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**MONETARY POLICY GUIDELINES
OF THE REPUBLIC OF KAZAKHSTAN
FOR 2013**

Foreword

In 2012, the rates of economic growth in the global economy were slowing down, thus strengthening the anticipations of the world leading economists about protracted nature of the economic crisis and inadequacy and, sometimes even impropriety, of decisions made to overcome crisis developments.

If in 2007-2010, the key focus of the measures taken to stimulate the development of the US economy and those of the Euro zone countries implied finding additional ways of liquidity injections in the economy with a view to stimulate domestic demand and decrease unemployment, in 2011-2012 the measures to ensure fiscal sustainability by means of cutting government expenditures and increasing taxes, started to be used more frequently. At the same time, it's obvious that a possible consequence of a smaller government support and higher taxes could be a lower business activity as well as the growth in the unemployment rate, and, thus, social tension.

To this end, the forecasts in respect of the growth of the global economy and of the Euro zone countries, in particular, are revised downward. Forecasts have been deteriorating due to the draught of 2012 that raises concerns about food crisis which becomes global. The practice of large-scale liquidity injections into the financial sphere used earlier on by central banks, governments of the developed countries and international financial institutions with a view to recover sustainable economic development, increased inflationary risks in the global commodity markets, just as some economists predicted.

A slowdown in the economic development in such big centers of the global economy as China and Japan is observed. These countries have a significant impact on economic trends in other countries, including Kazakhstan, thus suggesting a slowdown in the development of the global economy as a whole.

Nonetheless, forecasts made by the international financial institutions and the OPEC countries about the energy prices in 2013 are quite favorable – some growth is projected; this helps expecting that sustainable development trends in the primary exporting countries, including Kazakhstan, would persist.

Chapter 1. Macroeconomic Development and Monetary Policy of the Republic of Kazakhstan in 2012

1.1. Macroeconomic Development in 2012

- General Macroeconomic Trends

In 2012, the economic growth in Kazakhstan demonstrated some slowdown. During January-September 2012, a real growth in the gross domestic product in Kazakhstan, as compared to the respective period of 2011, accounted for 5.2%, in nominal terms – 13.5%. Intensive growth rates are observed in such sectors as trade (14.3% during January-November 2012 versus the respective period of 2011), communications (17.4%), and transport (7.1%). The development in the industry somewhat slowed down (0.4%), and the decrease in output occurred in the agricultural sector (-18.5%).

Generally, the economy develops within the forecasts, and the outcomes of macroeconomic planning are anticipated to be in line with the plan at end-2012.

The expansion of aggregate demand in the economy associated with the growth in lending activity of the banking sector and the increasing cash income of the population, appeared to be one of the factors for the growth in business activity in 2012. So, average monthly real wages accrued increased by 3.0% in October 2012 as compared to the respective month of 2011 (in 2011 – by 14.1%). At the same time, the unemployment rate decreased insignificantly: from 5.4% in January 2012 to 5.3% in November 2012.

- Balance of Payments for 9 months of 2012

A current account surplus for 9 months of 2012 was at US\$ 7.8 bln., having decreased by 30.5% as compared to the respective period of 2011.

A trade balance surplus decreased by 5.8% to US\$ 35.3 bln., and a net outflow of resources from revenue operations (including payroll and balance of investment returns) decreased by 3.2% amounting to US\$ 21.2 bln. As for other current account components, negative imbalances of services and transfers amounted to US\$ 5.6 bln. and US\$ 0.6 bln., respectively.

A deficit of the capital and finance account (including errors and omissions) amounted to US\$ 1.2 bln. during 9 months of 2012. A net outflow on direct investments abroad amounted to US\$ 1.0 bln. A net inflow on foreign direct investments in Kazakhstan amounted to US\$ 11.7 bln. As a result, a surplus on direct investments amounted to US\$ 10.7 bln. during 9 months of 2012.

A net outflow on portfolio investments of US\$ 12.8 bln. was secured by the growth in foreign assets of the National Fund of the Republic of Kazakhstan by US\$ 12.2 bln., as well as by a nearly US\$ 1 bln. decrease in debt commitments of the Kazakh banks.

- Fiscal Policy

Government spending on final consumption in January-November 2012 totaled KZT 5965.4 bln. About 50% of all state budget spending was allocated to education, social security and healthcare.

During January-November 2012, state budget revenues amounted to KZT 5432.3 bln. Tax revenues and official transfers represent key items in the structure of state budget revenues. A high percentage of official transfers was secured by the guaranteed transfer from the National Fund of the Republic of Kazakhstan to the state budget. In the environment of post-crisis developments, the decision was made to increase the amount of the guaranteed transfer by 15% to KZT 1380 bln., that was withdrawn in full at the end of 10 months of 2012.

As a result of excess expenditures over revenues in January-November 2012, the state budget ended up with the deficit of KZT 533.1 bln.

- Trends in the Banking Sector

In 2012, the banking sector had been demonstrating a slow but a steady recovery trend. As of December 1, 2012, bank assets amounted to KZT 13.7 trln., having increased by KZT 0.9 trln. or by 7.0% versus the beginning of the year.

At end-November 2012, the volume of credits reached KZT 9.7 trln., having increased by 10.5% since the beginning of the year. In doing so, lending in the local currency increased by 19.9% to KZT 6811.5 bln., and in foreign currency – decreased by 6.5% to KZT 2926.0 bln.

The volume of deposits of residents during January-November 2012 increased by 8.3% to KZT 9.1 trln. Corporate deposits increased by 3.7%, and deposits of individuals – by 17.9%. During January-November 2012, foreign currency deposits increased by 7.7% to KZT 2833.4 bln., deposits in the local currency – by 8.6% to KZT 6252.1 bln. During 11 months of 2012, households time deposits increased by 17.6%, including the domestic currency deposits – by 20.3%.

With the aim to increase sustainability of the domestic sources when building up the funding base of banks, increase stability of the financial system and protect depositors' interests, in September 2012 the decision was made to increase the equity of the Kazakhstan Deposit Insurance Fund by KZT 13.31 bln. to KZT 146.4 bln.

- Inflationary Trends

In the 1st half of 2012, the downward trend in the inflationary processes in the country that had been observed since the second half of 2011, continued. From autumn of 2012 onwards, because of increased tariffs for paid services including utilities and transport services, decreased crop forecast because of arid summer of 2012 as well as due to the seasonality factors, some acceleration of inflation was observed.

Besides, current processes in the member states of the Customs Union continue affecting the consumer market within Kazakhstan. Just like in 2011, the situation in the consumer market of Belarus doesn't have a significant influence on Kazakhstan due to small volumes of mutual trade, contrary to the Russian consumer market which affects the inflation in Kazakhstan in a certain way.

Nonetheless, in 2012 the inflation didn't go above the forecasts, the dynamics of annual inflation demonstrated the lowest rate since May 1999. At the end of 2012, the annual inflation was at 6.0%, and average annual inflation – 5.1%.

The major reasons for the growth in the inflation rate in 2012 were caused by a number of factors, among which the most significant were an unstable situation in the global commodity markets, a high level of world prices for commodities and foodstuffs, inefficient mechanism of pricing within Kazakhstan, and low competition in certain markets of goods and services.

The build-up of inflationary processes in Kazakhstan in 2012 occurred amidst a minimal impact on the part of monetary factors. In 2012, monetary aggregates were growing at moderate rates. During January-December of 2012, the reserve money expanded by 1.9%, money supply during January-November 2012 increased by 7.3%, and the volume of cash in circulation grew by 1.0%. Generally, money supply in the economy is commensurate with the growth of the economy.

- Trends of the Foreign Exchange Market

In 2012, world prices for major items of Kazakhstan's exports were at a fairly high level. As a result, the situation in the local foreign exchange market remained stable. In 2012, the exchange rate of the Tenge was fluctuating within KZT 147.50-150.86 per 1 US Dollar. During 2012, the exchange rate of the Tenge depreciated versus the US Dollar in nominal terms by 1.6%.

1.2. Monetary Policy of the Republic of Kazakhstan in 2012

The main goal of the National Bank of the Republic of Kazakhstan in 2012 was to ensure the price stability in the country and keep the annual inflation within 6-8%. In 2012, the annual inflation in Kazakhstan accounted for 6.0% (in 2011 – 7.4%).

- Liquidity Regulation

The National Bank of the Republic of Kazakhstan regulated short-term liquidity in the money market by conducting operations mainly aimed at liquidity absorption.

In the 1st half of 2012, despite a low level of interest rates, the demand for instruments of liquidity absorption (issue of short-term notes and deposit-taking) on the part of banks remained high. In the 2nd half of 2012, the volumes of liquidity in the banking sector were decreasing and, respectively, the demand for such instruments of the National Bank of the Republic of Kazakhstan on the part of banks decreased.

The demand for refinancing loans (operations on provision of liquidity) was limited throughout 2012.

In 2012, amendments were made to the minimum reserve requirements in respect of how the minimum reserve requirements themselves should be determined, as well as the structure of bank liabilities taken for the calculation of minimum reserve requirements and the structure of reserve assets. So, cash on hand and correspondent accounts in foreign currency were excluded from the structure of reserve assets. The build-up of bank reserve assets from assets in the Tenge only will allow the National Bank of the Republic of Kazakhstan to adequately estimate the level of available Tenge liquidity in the money market, to be more responsive to the change in the demand for the domestic currency and, respectively, increase the efficiency of its operations for liquidity regulation.

An additional criterion was introduced for differentiation of bank liabilities between short-term (less than 1 year) and long-term (over 1 year). Separate requirements were introduced for each type of liabilities: on the domestic short-term liabilities – 2.5%, on the domestic long-term liabilities – 0%, on foreign short-term liabilities – 6.0%, and on foreign long-term liabilities – 2.5%. Differentiated regulation will help limit the inflow of short-term speculative capital, diversify portfolio of banks, develop the market of long-term bank instruments, and reduce pressure on the foreign exchange market.

The introduction of the above changes to the minimum reserve requirements in general will not negatively affect the banking sector.

- Interest Rate Policy

Low rates of inflation gave rise to a gradual decrease in the official refinancing rate from 7.5% in February 2012 to 5.5% in August 2012 – a historically minimal level. Interest rate on deposits attracted from banks that serves as a lower boundary of the interest rate band of the National Bank of the Republic of Kazakhstan remained unchanged throughout 2012 and accounted for 0.5% on 7-day deposits and 1.0% – on 1 month deposits.

In the 1st half of 2012, there was an increase in the effective yield on short-term notes from 1.27% in December 2011 to 1.56% in July 2012. The decrease in liquidity volumes in the banking sector was accompanied by the decrease in the effective yield to 1.05% in November 2012. During 2012 as a whole, the effective yield accounted for 1.46%.

Market rates in the interbank market remained within the limits of the interest rate band of the National Bank of the Republic of Kazakhstan, closer to its lower boundary. At the beginning of 2012, interest rates in the money market remained at the minimal level, to a larger extent this is related to low activity and excessive liquidity of the market players. In the 2nd half of 2012, the upward trend of interest rates outlined, thus indicating the growth in activity among the money market players.

- Foreign Exchange Policy, National Fund of the Republic of Kazakhstan and Gold and Foreign Currency Assets of the National Bank of the Republic of Kazakhstan

In 2012, the National Bank of the Republic of Kazakhstan continued implementing the exchange rate policy within the context of the managed float regime.

With a view to prevent plummeting of the exchange rate and maintain stability of the foreign exchange market, the National Bank of the Republic of Kazakhstan participated in the stock exchange and off-exchange markets both as a buyer and a seller of foreign exchange, depending on the situation in these markets.

Stability of the domestic currency allowed the National Bank of the Republic of Kazakhstan to increase the country's international reserves. The volume of international reserves of the Republic of Kazakhstan during 2012 increased by 17.9% and amounted to US\$ 86.0 bln. at the end of 2012.

During 2012, gold and foreign currency assets of the National Bank of the Republic of Kazakhstan decreased by 3.6% to US\$ 28.3 bln. Such dynamics was caused, in the first instance, by the conversion of the Tenge receipts to the gold and foreign currency assets account of the National Bank of the Republic of Kazakhstan to replenish foreign currency assets of the National Fund of the Republic of Kazakhstan. During 2012, the National Bank of the Republic of Kazakhstan allocated US\$ 1.9 bln. to replenish assets of the National Fund of the Republic of Kazakhstan. As a result, assets of the National Fund of the Republic of Kazakhstan amounted to US\$ 57.8 bln. at the end of 2012, having increased by 32.4%.

During 2012, the volume of foreign exchange sold by the National Bank of the Republic of Kazakhstan to the Ministry of Finance of the Republic of Kazakhstan amounted to US\$ 355.4 mln.

Chapter 2. Scenarios for the Development of the Economy of the Republic of Kazakhstan for 2013-2015

The National Bank of the Republic of Kazakhstan, while elaborating the Monetary Policy Guidelines of the Republic of Kazakhstan, considered 3 scenarios of the economic development for 2013-2015, which 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 the Republic of Kazakhstan for 2013-2017. A key criterion for distinguishing between scenarios was an annual average level of the world oil prices (Table 1).

Table 1

	2013-2015		
	Scenario One	Scenario Two	Scenario III
World oil price	90 US Dollars per barrel	60 US Dollars per barrel	120 US Dollars per barrel

The forecasts for the key monetary policy indicators of the Republic of Kazakhstan are based on the forecasts of the balance of payments that are quite conservative.

In 2013-2015 the inflation background is expected to remain unchanged. The major risks of acceleration of inflation will be an unstable situation in the global commodity and foodstuffs markets, steady growth in business activity, underdeveloped domestic competitive market environment and high monopolization in certain markets of goods and services, and poorly developed trade infrastructure in a number of regions.

At the same time, minimization of impact by monetary factors on the inflationary processes build-up in the Republic of Kazakhstan will be ensured by maintaining an adequate money supply by the National Bank of the Republic of Kazakhstan.

In the implementation of all scenarios concerning the development of the Kazakh economy in 2013-2015, the main objective of the National Bank of the Republic of Kazakhstan is to ensure the price stability, which implies that the inflation will be kept within the band of 6.0-8.0%.

Scenario One assumes a stable development of the situation in the global commodity markets and financial markets. The global economy will be demonstrating a slow but incremental growth.

Under the baseline scenario, oil prices will be lower than the actual level in 2012. Nonetheless, in 2013-2015, rates of economic growth in Kazakhstan will be comparable with those of 2012.

With the world oil price of US\$ 90 per barrel, in 2013-2015 a trade balance surplus is anticipated to be within US\$ 33-37 bln. Distributions to foreign investors will remain at a fairly high level. As a result, the current account is expected to be between 1.9% - 2.5% of GDP in 2013-2015.

In 2013-2015, due to decreasing inflow of direct investments into Kazakhstan as well as to persistently significant rates of growth in foreign assets of the National Fund of the Republic of Kazakhstan, the capital and finance account (including "Errors and Omissions") will be in deficit.

As a result, an overall balance of payments is expected to be within (-)0.1% - 1% of GDP.

The rates of expansion in the money supply will be commensurate with the rates of growth in the nominal GDP in 2013-2015. Alongside with that, a favorable macro-economic situation accompanied by positive dynamics of economic growth will be conducive to the growth in the level of monetization (Appendix 1).

Scenario Two assumes pessimistic forecasts in the event if the situation in the global commodity and financial market deteriorates in the mid-term.

Should this scenario be realized, the growth rates of the Kazakh economy will slow down to 2% in 2013, with subsequent acceleration in the rates of real growth of the economy to 3.7% in 2015.

As part of this scenario, it is expected that business activity will be slowing, aggregate demand will decrease, balance of payments performance will deteriorate and money supply will go down.

A pessimistic scenario in the forecast for the balance of payments takes into account a significant reduction in the exports of goods to US\$ 57.2 bln. in 2013, and its subsequent growth to US\$ 59.8 bln. in 2015. Due to slowing growth rates and decreasing revenues in the economy, the imports of goods in the forecast period will also reduce to US\$ 37.8-38.7 bln. The reduced exports of goods will be also offset by the decreased distributions to non-residents. In this connection, a current account deficit is expected not to exceed 1.7% of GDP.

Generally, because of significant deterioration in the global market environment, problems with the financing of a number of projects with foreign participation might occur in 2013-2015. The falling world oil price will also result in decreased volumes of repayments on foreign direct investments. To this end, a net inflow on foreign direct investments will remain. In addition to that, in the environment of decreasing net receipts to the National Fund of the Republic of Kazakhstan and maintaining the same level of the guaranteed transfer to the national budget, an inflow of resources from foreign assets of the National Fund of the Republic of Kazakhstan will take place in the reviewed period. The combination of the above factors is conducive to a positive balance of the capital and finance account.

As a result, in 2013-2015 the deficit of the overall balance of payments will not exceed 2% of GDP, which allows maintaining international reserves at a level sufficient to finance imports of goods and services.

The decreased demand of the economy for cash will be accompanied by reduced money supply in 2013, with its subsequent expansion, although at limited rates. The level of monetization is anticipated to be stable throughout the forecast period while remaining at the existing level (Appendix 1).

According to estimates of the National Bank of the Republic of Kazakhstan, the probability of such scenario is fairly low.

Scenario Three assumes that macro-economic development of Kazakhstan in 2013-2015 will be of the most favorable nature. Alongside with that, the growth in business activity will put pressure on the price indices in all sectors. As a result, the rates of real growth will be commensurate with the growth rates implied in the baseline scenario.

In 2013-2015, exports of goods will exceed US\$ 100 bln. At the same time, significant export proceeds will be offset by the increased demand for imports and increased distributions to non-residents. As a result, a current account surplus in 2013-2015 will be within 4.0%-5.5% of GDP.

In the capital and finance account (including “Errors and omissions”) the growth in the deficit is anticipated, mainly because of the increased growth rates of foreign assets of the National Fund of the Republic of Kazakhstan.

As a result, the overall balance of payments in the forecast period is expected to be within the range of (-)0.2% to (+)0.6% of GDP, which, as a whole, will allow increasing the country's international reserves.

The demand for money will also appear to be higher as compared to the preceding scenarios. Alongside with that, just like in other scenarios, the dynamics of money supply will be in line with the nominal GDP growth. The level of monetization will somewhat increase and in general will be comparable with the indicators in the baseline scenario (Appendix 1).

The National Bank of the Republic of Kazakhstan believes that the first scenario of the development of the Kazakh economy is most likely to be implemented, and this scenario was taken as the baseline scenario. Based on these assumptions, monetary policy measures for 2013 have been developed.

Chapter 3. Monetary Policy in 2013

3.1. Monetary Policy Goals and Guidelines as Well as the Objectives in the Area of the Financial System Stability

Due to unstable developments in foreign markets as well as given a short-term nature of the monetary policy implemented, the decision was made to formulate the monetary policy of the Republic of Kazakhstan for 2013 only.

In 2013, the National Bank of the Republic of Kazakhstan will continue implementing the monetary policy where the goal is to ensure the price stability, which implies keeping the annual inflation within the band of 6.0-8.0% under any reviewed scenario in the development of the Kazakh economy. Therefore, the selection of instruments of liquidity regulation depends on any given scenario: both on provision and withdrawal of liquidity under the first scenario, primarily on provision of liquidity under the second scenario and primarily on withdrawal of liquidity under the third scenario.

Addressing the price stability issues, the monetary policy at the same time will promote stability of the financial sector. As part of this objective, the National Bank of the Republic of Kazakhstan will regularly analyze the operations conducted by banks in various segments of the money market and foreign exchange market with the view to analyze and minimize risks of a systemic nature as well as to reduce the possibilities for arbitrage.

The National Bank of the Republic of Kazakhstan will be applying any given monetary policy measures taking account of integration processes occurring as part of the Common Economic Space.

Given volatility in the global markets and negative economic trends in the development of the largest centers of the global economy, the problems of ensuring macroeconomic stability in Kazakhstan are of paramount importance. The

development and strengthening of integration processes as part of the CES and EurAsEC will play a certain positive role in meeting such objectives. In 2013, the efforts for coordination of the macro-economic, monetary and foreign exchange policies of the member states will be continued.

3.2. Monetary Policy Transmission Mechanism

- Current Situation

At present, the National Bank of the Republic of Kazakhstan has a fairly limited number of instruments. The National Bank of the Republic of Kazakhstan can withdraw liquidity by issuing short-term notes and taking deposits, and provide liquidity with the help of refinancing loans and REPO operations.

Development of the financial sector leads to the need for a more efficient liquidity regulation. To this end, the National Bank of the Republic of Kazakhstan will introduce new instruments, which will help enhancing the National Bank's role and regulate the money market liquidity in a rather flexible way.

In this environment, in 2013 a key perspective area for the National Bank of the Republic of Kazakhstan in the sphere of monetary policy is a stage-by-stage implementation of a new transmission mechanism, whose development and the first stage of implementation began in 2012. At the first stage, changes were made to the minimum reserve requirements and operations in the sector of automatic REPO were resumed as part of the pilot project at the Kazakhstan Stock Exchange that were suspended in 2005.

The National Bank of the Republic of Kazakhstan will change its approaches to the standing facilities for provision/withdrawal of liquidity (in respect of collateral, interest rates, and the scheme of liquidity provision), to open market operations (a new instrument will be introduced – auctions for the purchase of securities with their reverse sale).

In general, the purpose of these innovations is the activation of the credit channel of the monetary policy transmission and reducing the importance of its foreign exchange channel. The new mechanism will help reducing the dollarization of the economy, volatility of interest rates, a speculative component in the money market and, consequently, increasing flexibility and efficiency of liquidity regulation and monetary policy implementation, in general.

As part of implementation of the new mechanism, considerable attention will be given to the analysis of systemic risks. If risks arising in the financial market or its individual segments will be of a fundamental nature that would be expressed in the uniform behavior of all or majority of banks (for example, excessive demand or excessive supply of liquidity), then the National Bank of the Republic of Kazakhstan will be adjusting the applied instruments in a flexible manner to reduce the overall risk level.

In the event when resources borrowed by a bank (banks) from the National Bank of the Republic of Kazakhstan will be used to "upset" other segments of the

financial market and will result in the growth of volatility of interest rates or the exchange rate not predicated by the current economic situation, the National Bank of the Republic of Kazakhstan will impose restrictions on such bank (banks) in respect of their participation in its operations.

Where a bank often applies to the liquidity support instruments of the National Bank of the Republic of Kazakhstan, such bank may be subjected to a relevant additional (unscheduled) inspection by the Committee for Control and Supervision of the Financial Market and Financial Organizations.

- Development Outlook: Interest Rate Policy, Minimum Reserve Requirements, Liquidity Regulation, and Financial Stability Mechanisms

Interest Rate Policy

The interest rate policy of the National Bank of the Republic of Kazakhstan will be coordinated with the foreign exchange policy measures. As the monetary policy transmission mechanism develops and the spread of market interest rates narrows along the entire yield curve, the participation of the National Bank of the Republic of Kazakhstan in the domestic foreign exchange market will be gradually decreasing.

Given the introduction of new instruments, the interest rate band of the National Bank of the Republic of Kazakhstan will also change. Its boundaries will correspond to the interest rates under the standing facility operations (lower boundary – deposits of the National Bank of the Republic of Kazakhstan, and upper boundary – standing credit facilities).

The National Bank of the Republic of Kazakhstan will introduce a new benchmark in implementation of the interest rate policy – reference rate with the limits of tolerance that will be calculated on the basis of operations with a 7-day maturity. The interest rate policy of the National Bank of the Republic of Kazakhstan in relation to their setting and regulation will be aimed at minimization of possibilities for pricing arbitrage in various segments of organized and unorganized markets.

In the prospects for further development of the interest rates system of the National Bank of the Republic of Kazakhstan for provision and absorption of liquidity as part of mechanisms of the open market operations and standing facility, the official refinancing rate will be playing an indicative role, to a larger extent. The level of the official refinancing rate will be reflecting an overall situation in the money market while remaining positive in real terms.

Implementation of new operations and instruments as part of the monetary policy transmission will allow increasing the efficiency of the liquidity management and regulation as well as build an adequate yield curve on financial instruments in the money market.

In 2013, with a view to build a yield curve, the National Bank of the Republic of Kazakhstan, jointly with the Ministry of Finance of the Republic of Kazakhstan,

intend to make effort to strengthen the government securities market of the Republic of Kazakhstan as a benchmark in the money market for instruments with comparable maturities.

In 2013, the National Bank of the Republic of Kazakhstan will continue building up its own portfolio of government securities of the Republic of Kazakhstan. As part of this effort, government securities of the Republic of Kazakhstan will be repurchased from the market players in the long term in the secondary market.

Minimum Reserve Requirements

In 2013, the National Bank of the Republic of Kazakhstan will analyze the effect of a new mechanism of minimum reserve requirements implemented at the end of 2012 on the banking sector liquidity.

There is an intention to address the changes to minimum reserve requirements in order to enhance motivation for finding long-term funding sources and decreasing short-term operations and speculative operations. Based on the outcomes of the review of existing minimum reserve requirements and international experience, with a view to enhance the transmission function of reserve assets, the limitation of the use of cash on hand for compliance with minimum reserve requirements will be considered since this component is poorly regulated from the standpoint of the monetary policy.

Liquidity Regulation

In 2013, depending on the implementation of any given scenario of the economy, the National Bank of the Republic of Kazakhstan will conduct operations to provide or withdraw liquidity in the money market.

In the environment of excessive liquidity in the money market, the National Bank of the Republic of Kazakhstan will increase operations aimed to absorb the surplus liquidity and restore the market equilibrium.

In the environment of liquidity shortage, maturities of short-term notes of the National Bank of the Republic of Kazakhstan will be 3 and 6 months, in case of excessive liquidity the line of such instruments will be extended to 9 months. The maturities of deposits attracted from banks will remain unchanged and will be 7 days and 1 month.

In case of liquidity shortage in the money market, the volumes of operations for provision of liquidity will be increased. In these circumstances, when banks comply with minimum reserve requirements they may increase the demand for the Tenge liquidity, which, in its turn, will put pressure on the growth in interest rates in the REPO and swap markets. The National Bank of the Republic of Kazakhstan will try to limit interest rate volatility in the money market and to retain their average level within the established interest rate band, thus influencing the general interest rate trends.

Securities auctions for their purchase with reverse sale will represent the key instruments of the National Bank of the Republic of Kazakhstan for provision of liquidity to banks. Initially, auctions for the securities purchase with their reverse sale will provide liquidity to banks for 2 weeks, i.e. the maturities will coincide with the time frame within which banks have to comply with minimum reserve requirements.

The subject of negotiations at the auction for securities purchase with their reverse sale will be the yield rate with its minimum level to be determined by the National Bank of the Republic of Kazakhstan. The National Bank of the Republic of Kazakhstan will prepare a lombard list of collateral which will include highly-liquid financial instruments, government securities of the Republic of Kazakhstan in particular, and other liquid securities.

If auctions for securities purchase with their reverse sale appear to be an effective mechanism of liquidity provision, it should not be excluded that their frequency will increase, maturity range will be expanded, and the National Bank of the Republic of Kazakhstan in future will give up operations in the sector of automatic REPO in favor of such auctions.

In 2013, the National Bank of the Republic of Kazakhstan will continue to improve its standing facilities, mainly, with regard to liquidity provision. Such operations are expected to be used for addressing the structural problems with liquidity of certain banks and will be conducted with the use of expanded list of collateral. The rate on the standing credit facilities will be set at the upper boundary of the reference rate plus premium and will not be lower than the rate at the auction for securities purchase with their reverse sale.

Despite its permanent nature, such operations imply restrictions in relation to a number of applications for such facilities to the National Bank of the Republic of Kazakhstan (not more than 3 times during a limited period of time). The decision about the second provision of such loans during a certain period will be based on the review of the applying bank's financial condition. Where the results of examination of the bank's financial condition will indicate that its position is not quite sound, the National Bank of the Republic of Kazakhstan may consider providing a loan to the bank in the capacity of the lender of last resort (upon relevant application by the bank) and with an aim of the bank's financial rehabilitation, or may impose sanctions on such bank.

The review of the asset structure of banks show that the potential for expansion in the list of collateral is quite limited. The volume of liquid government securities and other securities may appear to be insufficient to satisfy the banks' need in case of the crisis developments or in case of systemic problems with liquidity in the banking sector. With this view, the National Bank of the Republic of Kazakhstan will consider the necessity of designing a mechanism for provision of liquidity to banks against the pledge of non-marketable assets. Loan recourse on loans with good

credit quality provided to banks that are mainly referred to the standard loan category, may become such kind of assets.

3.3. Foreign Exchange Policy

Foreign exchange policy is designed to ensure the balance between the domestic and international competitiveness of the Kazakh economy. Participation of the National Bank of the Republic of Kazakhstan in the domestic foreign exchange market will remain minimal, providing necessary conditions for further stable development of the economy.

Foreign exchange policy will be adequately responding to changes in the world prices, terms of foreign trade, thereby creating a basis for protection of the economy against negative impact of external shocks and impulses as well as for maintaining the stability of the financial market.

The National Bank of the Republic of Kazakhstan will continue its intervention with a view to smooth dramatic swings in the exchange rate of the Tenge while not affecting the buildup of a general trend of the exchange rate that is driven by market. In case of implementation of the first and third scenarios, the National Bank of the Republic of Kazakhstan will act primarily as a net buyer of foreign exchange, and in the event the second scenario is implemented – it will act as a net seller.

As the monetary policy transmission develops and the regulating role of interest rates increases, participation of the National Bank of the Republic of Kazakhstan in the domestic foreign exchange market will be reducing.

In 2013, the National Bank of the Republic of Kazakhstan will be analyzing various versions of the strategy for foreign exchange policy implementation in future taking into account those commitments that are made by the Republic of Kazakhstan as part of the integration processes with the Russian Federation and the Republic of Belarus. The analytical work on the study and assessment of impact by the Russian foreign exchange market on the development of the Tenge exchange rate will be continued.

3.4. Measures to Satisfy the Need of the Strategic Sectors of the Economy in Financial Resources

A stable operation of the banking sector as well as the growth in lending activity will foster the further development and extension of government programs focused on providing credits to the top-priority sectors of the economy, whose list is determined by the Government of the Republic of Kazakhstan.

A close look will be taken at the possibility of establishing bank financing facilities on the market principles through the purchase by accumulation pension funds of the medium-term bonds in the Tenge issued by banks. Participation of the National Bank of the Republic of Kazakhstan in the implementation of such facilities

will be indirect in respect of identifying the areas of macro-prudential regulation of banks and accumulation pension funds.

Successful implementation of such facilities can give an impetus to the financial market development as the channel for overflow of investments into the real sector of the economy and can provide medium-term funding sources to the top-priority sectors of the economy.

3.5. Measures for Cleaning Up Bank Balance Sheets

The expansion of long-term credits to the real economy is limited, inter alia, by the credit portfolio quality of banks since a high percentage of non-performing loans¹ forces the banks to create significant amounts of provisions.

To address the problem of low quality of bank assets, the National Bank of the Republic of Kazakhstan implements a set of measures including the establishment of a subsidiary, Problem Loans Fund (PLF), building up a required regulatory framework to enable banks to open subsidiaries which would acquire doubtful and bad assets (DAMC), as well as implementing the mechanism during 2011-2012 that facilitates the procedure of bad debt remissions.

The major volume of the assets transfer to the PLF and DAMC is anticipated to take place in 2013. Especially since the National Bank of the Republic of Kazakhstan initiated a number of amendments to the existing laws providing for extension in validity of tax exemptions for income generated from recovery of provisions when forgiving a bad debt by a bank, for the year 2013 as well as revision of tax treatment in respect of assets when they are transferred to a DAMC.

As an administrative incentive, from 2012 onwards as part of the early response measures thresholds for the percentage of non-performing loans in the loan portfolios of banks are implemented – not more than 20% from January 1, 2013 and not more than 15% - from January 1, 2014. Should a bank exceed the established thresholds, it will have to elaborate the plan of actions in which the regulator would assess the adequacy of actions taken by the bank to apply the "cleaning up" instruments including the write-off or remission of bad debt, transfer of assets to a DAMC as well as the sale of loans to the PLF, and should coordinate it with the National Bank of the Republic of Kazakhstan (Committee for Control and Supervision of the Financial Market and Financial Organizations). The risk of failure to fulfill the plan will be associated with the early response measures, enforcement measures and/or sanctions imposed on the bank and/or its shareholders.

¹ At end-October 2012, the percentage of loans past due over 90 days on the principal and/or accrued interest accounted for 30.9%, and percentage of loans classified as doubtful loans of category 5 and bad loans less provisions for individually assessed loans accounted for 36.7%

**FORECAST OF MONETARY POLICY INDICATORS
FOR 2013 - 2015**

SCENARIO ONE*(end of period)*

	2012		2013	2014	2015
	actual	estimate	forecast		
Inflation, % in annual terms	6.0	7.0	6.0-8.0	6.0-8.0	6.0-8.0
Reserve Money, KZT bln.	2 890	2 963	3 433	3 941	4 580
Money Supply*, KZT bln.	10 465	10 932	12 690	14 590	16 961
Deposits of Residents*, KZT bln.	9 086	9 432	10 949	12 589	14 622
Credits to the Economy*, KZT bln.	9 738	9 851	11 257	12 855	14 771
Monetization of the Economy**, %	36.5	34.6	34.7	34.6	34.6

SCENARIO TWO*(end of period)*

	2012		2013	2014	2015
	actual	estimate	forecast		
Inflation, % in annual terms	6.0	7.0	6.0-8.0	6.0-8.0	6.0-8.0
Reserve Money, KZT bln.	2 890	2 963	2 931	3 112	3 335
Money Supply*, KZT bln.	10 465	10 932	10 649	11 365	12 170
Deposits of Residents*, KZT bln.	9 086	9 432	9 247	9 848	10 546
Credits to the Economy*, KZT bln.	9 738	9 851	9 685	10 127	10 739
Monetization of the Economy**, %	36.5	34.6	34.1	34.2	34.2

SCENARIO THREE*(end of period)*

	2012		2013	2014	2015
	actual	estimate	forecast		
Inflation, % in annual terms	6.0	7.0	6.0-8.0	6.0-8.0	6.0-8.0
Reserve Money, KZT bln.	2 890	2 963	3 671	4 380	5 300
Money Supply*, KZT bln.	10 465	10 932	13 648	16 331	19 842
Deposits of Residents*, KZT bln.	9 086	9 432	11 699	13 994	17 003
Credits to the Economy*, KZT bln.	9 738	9 851	11 985	14 197	17 157
Monetization of the Economy**, %	36.5	34.6	34.7	34.8	34.9

* - January-November, 2012

** - January-September, 2012