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**MONETARY POLICY GUIDELINES
OF THE REPUBLIC OF KAZAKHSTAN
FOR 2011**

Foreword

The global economic crisis had a significant impact on the monetary policy implementation by the central banks of most countries and made alterations in the use of monetary policy instruments.

Since the second half of 2009 the global economy has been at one of the first stages of its recovery after the global financial crisis. According to the IMF's forecast, the global economy growth in 2010-2011 is estimated to be in the range of 4.5%. Nonetheless, the extent of recovery differs from country to country. In most developed countries the economic activity remains moderate whereas in major developing economies significant GDP growth was recorded. The GDP growth in the developed economies in 2010-2011 is anticipated to be at 2.5%, and in the developing countries – about 6.5%.

Given the moderate economic activity, high uncertainty about sustainability of the economic growth recovery and limited inflationary pressure in major developed countries, the central banks of those countries continue implementing the expansionist monetary policy. Particularly, the interest rate of the US Federal Reserve System has been at an all-time low level since December 2008. Interest rates of the European Central Bank have also been unchanged over the last year and a half.

On the other hand, central banks of the major developing countries where the economic growth recovery is accompanied by the increased inflation rate started to tighten their monetary policies to a certain extent. Thus, central banks in such countries as China, South Korea, Malaysia, and India made decisions to increase their interest rates.

In the mid-term the government authorities will focus on the efforts made to reorganize the systems of financial activity regulation, recover the balanced growth of the global economy and ensure a more sustainable economic surge.

Generally, the year 2010 may be regarded as the period of gradual and progressive restoration of business relationship between market entities and of entering into the economic growth phase.

1. Macroeconomic Development and Monetary Policy of the Republic of Kazakhstan in 2010

1.1 Macroeconomic Development in 2010

In 2010 the economy of the Republic of Kazakhstan demonstrated quite high development rates. So, the GDP growth during 9 months of 2010 amounted to 7.5%. According to estimates, the real GDP growth in 2010 will be about 7%.

During 9 months of 2010 the current account balance was formed with a profit of US\$ 4.7 bln. (or 5% of GDP). The inflow of direct foreign investments to Kazakhstan continues, with their volume amounting to US\$ 8.2 bln. at the end of 9 months of 2010.

At end-November 2010 the annual inflation was at 7.7% (in December 2009 – 6.2%).

The main factors of the inflationary growth in 2010 were related to the unbalanced demand and supply in the economy, which was mainly caused by:

- expanded absorption due to increased wages, social benefits and retirement benefits from the budget by 25% in 2010;
- remaining unstable situation in the global commodity markets, specifically because of adverse weather conditions resulting in the reduced supply of wheat, grains, etc. in the global market and the growth in prices for these commodities.

Payment systems of the Republic of Kazakhstan ensure timely processing of payments and money transfers within the country and are characterized by the high level of safety and efficiency. During 11 months of 2010, 27.0 million of transactions amounting to KZT 169.4 trln. were processed in the payment systems of the Republic of Kazakhstan, which is greater than in the similar period of the previous year by 15.8% and 18.7%, respectively.

Within the frameworks of achieving the established benchmarks, the monetary policy of the Republic of Kazakhstan was of a balanced nature. This was accompanied by maintaining the money supply at a low level. The growth rates of the money supply at the end of ten months of 2010 accounted for 15.7%, the reserve money in January-November 2010 contracted by 3.2%.

In 2010 the growth of the deposit base in the banking system was observed. Thus, during 11 months of 2010 the volume of residents' deposits increased by 13.3% to KZT 7451.3 bln., specifically deposits of legal entities increased by 13.4%, and deposits of individuals – by 13.2%. During 11 months of 2010 foreign currency deposits decreased by 8.1% to KZT 2640.6 bln., deposits in the domestic currency increased by 30.0% to KZT 4810.7 bln.

With the view to increase sustainability of the domestic sources when building up the bank funding base, to ensure the financial system soundness and protect the depositor interests, the National Bank of the Republic of Kazakhstan increased the capital of the Kazakhstan Deposit Insurance Fund by KZT 11 bln. in September 2010. Now the authorized capital of the Kazakhstan Deposit Insurance Fund amounts

to KZT 121 bln. This arrangement will promote a further steady growth of bank deposits, both of the population and of the legal entities.

The total volume of credits to the economy provided by banks during 11 months of 2010 decreased by 2%, amounting to KZT 7494.6 bln. In doing so, credits provided in the domestic currency increased by 7.9% to KZT 4255.6 bln., and credits in foreign currency decreased by 12.5% to KZT 3238.9 bln.

Thus, stabilization of the situation in the financial market of the Republic of Kazakhstan was not accompanied by the revitalization in the lending activity of the banking sector, and the volume of the economy's indebtedness on credits decreased to some extent. This is associated with a high level of substandard loans in the bank portfolios, persisting risks in the domestic and foreign capital markets, unclear prospects with regard to creditworthiness of the real sector and the population. In 2011 no rapid growth of credit activity is anticipated due to the write down of "bad" loans.

1.2 Monetary Policy of the Republic of Kazakhstan in 2010

In 2010 the main objective of the National Bank of the Republic of Kazakhstan was to ensure the price stability in the country and to keep the annual inflation rate within 6-8%.

Monetary policy measures of the Republic of Kazakhstan allowed retaining stability in the country's consumer market. According to the estimate made by the National Bank of the Republic of Kazakhstan, annual inflation for 2010 will be closer to the upper boundary of the target range established within 6-8%.

Measures of the National Bank of the Republic of Kazakhstan, as well as a favorable pricing environment for the major items of Kazakhstan's exports allowed retaining a stable situation in the domestic foreign exchange market. In these circumstances from February 5, 2010 the National Bank of the Republic of Kazakhstan expanded the exchange rate band of the Tenge: KZT 150/US\$ (+)10% or KZT 15, (-)15% or KZT 22.5. This band will be in effect till March 20, 2011.

During 2010 the exchange rate of the Tenge versus the US Dollar remained within the given band with the minimal involvement of the National Bank of the Republic of Kazakhstan in the domestic foreign exchange market. Alongside with that, there was a trend for the domestic currency appreciation.

In 2010 the interest rate band of the National Bank of the Republic of Kazakhstan remained unchanged. Throughout the year the official refinancing rate representing the upper boundary of the band remained at 7.0%. The rate on deposits attracted from banks and representing the lower boundary of the short-term interest rates band in the money market was 0.5% for 7-day deposits and 1.0% – for 1-month deposits.

Given the prevailing involvement of the National Bank of the Republic of Kazakhstan in the interbank market, the market rates in this market segment remained within the interest rate band of the National Bank of the Republic of Kazakhstan

closer to its upper boundary, which is mainly associated with low activity and excessive liquidity of the market participants.

The National Bank of the Republic of Kazakhstan regulated the short-term liquidity in the money market through the issue of short-term notes and attraction of deposits from banks. Despite the decrease in interest rates to the minimal level, the demand for such instruments on the part of banks remained high throughout the year. As a result, banks have accumulated a significant volume of reserves with the National Bank of the Republic of Kazakhstan.

Upon requests of individual banks that were undergoing the restructuring of their foreign debt, the National Bank of the Republic of Kazakhstan provided refinancing loans to support their current liquidity. The terms of such loans didn't exceed 1 month.

The mechanism of minimum reserve requirements as well as their ratios hasn't changed in 2010. The ratio of minimum reserve requirements for banks was 1.5% on domestic liabilities and 2.5% on other liabilities, and for banks undergoing the debt restructuring process – 0% on all liabilities of such banks.

Owing to the anti-crisis measures taken by the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan as well as due to a favorable environment in the global commodity markets, the recovery of economic growth in the country continued. At the same time, the GDP growth rates will be moderate in the mid-term. Alongside with that, it is anticipated that uncertainty regarding the development of the global economy will decrease.

2. Scenarios for the Development of the Economy of the Republic of Kazakhstan for 2011-2013

With an aim of formulating a consistent and balanced policy, the National Bank of the Republic of Kazakhstan made the decision to elaborate the Monetary Policy Guidelines of the Republic of Kazakhstan for one year taking into account medium-term projections for the three subsequent years.

The scenarios are synchronized and coordinated with the estimates made by the Government of the Republic of Kazakhstan when building up the Forecast for the Socio-Economic Development of Republic of Kazakhstan for 2011-2015.

Given the extent of impact on the Kazakh economy, an annual average level of the world oil prices was determined as a key criterion for distinguishing between scenarios when formulating the monetary policy for 2011-2013. Three scenarios for the development of macroeconomic situation were reviewed, which assume the level of oil prices at 35, 65 and 80 US Dollars for barrel.

The forecasts for the key indicators of the monetary policy of the Republic of Kazakhstan are based on the forecasts of the balance of payments¹ that are quite conservative (Table 1).

¹ When doing the forecast for the balance of payments for 2011-2013, assumptions and expectations of ministries and agencies of the Republic of Kazakhstan in respect of incoming foreign investments in large projects existing at end-September 2010 were also taken into account.

Table 1.

The Forecast of the Real GDP and the Balance of Payments Indicators in 2011-2013 under Three Scenarios

	2011			2012			2013		
	35	65	80	35	65	80	35	65	80
Real growth of GDP, %	-0.5	3.1	4.7	0.9	3.3	4.9	1.9	3.5	5
Current account, as % of GDP	-7.2	0.9	1.6	-5.8	1.5	1.5	-4.7	1.9	1.4
Balance of payments, as % of GDP	-1.9	2.8	2.6	-0.4	1.9	1.8	-1.8	2.2	0.6

The increase in pensions, benefits, wages and other welfare payments scheduled for 2011 was taken into account in all three scenarios. Such increase would require that relevant measures should be taken by the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan to maintain the aggregate supply at the level consistent with the aggregate demand in the economy.

Due to unclear prospects in relation to “bad” loan write offs by banks, the forecast or an estimate of the dynamics and volumes of credits to the economy doesn’t not seem to be feasible. The volumes of loan repayments and “bad” loan write offs are expected to be offset in 2011 by extensions of new credits. In this connection a stable level of indebtedness under credits of the economy is expected in 2011, and assumption of their growth by 10% a year was made for 2012-2013.

In 2011 the inflation background is expected to remain unchanged. This is associated with the fact that the major risks for acceleration of inflation in 2011 will be represented by the same factors that existed in 2010.

In 2011 the impact of monetary factors on the buildup of inflationary processes in the Republic of Kazakhstan will be minor just like in 2010.

In the implementation of all scenarios of the development of the Kazakh economy in 2011-2013 the main objective of the National Bank of the Republic of Kazakhstan is to ensure the price stability which implies that inflation will be kept within 6.0-8.0%.

Under *Scenario One* an insignificant contraction of the Kazakh economy is expected in 2010 with subsequent recovery in real growth of the economy to 2% in 2013.

Under this Scenario, the reduced business activity, contracted aggregate demand, deteriorated balance of payments performance and decreased money supply are anticipated.

The decreased demand of the economy for money would be accompanied by the contraction in money supply in 2011. In 2012-2013 money supply would increase to some extent but its growth rates would be limited.

Multidirectional dynamics of money supply would be conducive to some decrease in the degree of monetization (Appendix 1).

According to the estimate made by the National Bank of the Republic of Kazakhstan, a probability of this scenario's implementation is rather low.

In case of *Scenario Two*, oil prices would be higher as compared to Scenario One but lower than the actual level of 2010. As a result, growth rates of the Kazakh economy in 2011-2013 would slow down as compared to 2010.

Capital account in 2011-2013 would remain positive. However, by the end of the forecast period a net inflow may decrease, mainly because of decreased demand for gross direct foreign investments in large oil and gas projects if new operational stages of these projects would not start to be implemented.

Given that it is expected that the current account and the overall balance of payments in 2011-2013 would be positive.

The rates of expansion in money supply would be in line with the growth rates of nominal GDP in 2011-2013. At the same time a more favorable macroeconomic situation accompanied by positive dynamics of economic growth would contribute to the growth of the monetization level (Appendix 1).

Under *Scenario Three* the rates of economic growth in Kazakhstan in 2011-2013 are expected at a higher level as compared to the preceding scenarios.

As compared to the preceding scenario, with a higher level of export revenues and fixed volumes of the transfer to the republican budget, the growth rates of foreign assets of the National Fund of the Republic of Kazakhstan would accelerate. This would boost the outflow on capital account as compared to the preceding scenario.

As part of the third scenario a higher aggregate demand is expected as compared to the preceding scenario, including demand for imported goods. As a result, the profit of the overall balance of payments would be moderate.

The demand for money would also be higher as compared to the preceding scenarios. At the same time a significant growth in nominal GDP is anticipated in 2011, with the stabilization of its growth rates in 2012-2013. As a result, the dynamics of money supply would correspond to the dynamics of nominal GDP, thus ensuring the increased monetization in the forecast period (Appendix 1).

The National Bank of the Republic of Kazakhstan believes that the third scenario of the development of the Kazakh economy is most likely to be implemented; proceeding from there the monetary policy measures for 2011 have been formulated. Measures for the subsequent years will be specified based on the performance in 2011.

3. Monetary Policy of the Republic of Kazakhstan for 2011

In 2011 the National Bank of the Republic of Kazakhstan determines the implementation of monetary policy aimed at ensuring the price stability and

maintaining a low rate of annual inflation adequate to the macroeconomic assumptions as the top-priority area in its activity.

Despite the fact that the National Bank of the Republic of Kazakhstan determined the price stability as the main monetary policy objective, the transition to the inflation targeting principles is postponed to a longer-run horizon once the efficiency of interest rates as monetary policy instruments of the National Bank of the Republic of Kazakhstan increases.

Efforts will be continued to improve and enhance the efficiency of monetary policy instruments and the further increase of impact of measures taken on the condition of the money market.

When the established foreign exchange rate band of the Tenge is terminated, the National Bank of the Republic of Kazakhstan will move to the managed floating exchange rate regime. This is stipulated by the domestic currency stability promoted by a favorable pricing environment for major items of Kazakhstan's exports in the global markets and the balance of payments position. There are no fundamental assumptions for the Tenge devaluation in the mid-term. Also, if the 2nd and 3rd scenarios of the economic development are implemented due to the external surplus the domestic currency appreciation is very likely.

However, the transition to the managed floating exchange rate regime doesn't release the National Bank of the Republic of Kazakhstan of responsibility to promote the domestic currency stability. Measures of the National Bank of the Republic of Kazakhstan will be focused on preventing significant fluctuations of the real exchange rate of the domestic currency that may have a negative impact on the competitiveness of the domestic production in conditions of ever-changing global environment. The National Bank of the Republic of Kazakhstan will look to further reduce its involvement in the foreign exchange market in order to increase flexibility of the Tenge exchange rate.

Interest rate policy of the National Bank of the Republic of Kazakhstan will be aimed at maintaining the market-based interest rates in the money market of short-term instruments within the interest rate band of the National Bank of the Republic of Kazakhstan. In doing so, further implementation of the interest rate policy will be focused on narrowing the interest rate band.

The main efforts of the National Bank of the Republic of Kazakhstan will be concentrated on a more flexible regulation of the lower boundary of the interest rate band (interest rates on deposits of banks placed with the National Bank of the Republic of Kazakhstan), based on which bank liquidity is withdrawn. In addition, the change in the lower boundary of the interest rate band will be determined by the dynamics of forecasted inflation over mid-term. The official refinancing rate which represents the upper boundary of the band will be determined based on the current situation in the money market and the level of inflation.

In 2011 the National Bank of the Republic of Kazakhstan will consider the possibility of differentiation of rates on the operations of the National Bank of the Republic of Kazakhstan depending on the terms and conditions.

Short-term notes and deposits of banks with the National Bank of the Republic of Kazakhstan will remain as the main instruments for interest rate regulation in the financial market as well for sterilization of excessive bank liquidity.

The issue of short-term notes will be also intended for supporting the secondary government securities market, building up the yield curve for financial instruments with maturity less than one year. In 2011 the situation with liquidity in the money market will not change cardinally. Therefore, maturities of short-term notes are intended to be kept at the existing level – 3 and 6 months.

As necessary, the National Bank of the Republic of Kazakhstan will provide refinancing loans to support short-term liquidity of banks. These operations will remain as short-term. At the same time, the National Bank of the Republic of Kazakhstan doesn't expect the increase in demand for such resources. The possibility of providing liquidity through transactions with international financial organizations will be also considered.

With a view to increase the efficiency of instruments regulating the bank liquidity, the reactivation of direct REPO operations and reverse REPO operations with banks in the automatic REPO sector at the Kazakhstan Stock Exchange will be considered.

In 2011 the National Bank of the Republic of Kazakhstan will proceed to improve the mechanism of minimum reserve requirements, increase the efficiency of its application, mainly in respect of the change in the composition of reserve assets. The exclusion of foreign currency assets from the base of bank reserve assets will be considered. In the mid-term (in 2012-2013) the exclusion of cash in the bank from reserve assets is also going to be considered. In order to prevent significant deterioration of the situation with the bank liquidity, the National Bank of the Republic of Kazakhstan may consider decreasing the minimum reserve requirements.

The achievement of the inflation target within 6-8% under all scenarios will be supported by appropriate monetary policy measures. The increase in excessive money supply that may entail an increased inflationary pressure will be accompanied by the growth of sterilization operations of the National Bank of the Republic of Kazakhstan.

Monetary policy of the Republic of Kazakhstan will be adequate to the developing macroeconomic conditions. Money supply in the economy will be retained at the level corresponding to the growth of the economy. Monetary policy of the Republic of Kazakhstan will create conditions for addressing the revival of lending activity by flexible regulation of liquidity in the banking sector. However, the efficiency of such measures will be dependent on structural adjustments in the banking sector.

Monetary policy of the Republic of Kazakhstan, including foreign exchange policy, will take into account both potential economic benefits and negative implications and risks for the economy of the Republic of Kazakhstan resulting from

the implementation of arrangements attained as part of agreements of the Common Economic Space.

Monetary policy of the Republic of Kazakhstan will facilitate realizing the forecast of socio-economic development of the Republic of Kazakhstan.

If more favorable scenarios of economic development are implemented (Scenarios 2 and 3) in 2011, the monetary policy in the coming years will be pursued within the guidelines defined by this document. The key parameters of the monetary policy and the balance of payments, including monetary policy measures, will be specified for the coming years based on the performance in 2011.

FORECAST OF KEY MONETARY POLICY INDICATORS FOR 2011 - 2013

SCENARIO ONE

(end of period)

	2010	2011	2012	2013
Inflation, %	7.3	6.0-8.0	6.0-8.0	6.0-8.0
Official refinancing rate, %	7.0	6.0	6.0	6.0
Reserve money, KZT bln.	2805	2563	2673	2821
<i>% change</i>	<i>14.5</i>	<i>-8.7</i>	<i>4.3</i>	<i>5.5</i>
Money supply, KZT bln.	8754	7910	8220	8652
<i>% change</i>	<i>16.9</i>	<i>-9.6</i>	<i>3.9</i>	<i>5.2</i>
Deposits of residents, KZT bln.	7666	6917	7198	7572
<i>% change</i>	<i>16.6</i>	<i>-9.8</i>	<i>4.1</i>	<i>5.2</i>
Credits to the economy, KZT bln.	7489	7489	7564	7715
<i>% change</i>	<i>-2.0</i>	<i>0.0</i>	<i>1.0</i>	<i>2.0</i>
Monetization level of the economy, %	45.3	44.8	44.5	44.0

SCENARIO TWO

(end of period)

	2010	2011	2012	2013
Inflation, %	7.3	6.0-8.0	6.0-8.0	6.0-8.0
Official refinancing rate, %	7.0	7.0	7.0	7.0
Reserve money, KZT bln.	2805	3077	3379	3698
<i>% change</i>	<i>14.5</i>	<i>9.7</i>	<i>9.8</i>	<i>9.5</i>
Money supply, KZT bln.	8754	9673	20710	11766
<i>% change</i>	<i>1.9</i>	<i>10.5</i>	<i>10.7</i>	<i>9.9</i>
Deposits of residents, KZT bln.	7666	8477	9396	10331
<i>% change</i>	<i>16.6</i>	<i>10.6</i>	<i>10.8</i>	<i>10.0</i>
Credits to the economy, KZT bln.	7489	7489	8238	9062
<i>% change</i>	<i>-2.0</i>	<i>0.0</i>	<i>10.0</i>	<i>10.0</i>
Monetization level of the economy, %	45.3	45.6	46.0	46.2

SCENARIO THREE

(end of period)

	2010	2011	2012	2013
Inflation, %	7.3	6.0-8.0	6.0-8.0	6.0-8.0
Official refinancing rate, %	7.0	8.0	8.0	8.0
Reserve money, KZT bln.	2805	3316	3710	4132
<i>% change</i>	<i>14.5</i>	<i>18.2</i>	<i>11.9</i>	<i>11.4</i>
Money supply, KZT bln.	8754	10444	11781	13166
<i>% change</i>	<i>16.9</i>	<i>19.3</i>	<i>12.8</i>	<i>11.8</i>
Deposits of residents, KZT bln.	7666	9161	10358	11589
<i>% change</i>	<i>16.6</i>	<i>19.5</i>	<i>13.1</i>	<i>11.9</i>
Credits to the economy, KZT bln.	7489	7489	8238	9062
<i>% change</i>	<i>-2.0</i>	<i>0.0</i>	<i>10.0</i>	<i>10.0</i>
Monetization level of the economy, %	45.3	45.8	46.1	46.3