Approved
by the Resolution of the Board
of the National Bank of the Republic of Kazakhstan
No.242 dated November 29, 2017

NATIONAL BANK OF KAZAKHSTAN

MONETARY POLICY GUIDELINES OF THE REPUBLIC OF KAZAKHSTAN FOR 2018

Almaty
November 2017

FOREWORD

The main objective of the National Bank that is enshrined in the law is to ensure the price stability in the Republic of Kazakhstan.

While ensuring a low and predictable inflation rate, the National Bank promotes more efficient allocation of resources in the economy and development of sustainable economic growth. The price stability enables to maintain social welfare, reduce uncertainty by providing households and enterprises an opportunity to make saving and investment decisions for a longer-term planning horizon. With low inflation rates, the confidence of economic agents in future increases, costs are decreasing and, accordingly, management decisions about business development and expansion of production capacities are made, thus leading to the increased long-term investments and sustainable development of the economy.

Therefore, the National Bank sets the objective of anchoring the inflation at a low level and reducing its volatility as a top priority.

At this stage of development of the domestic economy, the process of a gradual reduction of inflation rate is necessary in order to maintain conditions for a stable and progressive economic growth without limitation of the aggregate demand. Since 2018, the National Bank will be gradually reducing the inflation targets to a medium-term target of 4%. At this point, measures need to be taken that have a long-term impact potential and not a short-term effect.

Encouraging the economic growth through money issue as a factor of short-term sparking of economic growth has a high inflation potential in the long run. Money issuance does not have an impact on structural macroeconomic parameters on which long-term economic growth depends. A slight and a short-term acceleration of the GDP growth rates as a result of currency issuance would be fully offset by a long-term deterioration of the economic situation, by imbalance of the foreign exchange market and the growth of inflation. A basic premise for a sustainable and efficient growth is to ensure a low and stable level of inflation and also to continue implementing economic structural reforms.

The National Bank will continue to follow principles of inflation targeting. This regime, basing on experience of a number of countries, both developed and developing, including those with the commodity orientation, proved its worth as a regime of successful disinflation, i.e. deceleration and stabilization of the inflation rate.

Management of households' and businesses' expectations regarding to future price behavior becomes an important pre-requisite in achieving the stated goals. At present, they remain insufficiently stable and are affected by the price changes in the markets of certain goods or services. Adherence to the stated targets supported by active communications will not only allow anchoring inflation expectations but will also help increase confidence in the National Bank and in the policy it implements, thus ensuring that the goal will be achieved in a more precise way.

I. THE MONETARY POLICY OF THE REPUBLIC OF KAZAKHSTAN IN 2017

In 2017, the monetary policy was being conducted in accordance with the principles of inflation targeting. Measures taken by the National Bank, including interest rate policy, were aimed to attain the inflation targets which were set within the target band of 6-8% for 2017.

As a result of a moderately tight monetary policy pursued by the National Bank in 2016 and in the first half of 2017 as well as being influenced by favorable internal and external factors, inflationary processes were decelerating. A stable situation in the commodity markets, the weakening external inflationary pressure, and appreciation of the exchange rate in the first half of the year furthered a downward inflation path. Reduction of the inflationary background was also driven by an aggregate impact made by a negative pattern of real income of the population, and by moderate growth rates of regulated services. Recovering growth rates in the economy and consumer demand did not have an inflationary pressure.

The annual inflation decelerated from 8.5% in December 2016 to 7.7% in October 2017, while remaining within the target band throughout the year. Certain supply shocks in the domestic food market and energy market slowed down a faster deceleration of inflation. Core inflation indicators, which are more responsive to the monetary policy measures, were demonstrating quite a steady decline. The National Bank did not react by tightening its policy in response to acceleration of inflation which occurred as a result of impact made by the short-term supply shocks.

In its decision-making regarding the monetary policy, the National Bank took into account, along with the actual inflation rate, its forecast parameters, inflation expectations as well as the outlining trends in the markets.

The tenge exchange rate was performing a function of an automatic stabilizer and was developing with the minimal involvement on the part of the National Bank. In the first half of the year, given a stabilized situation in external commodity markets, the exchange rate was gradually appreciating. In the third quarter, its behavior was mainly affected by internal short-term market factors. The increasing devaluation expectations led to an excess demand for foreign currency and, as consequence, to the increasing volatility and the weakening trend for the tenge.

The National Bank conducted interventions in order to stabilize the situation in the foreign exchange market and to satisfy the arising demand. The National Bank's participation in foreign exchange trades was limited. Interventions were conducted in June (their share of the total trading volume in the exchange FX market accounted for 2.9%), in August (1.8%), September (2.1%) and October (10.6%). The National Bank's interventions were aimed to solely smooth out short-term and speculative fluctuations not related to the influence of fundamental factors.

Given the assessment of contributing factors and inflation forecasts and key macroeconomic indicators in the medium-term decisions made by the National Bank were aimed to gradually ease monetary conditions. During 2017, the base rate level was gradually reduced from 12% to 10.25%. The gradual nature of the monetary policy easing was ensuring stability in the financial market.

Under the influence of continued overflow of resources from instruments denominated in foreign currency into the tenge instruments as well as by a persistently stimulative focus of the fiscal policy given a limited growth of lending, the money market was functioning in the environment of a structural liquidity surplus. Measures taken to support the banking system were also conductive to a persisting surplus. Thus, the National Bank developed the Program for Increasing Financial Soundness of the Banking Sector which includes providing support to a systemically important bank and increasing financial soundness of large and socially important banks. As part of the Program, the National Bank allocated over KZT 1.2 trln.

In order to limit a possible realization of inflation risks, the National Bank conducted operations to absorb excess liquidity, mainly by issuing short-term notes; their outstanding volume has increased by 12.8% over 10 months of 2017 and amounted to KZT 2.8 trln. at end of October. In addition, as part of the excess liquidity absorption effort, standing facilities were also used – 1 and 7-day deposits of the National Bank and one-day direct repos in the Kazakhstan Stock Exchange.

Operating monetary policy measures secured stability of the money market rates as well as helped keeping the targeted TONIA rate within the base rate interest rate band. In doing so, the liquidity surplus ensured that the rate was maintained primarily at the lower boundary of the interest rate band.

In 2017, the National Bank, jointly with the Ministry of Finance, continued to build an yield curve. The National Bank was issuing short-term notes with maturities of up to 1 year. In order to set benchmarks for yield of financial instruments for long term (over 10 years), in August the National Bank made a sale of long-term government securities with maturities of 12, 15 and 17 years from its own portfolio. The Ministry of Finance issued government securities with maturities of 2 to 15 years.

As a result, a risk-free yield curve which had been inverted in 2016 now is tending to normalization.

Keeping the attractiveness of the tenge deposits facilitated the further dedollarization in the banking system and helped increasing the bank funding in the domestic currency. At the end of October 2017, the share of foreign currency deposits accounted for 49.4% (54.6% – in December 2016, 70% – in January 2016).

Maximum recommended rates on retail deposits in the domestic currency were retained at 14%, interest rates on foreign currency deposits were lowered from 2% to 1.5% from July 1, 2017 with their further lowering to 1% from December 1, 2017. The actual rates on retail deposits in the tenge decreased from

12.0% in December 2016 to 11.5% in October 2017, and on corporate deposits – from 10.5% to 8.0%.

With a view to manage market expectations, both in terms of economic indicators and in respect of the monetary policy focus, in a more efficient manner, the National Bank continued to actively use the communication policy instruments. As part of its awareness-building effort, the Bank continued to publish inflation forecast for a medium-term horizon. Practical aspects of explanations about made decisions are fine-tuned; press-conferences, press briefings as well as meetings of the National Bank's top management with representatives of the expert community are held.

II. THE MONETARY POLICY OF THE REPUBLIC OF KAZAKHSTAN FOR 2018

1. The Target for 2018 and the Medium-Term Target

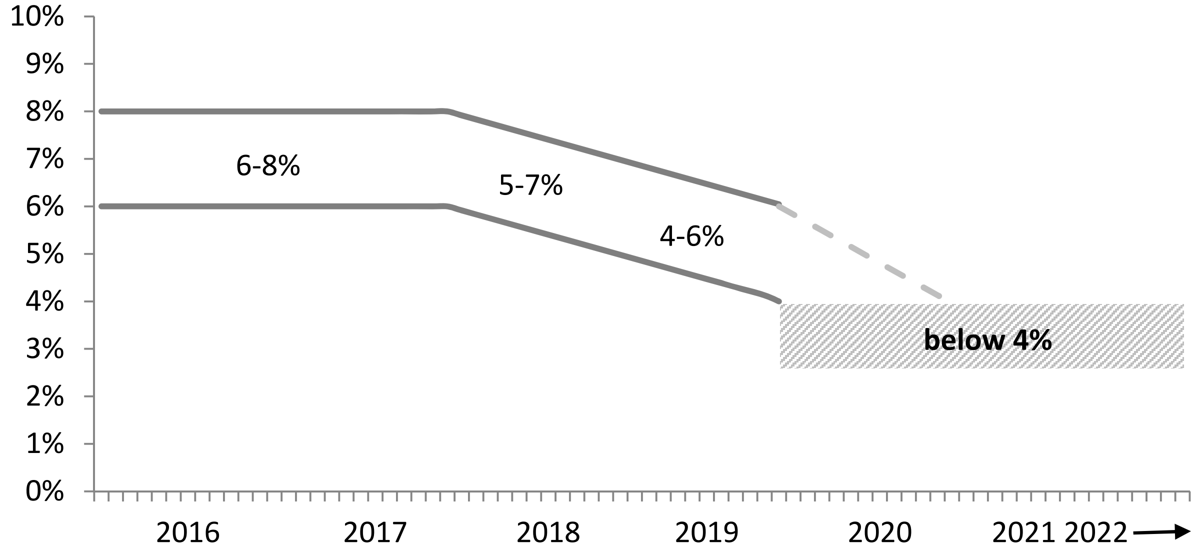
As part of implementation of the medium-term monetary policy strategy, the National Bank will begin to lower its inflation targets from 2018. A gradual approach to lowering the targets is determined by the need to support recovery processes in the economy.

The National Bank uses an annual consumer price index as an inflation target. The analysis of monetary policy measures may use other inflation indicators including the average annual inflation and core inflation indices.

Inflation targets are set as follows:

- 5-7% at the end of 2018,
- 4-6% at the end of 2019,
- Below but close to 4% at the end of 2020 and in the coming years.

The transition to the next level of the target band during 2018-2020 will not be stepped. The National Bank will be striving to ensure a downward inflation path within a continuous band.



The National Bank notes that external and internal risks (which can impede the attainment of inflation targets) may realize.

First, despite the fact that risks on the part of fiscal policy remain minimal (in 2018 the volume of receipts from the National Fund to the budget is expected to be reduced by rejection of targeted transfers and decreasing the guaranteed transfer amount), there is uncertainty about consolidation of the budget and attaining the planned budget deficit, thus creating risks of revision of budget parameters and the growth of injections into the economy.

Second, the risks of increase in prices associated with the business environment in certain goods markets may realize. The existing structure of food markets is exposed to the supply shocks because of the undeveloped competitive environment, a poor market infrastructure, and a small-scale nature of agricultural production.

The described risks, if realized, may significantly reduce the effectiveness of monetary policy and, as a result, lead to deviation of the inflation rate from the target band.

Apart from those, a possible change in the terms of trade and the respective deterioration of the balance of payments may contribute to the increased volatility of the exchange rate of the tenge. Realization of such risk may result in the increased devaluation and inflation expectations and the growing inflation, thus requiring a tighter monetary policy.

The National Bank will be performing the assessment of risks for inflation and will monitor the behavior of external and internal factors in the decision-making regarding the monetary policy. However, the National Bank will not respond to short-term deviations of inflation from the target in case if the supply shocks and temporary shocks realize. In the event of a significant and continuing deviation of actual inflation from the forecast path and in case of risks for inflation expectations, irrespective of the nature of a contributing shock, the National Bank will make decisions about changing the monetary policy parameters.

2. Basic Principles and Guidelines of the Monetary Policy for 2018

In 2018 the National Bank will continue implementing its monetary policy in line with the main principles of inflation targeting. The inflation targeting regime allows reducing inflation in an effective way and maintaining it at a level which implies the price stability, thus fostering the long-term economic growth in the best possible way.

The National Bank will continue to implement its interest rate policy which is focused on regulation of liquidity volumes and rates in the money market. Setting the base rate level and its band still represents a key element of the interest rate policy. Decision regarding the base rate level will be made based on the analysis of macroeconomic indicators and on the assumption that actual and forecasted inflation correspond to the targets. The situation in the economy and trends in foreign and local markets will be also taken into account. In 2018, decisions regarding the monetary policy will be made in accordance with the Schedule (Annex 1).

The base rate in real terms which means the base rate minus the forecasted inflation over a 12-month horizon will be maintained at the level not exceeding 4%, being in line with the long-term potential rates of the economic growth. The forward-looking monetary policy strategy helps build rational expectations among the market agents about the further interest rate behavior.

Effective functioning of the transmission mechanism is important. As the economy recovers, the banking sector becomes healthier, imbalances in the market are removed, the economy becomes dedollarized, and the financial market develops, the impact of the monetary policy instruments on inflation increases. In its turn, the National Bank will continue to improve the transmission channels, first of all, in respect of increasing effectiveness of the monetary policy instruments.

The work aimed to improve the performance of minimum reserve requirements which was began in 2017 will be completed in 2018 and will cover both the structure of reserve assets and liabilities and the level of reserve ratios. A new level of reserve ratios will be established which will allow withdrawing excess liquidity in the banking sector in an efficient way without posing additional risks to financial stability.

The National Bank will keep the existing set of instruments for standing facilities operations that includes direct and reverse repos in the Kazakhstan Stock Exchange, and deposits of banks in the National Bank. Auction of the National Bank's notes, deposit auction, buy/sell back securities auction (credit auction) and sell/buy back securities auction (direct repo auction) are intended to be used as open market operations.

<table>
<tr><th colspan="4">System of Monetary Policy Instruments of the National Bank</th></tr>
<tr><th>Purpose</th><th>Instrument Type</th><th>Instrument</th><th>Collateral</th></tr>
<tr><td rowspan="2">liquidity provision</td><td>standing facilities</td><td>reverse repo</td><td>government securities</td></tr>
<tr><td rowspan="4">open market operations</td><td>buy/sell back securities auction</td><td>Lombard list</td></tr>
<tr><td rowspan="5">liquidity withdrawal</td><td>NBRK' notes auction</td><td>-</td></tr>
<tr><td>deposit auction</td><td>-</td></tr>
<tr><td>sell/buy back securities auction</td><td>Lombard list</td></tr>
<tr><td rowspan="2">standing facilities</td><td>direct repo</td><td>government securities</td></tr>
<tr><td>deposits</td><td>-</td></tr>
</table>

Currently, the market's capabilities in absorbing available liquidity volumes without the risks of increasing inflation rates as well as without the risks for stability in the foreign exchange market are limited. Insufficient bank capitalization, low quality of existing borrowers and limitation in attracting new borrowers make it difficult for the existing excess of the tenge liquidity in the money market to seep into the real sector of the economy.

In view of this, the National Bank will continue with its policy of tying up the structural liquidity surplus; this effort will require a further shift in emphasis in the course of its sterilization towards the monetary policy instruments with longer maturities within the framework of open market operations. With that in mind, the National Bank will continue issuing short-term notes with maturities of 91, 182 and 364 days that will also contribute to the building of the yield curve segment for a horizon of up to one year.

The floating exchange rate regime is an integral part of the inflation targeting. The National Bank will be rigorously adhering to this regime. A floating exchange rate as an absorbent of external shocks in the first instance puts the balance of payments in equilibrium, and helps achieve the external equilibrium thus allowing the central bank to concentrate on attaining the internal equilibrium (the price stability).

A long-term trend of the exchange rate behavior will be determined by fundamental factors. At the same time, significant and destabilizing short-term exchange rate fluctuations which are not fundamental will be smoothed out by the National Bank’s fluctuations.

In 2018, the National Bank will continue to create pre-requisites for building an adequate yield curve in coordination with the Ministry of Finance of the Republic of Kazakhstan. The interest rate benchmark will foster the stock market recovery, which will have a positive effect on the growth of lending activity in Kazakhstan.

Where necessary, the National Bank will continue buying and selling securities in the secondary market.

Stabilization of the households’ inflation expectations is one of conditions for successfulness of the monetary policy measures in attaining the price stability. The keeping of inflation expectations of economic agents at a low and stable level minimizes the impact of supply shocks and enables the pricing mechanism to function more effectively. With this in mind, the National Bank will be paying attention to the measures for assessment of expectations of the households, enterprises and banks.

In order to make the market expectations management more efficient, the National Bank will continue using the communication policy instruments as one of the strategically important elements of the inflation targeting. The National Bank will continue to actively provide information about key macroeconomic indicators, regarding its monetary policy decisions, will provide explanation of factors and reasons which are fundamental to the behavior of macroeconomic indicators and the decision-making.

In 2018, the National Bank will continue to improve the Forecasting and Policy Analysis System. As part of the short-term measures, new approaches to the forecasting of macroeconomic variables are to be introduced; in the medium-term, parameters of the Quarterly Projection Model will be recalibrated and will also cover other sectors of the economy. Publication of analytical and research materials which clear up certain aspects of the monetary policy will be continued.

3. Other Policy Guidelines of the National Bank that Help Attain the Inflation Goals

The National Bank will continue to pursue measures within the framework of dedollarization the country's economy and its financial sector. A basic premise for that is to increase effectiveness and efficiency of the monetary policy measures in respect of achieving the inflation targets.

An important aspect in the dedollarization effort is to encourage that the general public and businesses make savings and hold assets in the domestic currency, thus ensuring their overflow from foreign currency. To ensure that, the differential between the recommended (marginal) interest rates on retail deposits in the domestic currency and in foreign currency (they are set by the Kazakhstan Deposit Insurance Fund) will be maintained.

The National Bank, without renouncing the principles of liberalization of the currency regime, will continue to optimize currency control and currency regulation whose current state leads to a number of risks.

The existing liberal regime is often used for legitimate capital outflows from the country and for keeping proceeds received by residents abroad, thus posing systemic risks in the economy and contributing to the increase of pressure on the national currency exchange rate.

Realization of other risks is possible with the forthcoming expansion of commercial activities for branches of foreign non-financial organizations, as well as the possibility of access to the Kazakhstani market for foreign banks and insurance organizations through establishment of branches (from December 2020). Retention of the existing non-resident status for branches of foreign entities and, as consequence, circulation of large volumes of foreign currency in the domestic market will reduce the monetary policy effectiveness and the National Bank's measures for dedollarization of the economy.

A special currency regulation regime within the territory of the International Center of Border Cooperation “Khorgos” and the Astana International Financial Center also dictates the necessity of adapting the legislation to new economic environment. The National Bank plans, jointly with the Government, to take systemic measures in the short-term and long-term horizon, without renouncing the basic principles of a liberal currency regime.

The following issues require the legislative adjustments: repatriation of proceeds from foreign economic activities that are held with foreign accounts and are not motivated by the operating needs, especially those belonging to state-owned enterprises or enterprises in the quasi-government sector; the currency residency status of branches of foreign entities operating in the Republic of Kazakhstan; domestic settlements with Kazakhstani companies in tenge exclusively.

Based on the international experience, the National Bank will initiate measures to harmonize the approaches to currency control and financial supervision in combating money laundering (AML/CFT) in order to take targeted measures in relation to suspicious foreign exchange transactions, including those transactions which have some features of getting money out of the country.

A healthy and fully functioning banking system is a key conducter of the monetary policy measures onto the real sector of the economy and the National Bank's target indicators. In this context, implementation of the Program for Increasing Financial Soundness of the Banking Sector of the Republic of Kazakhstan[1] which is scheduled for 5 years will clean up the banks' balance sheets from non-performing loans (through capitalization, write off or waiver of debt and other measures aimed to improve the asset quality), will increase the overall banking sector's equity thus supporting the lending to the real sector of the economy.

At the same time, changes in the credit market towards a significant increase in the activity of banks will be limited by a number of factors. In addition to the recovery of the banking sector, which will be gradual, the situation in the real sector of the economy will remain vague in 2018. In some industries further development of growth points is expected, but no comprehensive improvement is predicted at the micro level. The surveys conducted by the National Bank show that the acceleration of the lending rate will potentially be constrained by a limited number of high-quality borrowers and the risks of worsening financial conditions of current borrowers, as well as low payment discipline of big business as a specific factor for this segment. These restrictions will specify the continuation of the tight lending policy of banks in respect to the corporate sector. The consumer segment of bank lending in 2018 will be characterized by the trends of limited activity in the provision of mortgages under the banks' own programs amid the continuing demand from the population for unsecured consumer loans.

According to the National Bank's estimates, in 2018 moderate lending growth is expected, which will be comparable with the nominal GDP growth. At the same time, this growth will be supported by several, more stable large and medium-sized banks with a conservative credit policy. For particular banks, which will continue to solve the accumulated problems, the reduction in the loan portfolio is possible.

The growth in equity, reduction of the percentage of non-performing loans, revision and optimization of the existing strategies and business models of banks will lead to their increased activity in lending in the medium-term, to expansion and development of new and efficient types of banking services. Ultimately, the credit channel and the interest rate channel of the monetary policy transmission mechanism, which do not play their role to the full extent at present, will have a better efficiency (Annex 2).

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[1] approved by the Resolution of the Management Board of the National Bank of Kazakhstan as dated June 30, 2017 No.129

Annex 1

Schedule of Monetary Policy Decisions to be Made in 2018

In 2018, decisions regarding the base rate will be made 8 times in line with the following schedule:

January 15
March 5
April 16
June 4
July 9
September 3
October 15
December 3

Each decision regarding the base rate will be announced at 5.00 p.m., Astana time.

In 2018, four decisions regarding the base rate taken on March 5, June 4, September 3 and December 3 will be based on the outcomes of forecast rounds as part of the Forecasting and Policy Analysis System. These decisions will be accompanied by the issue of the Inflation Report, the National Bank’s quarterly publication.

Annex 2

Specifics of the Monetary Policy Transmission Mechanism in Kazakhstan

One of key issues of the monetary policy is an effective functioning of the transmission mechanism – a set of channels through which the monetary policy instruments of a central bank make an impact on the domestic economic processes.

The impact made by the transmission mechanism on the economy depends on many factors, including the economic environment, the structure and the development level of the financial system, and the behavior of economic agents. These factors determine the velocity, extent and nature of impulses transferred from one economic variable to another throughout the entire chain from the central bank's instruments to inflation and the economic growth rates. In this context, the National Bank is making an on-going effort aimed to fine-tune the transmission mechanism.

The specifics of the monetary policy transmission mechanism in Kazakhstan are determined by a high degree of dollarization, a poor diversification of the economy, non-profound level of development of the financial system, high exposure of its segments to external risks, low investment activity of the market participants and an insufficient number of effective financial instruments.

An important role in the inflation targeting regime is assigned to the functioning of the ***interest rate channel***. This channel reflects the impact of the central bank's rates on the market rates with a further pass-through onto the investment and consumer activity and domestic demand, and, ultimately, onto inflationary processes.

At present, a positive correlation between bank lending rates and the National Bank's base rate is increasing. At the same time, the interest rate channel is developing at a limited pace. The main constraints include insufficient development of the money market, a high level of dollarization, and unsoundness of the banking system, government subsidies of loan rates as well as the absence of a developed stock market. The impulse transfer is distorted at virtually each stage of the transmission mechanism.

At the first stage when there is a transmission of the change in the National Bank's base rate onto the interbank money market interest rates, the following constraining factors are typical.

Underdeveloped interbank lending market; the main reason for this may be the lack of confidence of the market participants in their counterpart. An interbank loan does not imply collateral; therefore it is a less reliable transaction. Volumes of interbank loans are scanty, and their interest rates, in fact, are random and unregulated.

In this context, the TONIA rate – the weighted average interest rate on repos – serves as an operating benchmark rate of the National Bank. The repo market implies the provision of collateral and is more liquid. However, TONIA is set as a result of operations conducted not only by banks but also by other financial organizations including the National Bank, and, therefore, it reflects the real situation not quite objectively.

Structural liquidity surplus in the money market determines that the target rate is maintained at the lower boundary of the base rate band. In the environment of systemic liquidity surplus, the majority of banks face a steady need to invest their resources. The excess liquidity supply over its demand causes the risk that interest rates would go below the boundaries of the interest rate band. With a view to keep the rates within the band, the National Bank has to absorb excess liquidity at the lower boundary of the interest rate band.

Minimum reserve requirements (MRRs) effectively represent the most efficient monetary policy instrument for withdrawing excess liquidity. However, its existing type limits the liquidity regulation and influence on the interbank money market rates.

Open market operations which are conducted at the National Bank's initiative on the basis of auction and are intended for maintaining the volume of liquid resources at the level corresponding to the base interest rate currently consist of short-term notes, buy/sell back securities auction and sell/buy back securities auction. The major portion of excess liquidity is withdrawn by short-term notes; however, absorption of bank liquidity by means of this instrument often does not reach the ultimate goal. A short-term note of the National Bank is a security which may be used as collateral. As a result of absorption, liquidity may come back to the banking system.

As for standing facilities, the necessity to furnish collateral on the part of the National Bank for liquidity withdrawal (direct repo) limits potential of this instrument. As a result, there are risks that interest rates go beyond the operating target in case of a significant growth in the supply of liquidity on the part of banks.

At the second stage, there is a transmission of changes in short-term money market rates onto rates on long-term instruments. In order to encourage long-term financial investments, an indicator is required that would reflect market expectations regarding interest rates. Therefore, despite the fact that classical monetary policy instruments imply the shortest maturities (up to 1 month) only, the National Bank issues notes with longer maturities (up to 1 year) in order to build the yield curve. In order to build a longer yield curve segment (over 1 year) liquidity of this market segment needs to be increased. For this purpose, on the supply side it is necessary to bind it with the fiscal position and the budget process; also, consistency, predictability and regularity of the government securities issues should be increased. On the demand side, the domestic class of institutional investors and other professional market participants needs to be established; the influence exerted by non-market (captive) investors on the pricing should be diminished; and the access to international investors should be provided.

In addition, at the second stage, the transmission of the financial market rates onto the cost of bank loans for the real sector of the economy takes place. At this stage, constraining factors for the transmission are the *poor asset quality and* *inadequate bank capital* for expansion of the credit supply (some banks are now undergoing recapitalization and restructuring), and a limited number of *good quality borrowers*. Besides, the effect of the interest rate pass-through is diminishing because of the *government subsidies of interest rates* on loans, thus distorting calculation of fair value of resources in the credit market.

At the last stage, the funding terms in the banking sector are passed-through onto decisions of economic agents regarding saving and consumption; this eventually affects the pricing. *The propensity to save in foreign currency* remains relatively high; this is evident from the percentage of bank deposits in foreign currency. Despite a downward trend of dollarization, it makes about 50%.

Another important channel is the ***foreign exchange channel***. Certain interest rate parity is employed in its functioning. An interest rate change provokes the change of the exchange rate and, as consequence, of net exports and aggregate demand. At present, the impact of interest rates on the nominal exchange rate of the tenge is weak. Low capital mobility results in the fundamental dependence of the nominal exchange rate of the tenge on the trade balance.

However, the change in the exchange rate of the tenge affects inflationary processes; moreover, the impact is asymmetric, i.e. depreciation and appreciation of the tenge have a non-proportional impact on consumer prices. According to the National Bank's estimates, the effect of pass-through of depreciation of the tenge exchange rate onto inflation accounts for about 12% (because of the growth in prices of non-food products, to a larger extent). When the tenge appreciates, the price decline is less notable.

The ***credit channel***, which functions via the regulation of volumes of bank reserves and, as consequence, the change in supply of loans by these banks at present is distorted by the stimulative fiscal policy focused on allocation of public resources to the real sector of the economy via the banking sector at non-market rates. The resulting liquidity surplus and imbalance in the cost of borrowing for different market participants distort the efficiency of the credit multiplier and force the National Bank to absorb excess resources.

The ***expectations channel*** which reflects the impact of changes in the central bank policy on expectations of economic agents is also important. Statements made by a central bank formulate ideas about the path of the interest rate movements in a short and long run and about a future inflation pattern. Expectations regarding the future level of inflation guide the behavior of agents already in the current period, affecting the aggregate demand. The higher the transparency of the central bank and the awareness of market participants about its further actions, the greater the confidence of economic agents in the monetary policy and the lower inflation expectations.

The peculiarity of expectations of economic agents in Kazakhstan is a high sensitivity to the exchange rate behavior. The economic agents tend to build their economic activity depending on the current and expected behavior of the nominal exchange rate of the tenge.

The monetary policy transmission mechanism is rather diversified and also consists of many other channels. Gradual elimination of factors constraining its functioning will increase the efficiency of transmission mechanism and improve the effectiveness of measures taken by the National Bank.