (in Q1 2007—30.0 percent). At the same time there was a decline in the share of enterprises with stable demand (from 54.7 percent to 51.7 percent) and in the share of enterprises whose demand for output

declined—from 14.4. percent to 9.3 percent. As a result the diffusion index for the change in demand for finished output of the sector increased in Q2 2007 to 64.3.

In Q3 2007 only 34.7 percent of enterprises participating in the survey anticipate an increase in demand, and only 4.6 percent of enterprises anticipate a decline in demand for finished output. As a result, we anticipate an increase in the diffusion index for the change in demand for finished output in Q3 2007 to 65.1 (Figure 7).

The situation with prices for finished output of polled enterprises and raw materials and supplies used in the production process is characterized by the existence of inflationary trends and continued inflationary expectations.

In Q2 2007 31.3 percent of enterprises noted an increase in prices for finished output (in Q1 2007—31.5. percent). There was a slight decline in the number of enterprises whose output prices declined—3.6 percent (in Q1 2007—5.4 percent). As a consequence, there was an increase in the diffusion index for the change in prices for finished output to 63.9 percent (in Q1 2007—63.0), which was the highest value over the period since 2005.

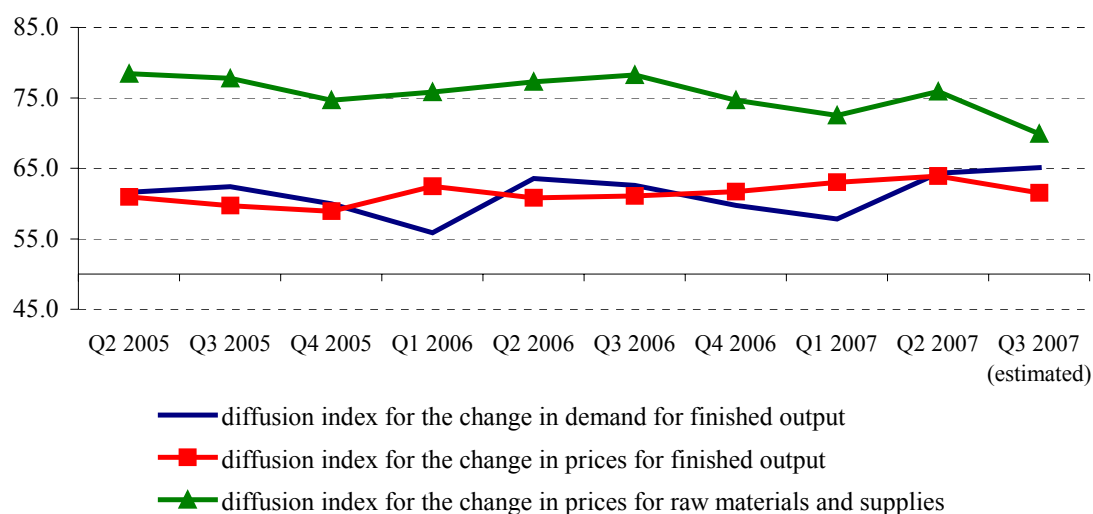
In Q3 2007 we are observing a decline in the diffusion index for the change in prices for finished output to 61.5, which is associated with the decline to 25.2 percent of the share of enterprises for whose output a price increase is forecast, with an insignificant 2.1 percent decline in the share of enterprises anticipating a decline in prices for their own finished output (Figure 7).

The slowing of the increase in prices for raw materials and supplies that we have observed since Q4 2006 was replaced with a certain increase in Q2 2007. The share of enterprises that noted an increase in prices grew from 56.3 percent to 61.3 percent, and 28.8 percent of the polled enterprises announced stable prices, whereas in the preceding quarter their proportion was 32.0 percent. The share of enterprises noting price declines for raw materials and supplies declined from 2.7 percent to 1.3 percent. As a result, the diffusion index for the change in prices for raw materials and supplies increased to 75.9.

The share of enterprises anticipating an increase in prices for raw materials and supplies in Q3 2007 will rise to 48.6 percent, and the share of enterprises anticipating a decline in prices is 0.5 percent. As a result the diffusion index is expected to decline to 69.9 (Figure 7).

Figure 7

Diffusion indices for changes in demand and prices



Source: Republic of Kazakhstan National Bank

Thus, the expectations of polled enterprises with respect to further price increases will remain negative. This is demonstrated by the relevant diffusion indices with a value significantly above 50.

1.4. Inflationary factors

Inflows of foreign currency into the Republic, an increase in aggregate demand, an active budgetary policy of the state, and also low labor productivity are contributing to continued inflationary potential in the economy of Kazakhstan in 2007.

According to the results for the first six months of 2007, the current account deficit was \$2,379.0 million (in the first six months of 2006 there was a surplus of \$55 million), which comprises 5.3 percent of GDP. Within the structure of the current account, only the trade balance was positive; and by comparison with the first half of 2006, the amount declined (by 5.2 percent). The deficit for the balance of services increased by 7.8 percent, the balance of income—by 31.1 percent, and current transfers—by a factor of 2.6.

The continuing growth of loan operations of banks on the international market was one of the main reasons that the overall balance of payments was positive (\$3,035.3 million).

In the second half of last year there was a certain slowing of growth of consumer and investment demand. In the current year demand on the part of the public and the real sector again began to grow.

Monetary income of the population increased in real terms in Q2 2007 by comparison with the same period in 2006 by 17.3 percent (in Q1 2007—by 19.7 percent). The increase in

retail commodity circulation in April-June 2007 by comparison with the same period in 2006 was 12.0 percent (in Q1 2007—by 9.8 percent).

Investments in fixed capital grew by 14.2 percent (in Q1 2007—by 7.1 percent). This trend was the result of increases in both foreign investments and loan resources of enterprises. Thus, the volume of loan resources in April-June 2007 by comparison with indicators for the same period in 2006 increased by 70.5 percent, and foreign investments increased by 11.5 percent.

The increase in real GDP, as an indicator of aggregate supply, in Q2 2007 by comparison with Q2 2006 is estimated at 9.9 percent (in Q1 2006—10.6 percent).

The expansion of consumer and investment demand was to a certain degree the result of significant growth of credit activity of the banking sector. Thus, in April-June 2007 the volume of credits issued increased by a factor of 2 by comparison with the same period in 2006. The weighted average rate for credits declined from 13.2 percent in March 2007 to 12.8 percent for the results for June 2007 (see 3.1.3. Credits to the Economy).

A substantial inflow of foreign currency and also high demand for credit resources are contributing to the increase in money supply in the economy of Kazakhstan.

In Q2 2007 the rate of expansion of base money was 5.2 percent (in April-June 2006—1.8 percent) and of the money stock—14.1 percent (15.9 percent). Given that the effect of money supply growth on inflation occurs with a certain time lag, a certain degree of stabilization of the growth rate of monetary aggregates in the current year will provide a restraining influence on the establishment of inflationary processes only at the end of the year (see 3.1. Money supply).

In Q2 2007 the budget policy of the state was quite moderate. It was characterized by both low receipts into the budget and minor expenditures.

During April-June 2007 by comparison with the same period in 2006 state budget expenditures grew by 1.9 percent, while receipts grew by 4.2 percent. As a result the budget surplus in Q2 2007 was T6.9 billion, whereas the same period in 2006 showed a deficit of T9.0 billion (see 2. Fiscal policy).

In 2007 we maintained the trend of the rate of growth for average monthly wages outpacing the rate of growth of labor productivity. In Q2 2007 labor productivity is estimated at 6.8 percent, whereas the real growth of wages reached 19.5 percent.

The situation on the domestic consumer market in the current year depends greatly on the situation on foreign markets. In particular, during Q2 2007 alone the prices of Brent grade oil increased by 14.8 percent and totaled \$71.3 per barrel at the end of June 2007 (according to World bank data). As a result, there was a trend toward increasing prices for

fuels and lubricants on the domestic market: gasoline increased in price by 3.1 percent (in Q2 2006—by 1.9 percent).

In addition, in Q2 2007 grain demonstrated some instability on world markets due to an increase in demand for grain. During June 2007 alone prices for wheat increased by 8.6 percent; and for Q2 as a whole the increase in prices was 10.6 percent (according to World Bank data). As a result, grain crops became more expensive on the Kazakh market in April-June 2007 by 3.1 percent (in the same period in 2006—by 0.4 percent).

Thus, despite a certain weakening of individual inflationary factors in the second half of 2006, they have reestablished themselves in the current year. As a result, these trends contributed to an increase in the inflationary background in the economy, which contributed to an increase in the annual inflation rate from 7.8 percent in March to 8.1 percent in June 2007.

2. Fiscal policy

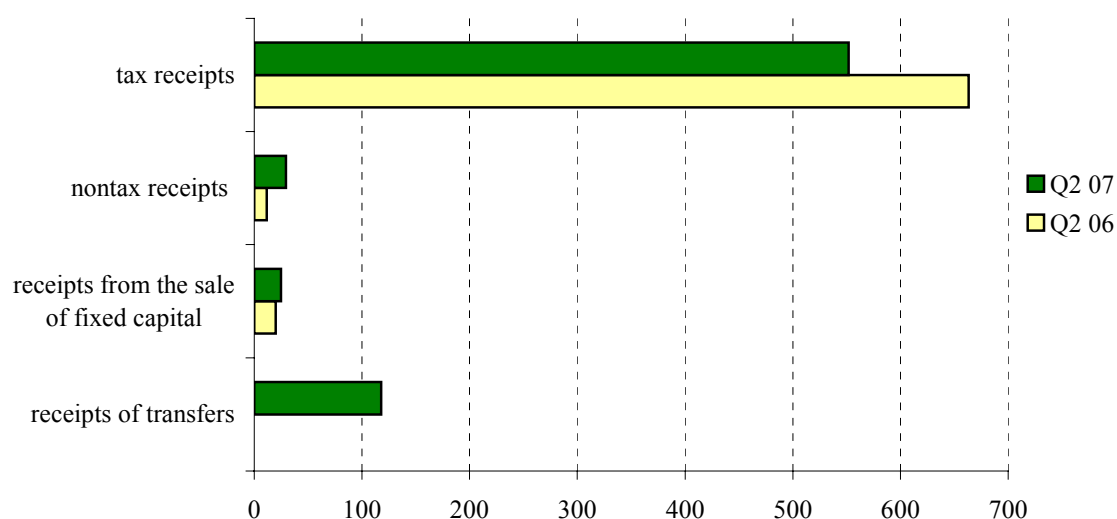
State budget receipts in Q2 2007 totaled T 726.3 billion, or 24.5 percent of GDP. Compared to the indicators for the same period of the previous year, this marked an increase of 4.2 percent. The increase in revenue resulted from an increase in volumes of nontax receipts and receipts from the sale of fixed capital, and also from official transfers.

The main state budget receipts in Q2 2007 were tax receipts (76.0 percent) and official transfers (16.2 percent).

Within the structure of tax receipts (Figure 8) there were increases in individual income tax (by 70.1 percent), value added tax (by 67.0 percent), social tax (by 66.9 percent), and excises (by 32.9 percent). Corporate income tax increased insignificantly (by 1.1 percent), while receipts for the use of natural resources declined by 83.2 percent, which is associated with the change as of July 1, 2006 in the mechanism for operation of the National Fund of the Republic of Kazakhstan (Box 1).

In Q2, 2007, a guaranteed transfer was collected to the republican budget from the National Fund in the amount of T 118.0 billion (Figure 8).

Figure 8
State budget revenue, billions of tenge



Source: Republic of Kazakhstan Ministry of Finance

In Q2 2007 state budget expenditures were financed in the amount of T 719.4 billion or 24.3 percent of GDP. By comparison with indicators for the same period in 2006, this represented an increase of 1.9 percent.

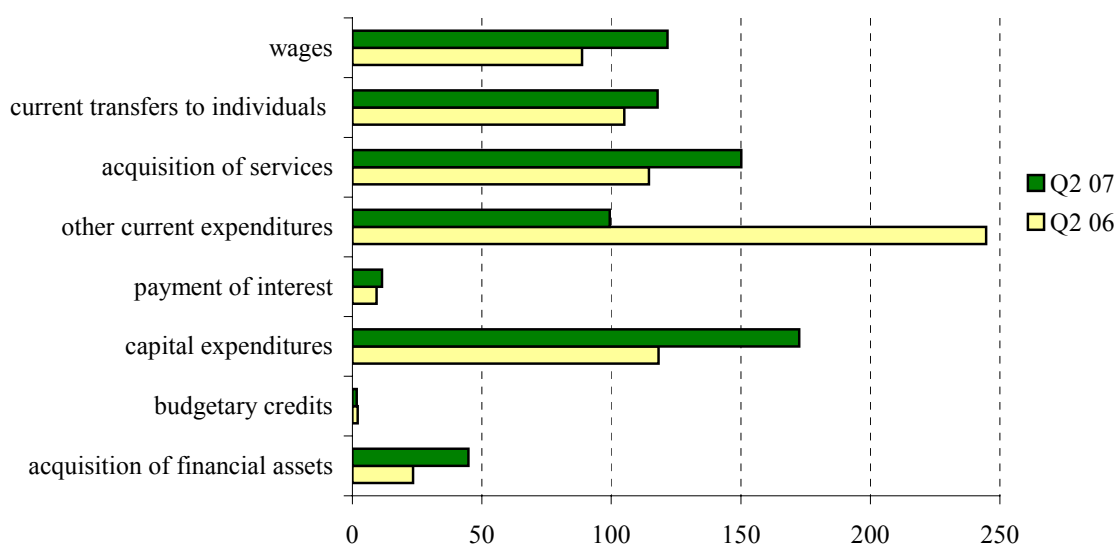
Current state budget expenditures were financed in the amount of T 500.5 billion. By comparison with indicators for the same period in 2006, they declined by 11.0 percent.

Within the reference period, a substantial share of current expenditures is represented by expenditures on the acquisition of services (by 30.0 percent), expenditures on wages (by 24.3 percent), and also current transfers to individuals (by 23.5 percent).

Capital expenses of the state budget in Q2 2007 increased by 45.9 percent by comparison with the same period in 2006. Budget credits in Q2 2007 declined 18.6 percent by comparison with the same period in 2006. Expenditures on the acquisition of financial assets grew by 91.8 percent (Figure 9).

Figure 9

State budget expenditures, billions of tenge

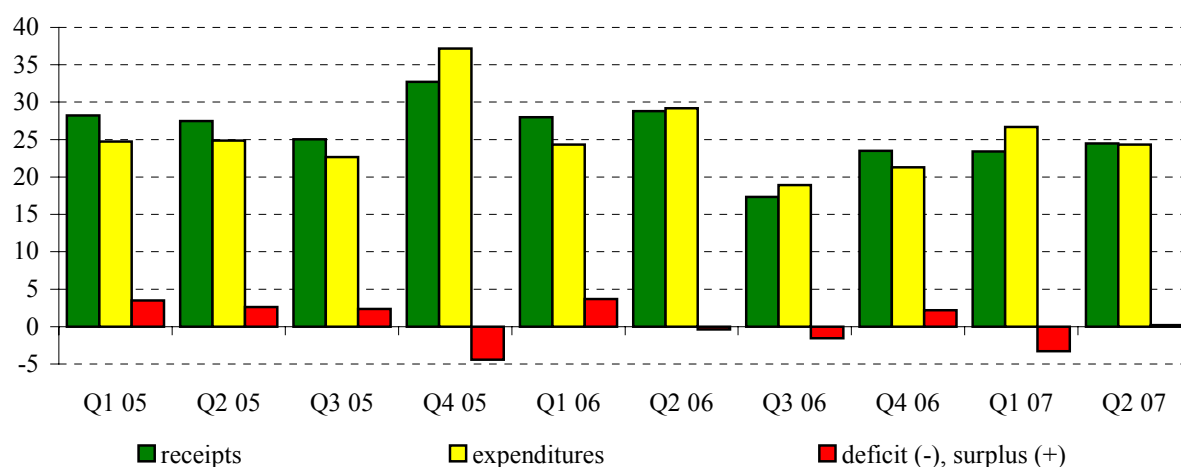


Source: Republic of Kazakhstan Ministry of Finance

As a result the state budget showed a surplus of T 6.9 billion (0.2 percent of GDP) in Q2 2007 compared to a deficit in Q2 2006 of T 9.0 billion (Figure 10).

Figure 10

Execution of the state budget, as a percentage of GDP



Source: Republic of Kazakhstan Ministry of Finance

Sources for financing the deficit were as follows: receipt of loans—T 45.9 billion, their repayment—T 44.0 billion, and use of available balances of budgetary resources—T 8.9 billion.

Government domestic debt in June 2007 by comparison with March 2006 increased by 10.0 percent to T 438.6 billion and was covered via the issuance of long-term treasury bonds.

External debt of the Government in Q2 2007 declined by 20.4 percent to \$1.4 billion. The decline in external debt was due to the repayment of Euronotes of Kazakhstan in the amount of \$350 million.

Box 1

Change in the mechanism for the operation of the Republic of Kazakhstan National Fund

In accordance with the system previously in operation, the sources for generation of the National Fund were:

- 1) official transfers from the republican budget, as determined by actual receipts to the republican budget from organizations of the raw materials sector in excess of their annual volumes as approved in the law on the republican budget for the corresponding fiscal year. Receipts from organizations of the raw materials sector comprised budget receipts for corporate income tax, VAT, windfall profits tax, bonuses, royalties, and the Republic of Kazakhstan's portion under production sharing for contracts concluded;
- 2) official transfers from the republican budget as determined from receipts from

privatization of state property under republican ownership and pertaining to the mining and processing sectors;

3) official transfers from the republican budget calculated in the amount of 10 percent of amounts of republican budget receipts planned in the republican budget from organizations of the raw materials sector;

4) official transfers from the local budget as determined from receipts from the sale of land plots for agricultural use;

5) investment income from management of the National Fund; and

6) other receipts and income not prohibited by legislation of the Republic of Kazakhstan.

Thus, the receipts to the National Fund cited in items 1) - 4) were reflected as both receipts and expenditures of the state budget.

The National Fund, in accordance with the previous system, could make expenditures:

1) to compensate losses of the republican budget, determined as the difference between approved and actual amount of receipts to the republican budget from organizations of the raw materials sector for the current fiscal year as a whole;

2) in the form of earmarked transfers moved from the National Fund to the republican budget for purposes defined by the President of the Republic of Kazakhstan;

3) to cover expenditures associated with management of the National Fund and the conduct of an annual audit.

In accordance with the new system, which went into effect on July 1, 2006, the sources for generation of the National Fund are:

1) budget receipts directed to the National Fund consisting of:

- direct taxes from enterprises of the oil sector, comprising corporate income tax, windfall profits tax, royalties, bonuses, the portion under production sharing, and rent tax on exported crude oil and gas condensate;

- receipts from the privatization of state property under republican ownership and pertaining to the mining and processing sectors; and

- receipts from the sale of land plots for agricultural use;

2) investment income from management of the National Fund; and

3) other receipts and income not prohibited by legislation of the Republic of Kazakhstan.

In addition, these types of receipts are credited directly to the National Fund without being reflected either in the revenue or expenditure portions of the state budget.

The National Fund makes expenditures on the following:

1) in the form of a guaranteed transfer from the National Fund to the republican budget for implementation of budgetary development programs (subprograms);

2) in the form of earmarked transfers that are moved from the National Fund to the republican budget for purposes defined by the President of the Republic of Kazakhstan;

3) to cover expenditures associated with management of the National Fund and the conduct of an annual audit.

3. Monetary policy

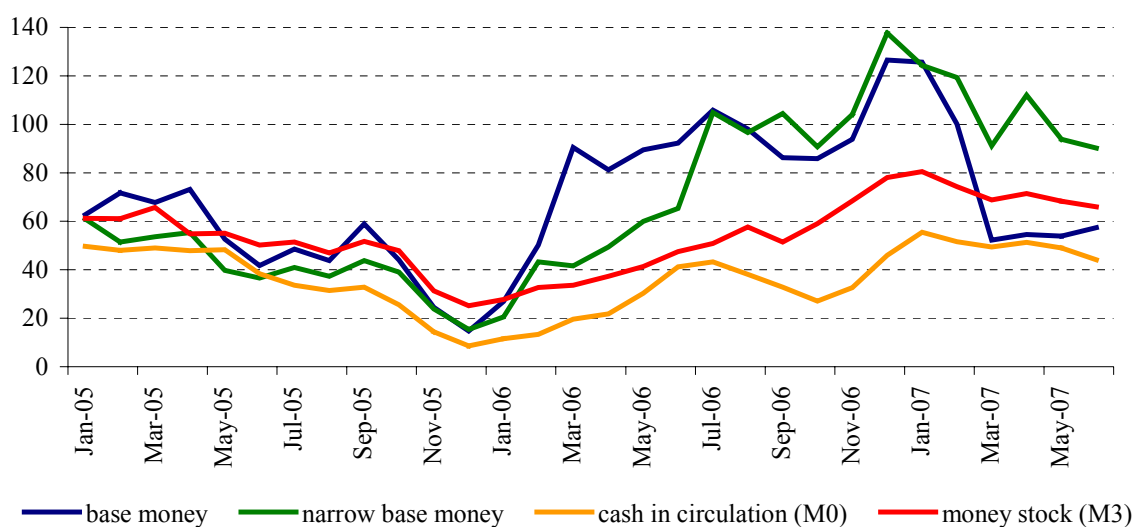
3.1. Money supply

In Q2 2007 the dynamics of monetary aggregates pointed in different directions. Base money expanded in annual terms, whereas narrow base money, the money stock, and cash in circulation declined. The rate of change of the monetary aggregates was, however, insignificant (Figure 11).

Figure 11

Dynamics of monetary aggregates

(as a percentage against the same month in the previous year)



Source: Republic of Kazakhstan National Bank

3.1.1. Base money

Base money at the end of June 2007 comprised T 1,666.7 billion. During Q2 2007 the expansion of base money comprised 5.2 percent. Narrow base money expanded during Q2 2007 by 25.4 percent.

In June 2007 by comparison with June 2006 base money expanded by 57.4 percent. This expansion resulted from the growth of international reserves of the National Bank.

Net international reserves of the National Bank increased in June 2007 by comparison with June 2006 by 71.0 percent to \$22.4 billion. Purchases of foreign exchange by the National Bank on the domestic currency market, despite the performance of operations to replenish assets of the National Fund and service external debt of the Ministry of Finance, led

to an increase by 75.4 percent of net foreign exchange reserves. Assets in gold increased by 26.2 percent as a result of operations performed and an increase in its prices on world markets.

Net domestic assets of the National Bank declined due to an increase in liabilities to banks, chiefly for short-term notes (see 3.3. Monetary policy instruments and operations).

A tightening of the mechanism for minimum reserve requirements, which entailed an increase in balances on correspondent accounts of banks with the National Bank and cash in cash departments of banks (Box 2) resulted in an expansion of narrow base money. This expansion in June 2007 by comparison with June 2006 was 90.2 percent. (Table 1).

Table 1

**Dynamics of changes in National Bank assets and liabilities
(as a percentage of the same period of the previous year)**

	Q3 06	Q4 06	Q1 07	Q2 07
Net international reserves	54.0	156.4	87.5	75.3
Net domestic assets	-1.1	-213.0	-184.1	-114.9
Net claims on government	38.4	-357.9	-10.7	-2.2
Claims on financial institutions	-25.6	-236.7	-369.4	-119.7
Claims on the rest of the economy	-87.8	-97.4	-77.9	-72.7
Other net domestic assets	-31.7	-49.6	57.0	-209.6
Base money	86.2	126.5	52.2	57.4
Cash outside the National Bank	35.6	49.9	54.0	49.3
Transferable deposits of banks	410.2	502.4	200.4	202.3
Other deposits of banks	-40.3	51.5	-17.1	-68.7
Narrow base money	104.5	137.8	91.1	90.2

Source: Republic of Kazakhstan National Bank

3.1.2. Money stock

During Q2 2007 money stock increased by 14.1 percent (in Q2 2006—15.9 percent) to T 4,489.2 billion. Net external assets of the banking system declined by a factor of 2.5, and domestic assets increased by 25.2 percent.

In June 2007 by comparison with June 2006 money stock growth comprised 66.0 percent (Figure 11) as a result of a significant increase in domestic assets of the banking system, while their net external assets continued to decline.

Within the structure of net external assets of the banking system, net international reserves of the National Bank increased, while net external assets of second-tier banks declined. It should be noted that based on results for Q2 2007 net external liabilities of second-tier banks exceeded net external assets of the National Bank, and as a result overall liabilities of the banking system to nonresidents exceeded its foreign assets.

The increase in domestic assets of the banking system was the result of continued high growth of credits provided to the economy (see 3.1.3. Credits to the economy). Claims of the banking system on the government declined due to an increase in balances on deposits of the government with the National Bank (Table 2).

An analysis of the dynamics of the main components of the money stock—cash in circulation and deposits in the banking system—shows that the prevalent role in the growth of money stock was played by the latter of the aforementioned components. As a result, according to the results for June 2007 the share of deposits of residents within the structure of the money stock increased to 82.3 percent by comparison with 79.7 percent in June 2006.

Table 2

Dynamics of money stock changes
(as a percentage of the same period of the previous year)

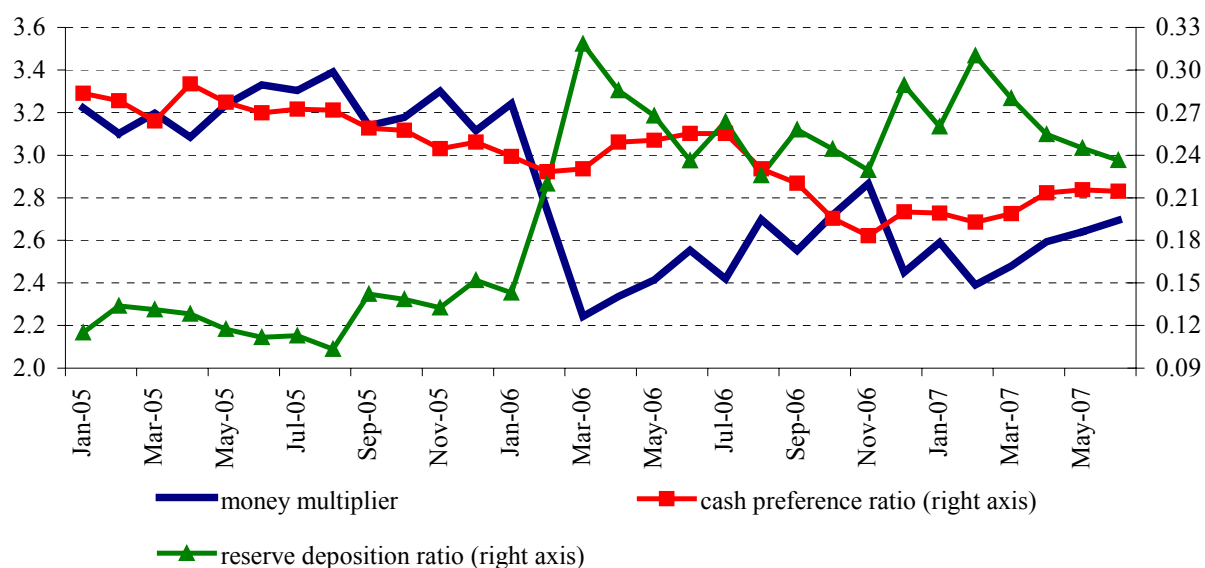
	Q3 06	Q4 06	Q1 07	Q2 07
Net external assets	-80.1	324.3	-35.2	-138.3
Domestic assets	115.8	66.3	91.5	94.4
Claims on government	142.0	-168.6	1397.1	-1538.8
Claims on the economy	80.1	84.1	93.0	108.0
Other net domestic assets	-43.2	-97.1	-96.9	-136.6
Money stock	51.5	78.1	68.7	66.0
Cash in circulation	32.8	45.8	49.3	44.2
Deposits of residents	56.3	86.1	73.2	71.6

Source: Republic of Kazakhstan National Bank

More significant rates of growth of the money stock by comparison with rates of expansion of base money caused an increase in the money multiplier from 2.55 in June 2006 to 2.69 in June 2007 (Figure 12).

Figure 12

Dynamics of the money multiplier and its components



Source: Republic of Kazakhstan National Bank

— Cash in circulation

Cash in circulation increased during Q2 2007 by 21.6 percent (in Q2 2006—by 26.0 percent) and comprised T 793.1 billion at the end of June. In June 2007 by comparison with June 2006 growth of cash in circulation reached 44.2 percent.

The growth of cash in Q2 2007 was the result of an increase in issuances from the cash departments of banks for payment of wages, withdrawals from deposits, and provision of loans.

In Q2 2007 by comparison with Q2 2006, issuances of cash from the cash departments of banks increased by 62.2 percent to T 2,652.7 billion, and receipts to cash departments of banks—by 64.7 percent to T 2,455.0 billion. As a result, the net issuance from cash departments of banks comprised T 197.7 billion (in Q2 2006—T 144.9 billion).

— Deposits of residents

As of the end of June 2007 deposits of residents reached T 3,696.1 billion. In Q2 2007 they grew by 12.6 percent. Deposits of legal entities increased by 10.7 percent, and of individuals—by 16.0 percent.

In annual terms deposits increased by 71.6 percent; a slowdown in annual rates is being observed for the second quarter in a row (Table 3). The annual growth of balances on deposits of nonbank legal entities was 65.6 percent and of individuals—83.1 percent.

Rates of growth of other deposits declined for the second quarter in a row, and transferable deposits in foreign currency also declined.

Deposits in the domestic currency practically doubled over the year, showing a 97.3 percent increase, while deposits in foreign currency increased by 21.5 percent.

Deposits of individuals increased by 83.1 percent, and of legal entities—by 65.6 percent.

Table 3

**Dynamics of changes in resident deposits
(as a percentage of the same period of the previous year)**

	Q3 06	Q4 06	Q1 07	Q2 07
Resident deposits	56.3	88.4	73.2	71.6
Transferable tenge deposits	71.2	77.1	55.4	75.7
of the population	73.5	75.4	66.9	71.0
of nonbank legal entities	57.1	77.3	53.6	76.5
Other tenge deposits	77.4	134.1	126.1	110.0
of the population	63.7	137.0	143.6	111.7
of nonbank legal entities	94.3	131.7	112.5	108.6
Transferable foreign currency deposits	28.7	53.6	12.5	-1.6
of the population	30.7	20.5	33.7	42.9
of nonbank legal entities	16.4	59.8	9.2	-9.2
Other foreign currency deposits	33.1	57.9	38.0	26.3
of the population	36.7	22.7	20.7	37.3
of nonbank legal entities	27.3	87.6	50.3	19.8

Source: Republic of Kazakhstan National Bank

3.1.3. Credits to the Economy

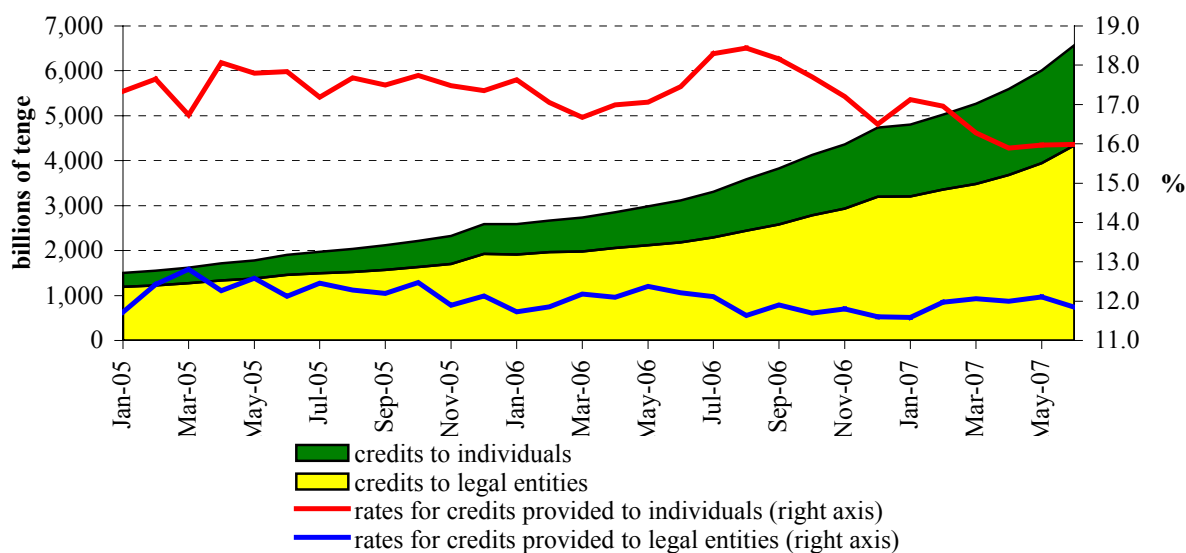
The high rates of credit expansion of second-tier banks in the economy of Kazakhstan declined in Q2 2007. During this period credits to the economy increased by 24.6 percent and reached T 6,568.6 billion. Credits to the population grew by 24.4 percent, and to legal entities—by 24.7 percent.

In June 2007 by comparison with June 2006 credits to the economy grew by a factor of 2.1, including credits to legal entities—by a factor of 2.0 and to individuals—by a factor of 2.4.

Interest rates on credits issued in Q2 2007 declined. The weighted average rate for credits to legal entities decreased from 12.1 percent in March 2007 to 11.8 percent in June 2007, and for credits to individuals—from 16.3 percent to 16.0 percent, respectively (Figure 13).

Figure 13

Dynamics of credits to the economy and interest rates on them



Source: Republic of Kazakhstan National Bank

— **Credits to legal entities**

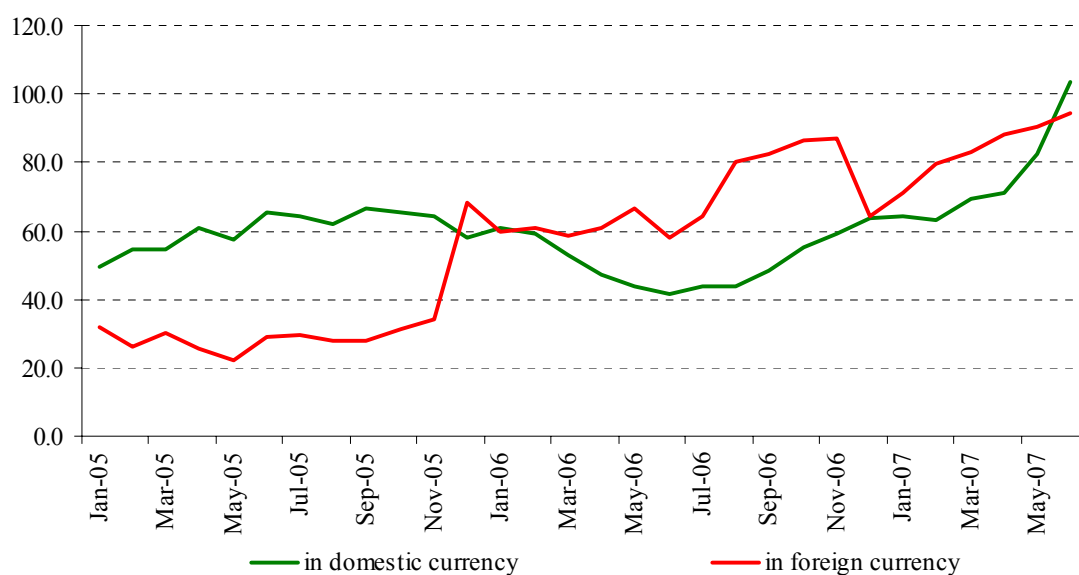
In June 2007 by comparison with June 2006 credits to legal entities grew by 99.1 percent.

In Q2 2007 the growth of credits in domestic currency exceeded growth of credits in foreign currency, which has not been noted since the beginning of 2006 (Figure 14).

Figure 14

Dynamics of credits to legal entities

(as a percentage of the same period in the previous year)



Source: Republic of Kazakhstan National Bank

The proportion of medium- and long-term credits within the volume of credits to legal entities at the end of June 2007 was 68.9 percent.

Within the structure of credits to legal entities, the largest share at the end of June 2007 consisted of credits for acquisition of working capital (43.5 percent), capital stocks (16.7 percent), and new construction and reconstruction of facilities (16.7 percent).

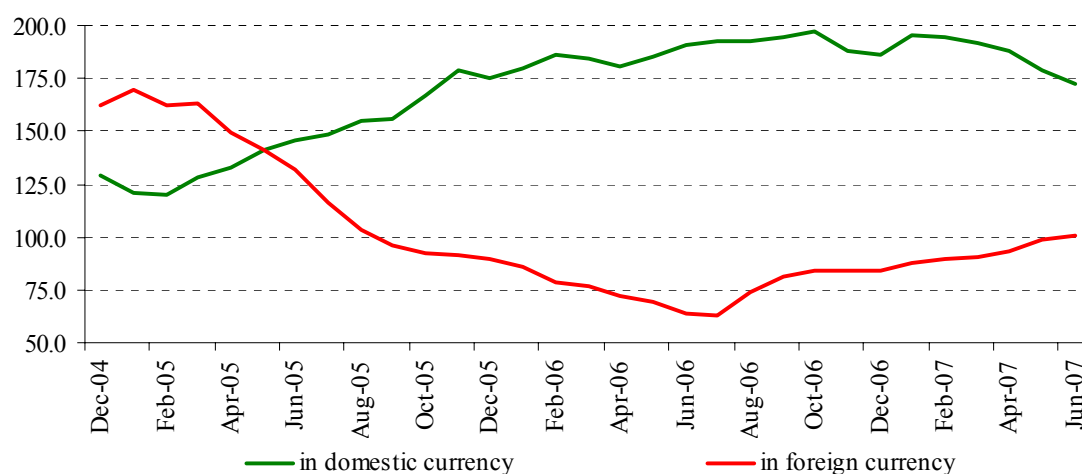
— Credits to the population

The annual increase in the dynamics of credits to the population was a factor of 2.4; within those dynamics, credits in the domestic currency are demonstrating higher rates of growth. In June 2007 by comparison with June 2006 credits to the population in the domestic currency increased by a factor of 2.7, whereas credits in foreign currency increased by a factor of 2.0 (Figure 15).

Figure 15

Dynamics of credits to the population

(as a percentage of the same period in the previous year)



Source: Republic of Kazakhstan National Bank

Within the structure of credits to the population, credits for consumer goals occupied 47.1 percent in June 2007. The proportion of credits to the population for construction and acquisition of housing was 33.7 percent in June 2007.

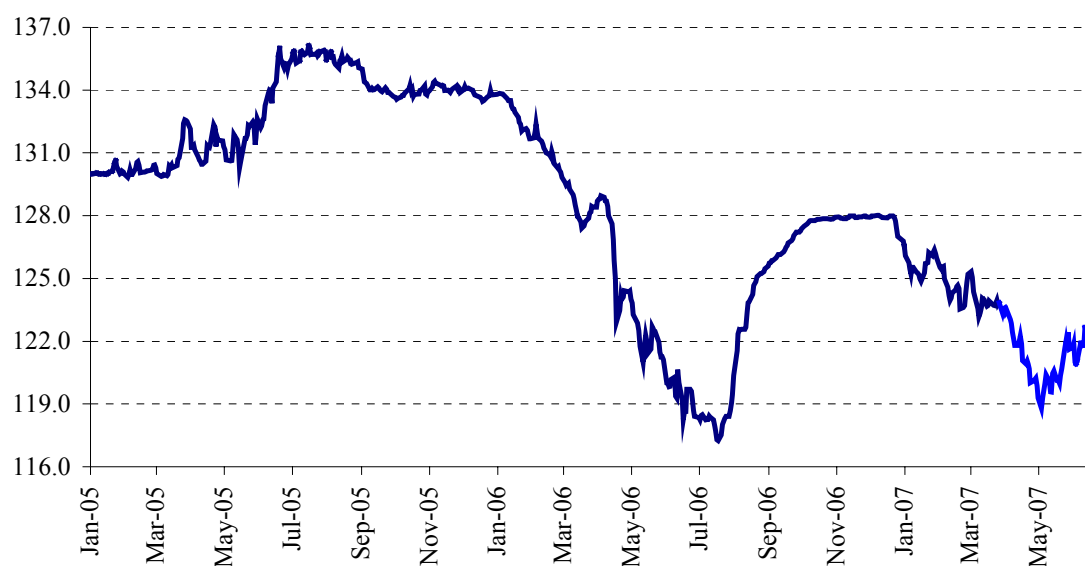
3.2. Exchange rate

In Q2 2007 the dynamics of the tenge's exchange rate against the U.S. dollar was characterized by trends in differing directions. Altogether, based on results for the quarter, the exchange rate of the tenge appreciated against the U.S. dollar by 1.2 percent—from T 123.84 per dollar to T 122.31 per dollar.

The weighted average exchange rate of the tenge for Q2 2007 was T 121.38 per dollar, having strengthened by 2.8 percent by comparison with the indicator for Q1 2007. During the quarter the tenge changed against the dollar within a range from T 118.79 – T 123.60 per dollar (Figure 16).

Figure 16

Dynamics of the nominal exchange rate of the tenge against the U.S. dollar



Source: Republic of Kazakhstan National Bank

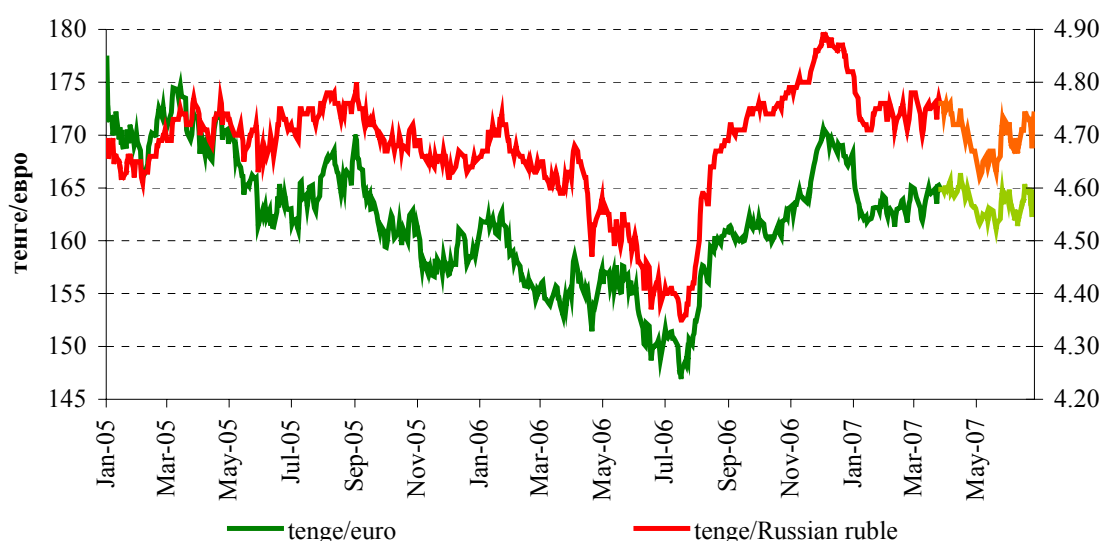
There was a significant nominal appreciation of the tenge against the U.S. dollar in April (3.0 percent), while in May the tenge depreciated (1.9 percent) and in June the tenge remained relatively stable (appreciation by only 0.1 percent).

Given that volumes of transactions with Russian rubles on the exchange segment of the domestic currency market remains insignificant, and that no transactions were carried out with the euro at all in Q2 2007, the exchange rate of the tenge against those currencies is calculated on the basis of a cross-rate against the U.S. dollar. Correspondingly, the dynamics of the tenge exchange rate against the euro and the Russian ruble were determined by the dynamics of the tenge exchange rate against the U.S. dollar, the position of the single European currency on the international financial market, and policy of the Central Bank of Russia with respect to the exchange rate of the Russian ruble against a basket of currencies.

During Q2 2007 the official tenge exchange rate against the euro and the Russian ruble appreciated by 0.1 percent and 0.4 percent respectively (Figure 17).

Figure 17

Dynamics of the official tenge exchange rate against the euro and the Russian ruble



Source: Republic of Kazakhstan National Bank

During Q2 2007 the situation on the internal currency market was determined by the situation on global foreign exchange markets, the status of the country's balance of payments, and large volumes of operations on the currency sector of the stock and interbank markets.

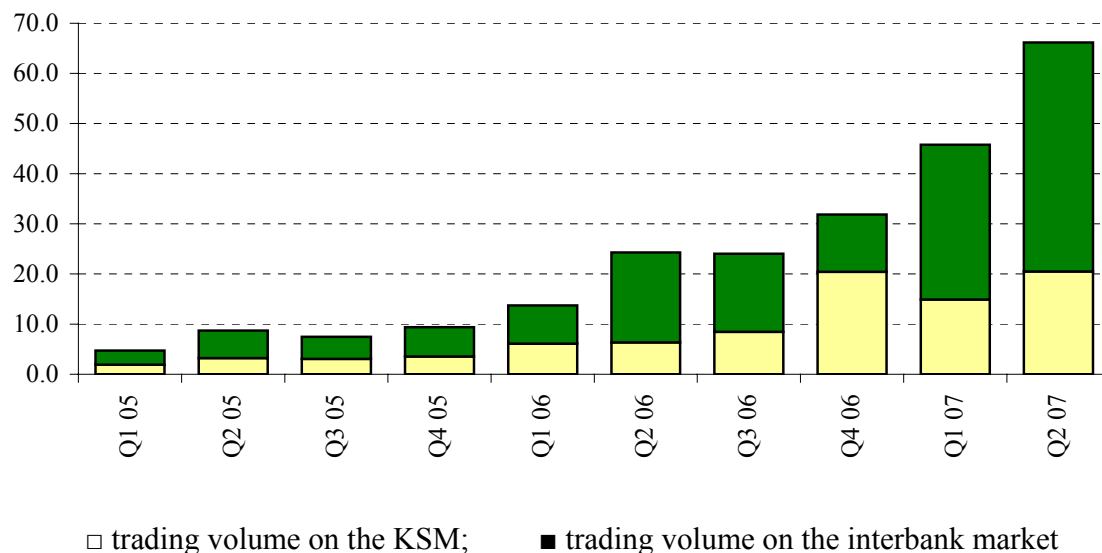
Overall, the exchange rate dynamics of the tenge against the dollar on the domestic currency market corresponded to the exchange rate dynamics of the euro against the dollar on the world currency market. Thus, in April the euro appreciated against the U.S. dollar in nominal terms by 2.2 percent and in May it weakened by 1.1 percent, whereas in June the exchange rate of the euro against the U.S. dollar remained relatively stable (appreciation by 0.4 percent).

In Q2 2007 large volumes of trading took place on the currency sector of the Kazakhstan Stock Market [KSM] and on the interbank currency market, which may indicate a speculative mood on the part of market participants. Thus, the total volume of trading on the domestic currency market was \$66.1 billion, which was a 44.4 percent increase by comparison with Q1 2007.

The volume of exchange trading in dollar positions on the Kazakhstan Stock Market increased by 37.5 percent by comparison with Q1 2007 and comprised \$20.5 billion (the net volume of trading on the Kazakhstan Stock Market was about 60 percent of gross volume). On the over-the-counter currency market, the volume of operations in Q2 2007 increased by comparison with the previous quarter by a factor of 47.8 percent and comprised \$45.7 billion (Figure 18).

Figure 18

Volume of trading on the domestic currency market, billions of U.S. dollars



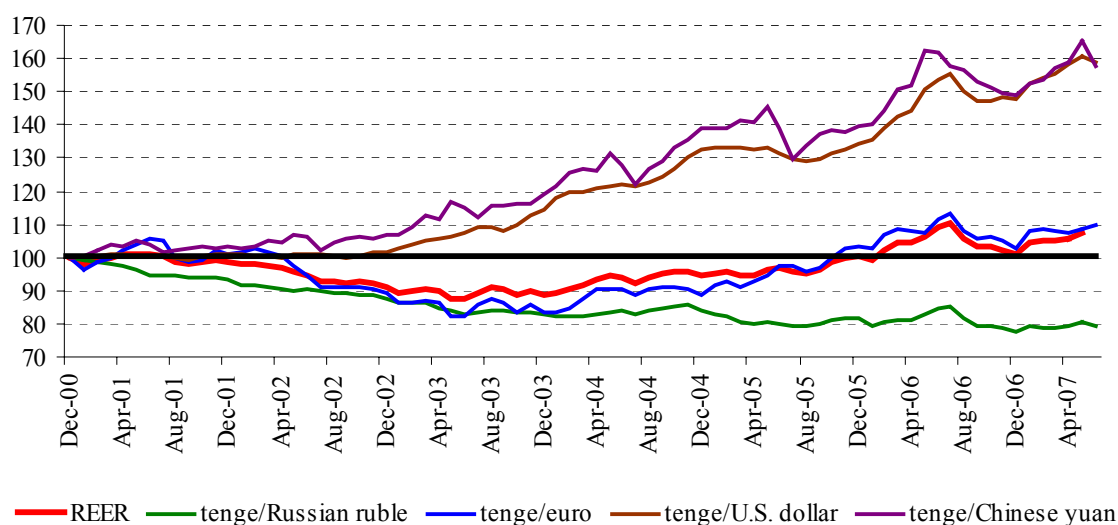
Source: Republic of Kazakhstan National Bank

Based on results for Q2 2007, the index of the real effective exchange rate (REER) for the tenge and the indices of the real exchange rate of the tenge against the main currencies increased. Thus, according to preliminary data the REER index for the tenge increased by 1.6 percent. In addition, the tenge appreciated against a basket of CIS country currencies by 1.5 percent and against a basket of currencies of all other countries—by 1.6 percent.

During Q2 2007 the tenge appreciated in real terms by 3.3 percent against the U.S. dollar, by 0.5 percent against the euro, by 0.9 percent against the Russian ruble, and by 4.2 percent against the Chinese yuan (Figure 19).

Figure 19

**Indices of real exchange rates of the tenge
(December 2000 = 100 percent)**



Source: Republic of Kazakhstan National Bank

3.3. Monetary policy instruments and operations

In the current year the National Bank has significantly reduced its participation in the currency market. According to results for Q2 2007 the National Bank's participation ratio on the KSM was (-)8.9 percent. In April the National Bank was a net purchaser, and in May and June it was a net seller of foreign currency.

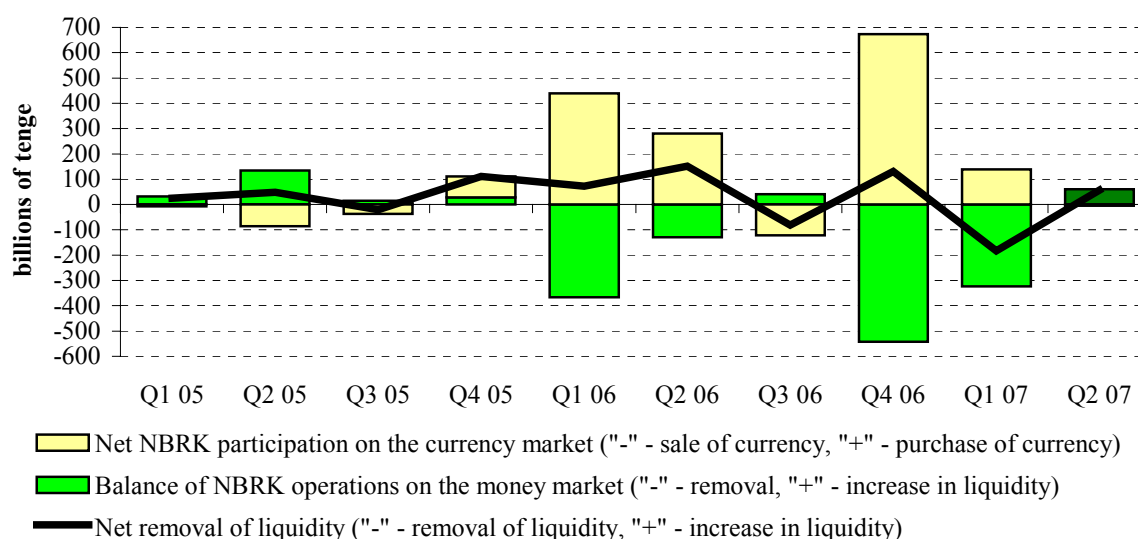
In addition, in Q2 2007 the National Bank purchased \$259.4 million in foreign currency for National Fund purposes.

With the aim of regulating inflation, the National Bank carried out operations to regulate liquidity of second-tier banks by issuing short-term notes and attracting deposits from the banking sector (see 3.3.2. Open market operations and 3.3.3. Standing mechanisms).

For Q2 2007 as a whole, the sum total of National Bank operations on the financial market was an increase in liquidity (Table 20).

Figure 20

Balance of National Bank operations on the domestic market

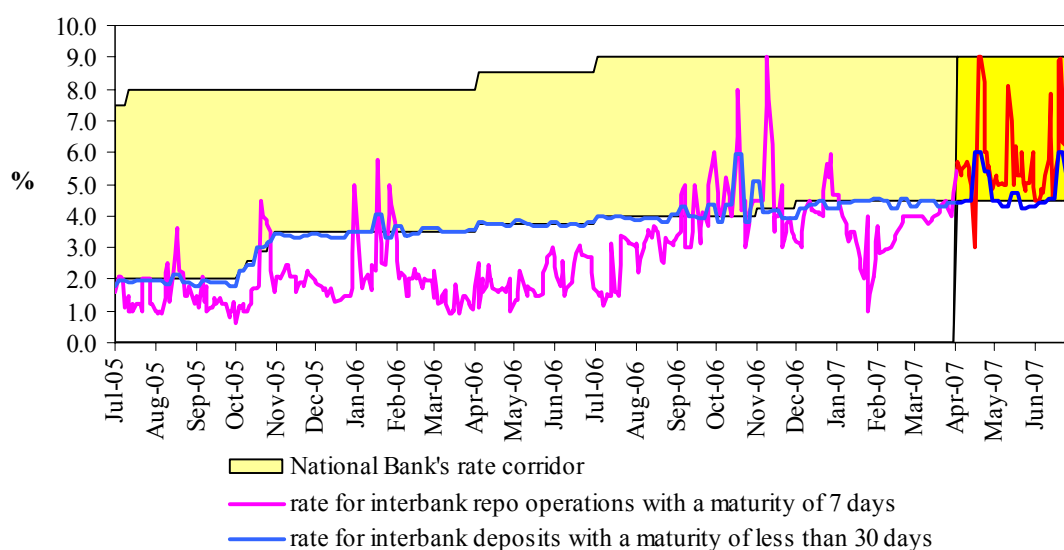


Source: Republic of Kazakhstan National Bank

In Q2 2007 the National Bank continued implementing a strict monetary policy that, *inter alia*, included maintaining at a high level rates for its own operations. Thus, the official refinancing rate was kept at the level of 9.0 percent per annum. Correspondingly, the rate for deposits attracted from second-tier banks, equal to half of the official refinancing rate, was 4.5 percent.

In Q2 2007 there was some increase in yield on the money market for operations that are comparable in terms of maturity. On average, their level for the quarter was within the limits of the National Bank's rate corridor. The weighted average rate for interbank deposits with maturities up to 30 days in Q2 2007 was at the level of 4.7 percent (in Q1 2007—4.4 percent). The weighted average rate for interbank repo operations with a maturity of 7 days was 7.21 percent (in Q1 2007—3.10 percent). (Figure 21).

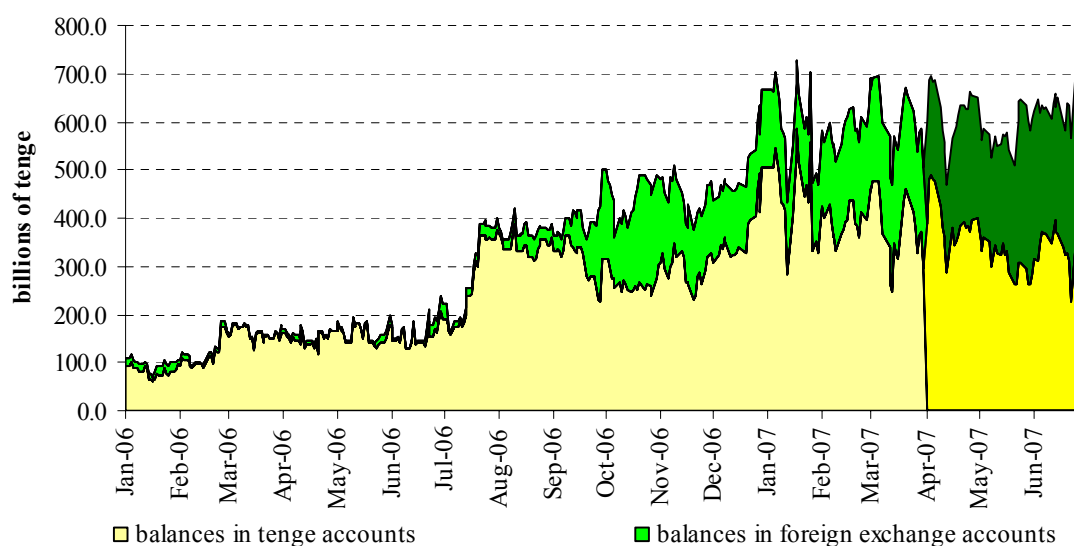
Figure 21
Limits of the National Bank's rate corridor



Source: Republic of Kazakhstan National Bank

In Q2 2007 an insignificant increase in balances on correspondent accounts of second-tier banks with the National Bank was accompanied by an increase in balances on accounts in foreign currency. Balances on correspondent accounts in domestic currency in this period declined somewhat (Figure 22).

Figure 22
Balances on correspondent accounts of banks with the National Bank



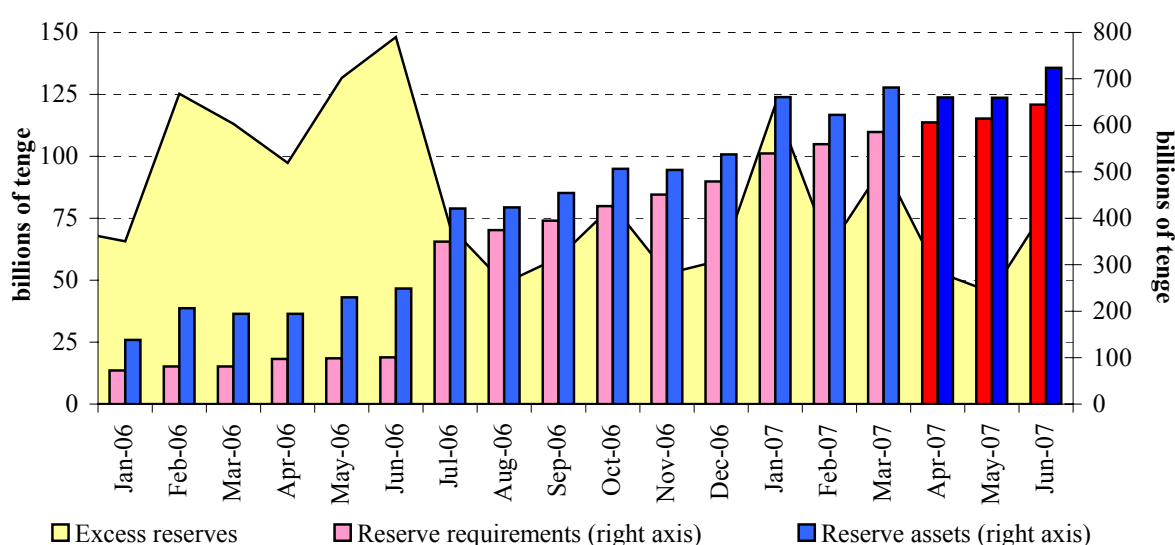
Source: Republic of Kazakhstan National Bank

3.3.1. Minimum reserve requirements

As a result of the change to the mechanism for generating and meeting minimum reserve requirements effective July 12, 2006, beginning with the second half of 2006 there was a significant reduction of excess liquidity of second-tier banks. As an average for April-June 2007, reserve assets exceeded the necessary volume of reserve deposition by 12 percent (in Q1 2007—by 19 percent) (Figure 23).

Figure 23

Achievement of minimum reserve requirement norms



Source: Republic of Kazakhstan National Bank

Box 2

Procedure for the generation and achievement by second-tier banks of minimum reserve requirements

The structure of a bank's liabilities that are used for calculating minimum reserve requirements shall include the amount of the bank's domestic liabilities and the bank's other liabilities. A bank's domestic liabilities are defined as the amount of liabilities to residents according to a strictly defined list regardless of their maturity. A bank's other liabilities are calculated as the amount of the bank's liabilities to nonresidents and liabilities for debt-based securities regardless of residency designation.

When recording reserve liabilities (both for domestic and for other liabilities), the calculation shall include the amount of the bank's liabilities with respect to principal, interest, and arrears.

The period for determination of minimum reserve requirements shall comprise 14 calendar days and begin from the first Tuesday of the week and end with the last Wednesday of the 14-day period for determination of minimum reserve requirements.

Minimum reserve requirement norms shall be met via the generation by banks of reserve assets, which shall include cash tenge in the cash department and money on correspondent accounts with the National Bank in domestic and freely convertible foreign currencies.

The bank shall place money in reserve assets in such a fashion that the average amount of the reserve assets during the period of generation of reserve assets will not be less than the average amount of the minimum reserve requirements for the period of determination of minimum reserve requirements.

The period of generation of reserve assets shall comprise 14 calendar days and shall begin from the first Thursday of the week in which a period for determination of minimum reserve requirements begins and end on the Wednesday of the week in which a period for determination of minimum reserve requirements ends.

The minimum reserve requirement norms for second-tier banks are at 6 percent for a bank's domestic liabilities and 8 percent for a bank's other liabilities.

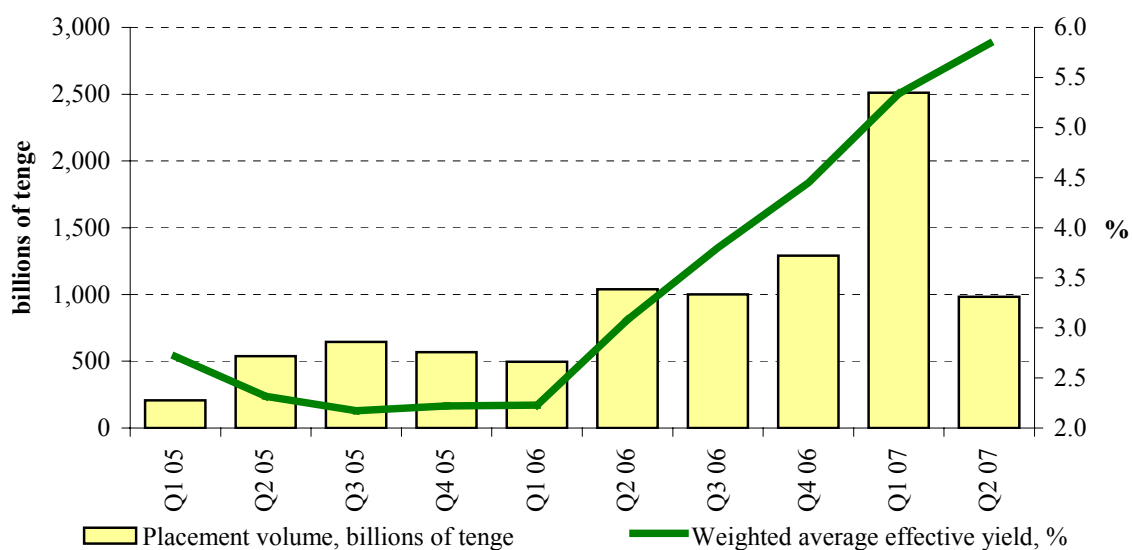
This mechanism has been in operation since July 12, 2006.

3.3.2. Open market operations

In Q2 2007 the volume of issued short-term notes declined by 60.9 percent by comparison with the preceding quarter and comprised T 981.9 billion. The notes were issued with a maturity of 28, 91, 182, and 365 days. The weighted average yield for the placed notes increased from 5.34 percent in Q1 2007 to 5.84 percent in Q2 2007 (Figure 24).

Figure 24

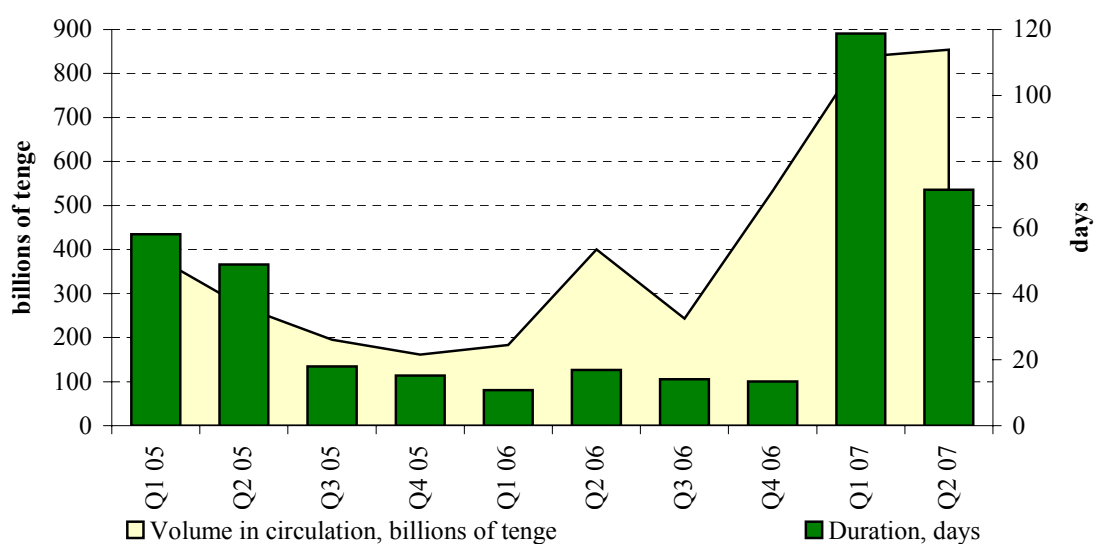
**Volume of placement of short-term notes and their yield
(over the period)**



Source: Republic of Kazakhstan National Bank

At the end of June 2007 the volume of short-term notes in circulation was T 853.9 billion, which is 2.0 percent more than the volume at the end of March 2007. The duration of notes in circulation at the end of June 2007 was 71 days (Figure 25).

Figure 25
Short-term notes in circulation
(as of the end of the period)



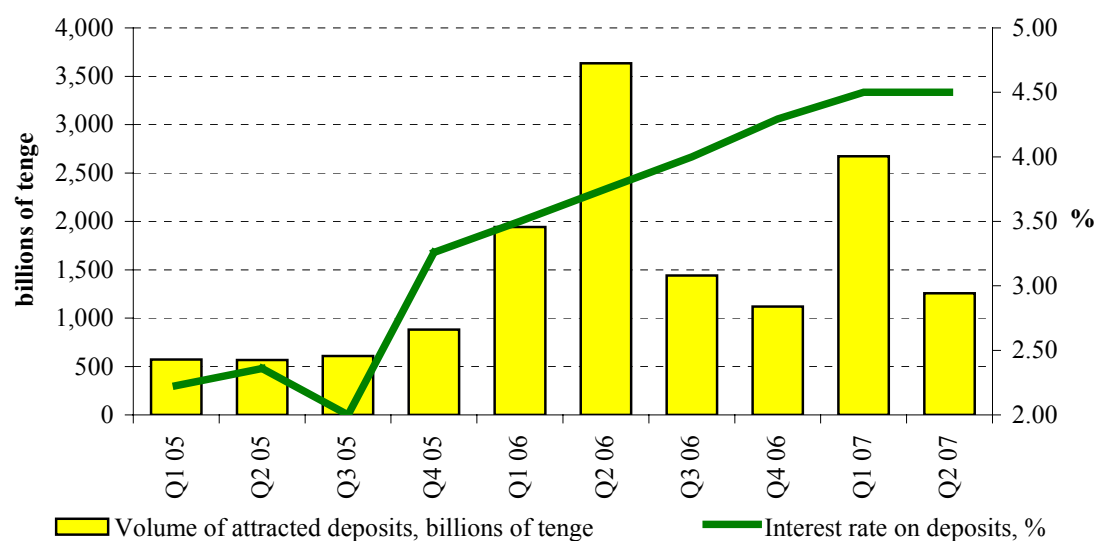
Source: Republic of Kazakhstan National Bank

3.3.3. Standing mechanisms

In Q2 2007 the National Bank attracted at a rate of 4.5 percent T 1,258.8 billion in deposits from second-tier banks, which is 52.9 percent less than the volume for Q1 2007. The period of attraction of deposits was 7 days (Figure 26).

Figure 26

Volume and interest rates for deposits attracted by the National Bank

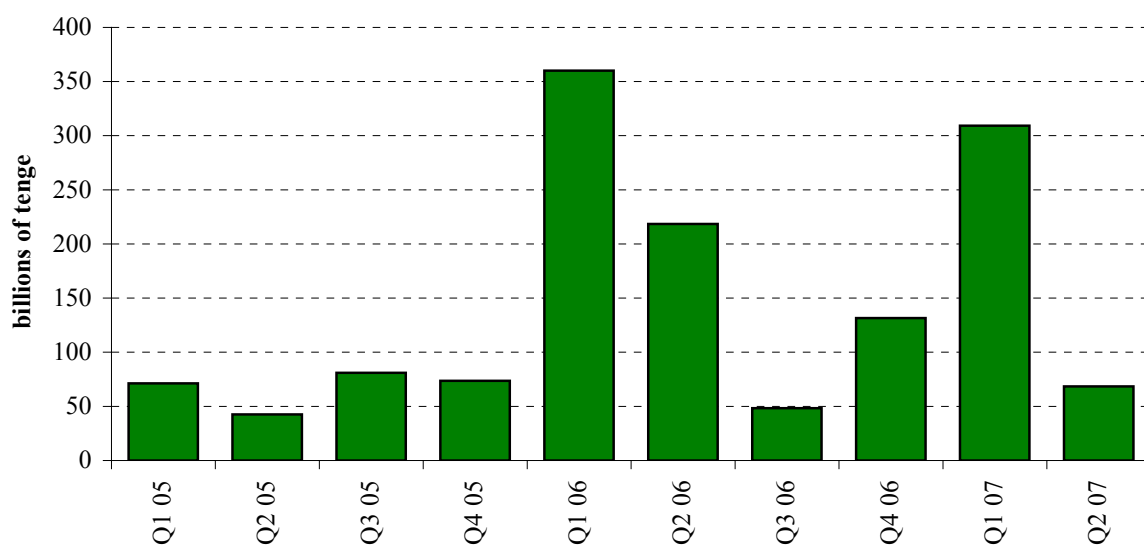


Source: Republic of Kazakhstan National Bank

The decline in volumes of attraction of deposits from second-tier banks in Q2 2007 was accompanied by a reduction of the volume of unpaid liabilities of the National Bank with respect to them by a factor of 4.5 to T 68.5 billion (Figure 27).

Figure 27

Volume of unpaid liabilities of the National Bank for deposits attracted from second-tier banks (at the end of the period)



Source: Republic of Kazakhstan National Bank

For purposes of replenishing liquidity of banks, in Q2 2007 the National Bank conducted reverse repo operations (these operations had not been carried out since January 2006). The total volume of reverse repo operations was T 149.7 billion. As of the end of Q2 2007 the balance of unpaid indebtedness of banks to the National Bank was T 10.0 billion.

4. Inflation forecast

4.1. Estimated inflation forecast for Q2 2007

The actual level of inflation in Q2 2007 (1.9 percent) exceeded the forecast for that period (1.6–1.8 percent) published in the previous issue of the “Inflation Survey.” In April the actual level of inflation was below the forecast level, and in May and June inflation was higher than anticipated.

In Q2 2007 inflation was caused by an increase in prices for foodstuffs and non-food products. Within their structure, the greatest increase in prices occurred for fruits and vegetables, meat products, fish and seafood, and gasoline.

June should be especially distinguished in the inflation dynamics in this period. We have not observed such a substantial increase in prices (by 0.8 percent) since 2000. In June there was a significant increase in prices for fruits and vegetables that is uncharacteristic of that period. The increase can be partially explained by interruptions in deliveries of fruits and vegetables from neighboring states, particularly from Uzbekistan.

In the first half of 2007 there was an increase in prices for grain crops on the global market. As a consequence, this resulted in an increase in prices for that product on the domestic market as well. As a result, in April-June 2007 there was an increase in prices for livestock products (due to the increased cost of fodders).

Due to the divergence between forecast and actual data in May–June, actual annual inflation in June 2007 exceeded the forecast. Thus, based on results for June, inflation was 8.1 percent against a forecast of 7.8–8.0 percent

4.2. Inflation forecast for 2007

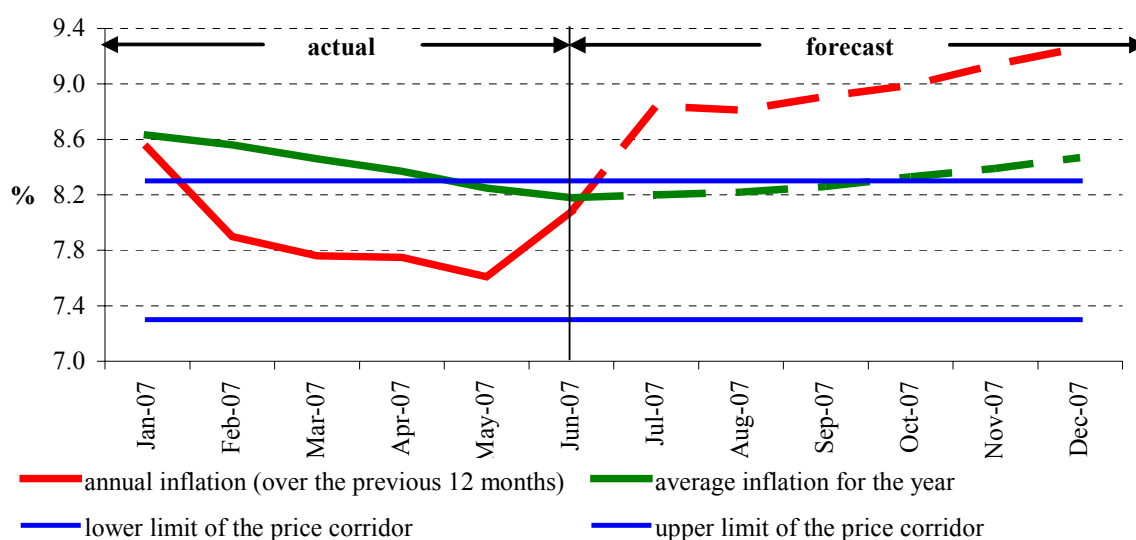
In 2007 the macroeconomic situation in Kazakhstan is defined by such indicators as high inflows of foreign capital into the country, a significant expansion of aggregate demand, high liquidity of the domestic financial sector, and low labor productivity. As a consequence, in the second half of the year there will be a new period of accumulation of inflationary processes in the economy, which as a result will contribute to growth of inflation comparable to indicators for 2006.

In accordance with the Guidelines for Monetary Policy for 2007–2009, the National Bank has defined an inflation forecast for 2007 within the limits of 7.3–8.3 percent, which corresponds to the forecast for "moderate prices for oil and high capital inflows" (Figure 28). This scenario assumes that the average world price for oil in 2007 will not exceed \$60 per barrel. Based on the results for the first six months alone, however, one can say that we are witnessing the "high prices for oil" scenario given that according to World Bank data the world price for Brent grade oil averaged \$63.4 over January–June 2007. According to the

"high prices for oil" scenario, average annual inflation for 2007 is defined within the limits of 8.2–9.2 percent.

Figure 28

Inflation, actual and forecast in 2007



Source: Republic of Kazakhstan National Bank

4.2.1. Inflation forecast for Q3 2007

In Q3 2007 we expect that inflation will be at a lower level by comparison with the preceding quarter and will comprise 1.7–2.0 percent (in Q3 2006—1.0 percent). Annual inflation at the end of September 2007 is forecast within the limits of 8.8–9.0 percent.

In July–September 2007 we expect a certain stabilization of inflationary processes, which will be caused first and foremost by seasonal factors. This presupposes a decline in prices for fruit and vegetable products. Price formation for meat and dairy products will be influenced by the situation on the external market.

The beginning of seasonal agricultural work presupposes an increase in prices for fuels and lubricants. In addition, the beginning of the new school year will be characterized by an increase in prices and tariffs for services of educational institutions, and also for clothing and footwear.

It should also be noted that in the lead-up to the election of deputies to the *Majlis* of the Parliament of the Republic of Kazakhstan in August 2007, the local executive authorities will apply special efforts to support price stability in the regions.

In addition, measures that are being taken by the National Bank in 2007 will also "brake" the development of inflationary process in the Republic.

4.2.2. Inflation forecast for Q4 2007

In October–December, as the situation of past years demonstrates, there is increased activity on the consumer market due to higher demand as a consequence of the December holidays. As a result, the period is characterized by the highest increase in consumer prices.

The National Bank expects that inflation in Q4 will comprise 2.6–2.8 percent (in Q4 2006—2.4 percent). Annual inflation results for December 2007 are forecast at 9.3 percent, and average annual results are forecast at 8.5 percent.

Inflation will be influenced, as previously, by such factors as an increase in consumer and investment demand in excess of economic growth, a significant inflow of foreign capital, and high credit activity in the banking sector.