

National Bank
National Bank
of the Republic of Kazakhstan
of the Republic of Kazakhstan

Inflation Report
2nd quarter 2006

Contents

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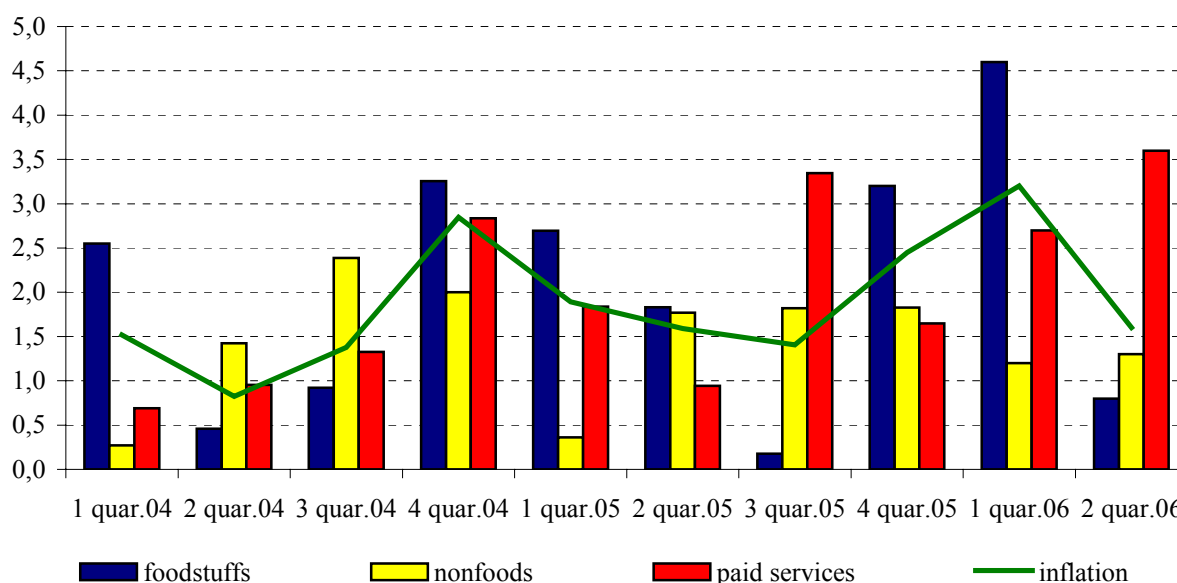
1. Inflation

a. Consumer prices

Deceleration of growth of prices in the consumer market as against the previous quarter of the current year was seen in the 2nd quarter of 2006 and compared with the corresponding period of the previous year the rate in inflation has not changed. As per the results of the 2nd quarter of 2006 the growth rate of consumer prices has reached 1.6% (graph 1).

Graph 1

Dynamics of inflation and its components (% of the previous period)



Source: Agency of the Republic of Kazakhstan for Statistics

The basic reason for the consumer prices' growth in the 2nd quarter of 2006 was the appreciation of paid services to the population by 3.6%, mainly those in the housing and communal services. Dynamics of prices of the housing and communal services sector was shaped under the influence of the growth of prices of gas utilities, electric power supply and water supply.

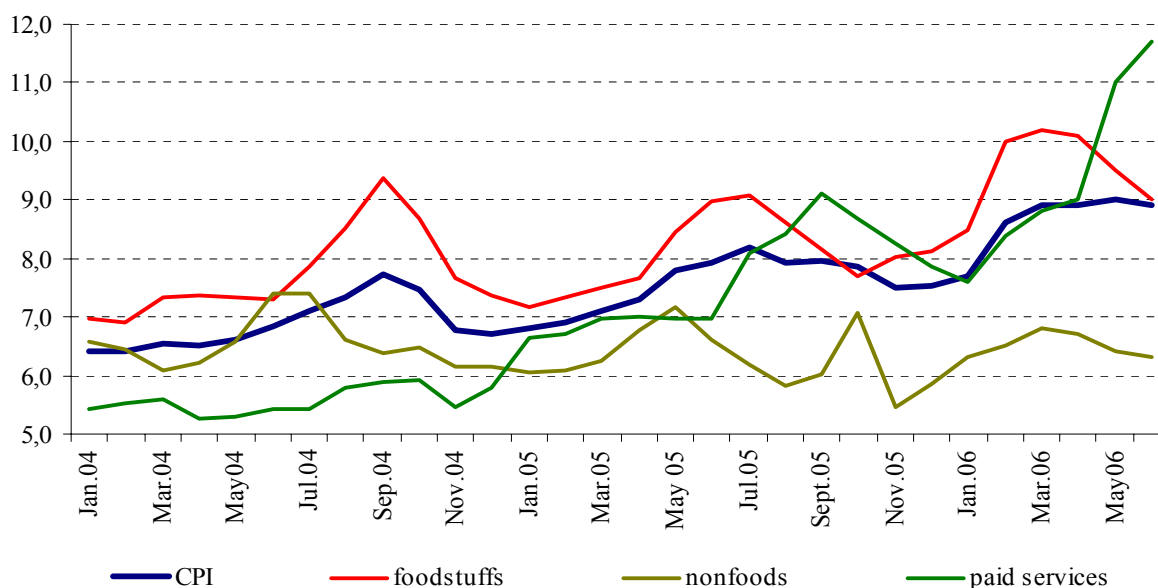
The rise of prices of nonfoods in the 2nd quarter of 2006 made 1.3%. The highest rise in their structure fell on gasoline, printed matters, garments and footwear.

The rise of prices of foodstuffs in April-June 2006 compared with that in the 1st quarter 2006 considerably slackened and made 0.8%. The highest price advance in their structure fell on the fruit and vegetable products. Besides, fish and sea-foods, meat products and bread became a bit more expensive. Prices of eggs, dairy products, butter and fats and also sugar were recorded as dropped.

All in all, as per the results of the first six months of the current year (June 2006 as against December 2005) the rate of inflation was 4.8% and in annum terms as of the end of June 2006 it was 8.9% (as of the end of December 2005 – 7.5%). During the year foodstuffs grew dear by 9.0%, nonfoods by 6.3%, paid services by 11.8% (Graph 2). In annum terms the main price appreciation covered sugar, fruit and vegetable products, gas utilities, transport services and those in the educational institutions.

Graph 2

Dynamics of inflation and its components
 (% of the corresponding month of the previous year)



Source: Agency of the Republic of Kazakhstan for Statistics

The rise of consumer prices in April-June 2006 was primarily affected by the seasonal factors in some markets of goods and services, mainly regarding fruit and vegetable products and the situation in the sphere of regulated services.

In the 2nd quarter of 2006 prices of fruits and vegetables increased by 6.5%, tariffs on the housing and communal services by 6.0%. In accordance with the estimate of the National Bank just these two groups in April-June of the current year made the inflation grow a bit over 1% whereas the share of the rest components of CPI was nearly 0.6%.

Analyzing the dynamics of price changes in fruit and vegetable products in the previous years, one can note that in the 2nd quarter of 2006 their growth was at higher rates than that of other goods except 2004 when the prices of these goods were recorded as decreasing. On average, prices of fruits and vegetables in April-June 2004-2005 had been growing by 5.5%.

Furthermore, the influence of the seasonal factor at the period under review promoted decrease in prices of dairy products and eggs.

The modest decrease in prices of sugar in the 2nd quarter of 2006 was most probably conditioned by the adjustment of its price after the sharp appreciation in the previous quarter, since the cost of sugar in the previous years was, as a rule, appreciating.

Since 2005 there has been the overrun of the growth rates of tariffs on paid services in the structure of the consumer price index as against the rates of growth of goods' prices. Appreciation of tariffs on paid services in the 2nd quarter of 2006 was shaped at the maximum level for the period that followed the 3rd quarter of 1998 when the growth reached 3.9%.

Inflation in Kazakhstan in recent years including that in the current years too has been caused by the imbalance between aggregate demand and aggregate supply. Rates of growth of aggregate demand outrun the rates of expansion of aggregate supply, thus causing the growth of prices in the economy.

The growth of aggregate demand, in its turn, is strengthened by the increase in the incomes of the population including salaries and emoluments, pensions, allowances, etc., other revenues of enterprises and proceeds in the budget.

A rise in the demand of the population was strengthened by considerable rates of growth of real money incomes of the population which in April-June 2006 as compared with the corresponding period of 2005 increased by over 13%. The growth of retail turnover as an indicator of demand of the population in the 2nd quarter of 2006 as against that in the corresponding period of 2005 made over 14%.

The volumes of investments in the fixed assets, which are characterized by the demand of enterprises in the 2nd quarter of 2006 as against that in the 2nd quarter of 2005 increased by 19.7%. The largest investments in the current years were directed to the recovery of crude oil and natural gas, transactions with real estate and the development of transport and communications (investments in these types of activity made over 70% of the total volume of investments in the fixed assets).

Technological structure of investments in the fixed assets in recent years is characterized by a considerable share of investments in the active part of the fixed capital (in January-June 2006 and 2005 it was 34.7%, respectively). Thus, considerable investments in machinery and equipment have to facilitate technical re-equipment of the fixed capital and it has to become an important factor for the growth of labor productivity and create conditions for cutting down the price growth in the consumer market.

The consumer demand of the population and the investment demand of enterprises are strengthened by the increase in accessibility of credit facilities. Credit to the economy increased in the 2nd quarter of the current year by 14.0%. At the same time credit facilities for the consumer purposes of the population rose by 31.1%.

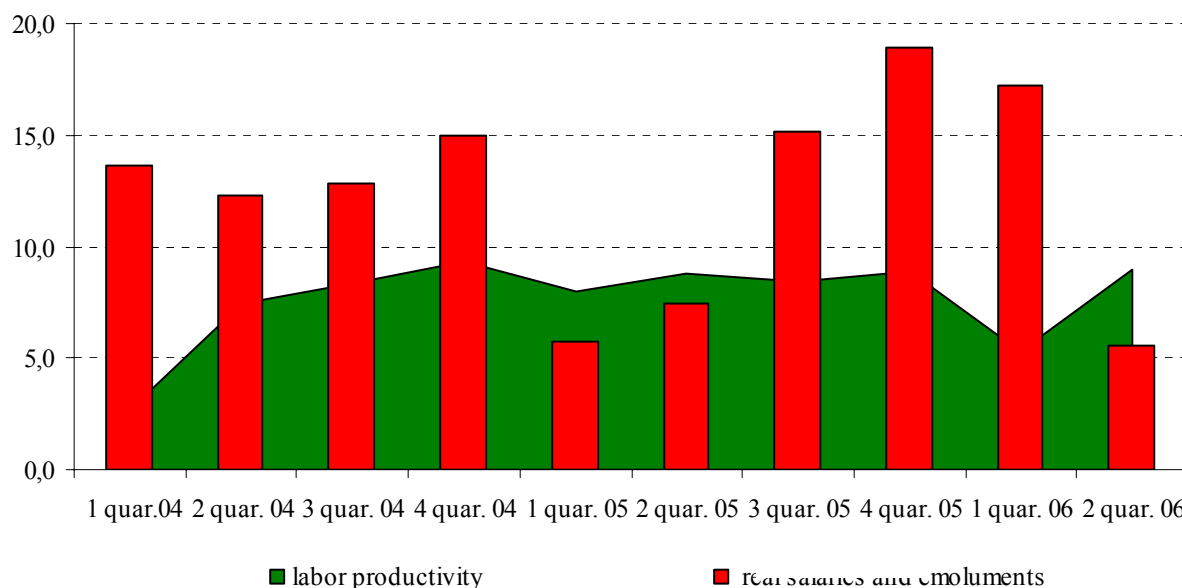
The growth of the consumer and investment demands significantly outruns the rates of growth of economy and in April-June 2005 they rated at 10.8%.

The appreciable increase in the budget revenues promotes the relevant increase in the budget expenditure. The state budget expenditure in the 2nd quarter of 2006 increased by 65.3%, whereas the nominal GDP rose by 38.8%. The state spends faster than the rate of growth of economy. In this case the expansionist nature of the budget policy is implied. Beside the positive results of this process the negative ones may be noted as well, i.e. the budget expenditure stimulates the high rates of increase in aggregate demand, as they are, and inflation too.

The increase in the real salaries and emoluments that surpasses the growth of labor productivity is still the important factor which places pressure on the growth of consumer prices. Despite the fact that the increase in labor productivity in April-June 2006 (compared with that in the corresponding period of the previous year) surpassed the growth of salaries and emoluments as 8.9% against 5.6%, in general as per the results of the first six months the real salaries and emoluments were growing faster than the labor productivity as 11.2% against 7.2% (Graph 3).

Graph 3

**Dynamics of real salaries and emoluments and labor productivity
(% of the corresponding period of the previous year)**



Source: The Agency of the Republic of Kazakhstan for Statistics

Increase in revenues of subjects of economy (population, enterprises) causes increase in the demand for money. The relevant growth of monetary offer (monetary aggregates) is secured by the expansion of bank crediting of economy and by the inflow of foreign capital. At the same time this inflow is secured by both the increase in the export earnings mainly related to the rise of the world prices (by 10.6% in the 2nd quarter of 2006) and the considerable banks' borrowings abroad. For instance, as of the end of June 2006 the volume of gross liabilities of the second tier banks to non-residents in freely convertible currencies reached the amount of USD 18.3 billion, thus for April-June 2006 having been increased by 16.0%.

The growth of the rate of inflation takes place against the background of rates of growth of monetary aggregates despite the tightening of monetary policy. The money supply for April-June 2006 grew by 15.9% (by 5.0% in the corresponding period of 2005) and cash in circulation by 26.0% (by 6.7%).

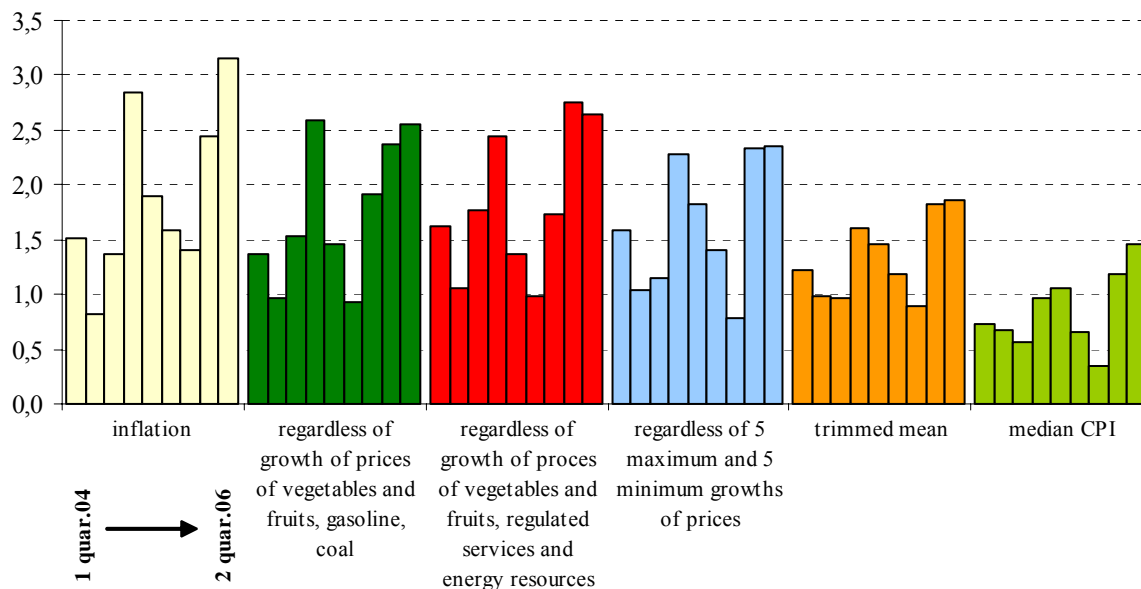
b. Core inflation

The core inflation dynamics in the 2nd quarter of 2006 was of differently directed nature. The core inflation calculated by variants 1, 4 and 5 grew as against the figures of the corresponding period of the previous year and at the same time the core inflation index as per the variant 3 remained unchanged and as per the variant 2 it decreased (Graph 4).

The rate of general inflation in April-June 2006 was growing at the rates that overran the rates of increase in core inflation by all the methods. This situation was conditioned by considerable appreciation of some types of goods and services excluded at calculating it (fruits and vegetables, sugar, regulated services).

Graph 4

Inflation and core inflation in 2004-2005 (in % of the previous period)



Source: Agency of the Republic of Kazakhstan for Statistics

Considerable appreciation of transport services and the housing and communal services in the 2nd quarter of 2006 made it possible for the core inflation as per variant 2 was shaped at a lower level than the core inflation as per the variant 1.

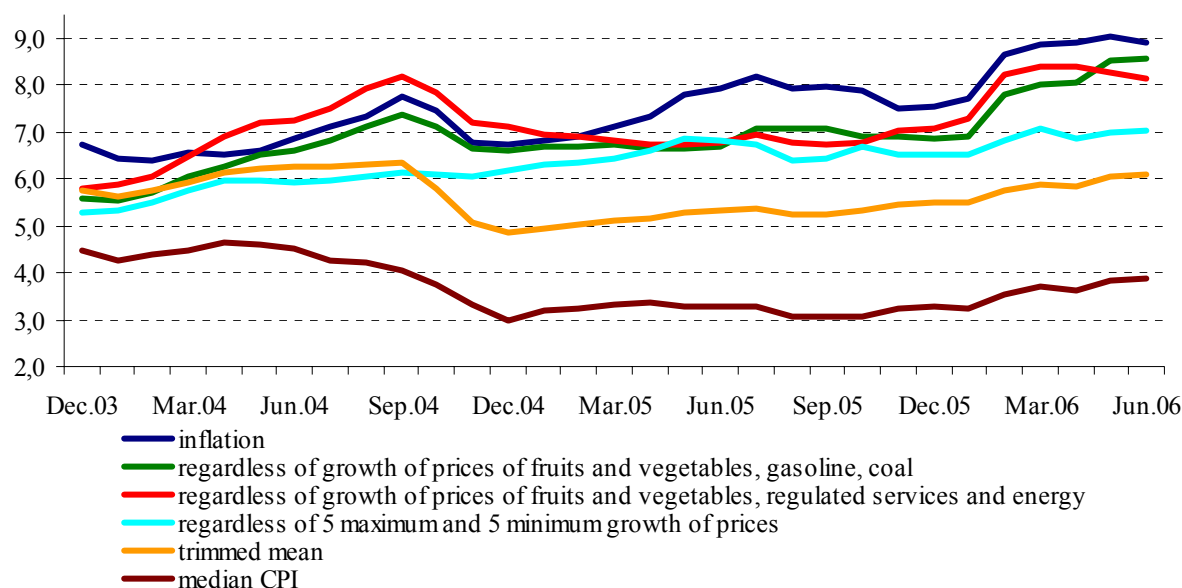
Despite the appreciation of fruit and vegetable products the insignificant decrease in prices of such components of the consumer goods basket as eggs, dairy products, fats and oils was observed at the reporting period. Since all these components are excluded at calculating the core inflation figures as per the variants 3, 4 and 5, their level in the 2nd quarter of 2006 was also shaped at a less value as against the level of general inflation.

Regardless of the decrease in core inflation by all the methods in the 2nd quarter of 2006 its level was higher than that at the corresponding period of the last year.

Indices of core inflation in annum terms by all the methods remained at the level that did not exceed the index of general inflation. Nevertheless, the increase of its level was seen in the 2nd quarter only as per the variants 2 and 3 (Graph 5). It proves that the inflationary pressure on the economy is still on.

Graph 5

Inflation and core inflation (% in annum terms)



Source: Agency of the Republic of Kazakhstan for Statistics

c. Prices in real sector of economy

Prices in industrial production

In accordance with data of the Agency of the Republic of Kazakhstan for Statistics, in April-June 2006 the producing enterprises increased their prices by 8.8% (by 5.6% in the 2nd quarter of 2005). Their output grew dearer by 9.2% but at the same time the products of interim consumption appreciated by 10.2%, means of production by 0.9%, consumer goods by 0.9%. Prices of production services grew dear by 4.2%.

In mining industry the growth of prices in the 2nd quarter of 2006 made 7.7% (8.5% at the corresponding period of 2005). Dynamics of prices in these industries was formed under the influence of price changes in the fuel-energy resources: oil grew dearer by 7.9%, gas condensate by 8.4%. At the same time the oil products appreciated by 8.4%, coal price decreased by 0.7%. In general, the prices of energy resources during the 2nd quarter of 2006 rose by 7.5%.

Rates of price appreciation in the manufacturing industry made 11.3%, thus considerably exceeding the index of the corresponding period of the previous year (2.7%). At the same time the producing enterprises' prices of non-ferrous metals increased by 39.1%, those of rolled ferrous metals rose by 4.1%.

The domestic producers' prices of pharmaceutical preparations in the 2nd quarter of 2006 decreased by 2.8% and those of textile and ready-made garments increased by 0.1% and foodstuffs by 0.5%.

Prices and tariffs in the production and distribution of electric energy, gas and water in the 2nd quarter of 2006 rose by 5.7% (by 2.5% in the 2nd quarter of 2005).

In annum terms the appreciation of prices in the garment manufacture was 25.2%.

Prices in agriculture

In accordance with data of the Agency of the Republic of Kazakhstan for Statistics, the prices agricultural products in the 2nd quarter of 2006 decreased by 1.3% (by 0.3% in the 2nd quarter of 2005). At the same time that depreciation of prices was secured by the decrease in prices of livestock products totally by 3.6% whereas the prices of crop production grew by 9.5%.

The seasonal decrease in prices of milk (by 15%), eggs (by 10.4%) was recorded in the structure of prices of livestock products. Poultry and eggs increased in prices by 1.5%.

The prices of crop production products appreciated due to the growth of prices of vegetables (by 0.1%) and cereal crops (by 0.4%).

In annum terms the prices in agriculture decreased by 0.9%.

Monitoring of enterprises

In the 2nd quarter compared with the previous quarter the general demand for the finished products produced by the polled enterprises increased. This increase in demand for the finished products was noted by 37.5% of polled enterprises (27.5% in the 1st quarter) and simultaneously the share of enterprises which noted the decrease in demand declined from 15.8% up to 10.2%. Decrease in the share of enterprises (up to 32.2%) which expect an increase in the demand is anticipated in the 3rd quarter of 2006 and that of the share of enterprises (up to 5.0%) which, on the contrary, expect a decrease in the demand for finished products. The share of enterprises which found difficulty in replying was 13.7%.

Stability of prices of finished products was recorded in the 2nd quarter of 2006 compared with that in the previous quarter. The share of enterprises with stable prices boosted up to 67.4% (65.7% in the 1st quarter) and the share of enterprises which stated the appreciation of prices (29.5% in the 1st quarter) lowered up to 27.0%. 21.1% of the polled enterprises in the 3rd quarter expect appreciation of prices of their own products, 2.9% of the polled enterprises stated the reduction of prices and 75.8% of enterprises believe that prices will not change or could not answer at all.

The situation concerning prices of raw and other materials in the 2nd quarter as against the previous quarter became somewhat better. The share of enterprises which noted the appreciation of prices rose from 55.8% up to 58.0% and the share of the polled enterprises which stated the price stability decreased from 39.7% down to 38.2%. However, only 45.3% of enterprises expect appreciation of prices of raw and other materials in the 3rd quarter of 2006, stability of prices is expected by only 32.8% of enterprises and 19.7% of enterprises could not give their answer.

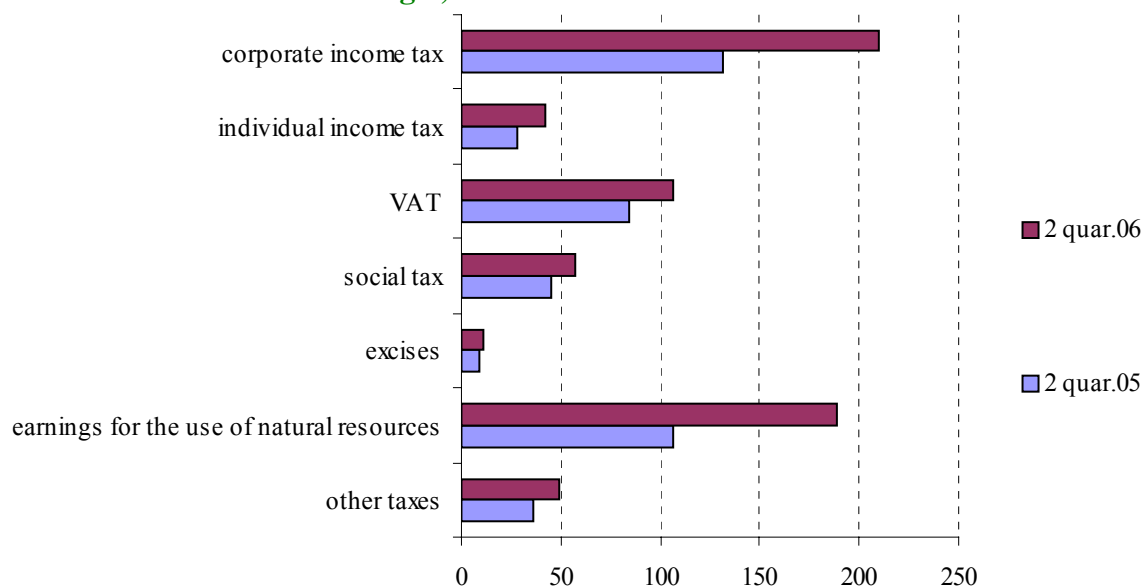
2. Fiscal policy

In accordance with data of the Ministry of Finance of the Republic of Kazakhstan the revenues in the state budget for the 2nd quarter of 2006 were 695.1 billion tenge. Compared with the indices of the corresponding period of the previous year they were increased by 49.2%. Besides, the revenues as against GDP increased up to 29.2% whereas in the 2nd quarter of 2005 they made 27.2% and 28.0% in the 1st quarter of 2006.

The main volume of revenues in the state budget falls on tax earnings (95.4%), in the structure of which the largest ones are still corporate income tax, earnings for the use of natural resources and VAT (Graph 6). The earnings for the use of natural and other resources at the period under consideration considerable increased by 78.0% and at the same time the basic reason for that increase was the growth of receipts on the surplus profit tax (by 2.8 times). Earnings on the corporate income tax rose by 59.4% and individual income tax by 46.9%.

Graph 6

Tax revenues in the state budget, billion KZT



Source: Ministry of Finance of the Republic of Kazakhstan

Proceeds from the raw material enterprises in the 2nd quarter of 2006 were growing at the rates which outran the rates of growth of revenues from other sectors of economy. This situation can be explained by the considerable appreciation of prices of oil and, respectively, the increase in revenues of oil companies. E.g. corporate income tax paid by the raw material enterprises as against the 2nd quarter of 2005 increased by 98.8% and compared with the rest enterprises by 41.7%. Royalty from the raw material enterprises rose by 5 times as much whereas that from the other enterprises decreased by 5.1 times as little.

Non-tax revenues in the state budget decreased by 36.1% and, on the contrary, earnings from sales of the fixed capital rose by 2.9 times.

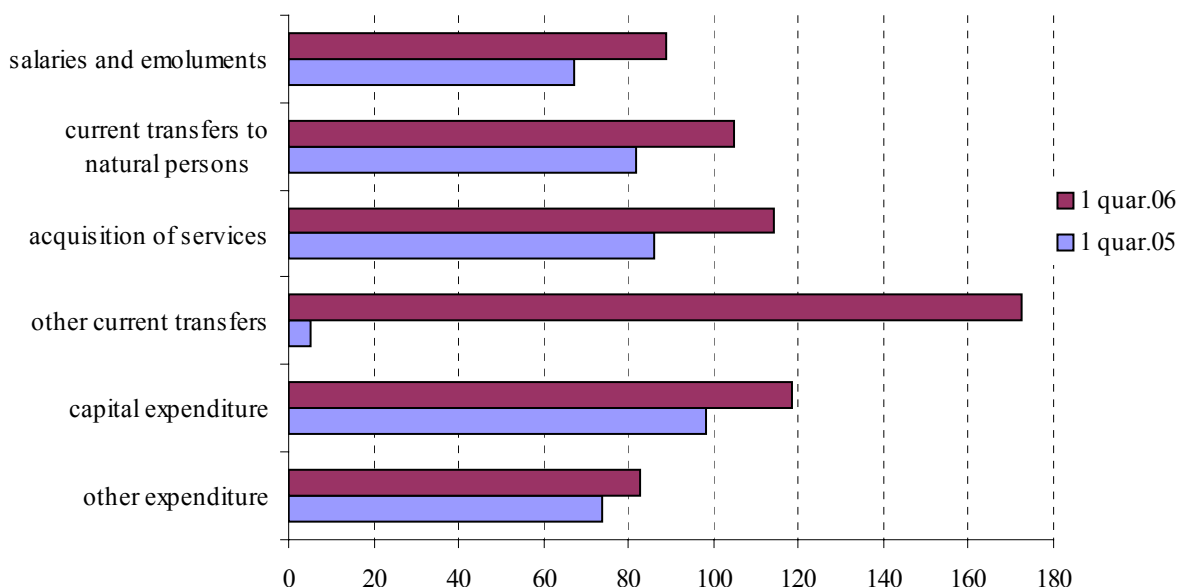
Expenditure of the state budget in the 2nd quarter of 2006 were financed to the amount of 681.2 billion tenge. Compared with the indices of the similar period of the previous year, expenditure was increased by 65.3%. As against GDP the expenditure were raised up to 28.6% whereas in the 2nd quarter of 2005 it was 24.1% and only 21.6% in the 1st quarter of 2006.

As against the similar period of 2005 the current expenses in the 2nd quarter of 2006 were increased by 78.9% and capital input by 20.3%.

A considerable share of the current expenses at the period under consideration was represented by other current transfers, mainly transfers to the National fund (30.2%) as well the expenses on acquisition of services (20.4%). Also, the share of expenses paid in cash i.e. current transfers to natural persons (18.7%) and those on salaries and emoluments (15.8%) are still at the high level (Graph 7).

Graph 7

Expenditure of the state budget, billion KZT



Source: Ministry of Finance of the Republic of Kazakhstan

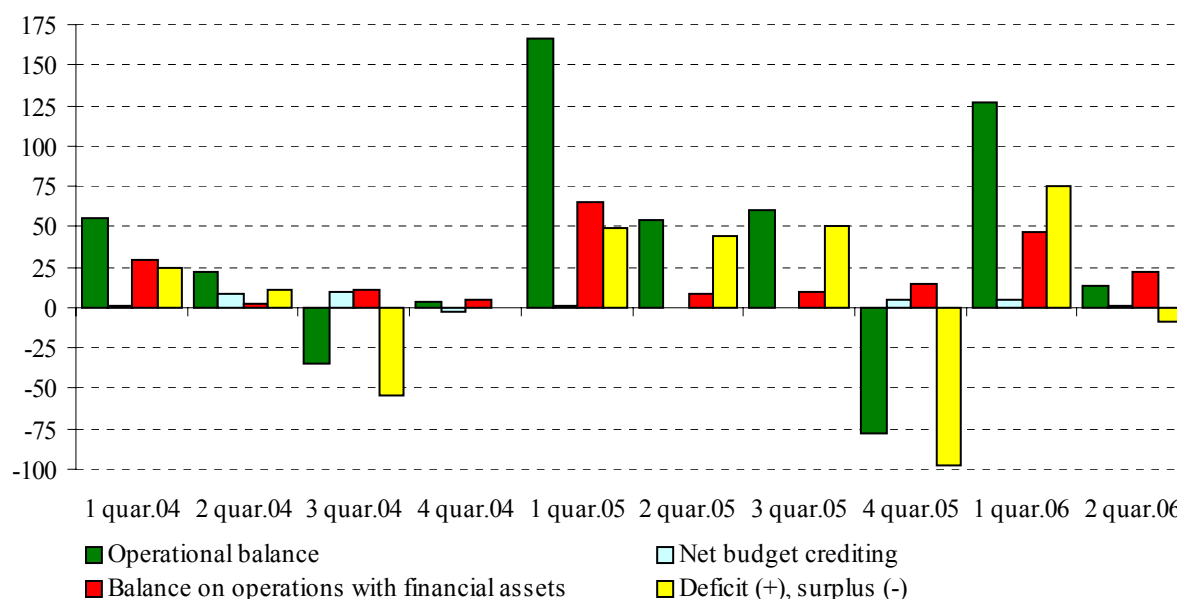
As a result of revenues over expenditure the state budget was formed with the positive operational balance amounting to 13.8 billion tenge whereas in the 2nd quarter of 2005 it was 53.6 billion tenge and in the 1st quarter of 2006 it amounted to 126.7 billion tenge.

The volume of net budget crediting in the 2nd quarter of 2006 was shaped positive amounting to 0.8 billion tenge, thus having grown by 67.1% as against the corresponding period of the previous year. At the same time granting of crediting reduced by 39.7% and repayment of credits decreased by 56.8%. Increase of expenses on acquisition of the state financial assets by 2.2 times as much with the reduction of earnings from sales of them by 4.0 times as little entailed in the growth of balance on these operations by 2.6 times as much amounting to 22.0 billion tenge.

As a result the state budget in the 2nd quarter of 2006 was formed with the deficit amounting to 9.0 billion Tenge (0.4% to GDP) against the surplus in the 2nd quarter of 2005 amounting to 44.8 billion Tenge (Graph 8).

The sources of financing of a possible deficit were formed as follows: proceeds from loans – 40.5 billion tenge, repayment of them – 38.9 billion tenge, use of funds on the Governmental accounts as a residual as per the operations at the previous periods – 7.3 billion tenge.

Graph 8

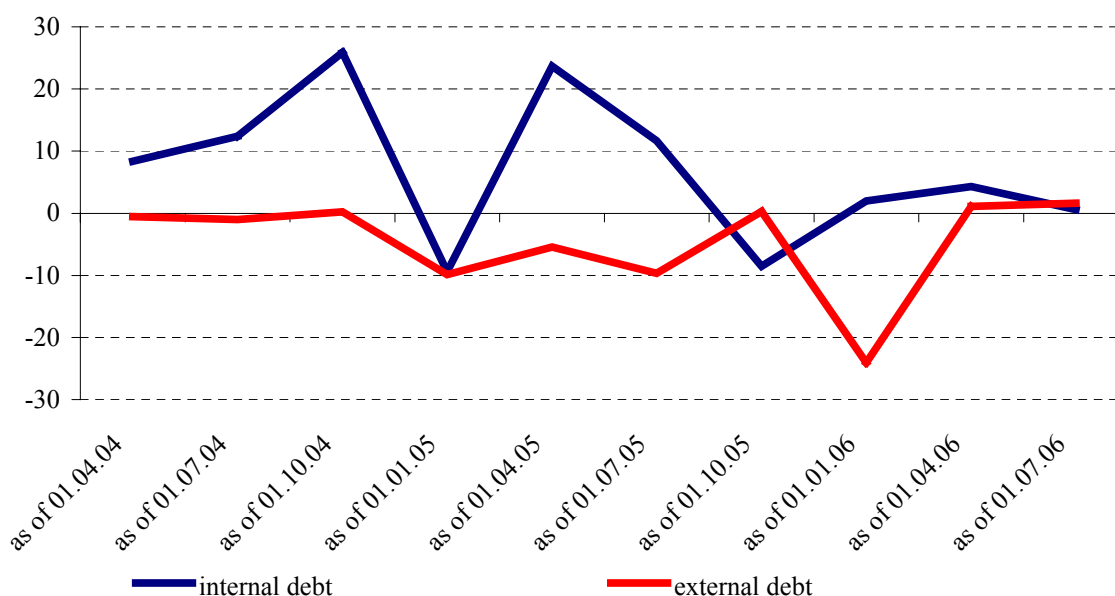
Administration of the state budget, billion KZT

Source: Ministry of Finance of the Republic of Kazakhstan

The Government's internal debt in June 2006 as against March 2006 increased by 0.6% making 312.5 billion tenge and it was secured by issuing the long-term Treasury obligations.

The Government's foreign debt in the 2nd quarter of 2006 compared with that in the previous quarter rose by 1.6% amounting to USD 1.8 billion (Graph 9).

Graph 9

**Dynamics of Government's debt
(% of the previous period)**

Source: Ministry of Finance of the Republic of Kazakhstan

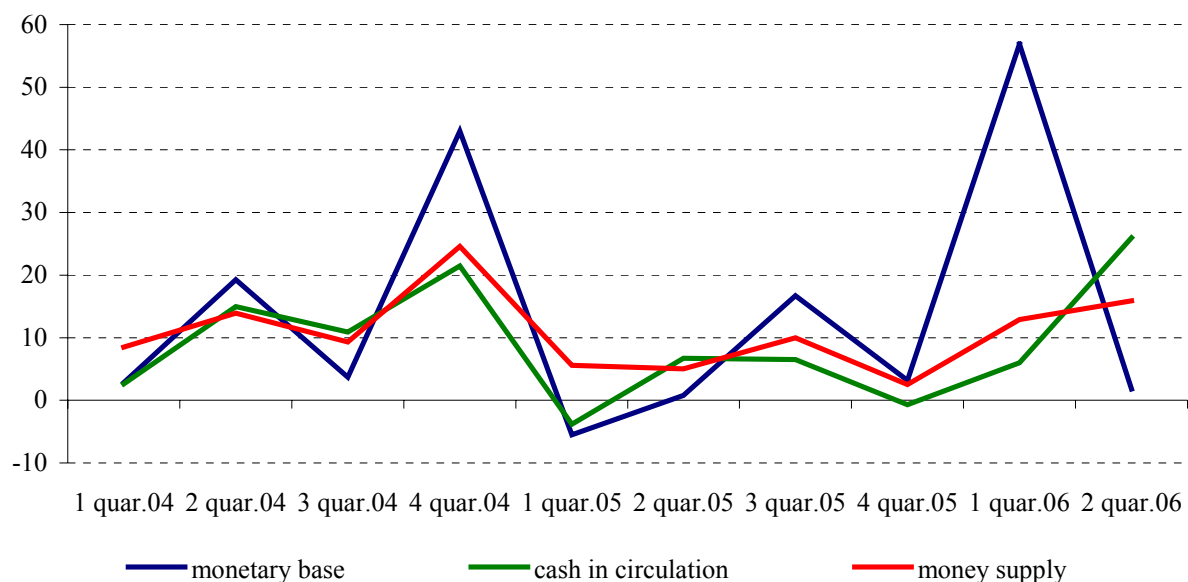
2.Monetary policy

a. Monetary offer

The growth of monetary aggregates was continued in the 2nd quarter of 2006. However, different trends were observed in the growth dynamics. For example, after considerable extension of the monetary base in the 1st quarter of 2006 by 56.9% it increased by 1.8 % in the 2nd quarter. Rates of increase in money supply and cash in circulation in the 2nd quarter of 2006 grew as against the rates in the previous quarter. Money supply increased by 15.9% in the 2nd quarter against 12.9% in the 1st quarter and cash in circulation by 26.0% against 6.0%, correspondingly (Graph 10).

Graph 10

Dynamics of monetary aggregates (% of the previous period)

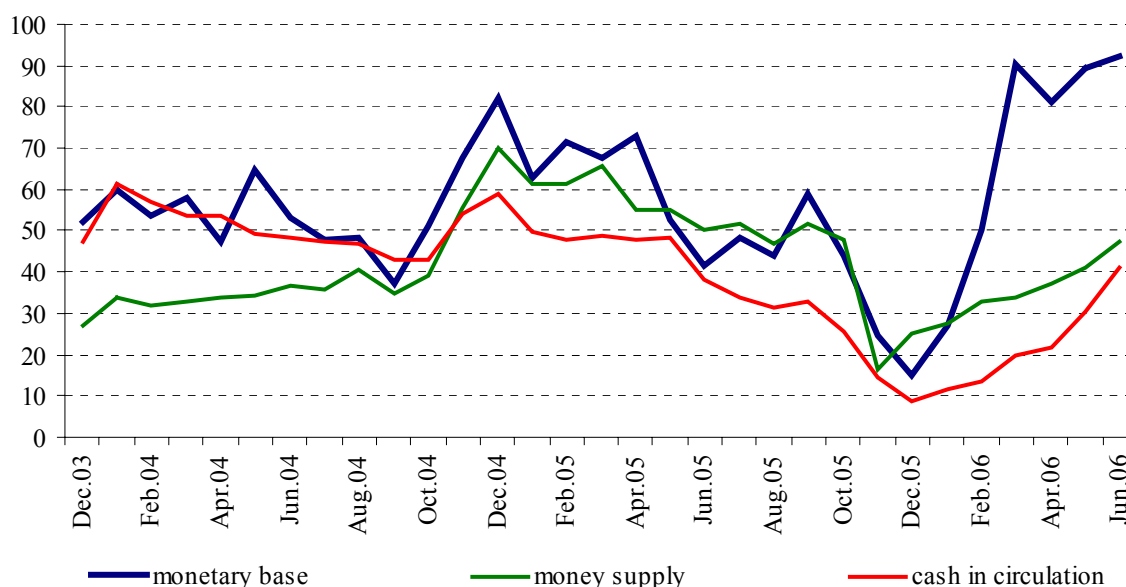


Source: National Bank of the Republic of Kazakhstan

In annum terms the rates of extension of the monetary base in the current year have been demonstrating maximum values since February 1996. The trend of growth of money supply in annum terms has been outlined since December 2005 and that of cash in circulation since January 2006 (Graph 11).

Graph 11

Dynamics of monetary aggregates
 (% of the corresponding period of the previous year)



Source: National Bank of the Republic of Kazakhstan

Monetary base

Monetary base as of late June made 1059.0 billion Tenge. Compared with the indices of June 2005 i.e. in annum terms the extension was 92.3%. Narrow monetary base i.e. the monetary base regardless of fixed deposits of the second tier banks at the National Bank extended for the similar period by 65.3%.

Extension of monetary base was secured by the growth of net foreign assets of the National Bank by 43.4% and a small increase of net internal assets of the National Bank by 7.2%.

Net international reserves of the National Bank in June 2006 as against those in June 2005 increased by 63.3%, thus amounting to USD 13.1 billion. Purchase of foreign exchange by the National Bank in the foreign currency market, despite the operations for replenishing the assets of the National fund and servicing the foreign debt of the Ministry of Finance resulted in the increase of net currency reserves by 65.9%. Assets in gold increased by 40.6% as a result of fulfilled operations and the appreciation of its price in the world markets by 37.5%.

Net requirements to the Government in the structure of net internal assets of the National Bank in June 2006 compared with those in June 2005 grew by 31.2% and also other net internal assets increased by 1.5 times as much. The increase of net internal requirements to the Government was secured by the reduction of residuals on the accounts with the National Bank. Other net internal assets grew due to the recalculation of assets in foreign currencies and precious metals.

Requirement to the sectors of economy decreased by 49.9% including those to the financial institutions due to the rise of the volume of short-term notes in circulation by 47.2% (Table 1).

Table 1

Dynamics of changes in assets and liabilities of the National Bank
(% of the corresponding period of the previous year)

| | 1 quar.06 | 2 quar.06 |
|---|-------------|--------------|
| Net external assets | 15,8 | 43,4 |
| Net internal assets | 37,8 | 7,2 |
| Net internal credit | 40,8 | -17,0 |
| net requirement to the Government | 5,9 | 31,2 |
| requirement to the financial institutions | 53,6 | -47,9 |
| requirement to the rest economy | -23,5 | -62,5 |
| Other net internal assets | 14,1 | 147,1 |
| Liabilities | 66,6 | 90,1 |
| Monetary base | 90,5 | 92,3 |

Source: National Bank of the Republic of Kazakhstan

Monetary review of second tier banks

In annum terms (June 2006 compared with June 2005) net external assets of the banks reduced by 2.5 times as little as a result of a higher growth of liabilities to non-residents by 83.6% as against the rates of increase of requirement to them by 44.9% (Table 2).

Table 2

Monetary review of second tier banks
(% of the corresponding period of the previous year)

| | 1 quar.06 | 2 quar.06 |
|---|---------------|---------------|
| Net external assets | -109,6 | -143,2 |
| requirement to non-residents | 80,8 | 44,9 |
| liabilities to non-residents | 93,2 | 83,6 |
| Internal assets | 62,0 | 70,3 |
| Requirement to the National Bank | 60,3 | 137,9 |
| Internal credit | 63,0 | 59,2 |
| net requirement to the Government | -2,5 | -14,2 |
| requirements to the economy | 68,1 | 64,1 |
| Other net internal assets | -65,1 | -64,1 |
| Liabilities | 46,0 | 47,9 |

Source: National Bank of the Republic of Kazakhstan

The growth of requirements to non-residents and requirements on securities (by 73.7%) was related to the increase in crediting of non-residents (by 61.5%). Liabilities to the non-residents grew as a result of the increase of credits from non-residents (by 3.9 times as much) and also due to the securities placed (by 37.5%). Deposits placed by the domestic banks with the foreign banks reduced by 1.3%.

The growth of the internal credit in the structure of internal assets of the second tier banks the volume of which in June 2006 increased as against that in June 2005 by 70.3%, was secured by the increase in requirement to the economy (by 64.1%). Credits to legal persons rose by 49.7% and to the population by 2.1 times as much. Reduction of requirements to the Government took place due to the reduction, by 16.0%, of the volume of the public securities of the Ministry of Finance in the portfolio of the second tier banks.

In June 2006 compared with the corresponding period of the previous year the growth of requirements to the National Bank was secured by the increase in residuals on the accounts of the second tier banks by 3.2 times as much and short-term notes in the banks' portfolios by 2.0 times as much.

Other net internal assets of the banks reduced by 64.1%.

Deposits in the structure of the second tier banks rose by 48.8%.

Money supply

Money supply as of late June 2006 reached 2714.1 billion tenge. In annum terms (compared with June 2005) the growth rate was 47.5%.

Net external assets of the banking system in June 2006 as against those in June 2005 reduced by 43.5% as a result of the decrease in the net external liabilities of the second tier banks despite the upturn of net external assets of the National Bank.

The advancement of internal assets of the banking system was secured by the continuous high growth of volumes of crediting of economy which entailed the increase in these requirements in June 2006 compared with June 2005 by 63.8%. Net requirements to the Government reduced by 96.0%. Other net internal assets of the banking system fell away by 31.1% (Table 3).

Deposits of residents in the money supply structure went up during the year (June 2006 as against June 2005) by 49.2% and cash in circulation by 41.2%.

Table 3

Dynamics of changes in money supply (% of the corresponding period of the previous year)

| | 1 quar.06 | 2 quar.06 |
|--------------------------------|--------------|--------------|
| Net external assets | -45,4 | -43,5 |
| Internal assets | 92,2 | 89,6 |
| requirements to the Government | 127,9 | 96,0 |
| requirements to the economy | 67,8 | 63,8 |
| other net internal assets | -37,4 | -31,1 |
| Money supply | 33,6 | 47,5 |
| cash in circulation | 19,6 | 41,2 |
| deposits of residents | 37,3 | 49,3 |

Source: National Bank of the Republic of Kazakhstan

– Cash in circulation

As of the end of June 2006 cash in circulation amounted to 550.0 billion tenge. As against June 2005 it increased by 41.2%.

Data on cash circulation in the second tier banks and organizations that perform some types of bank operations facilitate determination of factors which influenced the increase in cash (Table 4).

Withdrawal of cash from the banks' cash departments in the 2nd quarter of 2006 as against that in the previous period of the last year went up by 45.2% amounting to 1635.2 billion tenge and the incomings to the banks' cash departments by 38.3% amounting to 1490.4 billion Tenge. As a result net withdrawals from the banks' cash departments made 144.9 billion tenge.

Table 4

Balance of payments and receipts of cash through banks' cash offices
 (% of the corresponding period of the previous year)

| | 1 quart.06 | 2 quart.06 |
|---|----------------|--------------|
| Goods, services and works performed | -57,9 | -135,9 |
| withdrawal for payment | 36,1 | 22,8 |
| earnings from sales | 42,3 | 39,7 |
| Salaries and emoluments (with regard to funds in Bancomats, demand deposits and on the accounts of natural persons) | 40,6 | 43,1 |
| Agricultural products | 36,9 | 86,3 |
| Operations with foreign exchange | -10,2 | 5,7 |
| allocation for purchase of foreign exchange | 16,8 | 23,5 |
| earnings from sales of foreign exchange | 13,2 | 4,4 |
| Time deposits of natural persons | -223,8 | -23,1 paza |
| payments of deposits | 33,6 | 69,3 |
| incomings to deposits | 53,7 | 110,7 |
| Loans to natural and legal persons | 34,8 | 426,8 |
| granting of loans | 422,0 | 355,7 |
| repayment of loans | 161,0 | 97,5 |
| Pensions and allowances | 28,2 | 22,9 |
| Other items | -4,2 | 6,5 |
| Aggregate balance of payments and receipts of cash | 1 004,7 | 197,0 |
| expenditures from banks' cash departments | 45,0 | 45,2 |
| receipts to banks' cash departments | 40,6 | 38,3 |

Source: National Bank of the Republic of Kazakhstan

The continuous increase in the population's cash incomes including salaries and emoluments, social payments from the budget and business activity in the economy had a crucial influence on the rise of withdrawals of cash from the banks' cash departments.

In April-June 2006 the aggregate upturn of net withdrawals from the banks' cash departments for the remuneration of labour, charging of Bancomats and on the demand deposits and current accounts of natural persons compared with that in the corresponding period of 2005 went up by 43.1% amounting to 368.2 billion tenge. Rise of the state's expenditure on payment of pensions and social allowances entailed the growth of withdrawals of cash from the banks' cash departments by 22.9% amounting to 69.9 billion tenge.

Net withdrawals of cash for granting of loans to natural and legal persons from the banks' cash departments in the 2nd quarter of 2006 as against those in the 2nd quarter of 2005 increased by 3.3 times as much and amounted to 22.2 billion Tenge.

The increase in withdrawal of cash in circulation was also related to the increase in withdrawal of cash from the banks' cash departments for the payment of agricultural products by 86.3% amounting to 24.2 billion tenge.

Strengthening of tenge against USD dollar and the relevant growth of respective expectations of the population facilitated the decrease in the demand for foreign exchange cash. As a result, the higher growth of purchases, by banks, of foreign exchange cash as against the rates of sales of it by banks promoted the increase in cash in circulation. The balance on these operations at the period under consideration made 9 billion tenge compared with indices of the 2nd quarter of 2005.

Receipts in the banks' cash departments from sales of goods, works and services as well as receipts to the natural persons' time deposits with the banks became the operations with ready tenge which favored the decrease in their volume in circulation.

Net receipts in the banks' cash departments from sales of goods, works and services in the 2nd quarter of 2006 as against those in the 2nd quarter of 2005 grew by 2.4 times as much, thus amounting to 59.6 billion tenge. Receipts of cash to the deposits with regard to withdrawals from then went up by 23.1 times as much amounting to 21.7 billion tenge.

– Deposits of residents

Deposits of resident as of late of June 2006 made 2154.1 billion tenge. As against those in June 2005 they rose by 49.2%.

Residuals on the deposits of non-bank legal persons during the year (June 2006 as against June 2005) increased by 50.2% and those on the deposits of the population by 47.3% (Table 5). At the same time the share of other deposits which are one of the principal course of crediting of the real sectors of economy, was 69.8 % of the volume of deposits, thus having arisen from 67.8% as per the results of the 1st quarter of 2006. The share of deposits in national currency grew from 62.2% as per the results of March 2006 up to 66.1% as per the results of June 2006.

Table 5

Dynamics of changes in deposits of residents (% of the corresponding period of the previous year)

| | 1 quart.06 | 2 quart.06 | share, % ¹ |
|---|-------------|-------------|-----------------------|
| Deposits of residents | 37,3 | 49,2 | 100,0 |
| Transferable deposits in KZT | 47,9 | 46,1 | 24,5 |
| of population | 50,1 | 69,8 | 3,8 |
| of non-bank legal persons | 47,6 | 42,5 | 20,7 |
| Other deposits in KZT | 56,3 | 84,1 | 41,6 |
| of population | 32,6 | 80,9 | 19,4 |
| of non-bank legal persons | 81,2 | 87,1 | 22,2 |
| Transferable deposits in foreign exchange | 5,2 | -1,9 | 5,8 |
| of population | 24,1 | 1,5 | 0,8 |
| of non-bank legal persons | 2,7 | -2,5 | 4,9 |
| Other deposits in foreign exchange | 20,9 | 29,1 | 28,2 |
| of population | 34,3 | 8,5 | 10,4 |
| of non-bank legal persons | 13,0 | 45,2 | 17,8 |

Source: National Bank of the Republic of Kazakhstan

The dynamics of deposits was primarily determined by other tenge deposits of natural and non-bank legal persons which, in June 2006 compared with June 2005 increased by 84.1%.

The reduction of residuals on the transferable deposits of non-bank legal persons by 2.5% should be noted. This reduction and also the insignificant rise of residuals on other deposits in foreign exchange are most probably related to the strengthening of tenge against the USD dollar.

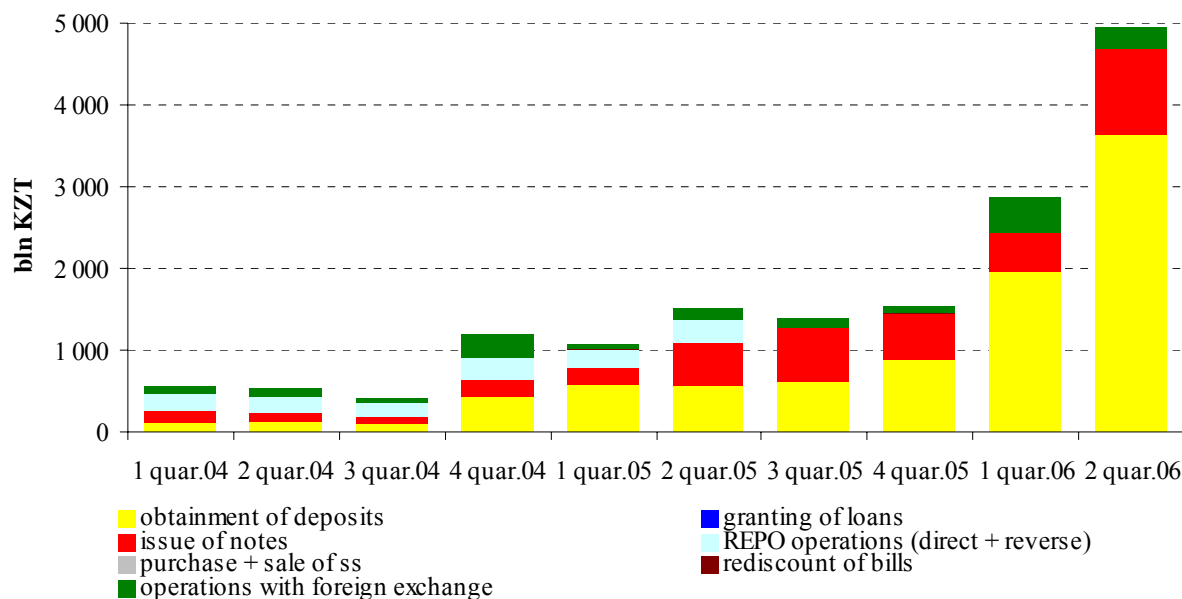
¹ As of 1st of June 2006

a. Instruments and operations of monetary policy

The gross volume of operations of the National Bank for the 2nd quarter of 2006 including the issue of short-term notes, obtainment of deposits, rediscount of bills as well as the purchase and sales of foreign exchange made 4959.9 billion tenge, thus having increased by 72.3% as against the previous quarter. At the same time, the volume of operations in the money market rose by 91.8% and reduced in the foreign exchange market by 36.1% (Graph 12).

Graph 12

Operations of the National Bank in the domestic financial market



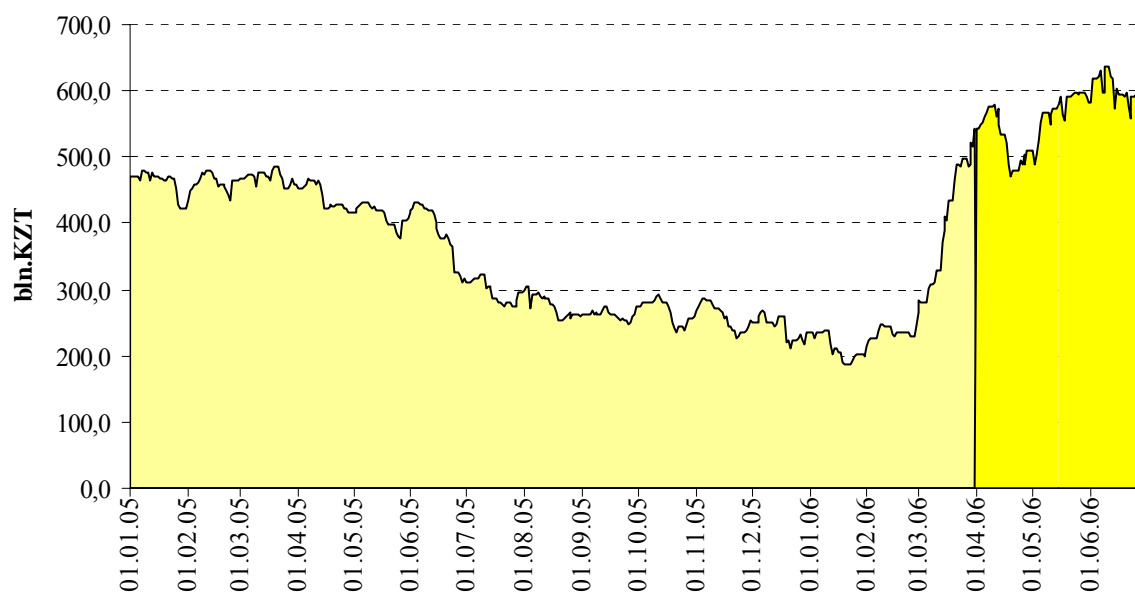
Source: National Bank of the Republic of Kazakhstan

The volume of operations of the National Bank in the money market in the 2nd quarter of 2006 made 94.3% of the volume of operations of the National Bank in the domestic financial market (84.8% in the 1st quarter of 2006). At the same time the National Bank obtained deposits from the second tier banks, issued short-term notes and rediscounted the bills.

Operations with foreign exchange were 5.7% of the volume of operations of the National Bank in the domestic financial market.

Increase in the gross volume of operations in the money market entailed the relevant increase in the volumes of sterilization of liquidity (short-term notes in circulation plus residuals on the banks' deposits with the National Bank). They went up by 13.9% from 542.9 billion tenge as of the beginning of the 2nd quarter of 2006 and up to 618.3 billion tenge as of the end of the same quarter. At the same time the average daily balance of operations on sterilization rose by twice from 285.1 billion tenge up to 567.2 billion tenge in the 2nd quarter of 2006 (Graph 13).

Graph 13

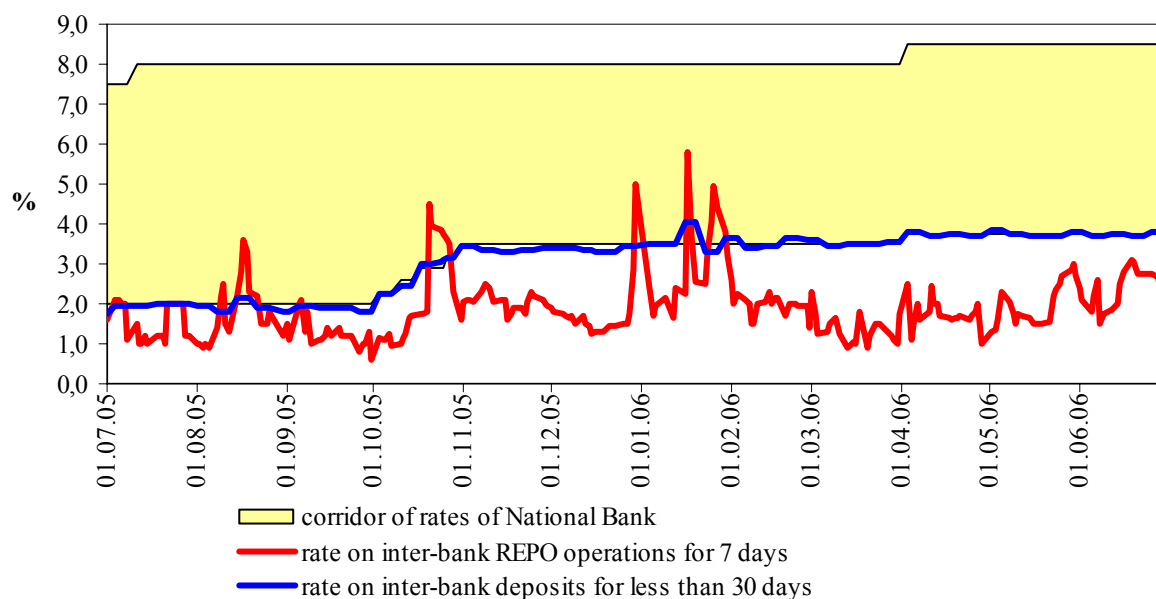
Daily balance of sterilizing operations of the National Bank

Source: National Bank of the Republic of Kazakhstan

National Bank's rates

In the 2nd quarter of 2006 the National Bank increased the rates for its own operations. Since 1st of April the official refinancing rate (upper limit of the corridor of rates of the National Bank) was raised from 8.0% up to 8.5% and the rate on deposits obtained (lower limit of the rates' corridor) was raised from 3.5% up to 3.75% (Graph 14).

Graph 14

Limits of corridor of rates of the National Bank

Source: National Bank of the Republic of Kazakhstan

In the 2nd quarter of 2006 the rate on inter-bank deposits for less than 30 days was in the corridor of the National Bank's rates or coincided with its lower limit. The rate on the inter-bank REPO operations was still below the limits of the National Bank's corridor of rates.

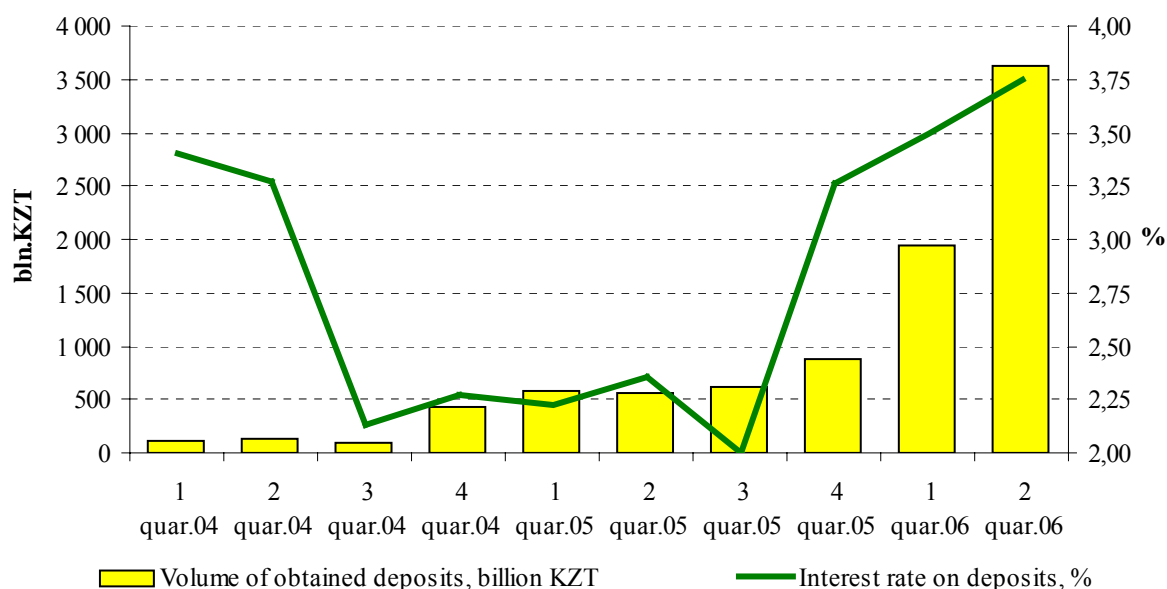
Obtainment of deposits

Obtainment of deposits has the largest scope in operations of the National Bank. It is related to the short time spent for these operations, daily fulfillment of them, absence of restrictions of the maximum volume of obtainments and also high profitability on them.

In the 2nd quarter of 2006 the National Bank obtained tenge deposits from the second tier banks to the amount of 3635.0 billion tenge and this amount is historically the maximum one. As against the previous quarter the volume of the obtained deposits rose by 87.3%. The dates of obtaining the deposits were 7 days. In the 1st quarter of 2006 the refinance rate on the obtained deposits was 3.75% (Graph 15).

Graph 15

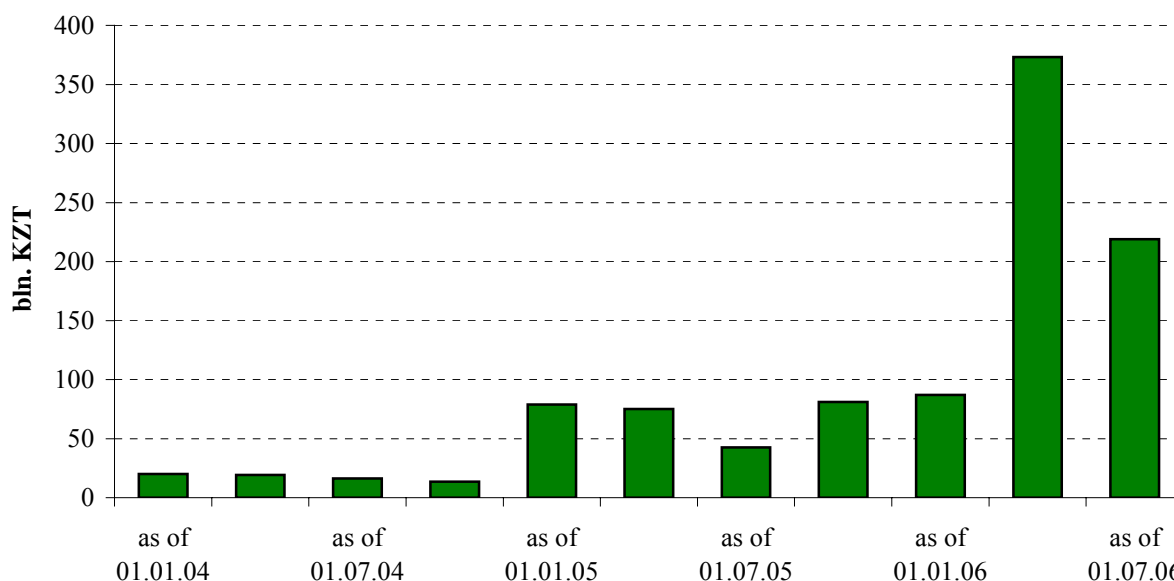
Volume and interest rates on the deposits obtained by the National Bank



Source: National Bank of the Republic of Kazakhstan

Despite the growth of volumes of operations on obtainment of deposits from the second tier banks the volume of unpaid liabilities on them of the National Bank as of the end of the quarter compared with that as of the beginning of the quarter reduced by 41.4% amounting to 218.9 billion tenge (Graph 16).

Graph 16

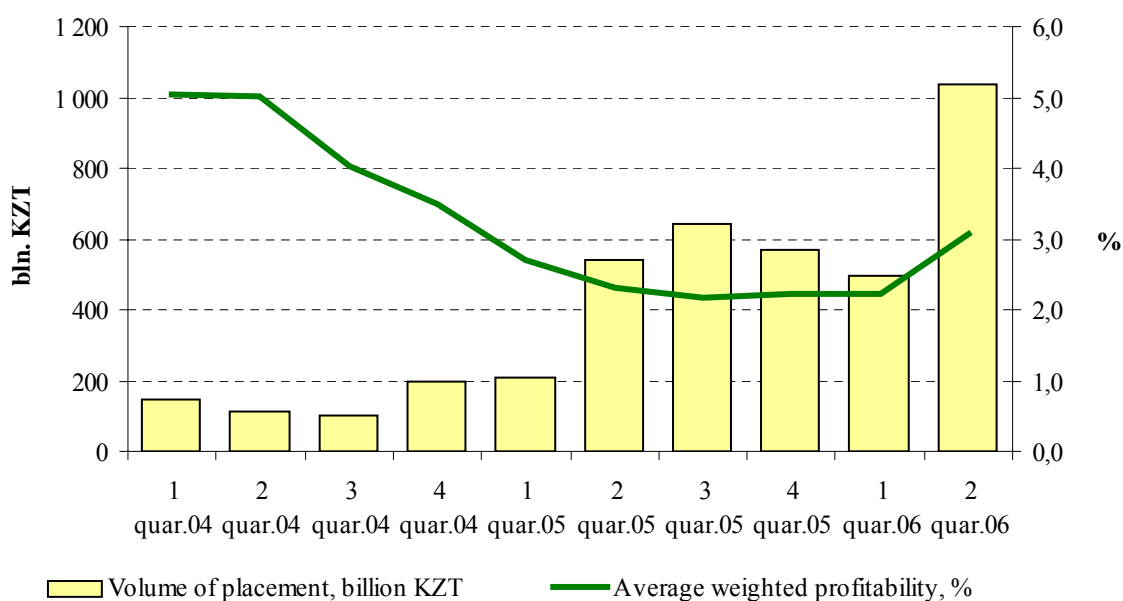
Volume of unpaid liabilities of the National Bank on the deposits obtained from second tier banks

Source: National Bank of the Republic of Kazakhstan

Issue of short-term notes

In the 2nd quarter of 2006 the placement of short-term notes of the National Bank reached its historical maximum and amounted to 1039.2 billion tenge which is 2.1 times as much as that in the previous quarter. The notes were issued to be circulated within 28 days. The profitability on notes placed rose from 2.23% in the 1st quarter up to 3.08% in the 2nd quarter of 2006 (Graph 17).

Graph 17

Volume of placement of short-term notes and profitability (for the period)

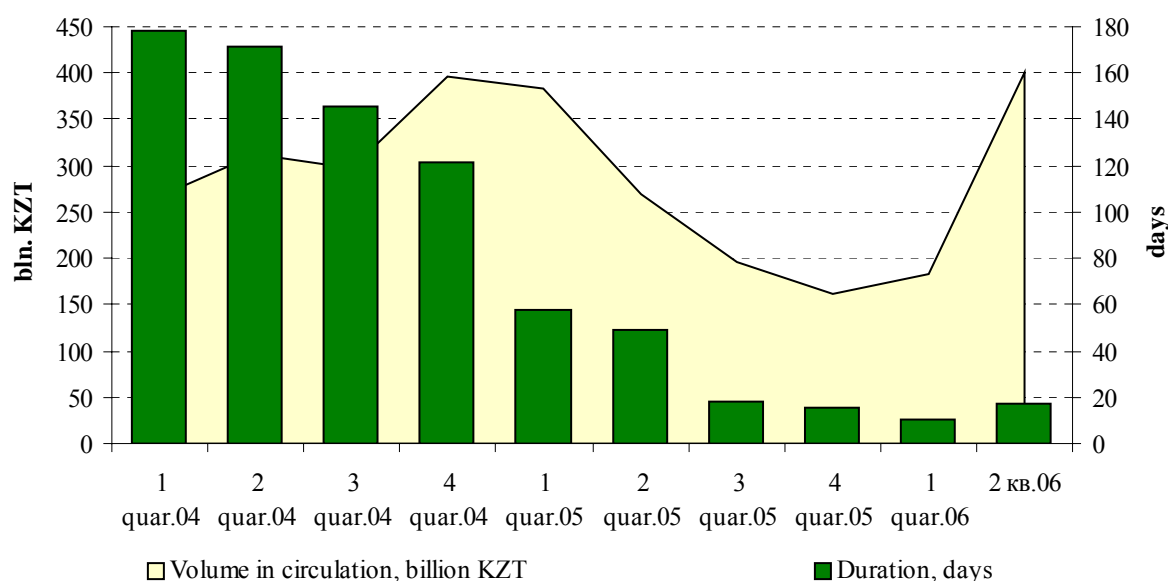
Source: National Bank of the Republic of Kazakhstan

In monthly terms the volumes of issuance of short-term notes were constantly rising: from 230.1 billion tenge in April up to 491.7 billion tenge in June. It was related to the increase in volumes of offering them by the National Bank. Whereas in the 1st half of the quarter the offer volume in each auction was 60 billion tenge, since 15th May the offer had been raised up to 100 billion tenge.

As of late June 2006 the volume of short-term notes in circulation made 400.0 billion tenge, thus being 2.2 times as much as that as of the end of the 1st quarter of 2006. Duration of notes in circulation as of the end of the 2nd quarter of 2006 rose up to 16.9 days (Graph 18).

Graph 18

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



Source: National Bank of the Republic of Kazakhstan

Granting of loans

In the 2nd quarter of 2006 the National Bank did not granted any refinance loans and special loans.

Exchange rate

The situation in the foreign exchange market in the 2nd quarter of 2006 was characterized by the sharp increase in the tenge exchange rate against the US dollar. In general over the quarter the tenge exchange rate strengthened against the US dollar by 7.78% – from 128.40 KZT/US dollar up to 118.41 KZT/US dollar.

During the quarter the situation in the domestic exchange market was determined by the continuous inflow of considerable volumes of currency earnings. This inflow was conditioned by the high level of world prices of energy resources, large volumes of operations in the currency segment of KASE and inter-bank markets and expectations of the market participants of the ongoing devaluation of the US dollar. All these factors created preconditions for the excess supply of foreign exchange over the demand for it. Another factor of the excess supply is still the obtainment, by the second tier banks, of foreign borrowings. For example, for the 2nd quarter of 2006 the increase in liabilities of the banks to non-residents made USD 1445.5 million (USD 1170.7 for the 1st quarter of 2006).

The large volumes of trades was recorded in April in the domestic foreign exchange market (the Kazakhstan's Stock Exchange) and in the over-the-counter inter-bank exchange market, and it can prove the negative attitude of investors to the US currency. In April the volume of operations in the KASE was USD 2396.8 million. In this situation the tenge exchange rate against the US dollar in the domestic foreign exchange market strengthened in nominal terms by 3.10% (from 128.40 tenge/US dollar up to 124.42 tenge/US dollar).

In May the weakening of the US dollar exchange rate against Euro in the world market continued – during the month the US dollar decreased against Euro by 2.8% from \$1.254 to \$1.289. The pair tenge/US dollar was moving in the similar way: during the month the tenge exchange rate against the US dollar strengthened in nominal terms by 2.54%. At the same time the volumes of trades in the domestic foreign exchange market remained high: in May the volume of operations at KASE was USD 2443.1 million and in the over-the-counter exchange market USD 7047.4 million.

In June the US dollar grew against Euro by 1.4% from \$1.289 up to \$1.271. In June the rates were raised both in Europe and USA. On the 8th of June the European Central Bank (ECB) raised the basic interest rate by 0.25 points up to 2.75% and on the 29th of June the ECB raised the rate up to 5.25%. Meanwhile, the Federal Reserve System (FRS) clarified that the next increase in the interest rate would be dependent on the incoming economic data. Despite some strengthening of the US dollar in the world foreign exchange market devaluation-related expectations regarding the further moving of the US dollar exchange rate remained in the domestic exchange market as before – nominal strengthening of the tenge exchange rate for the month was 2.35%.

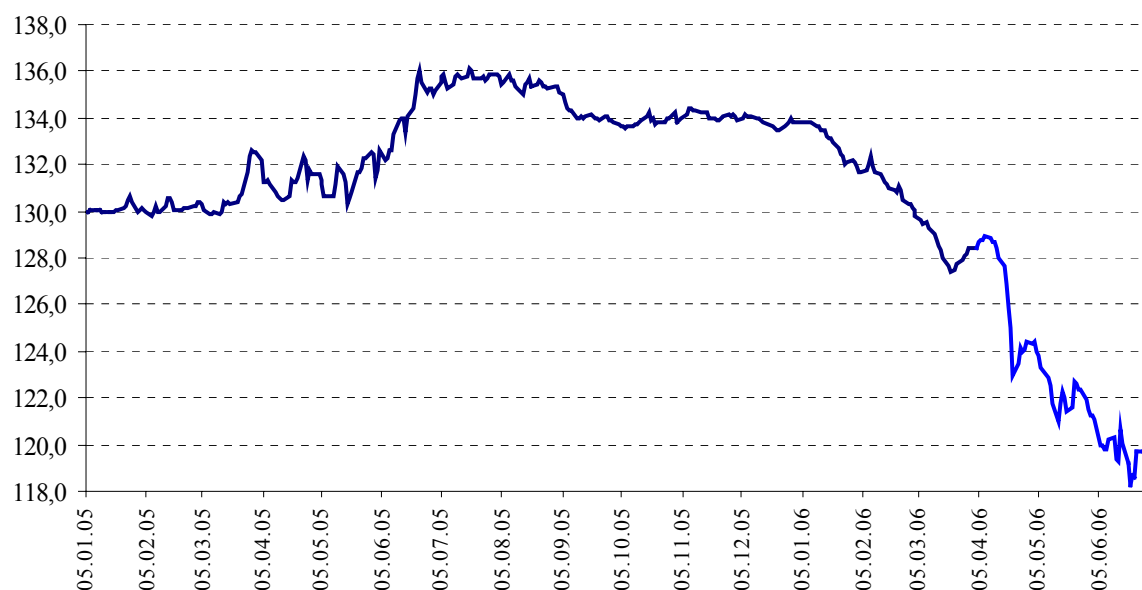
It is worth noting that in the 2nd quarter of 2006 the strengthening of the tenge exchange rate against the US dollar in nominal terms was maximum for both the quarter as a whole and separately by months for the entire history of existence of tenge (except January 2004 when the tenge exchange rate against the US dollar strengthened by 2.73%).

The tenge's average weighted exchange rate for the 2nd quarter of 2006 made 122.71 KZT per a US dollar, thus having strengthened by 6.7% as against the figure of the 1st quarter of 2006. Through the quarter the tenge exchange rate changed against the US dollar in the range between 118.26 tenge – 128.95 tenge per USD 1 (Graph 19).

The dynamics of the tenge exchange rate against the European currency in the Kazakhstan's market was also effected by the state of the common European currency in the international financial market. The official tenge exchange rate against Euro for the 2nd quarter of 2006 strengthened by 3.94% making 148.81 tenge per Euro as of the end of the period.

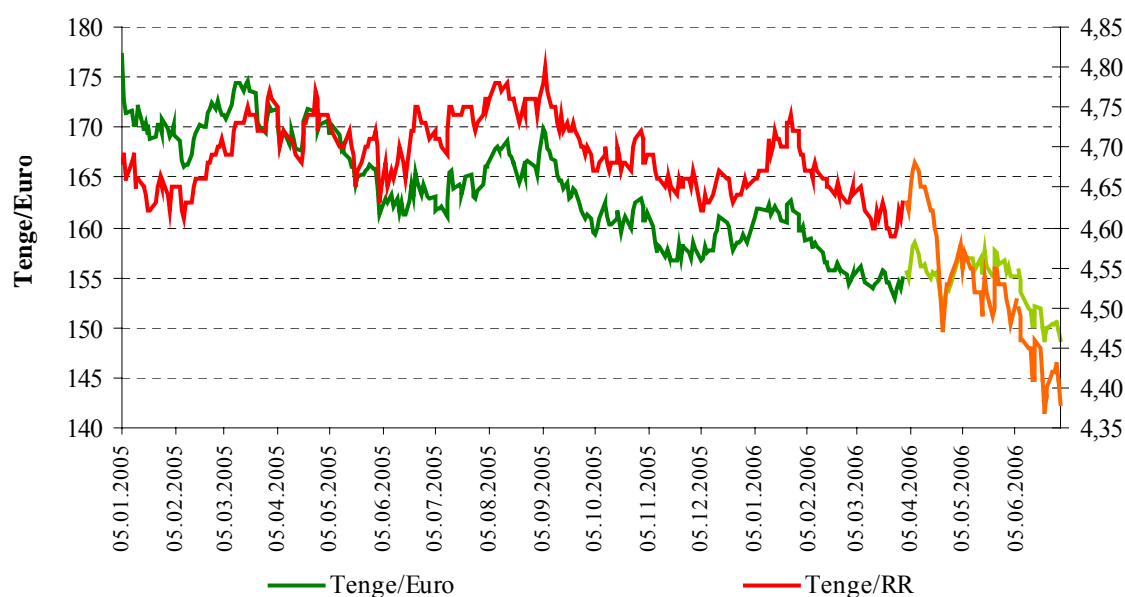
The dynamics of the Russian Rouble exchange rate against tenge was specified mainly by the policy of the Russian Central Bank regarding the Russian Rouble exchange rate against the currency basket. For example, for the 2nd quarter of 2006 the official tenge exchange rate against the Russian Rouble strengthened by 5.4% (Graph 20).

Graph 19

Dynamics of the nominal exchange rate of Tenge to US dollar

Source: National Bank of the Republic of Kazakhstan

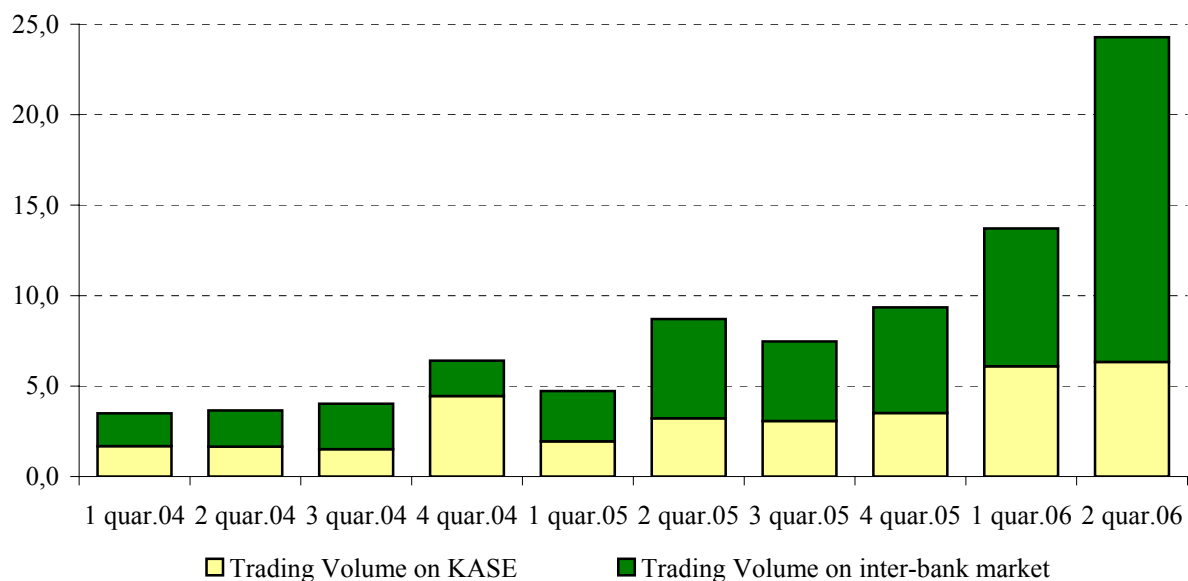
Graph 20

Dynamics of the official exchange rate of Tenge to Euro and Russian Rouble

Source: National Bank of the Republic of Kazakhstan

In the 2nd quarter of 2006 the volume of the exchange trades in dollar positions at the Kazakhstan's Stock Exchange made USD 6.3 billion, thus being 3.9% as much as that during the 1st quarter of 2006. In the over-the-counter foreign exchange market the volume of operations for the 2nd quarter of 2006 compared with that in the previous quarter boosted by 114.1% amounting to USD 17.9 billion (Graph 21).

Graph 21

Trading Volume on the domestic foreign exchange market, USD billion

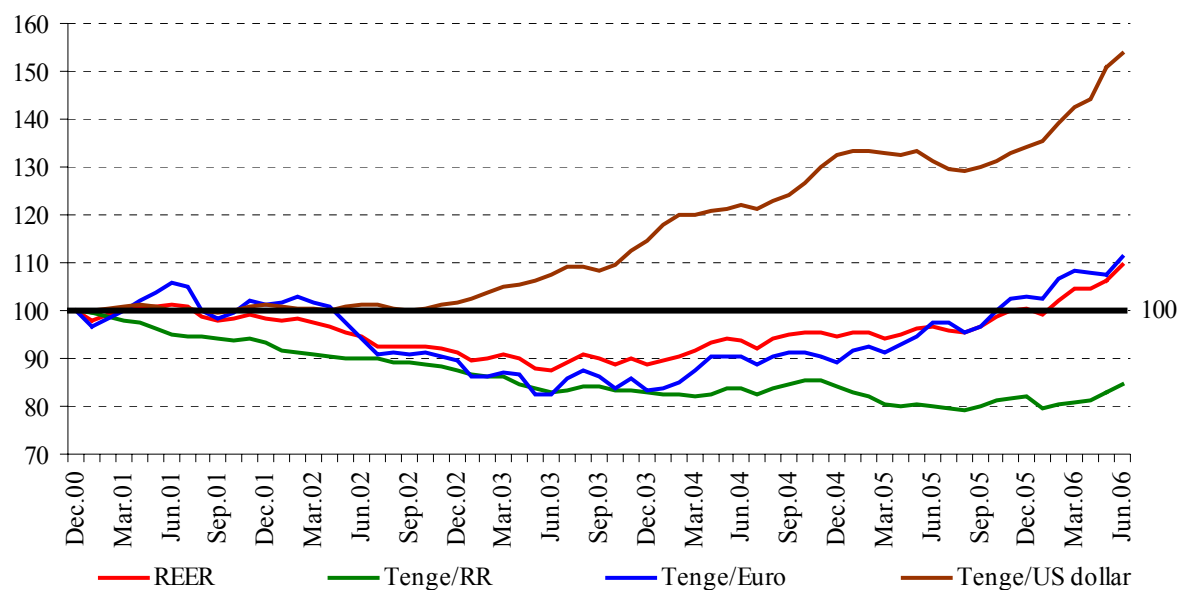
Source: National Bank of the Republic of Kazakhstan

On the 25th of April the National Bank disseminated the press release devoted to the further policy concerning the exchange rate. The press release stated that for the purpose of increasing the efficiency of operations on regulation of inflation, from then the National Bank intended to keep the regime of floating exchange rate and reduce the volumes of operations with foreign exchange in the domestic exchange market. As a result, the participation of the National Bank in the exchange market in the 2nd quarter of 2006 started gradually being reduced. E.g. the ratio of the National Bank's participation in the Kazakhstan's Stock Exchange in April was 42.1%, in May – 35.6%, in June – 17.6%.

The real effective exchange rate (REER) index as of the results of the 2nd quarter of 2006 grew by 4.6%. Real strengthening of tenge against the US dollar made 7.7%, against euro – 2.9%, against the Russian rouble – 3.3% (Graph 22).

Graph 22

Real Exchange Rate Indices (December 2000 = 100%)



Source: National Bank of the Republic of Kazakhstan

Rediscount of Bills

During the 2nd quarter of 2006, 6 bills amounting to 500 million tenge were accepted for rediscounting, and the bills amounting to 789.6 million tenge were retired. As of the 1st of July 2006 the National Bank's portfolio contained bills amounting to 1.0 billion tenge.

2. Inflation forecast

a. Estimate of inflation forecast for the 2nd quarter of 2006

The actually formed rate of inflation in the 2nd quarter of 2006 (1.6%) complies with the forecast for that period (1.4-1.6%), which was published in the previous issue of the “Inflation Review”. Differences between the forecast and the actual situation were observed in monthly terms. For example, the actual rate of inflation over the forecast was recorded only in May: with the 0.4% forecast the actual value was shaped at the level of 0.8% whereas in April and June the actual inflation was a little less than the forecast.

The prices in the consumer market in May 2006 were formed under the influence of appreciation of paid services to the population. The growth of prices and tariffs on paid services at that period was 2.1%, thus having been the highest monthly index since July 1998. Appreciation of paid services in May 2006 was caused by the rise of prices of the housing and communal services (sphere) in the structure of which the appreciation of prices of the cold water supply (16.0%) and sewage facilities (12.4%) was the most considerable.

Besides, fruits and vegetables got up significantly in April-June 2006. At the same time, whereas the growth of prices of fruit and vegetable products was completely expectable, forecasting the appreciation of paid services in view of the dynamics of the last years was impossible.

Deviations between the forecast and the actual situation by some months entailed the significant excess of the actually formed annual inflation rate as per the results of the 2nd quarter of 2006 over the forecast. E.g. the annual rate of inflation made 8.9% whereas the forecast was 8.4%.

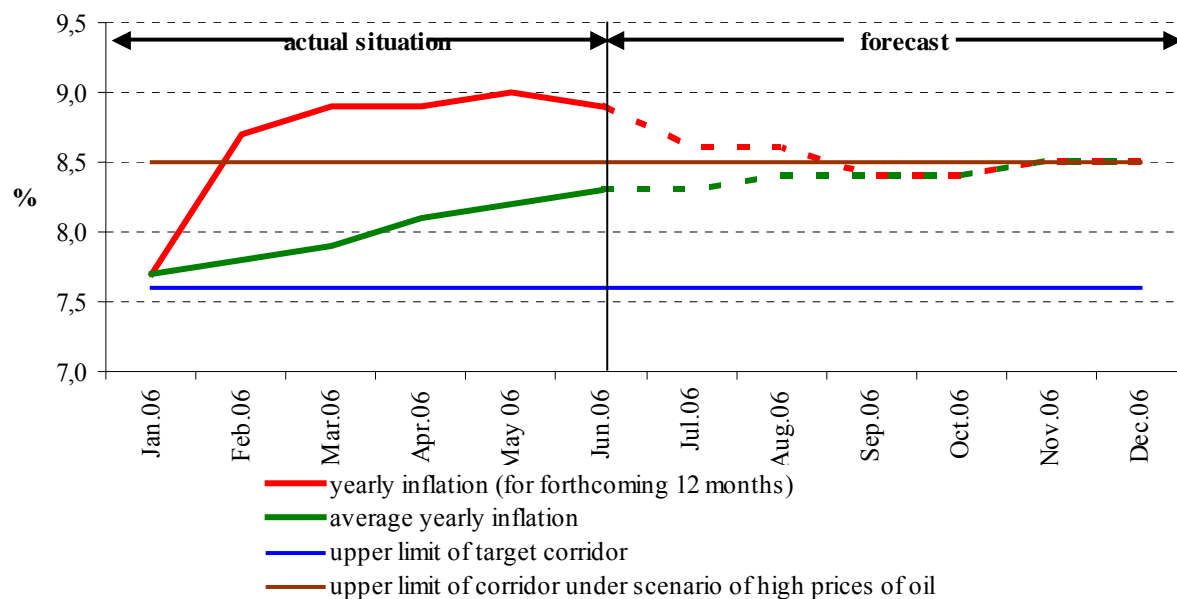
b. Inflation forecast for 2006

While devising the monetary policy for 2006-2008 the National Bank considered two scenarios. The criterion of splitting into two scenarios is the level of world prices of oil (scenario of moderate prices and scenario of high prices).

The scenario of moderate prices presumes that the average world prices of Brent oil will remain at USD 45-60 per barrel and the world interest rates will remain approximately at the current level. With these assumptions the average annual rate of inflation in 2006 is expected at 5.7-7.3%.

The scenario of high prices of oil presumes the further appreciation of prices of oil at the forthcoming three years' period. It is expected that under this scenario the average world prices of Brent oil will exceed USD 65 per barrel. With these assumptions the higher rate of inflation – 6.9%-8.5% is expected in 2006 (Graph 23).

Graph 23

Actual situation and inflation forecast in 2005

Source: National Bank of the Republic of Kazakhstan

Inflation forecast for 3rd quarter of 2006

It is expected in the 3rd quarter of 2006 that inflation will be within 0.9-1.1% (1.4% in the 3rd quarter of 2005) and this rate corresponds to 8.4% in annum terms as of late of September 2006.

Pricing of foodstuffs in the 3rd quarter of 2006 will take place mainly under the influence of the seasonality factor. Analyzing the situation in the past years it is expected that the prices of fruit and vegetable products, which will be decreasing or growing a bit, will promote keeping the prices down. Prices of dairy products and eggs after the seasonal reduction in the first half year of 2006 will most probably increase.

In the structure of nonfoods the appreciation of prices is expected for the most important components: fuels and lubricants as well as garments and footwear. Pricing of energy resources in the domestic market will be affected by the current situation in the world markets. Besides, prices of gasoline in the 3rd quarter of 2000-2005 grew gear by more than 10% except the 3rd quarter of 2002 when the reduction of its price by 6.7% was observed. Appreciation of prices of garments and footwear is expected to be insignificant under the seasonality factor.

The measures undertaken by the National Bank for tightening of the monetary policy at the beginning of 2006 have begun restraining the inflation which, in annum terms, decreased from 9.0% in May 2006 to 8.9% in June and to 8.7% in July 2006.

Furthermore, since the 3rd quarter of 2006 the National Bank has re-increased the rates on its own operations (since the 1st of July the official refinance rate has been raised from 8.5% up to 9.0% and the rate on deposits to be obtained from the second tier banks has been arisen from 3.75% up to 4.0% since the 3rd of July 2006) and has also amended the mechanism of calculation of minimum reserve requirements. These measures will facilitate some appreciation of credit resources, which, in its turn, will make it possible to decrease the rates growth of crediting and monetary offer and, eventually, reduce the inflation.

As in 2005 too, the measures for the arrangement of food caravans from the southern regions of the country, Kyrgyzstan and Uzbekistan are elaborated to provide the population with food products, prevent the groundless growth of prices of the principal goods and

services in summertime, creation of additional shopping streets for disposal of products from suburban garden-plots and household plots, procuring points.

In order to stabilize prices the Government of the Republic of Kazakhstan adopted the Resolution No. 285 fated 15.04.2006 «On Additional Measures for Stabilization of Prices in the Consumer Market». In accordance with this document the work on prevention of a groundless growth of prices of principal goods and services for the population and, first of all those of foodstuffs, especially meat and fruit and vegetable products will be intensified. Also, the measures for suppressing price collusions, disclosing and restraining an unfair competition, abuse of their dominant position by the market entities.

Also, the Order of the Chairman of the Agency of the Republic of Kazakhstan for Regulation of Natural Monopolies No. 110a-OД dated 15.04.2006 established the temporary reducing rates at 0.5% to tariffs and services of the main-line railway network at transporting the fruit and vegetable, fruit and berry products, cucurbits crops, perishable products with this Order being effective from the 15th of April till 1st of October 2006.

Inflation forecat for 4th quarter of 2006

The period from October till December is characterized by the growth of demand in the consumer market due to the December holidays. As a result, the prices at this period show their highest level through the whole year.

The National Bank expects that the inflation in the 4th quarter of 2006 will make 2.5-2.7% (2.4% in the 4th quarter of 2005).

As before, inflation will be affected by such factors as the rise of the consumer and investment demand overrunning the economic growth, considerable increase in volumes of external borrowings and high credit activity of the financial sector.

Anti-inflation measures undertaken by the National Bank and the Government are to secure the control of inflation at that period. Should the measures undertaken be insufficient to control the inflation, the National Bank will tighten the monetary policy ever more, i.e. increase the rates on its own operations, enhance the volumes of issuing the short-term notes and raise the standards of minimum reserve requirements.

Development of the situation in the economy of Kazakhstan and in the world market proves that at present out of two scenarios identified by the Monetary policy guidelines of the for 2006-2008 (scenarios of moderate and high prices of oil) the scenario of high oil prices (over USD 65 per barrel) is under implementation.

The average yearly inflation as per the results of 2006 will most probably take shape at the level nearer to the upper limit of 6.9-8.5%.