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**MONETARY POLICY GUIDELINES  
OF THE REPUBLIC OF KAZAKHSTAN  
FOR 2014**

**Foreword**

In 2013, the global economy was recovering at a slow pace and the recovery process was characterized by instability. The major contribution to the global economy growth fell on developing countries and emerging markets since exactly these countries served as a the main catalyst for the aggregate demand at the global level. At the same time, there are anticipations about some slowdown in the growth rates in developing countries. Such scenario may require additional measures to encourage sustainable domestic demand, investment activity, increased labor productivity and reduction in unemployment.

In the majority of developed countries, the problem of crisis is solved through the programs of “pumping” cheap resources into the economy. Such massive issue of currency takes place both with the help of budget resources and of the central bank monies. However, as the experience has shown, such measures are effective in a short term; they contribute to improvement in macroeconomic environment to a small extent and, as a rule, solve the problems of financial sectors.

In order to solve these problems, fundamental measures are required that will help keep the inflation at an optimal level, maintain financial stability in the region, and solve fiscal problems. Yet, these measures including inevitable gradual curtailing of quantitative mitigation measures, should not result in reduced business activity and slowdown in the rates of growth of the economy. At the same time, international economists and experts project that economies in developed countries will strengthen in 2014-2015.

Development outlook of the global economy, especially in such countries as the USA, China, Russia, and Euro zone countries, will influence the development of economic processes in Kazakhstan. The situation in the global energy markets and unsteady development of global financial markets may become the main sources of

instability. In general, robustness of the Kazakh economy does not cause any concerns: a stable domestic demand, low unemployment, sustainable budget, moderate inflation rates, and steady development of the financial sector will be conducive to progressive and sustainable development of the economy.

## **Section 1. Macroeconomic Development and Monetary Policy of the Republic of Kazakhstan in 2013**

### **1.1. Macroeconomic Development in 2013**

#### **- General Macroeconomic Trends**

In 2013, accelerated rates of economic growth were observed in Kazakhstan. During January-December 2013 (according to preliminary data), the real growth of the gross domestic product in Kazakhstan accounted for 6.0%, and the nominal growth accounted for 12.5% versus the same period of 2012. The highest rates of growth in the production output were observed in such sectors as communications (14.0% during January-December 2013 versus January-December 2012), trade (12.7%), agriculture (10.8%), and transport (7.5%),

A stable growth of the economy in 2013 was related to sustainable growth in the aggregate demand that was supported both by increased lending on the part of the banking sector and increased cash income of the population. So, in January-December 2013, a cash income per capita increased by 9.5% in nominal terms and by 3.5% in real terms versus the same period of 2012.

#### **- Balance of Payments for 2013**

A current account deficit for 2013 was at US\$ 117.8 mln. (in 2012 – the surplus of US\$ 1.1 bln.).

A trade balance surplus decreased by 11.7% to US\$ 33.7 bln. As for other current account components, negative imbalances of primary income, international services and secondary income amounted to US\$ 25.3 bln., US\$ 6.9 bln. and US\$ 1.6 bln., respectively.

The finance account (excluding reserve assets) showed up the deficit of US\$ 3.6 bln. An outstripping growth of liabilities over assets on foreign direct investments resulted in a negative balance of US\$ 7.8 bln. due to the growth in foreign assets of the National Fund of Kazakhstan of US\$ 7.7 bln.

#### **- Fiscal Policy**

During 2013, state budget revenues amounted to KZT 6459.4 bln. Tax revenues (over 70% of total revenues) and official transfers (over 20%) 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.

During 2013, government spending on final consumption amounted to KZT 7160.3 bln. About 50% of all state budget spending was allocated to education, social security and healthcare.

As a result of excess expenditures over revenues in 2013, the state budget ended up with the deficit of KZT 700.9 bln.

### **- Trends in the Banking Sector**

In 2013, the situation in the banking sector remained stable. As of January 1, 2014, bank assets amounted to KZT 15.5 trln., having increased by KZT 1.6 trln. or by 11.4% versus 2012.

At the end of 2013, the volume of credits reached KZT 11.3 trln., having increased by 13.4% on a year-to-year basis. In doing so, lending in the local currency increased by 12.7% to KZT 7936.7 bln., and in foreign currency – by 15.0% to KZT 3354.9 bln.

During 2013, the volume of deposits of residents increased by 12.1% to KZT 10.1 trln. Corporate deposits increased by 9.9%, and deposits of individuals – by 15.8%. During 2013, foreign currency deposits increased by 40.6% to KZT 3772.0 bln., and deposits in the local currency – by 0.04% to KZT 6313.8 bln. During 2013, household deposits increased by 15.7%, including deposits in the local currency – by 6.5%.

### **- Inflationary Trends**

In 2013, inflationary processes tended to slow down. During 2013, annual inflation had been at 4.8% (December 2013 to December 2012).

In 2013, paid services demonstrated the highest increase in prices (by 8.0%), while the growth rates of prices for foodstuffs and non-food products remained moderate (by 3.3% each).

Stable macroeconomic development of Kazakhstan accompanied with the growth in production in the real sector and in agriculture is expressed in the growth of the aggregate supply in the economy and sufficiency of goods and services in the market. However, high monopolization and low competition in certain markets of goods and services contribute to persisting inflationary expectations.

Impact of monetary factors on the inflation remains minimal. In 2013, monetary aggregates were growing at moderate rates. During January-December 2013, the reserve money contracted by 2.2%, the money supply growth accounted for 10.2%, and the volume of cash decreased by 1.0%. The money supply in the economy generally remains at the level corresponding to the growth of the economy.

### **- Trends of the Foreign Exchange Market**

Despite persistently high oil prices in the global markets, currencies of the majority of oil exporting countries demonstrated a depreciation trend in 2013. So, during 2013 the Russian ruble depreciated by 7.7% versus the US Dollar. During the period, fluctuations in the exchange rate of the Russian ruble versus the US Dollar accounted for +/-6% of the average value, and volatility accounted for 9.0%.

During 2013, the Euro appreciated versus the US Dollar by 4.3%. Fluctuation range of the Euro exchange rate versus the US Dollar accounted for +/-4% of the average value, with the exchange rate volatility accounting for 8.5%.

Thus, amidst favorable pricing environment in the global energy markets as well as stability in foreign exchange markets of the trade partner countries, the situation in the domestic foreign exchange market of Kazakhstan remained stable. Meanwhile, at the end of 2013, given depreciation of local currencies in a number of developing countries, including the trade partner countries of Kazakhstan, devaluation expectations in the Kazakh foreign exchange market increased. In 2013, the Tenge exchange rate was fluctuating within KZT 150.23-154.52 per 1 US Dollar. During 2013, the Tenge had depreciated versus the US Dollar by 2.2% in nominal terms.

## **1.2. Monetary Policy of the Republic of Kazakhstan in 2013**

The primary goal of the National Bank of the Republic of Kazakhstan in 2013 was to ensure the price stability in the country.

### **- Liquidity Regulation**

The National Bank of the Republic of Kazakhstan regulated short-term liquidity in the money market by conducting operations both on the provision of liquidity and its withdrawal.

During 2013, the demand of banks for operations on liquidity absorption (issue of short-term notes and deposit-taking) was gradually decreasing. The decreasing volumes of available Tenge liquidity in the banking sector were conducive to the fact.

The demand for refinancing loans (operations on provision of liquidity) was limited throughout 2013.

In 2013, during the periods of short-term deficit in the available Tenge liquidity in the banking sector, the National Bank of the Republic of Kazakhstan provided liquidity through reverse REPO operations at the Kazakhstan Stock Exchange in the automatic REPO sector.

### **- Interest Rate Policy**

Low rates of inflation were the reason to keep the official refinancing rate unchanged at 5.5% per annum in 2013.

The interest rate on deposits attracted from banks remained unchanged throughout 2013 and was 0.5% on 7-day deposits and 1.0% – on one month deposits.

In the first half of 2013, the effective yield on short-term notes remained virtually unchanged at 1.05%, having decreased from 1.61% in December 2012. During this period, the National Bank of the Republic of Kazakhstan was issuing mainly short-term notes with the 3-month maturity (in April 2013 one auction was held where 9-month notes were placed). In the second half of 2013, the effective yield on short-term notes increased: from 1.05% in May 2013 to 2.17% in October 2013. In November-December 2013, the National Bank of the Republic of Kazakhstan did not issue any short-term notes due to the absence of demand for such instruments on the part of banks.

In 2013, the minimum reserve requirements remained unchanged: 2.5% on the domestic short-term liabilities, 0% on the domestic long-term liabilities, 6.0% on foreign short-term liabilities, and 2.5% on foreign long-term liabilities.

In 2013, the structure of reserve assets had gradually changed: the share of bank correspondent accounts in the Tenge decreased (from 61.5% at December 31, 2012 да to 55.4% at December 30, 2013). Accordingly, the share of cash denominated in the domestic currency in the banks' cash-desk increased. Along with that, in 2013 reserve assets exceeded the required reserving volume by 2.7 times on average in the system as a whole.

In 2013, market rates in the interbank market were volatile. At the beginning of 2013, interest rates in the money market were maintained at the minimal level; this was to a larger extent associated with low activity of the market players and excessive Tenge liquidity held by them. In the second half of 2013, amidst reduced Tenge liquidity available in the money market the increased activity of the money market players was observed, being expressed in increased volumes of conducted operations and the growth of interest rates.

#### **- 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 2013, the National Bank of the Republic of Kazakhstan continued to implement 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 in 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 and subject to continued existence of general market trends.

During 2013, gross international reserves of the National Bank of the Republic of Kazakhstan decreased by 12.6% to US\$ 24.7 bln. At the end of 2013, assets of the

National Fund of the Republic of Kazakhstan amounted to US\$ 70.8 bln., having increased by 22.2% versus the beginning of the year. During 2013, international reserves of the Republic of Kazakhstan increased by 10.8% and amounted to US\$ 95.5 bln. at the end of 2013.

## **Section 2. Scenarios for the Development of the Economy of the Republic of Kazakhstan for 2014-2016**

The National Bank of the Republic of Kazakhstan, while elaborating the Monetary Policy Guidelines of the Republic of Kazakhstan, considered two scenarios of the economic development for 2014-2016, which are coordinated with the Government of the Republic of Kazakhstan when designing the Forecast for the Socio-Economic Development of the Republic of Kazakhstan for 2015-2019. A key criterion for distinguishing between scenarios was an annual average level of the world oil prices.

The forecasts for the key monetary policy indicators of the Republic of Kazakhstan are consistent with the forecasts of the balance of payments; when such indicators were designed in respect of oil production and exports the projections by the Ministry of Oil and Gas of the Republic of Kazakhstan were employed, and in respect of the future expansion of the Tengiz oil field the information from various sources was used.

The forecast of the macroeconomic indicators in 2014 was based on the baseline development scenario which assumes that the oil price would be at US\$ 95 per barrel; in doing so, a slight expansion in the current account deficit is anticipated because of deterioration in the trade balance.

In 2014, a net borrowing under direct and other investments is expected to decrease while foreign assets of the National Fund of the Republic of Kazakhstan will be increasing at high rates.

In 2014, the inflationary background is expected to remain at the existing level. The key risks of inflation will be such factors as instability in the global markets of raw materials and foodstuffs, inefficient pricing mechanism, steady growth of business activity, insufficient level of the domestic competition and a high level of monopolization in certain markets of goods and services, and poorly developed trade infrastructure in a number of regions.

In doing so, the impact of monetary factors on the buildup of inflationary processes will be limited by way of maintaining the money supply by the National Bank of the Republic of Kazakhstan at an adequate level.

Given the increased volumes of funds allocated from the National Fund of the Republic of Kazakhstan to support the economy in 2014-2015 as well as the existence of devaluation expectations in the economy, assessment of the dynamics of money supply appears to be quite difficult. To a certain extent, the development of monetary aggregates will depend on the schedule and orientation in utilization of

allocated resources; this requires an ongoing monitoring and prompt measures to be taken in liquidity management.

**In the implementation of all scenarios concerning the development of the Kazakh economy in 2014, the main objective of the National Bank of the Republic of Kazakhstan is to ensure the price stability, which implies that the annual inflation will be kept within the band of 6.0-8.0%.**

In the coming years, the inflation target will be revised and will be determined depending on the situation developing in the domestic and global economies. The inflation will be reduced gradually and on a stage-by-stage basis through joint efforts of the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan. Such measures will be of a balanced nature. Strict measures taken to dramatically reduce inflation within a short time will have negative effect on the economy and will not allow ensuring its stable and progressive growth.

Reduction of inflation in the mid-term will allow establishing the required basis to ensure the transition to the inflation targeting regime in Kazakhstan in the long run. The duration of the transition period will depend on effectiveness and success of measures taken by the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan to develop competitive markets of goods and services, decrease the level of dollarization, develop the country's financial sector including its stock market, increase soundness of the banking sector, and implement a new monetary policy transmission mechanism.

The **first scenario** assumes a slow but a consistent development of the global economy. This scenario assumes that in 2015-2016 the world oil price will be US\$ 90 dollar per barrel.

Under the scenario, a trade balance surplus is expected to decrease versus the level of 2014, while a significant deficit in the balance of services and distributions to foreign investors will remain. As a result, the current account will be negative in the forecast period.

In respect of portfolio investments, the decreased rates of buildup in foreign assets of the National Fund of the Republic of Kazakhstan are expected, with significant volumes of investments on earlier loan agreements.

The dynamics of the money supply will correspond to the rates of growth in nominal GDP. The level of monetization is expected to be stable throughout the forecast period, being maintained at the existing level.

The **second scenario** assumes pessimistic projections in case the situation in the global commodity and financial markets deteriorates in a mid-term. Under this scenario, the world oil price in 2015-2016 is anticipated to be at US\$ 80 per barrel.

If this scenario is implemented, the real growth of the Kazakh economy is expected to slow down in 2015, with some acceleration in the rates of real growth of the economy in 2016.

Under this scenario, slowing business activity, decreased aggregate demand, deteriorated balance of payments performance and decreased money supply are expected.

Significant deterioration in the current account will be offset by the decrease in net lending (outflow) on portfolio investments because of reduced revenues to the National Fund of the Republic of Kazakhstan while the approved volumes of the guaranteed and target transfers to the national budget will be maintained.

The decreased demand of the economy for funds will be accompanied by the slowdown in the rates of growth in the money supply in 2014 followed by its expansion but at limited pace. The level of monetization will slightly decrease.

*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 2014 have been elaborated.*

### **Section 3. Monetary Policy in 2014**

In 2014, the National Bank of the Republic of Kazakhstan will continue implementing the monetary policy where the primary goal is to ensure the price stability.

Effectiveness of the monetary policy in achieving the established target will be determined by the measures aimed to ensure stability of the financial sector. The National Bank of the Republic of Kazakhstan will analyze the situation in the banking sector on an ongoing basis with a view to identify and assess systemic risks as well as to reduce the possibilities for arbitrage and speculative transactions.

The National Bank of the Republic of Kazakhstan will continue to implement the exchange rate policy aimed at ensuring the balance between the domestic and foreign competitiveness of the Kazakh economy.

In 2014, the National Bank of the Republic of Kazakhstan will continue to take measures for further implementation of a new monetary policy transmission mechanism.

When implementing its monetary policy, the National Bank of the Republic of Kazakhstan will regulate the Tenge liquidity in the money market with a view to ensure the price stability. Main efforts will be focused on increasing effectiveness of the instruments to be applied. In this context, measures will be undertaken to improve the interest rate channel.

The National Bank of the Republic of Kazakhstan will be implementing its new monetary policy transmission mechanism in several stages. During the preparatory stage in 2012-2013, amendments had been made to the mechanism of



minimum reserve requirements, and REPO operations in a pilot mode were launched at the Kazakhstan Stock Exchange.

In 2014, the National Bank of the Republic of Kazakhstan will take up the next stage of implementation of the new monetary policy transmission mechanism. That stage implies taking measures to set the interest rate band of the National Bank of the Republic of Kazakhstan, launch auctions for the buy/sell back of securities, introduce new instruments for liquidity provision (standing facilities), and further fine-tune the mechanism of minimum reserve requirements and exchange rate policy.

### **Interest Rate Policy of the National Bank of the Republic of Kazakhstan**

In the course of its stage-by-stage transition to the inflation targeting regime, the National Bank of the Republic of Kazakhstan will take measures to introduce the key (basic) interest rate and linked interest rates of the band whose boundaries will correspond to rates on standing facility operations (lower boundary – deposits of the National Bank of the Republic of Kazakhstan, and upper boundary – standing facility loans).

The interest rate which is formed in the money market of short-instruments will serve as an operating benchmark of the key (basic) rate; such rate will become the main effective instrument of anti-inflationary policy pursued by the National Bank of the Republic of Kazakhstan (target rate).

This rate will be targeted by the National Bank of the Republic of Kazakhstan by way of:

- setting and publishing the key (basic) rate, with rates of the operating band linked to it;
- conducting operations in the open market within interest rates of the operating band.

Interest rates on such operations will form the operating interest rate band of the National Bank of the Republic of Kazakhstan. Open market operations will be conducted by the National Bank of the Republic of Kazakhstan in such a way so that the targeted rate should be maintained within the given floating operating band and should reflect a change in the key (basic) rate. Where the market rates are set above/below the interest rate band, the National Bank of the Republic of Kazakhstan will conduct operations to provide/withdraw liquidity.

### **Short-term Liquidity Regulation**

The National Bank of the Republic of Kazakhstan will be regulating short-term liquidity in the banking sector through the existing mechanisms and new instruments. The volume of participation of the National Bank of the Republic of Kazakhstan in the money market will be determined depending on the situation with the Tenge liquidity.

In 2014, the National Bank of the Republic of Kazakhstan, in the event of critical shortage of the Tenge liquidity in the money market, will continue conducting REPO operations at the Kazakhstan Stock Exchange.

Auctions for the buy/sell back of securities (a credit auction), where the main objective is to inject short-term liquidity into the banking system, will be the main operations used by the National Bank of the Republic of Kazakhstan to influence the targeted rate.

At present, a required framework (regulatory and technical) has been designed to conduct these operations. The National Bank of the Republic of Kazakhstan will introduce the credit auction arrangement after identifying the key parameters of its interest rate policy. Based on those, the decision about interest rates, terms and frequency of such operations will be made.

Should auctions for the buy/sell back of securities appear to be an effective liquidity provision mechanism, it might be possible that their regularity and frequency will increase, the range of their terms will expand, and the National Bank of the Republic of Kazakhstan will gradually give up on conducting operations in the sector of automatic REPO in future.

The Tenge liquidity in the banking sector will be supported, among other things, with the help of cross-currency interest rate swap.

Structural problems with liquidity in some banks will be addressed by using standing facilities (operations conducted upon requests from banks), which are the instruments to reduce systemic risks in order to ensure financial stability. Standing facility operations will be conducted at penalty rates with expanded collateral; the arrangement will include a limited number of requests for such facilities (no more than 3 times during a limited period of time).

The National Bank of the Republic of Kazakhstan will consider expanding the collateral framework when conducting operations to provide the Tenge liquidity. The possibility and appropriateness of introducing restrictions as to the total volume of banks' liabilities to the National Bank of the Republic of Kazakhstan will be studied. Such restriction will enable the National Bank of the Republic of Kazakhstan to treat the list of acceptable collateral in a flexible manner by expanding or narrowing this list depending on priorities of its monetary policy.

### **Exchange Rate Policy of the National Bank of the Republic of Kazakhstan**

A dramatic and significant deterioration of the balance of payments in the second and the third quarters of 2013 put a heavy devaluation pressure on the exchange rate of the Tenge.

Based on performance for 2013, the current account deficit amounted to US\$ 117.8 mln. or (-)0.1% of GDP. During 2013, exports of goods decreased to US\$ 83.4 bln. against the US\$ 49.7 bln. growth in their imports. As a result, the balance of trade surplus decreased to US\$ 33.7 bln.

Amidst deteriorating balance of payments and increasing devaluation expectations, dollarization of the economy started to increase. During 2013, the share of foreign currency deposits increased from 29.8% to 37.4%.

The exchange rate of the Tenge was supported by significant interventions on the part of the National Bank. In 2013, the volume of gold and foreign currency assets of the National Bank decreased by 12.6% to US\$ 24.7 bln. Only during June-July 2013, gold and foreign currency assets of the NBK decreased by 10.2%.

On February 11, 2014, the National Bank of the Republic of Kazakhstan made the decision to give up maintaining the exchange rate of the Tenge at the same level.

The Tenge exchange rate fluctuation band was set at KZT 185 plus/minus KZT 3 per 1 US Dollar and the policy for smoothing the plummeting of the exchange rate and short-term exchange rate volatility was continued. The long-term trend for the Tenge exchange rate will be determined on the basis of fundamental internal and external macroeconomic factors. There may be changes in the exchange rate both towards its depreciation and appreciation; this will be driven by the situation in the global economy.

In 2014, the National Bank of the Republic of Kazakhstan will be considering a change in the mechanism of operations in the domestic foreign exchange market.

### **Further Improvement of the Mechanism of Minimum Reserve Requirements**

In 2014, the National Bank of the Republic of Kazakhstan will continue studying international experience regarding the use of the mechanism of minimum reserve requirements and will also continue taking measures to fine-tune the mechanism.

The experience of central banks in other countries shows that in many countries cash on hand is not included in reserve assets or its volume is limited for compliance with minimum reserve requirements.

Limitation of the use of cash on hand or its exclusion for compliance with minimum reserve requirements in Kazakhstan may help increase effectiveness of the new monetary policy transmission mechanism in general. To this end, the National Bank of the Republic of Kazakhstan considers a limitation of the use of cash on hand in the Tenge for compliance with minimum reserve requirements by banks.