**The Governor E.Dossaev Statement**

**on the base rate of the National Bank**

**September 9, 2019**

**Almaty**

**Dear representatives of the media community!**

Today, the National Bank has decided to raise the base rate by **25 b.p.** up to **9.25%** per annum.

**The dynamics of actual inflation** during recent months has been slightly higher than our forecast. In August of this year **the annual inflation accelerated to 5.5%** compared to our previous estimates of 5.1-5.2%.

According to the results of **the forecast round**, we expect an acceleration of inflation on the horizon of the next 6 months. Our latest estimates show that **inflation** at the end of this year will approach **5.7% -5.8%** compared with the previous forecast of **5.5%**. At the same time, the effect of a number of inflationary factors creates the risks for inflation to exceed the upper boundary of the target range in the first quarter of 2020.

By the end of **2020**, inflationary processes will slow down, and the inflation rate will develop within the target range of 4-6%.

I will focus on the key internal and external factors behind the today's decision.

**THE FIRST FACTOR is a significant fiscal stimulus as a result of rising budget spending.**

The overall effect of fiscal stimulus in 2019 in accordance with the new forecast is estimated at **0.5 p.p.** of the additional contribution to inflation compared with the previous estimate of **0.3 p.p.** This is due to the more substantial than expected multiplier effect of new social spending on household income and demand in the economy.

Amid the increase in social support spending, a 1.5 times increase in the minimum wage, and wages for civil and budget employees, **real wages** in the economy as a whole increased in January-June of this year by **8.9%**, **real household income** - by **5.1%.**

**Consumer lending is increasing**. In July of this year the volume of banks’ consumer loans increased by **24.1%** year on year.

As a result, **domestic consumer demand** has expanded significantly. **Retail turnover growth** for January-July of this year grew by **5.4**%.

**Consumer import** is increasing: for the first half of this year a growth amounted to **4.8%**, especially in the part of non-food products – **7.3%**. At the same time, the cost of imports of consumer goods is growing faster than domestic prices.

**The SECOND FACTOR is the increase in world food prices, which affects the value of exports and domestic prices.**

The FAO Food Price Index has increased by **5.1%** since the beginning of this year as a result of rising global consumption and declining food stocks.

First of all, it affected the prices of meat and grain. The index of export prices of Kazakh meat producers since the beginning of the year has increased by 36%, and the volume of exports – by 2.8 times. The cost of grain exports has become more expensive by almost 12%.

According to our estimates, due to the increase in prices in the world market, the growth of domestic prices for meat and bread products alone led to the increase in inflation by **1%** in annual terms.

Further growth in world food prices will continue to affect the domestic food inflation in 2020.

**The THIRD FACTOR is an inflationary pressure from business activity.**

A growth of domestic economic activity remains above the expectations of the National Bank. In the first 7 months of this year, the **short-term economic indicator** increased by **4.4%.** The growth is observed in all major industries.

The growth of real GDP is higher than the forecast of the National Bank due to the growth of domestic demand and higher actual oil prices compared to the baseline forecast of the NBK at the oil price of 60 US dollars a barrel. The NBK's revised forecast for GDP growth is **3.8% at the end of 2019**. In 2020, GDP growth is expected to slow to **3.5%** amid a gradual deceleration in consumer demand and a weakening of fiscal stimulus.

We estimate the difference between actual and potential GDP will be **positive** until the end of the forecast horizon, which is a signal of persisting inflationary pressure in the economy.

**The FOURTH FACTOR is the deterioration of the current account of the country's balance of payments, affecting the dynamics of the exchange rate and its pass-through effect on prices.**

Under the baseline scenario, the **current account deficit** is expected to reach **1.8-2.2% of GDP** in 2019 and **3.4-3.8% of GDP** in 2020.

The decline in exports of goods is expected due to increased **volatility in oil prices**, planned maintenance work at large oil and gas fields, as well as a slowdown in external demand from China and the EU.

Since the beginning of the year the average Brent oil price level stood at **65 US dollars** a barrel compared to **72 US dollars** a barrel of Brent crude oil. Consensus forecasts indicate that the recovery of world oil prices to the levels of previous years is not expected. The forecast for 2019-2020 is **64-67 US dollars** a barrel.

A high growth in imports is projected as well. This is primarily due to the implementation of major infrastructure and investment projects, such as the expansion of TCO, the construction of the Saryarka gas pipeline, and others that will support the demand for imported investment goods. The growth of demand for consumer imports is also projected due to the growth of real household income.

This will affect the balance of the exchange rate channel, which remains a risk for inflation via higher import prices. In the foreign market, trade conflicts between the US and China keep the risks of tenge weakening.

**Among the positive factors affecting the dynamics of inflation, I would distinguish the following.**

First, a reduction in the cost of gasoline in the composition of **non-food inflation**, as well as tariffs for regulated services in the composition of **paid services**.

Second, **inflation expectations** have stabilized in recent months. According to the August survey, **60%** of respondents expect the current inflation rate to remain or decline over the next 12 months, compared to **55%** in the previous forecast round. The household expected inflation for the year ahead is estimated at **5.3%** (**5.4%** in June and July 2019).

Third, external monetary conditions are easing, which reduces the risks of capital outflows from developing countries. The **US Federal Reserve** has cut interest rates for the first time in 10 years. The **European Central Bank** kept rates unchanged until the first half of 2020. The Central Bank of Russia, owing to the slowdown in inflation and the transition to a neutral monetary policy, has eased monetary conditions (rate cut to 7%).

At the same time, **the constraining effect of positive external factors does not fully compensate for the impact of internal inflationary factors.**

Taking into account the balance of internal and external conditions, the National Bank takes **proactive measures** to prevent inflation risks.

The **base rate** in real terms, taking into account the decision taken today, is estimated at **3.3-3.5%**. This level corresponds to the upper limit of our estimates for its neutral level of 3-3.5%.

Since June of this year, we have already **raised the rates on money market operations** to the upper limit of the interest rate corridor, as well as gradually lengthened the terms of short-term notes issued by the National Bank. As a result, the share of notes with a maturity of 6-12 months increased from **43% in** May to **73% in** August. This constrains the potential for a rapid flow of tenge liquidity to the foreign exchange market.

The **TONIA indicator**, which is a benchmark in the money market, has reacted and now is forming at higher levels.

In the **foreign exchange market**, after a period of volatility observed in March, June and July of this year, the situation has stabilized: supply and demand are balanced.

Nevertheless, the foreign exchange channel remains one of the main risks for inflation growth through the rise in the cost of imports. In this regard, an increase in the base rate will increase the attractiveness of tenge assets, which in turn will limit the pass-through effect on inflation.

Within the framework of the Agreement on coordination of macroeconomic policy measures for 2019, the joint work of the National Bank and the Government on **the development of the market for government securities** will continue. The plot of an adequate yield curve will provide a full-fledged market pricing of debt capital for a period of more than 1 year.

In order to achieve the stated inflation target, the National Bank will make **further decisions** on the base rate taking into account the compliance of the actual and projected inflation dynamics with the target range, the emerging risks from domestic demand, import growth and the situation in the world economy.

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The next decision on the base rate will be announced on October 28, 2019 at 15: 00 Nur-Sultan time.

**Thank you for your attention!**