



# Monetary Policy REPORT

SEPTEMBER 2022



NATIONAL BANK OF KAZAKHSTAN



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**Monetary Policy Report** is a quarterly publication of the National Bank, which contains the analysis of key macroeconomic factors affecting inflation as well as the forecast of macroeconomic parameters in the short- and medium-term horizon.

The Report is published in an electronic form on the official Internet resource of the National Bank in the Kazakh, Russian and English languages.

The forecast and analysis of macroeconomic indicators was prepared on the basis of statistical information as at **September 1, 2022**.

## SUMMARY

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The geopolitical crisis keeps having a negative impact on the global economic development. The risks to further development of the global economy are shifted to the downside. Recession risks have increased significantly.

Under the pressure of rising energy prices and growing uncertainty, economies of many countries slowed down. The weaker economic activity is proved by business activity indicators. At the end of July 2022, the Global Composite PMI decelerated. Deceleration was accompanied by a decline in production volumes, new orders, cuts of new jobs in a number of countries, as well as a further decline in purchase and sale prices. In terms of countries, the slowdown in business activity is largely dictated by weakness in developed countries. Production volumes decreased in the USA, EU, Japan and the UK. In developing countries, including China, production was increasing, albeit at a slower pace.

The global inflation is staying at historical highs. However, due to some decline in world oil prices and other energy carriers in some countries in July 2022 the annual inflation decelerated.

Growth of the global economy is expected to slow down from 6.1% in 2021 to 3.2% in 2022 and to 2.9% in 2023.

As compared to the previous forecasting round, the forecasts for the countries-Kazakhstan's trading partners have been revised again. This year, China is expected to grow at a slower pace than previously expected as a result of ongoing anti-COVID restrictions and a deepening real estate crisis. Forecasts regarding the EU for this year remained unchanged. As for Russia, the economic downturn driven by high energy prices and a more moderate decline in exports is expected to be less severe than it was previously projected.

The outlook for global inflation has been raised due to the current food and energy prices as well as persisting imbalances between supply and demand. Thus, external inflationary pressure on consumer prices in Kazakhstan will remain elevated until the end of the forecast period.

In August, the annual inflation in Kazakhstan kept accelerating, reaching 16.1%. The main contribution is still being made by food products; at the same time, non-food inflation and inflation of paid services are accelerating at a faster pace. The current inflation dynamics have resulted from the pressure on both the demand side and supply side.

Consumer prices are rising because of the growing costs – both domestic and external costs, including high global energy prices, depreciation of the tenge against the Russian ruble, disruption of supply chains and a corresponding increase in the cost of transport services, high inflation in trading partner countries against a positive real growth of household income. In general, the process of adjusting consumer prices to external shocks is ongoing.

High costs are also driven by an insufficient growth of labor productivity in the economy. At the same time, real wage growth remains significant, reflecting largely the rise in prices in the economy rather than the growth of labor productivity.

Among internal factors, a positive fiscal impulse should also be pointed out; it offsets the decline in food prices in the global markets, having an upward impact on the demand in the medium term. In addition, high inflation expectations are putting upward pressure on inflation.

In this context, inflation will keep accelerating until the first quarter of 2023, when its peak is reached. At the end of 2022, the annual inflation will be in the range of 16-18%. In future, inflation is expected to gradually slow down to 7.5-9.5% by the end of 2023. The downward trend in inflation will intensify throughout 2024. Meanwhile, it will still build up above the target band and will be at 5.5-7.5%.

Kazakhstan's economy continues to function in the environment of a geopolitical crisis, the persisting problems in global logistics and the supply of raw materials and supplies for production. Given the scheduled overhaul at the Kashagan field in June of this year, the growth of economic activity during seven months slowed down to 3.3%, which is below the National Bank's expectations.

At the same time, the main sectors of the economy retain their positive development pattern. The upturn is observed in the manufacturing industry, associated with the increased growth rates in mechanical engineering, food, beverage and metallurgical production. The expansion of wholesale and retail trade turnover is driven by the rise in prices for the main export commodities and the easing of quarantine restrictions. The mining sector also made a positive contribution to the GDP growth, despite the contraction this June because of the scheduled overhaul at Kashagan. There is a steady growth in construction, one of the drivers of GDP growth in recent years, as well as transport services.

Before the end of this year, a further slowdown in the economic activity is anticipated, which will be associated with reduction in crude oil production in August and September of this year as a result of production interruptions at the CPC and a scheduled overhaul at large fields. Therefore, feebler dynamics of exports are expected in the third quarter of this year, with the growth recovering by the end of the year against the accelerating ramp-up of oil production in the country. Kazakhstan's economy will slow down to 2.5-3.5% at the end of 2022. In 2023, due to the decreasing overall level of uncertainty, the growth of Kazakhstan's economy will accelerate to 4-5%. The domestic demand will drive the economic activity supported by fiscal stimulus. Exports will be an additional factor in the GDP growth, owing to the expected increase in oil production in the country.

The difficult geopolitical situation in the world continues to bring up high uncertainty into the forecast assumptions of macroeconomic indicators, which leads to the persistence of risks of inflation deviating from its forecast values at a high level.

Thus, there is a risk of a second wave of growth in food prices, which is associated with the risk of a rise in world prices for fertilizers against the backdrop of a tense geopolitical situation. The risk of capital outflow from emerging market currencies to developed currencies is still high. In addition, due to the fact that high inflation will remain in the medium term, the risk of unanchoring inflation expectations is persisting.

The risk of demand-pull inflationary pressure became more pronounced. This was caused by an upward revision of budget spending in 2023. Given the low fiscal discipline and periodic upward revision of government spending in prior years, it is not excluded that the budget parameters in the years to follow may be further revised in the direction of expanding the expenditure side, which may become an additional source of pro-inflationary pressure in the economy.

## I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

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### 1.1. Forecast Assumptions

The growth outlook for the global economy has deteriorated compared to the preceding “May-June 2022” forecasting round. The risks of recession have risen significantly. According to the IMF forecasts, the global economy will slow down from 6.1% in 2021 to 3.2% in 2022 and to 2.9% in 2023. Developed countries, led by the EU and the US, will show a significant slowdown in economic growth. At the same time, the EU countries, due to their energy dependence on Russia, will experience a stronger impact from the crisis. The Chinese economy, under the pressure of the anti-COVID policy, will grow at a weaker pace than previously predicted. Given that these countries are the main export destinations for many developing economies, it is likely that they will experience a decline in world trade and an increase in capital outflows. The main risks of a weaker global economic development include the worsening geopolitical risks, a faster-than-expected tightening of the monetary policy by major central banks, recurrent lockdowns in China due to Covid-19, and the materialization of the food and energy crisis.

Forecasts of Consensus Ecs regarding the EU economy for 2022 are retained at 2.8% (YoY), largely reflecting the positive momentum gained from the recovery in 2021 and a stronger than previously forecast growth in the first quarter of 2022. Due to spillovers from geopolitical risks and tightening financial conditions, the economic growth forecast for 2023 was reduced from 2.3% (YoY) to 1.4% (YoY). These factors are expected to significantly weaken the investment and consumer activity, as well as reduce the real value of savings accumulated during the pandemic. In turn, the expected decline in energy supplies will lead to a further reduction in industrial production and an increase in energy prices. The estimate for export growth, despite the expected minor depreciation of the euro against other world currencies, has been significantly lowered. Import estimates are also downgraded amid the sluggish activity. Over the forecast horizon, the economy is anticipated to be supported by a strong labor market, fiscal measures, as well as further implementation of the EU’s Economic and Social Recovery Plan designed by the European Commission (Figure 1).

Forecasts of Consensus Ecs. about the Chinese economy for 2022 were lowered from 4.7% (YoY) to 3.7% (YoY) because of the imposed anti-Covid restrictions, disruptions in the supply chains and the deepening crisis in the real estate market. Estimates for 2023 have been raised from 5.1% (YoY) to 5.4% (YoY). The anticipated growth will be supported by infrastructure investment, relatively strong exports as well as a gradual easing of the commitment to a zero-tolerance policy for Covid-19. Retail sales as a proxy for consumer demand will rise from 2.8% to 8.7%. Growth in the industry will approach the pre-Covid levels of 2019. The economic activity in the country will also be supported by relatively soft monetary policy and activities ahead of the 2024 presidential election. New restrictions due to Covid-19, increased capital outflows amid more aggressive policies of major central banks, as well as a worsening geopolitical situation because of Taiwan will remain to be the key risks for the country (Figure 2).

According to forecasts made by Consensus Ecs., a projected economic downturn in Russia will be less profound versus the earlier forecasts owing to the implemented support measures, high energy prices and a more moderate reduction of exports.

In 2022, the Russian economy is estimated to fall by about 5.0% (YoY). A fairly sharp decline is forecasted for investments and household consumption. Given the imposed sanctions, exports will also reduce, which, in turn, will have a negative impact on the oil sector and the industry as a whole. In 2023, it is expected that the Russian economy will be most affected by the sanctions imposed by the West. However, as economic agents adapt to new conditions, the decline in economic activity will be replaced by moderate growth. The fall of the economy will account for 2.5% (YoY) (Figure 1).

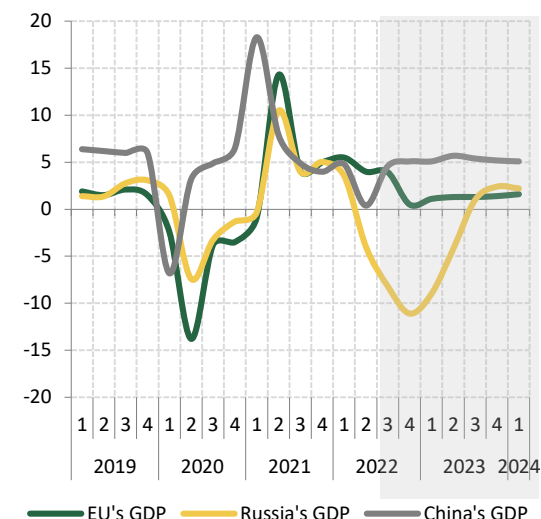
**The IMF's forecasts regarding the global inflation for 2022-2023 provide for faster price increases than previously expected. The 2022 inflation forecast for developed countries has been raised from 5.7% to 6.6%, for developing countries – from 8.7% to 9.5%. In 2023, inflation is assumed to slow down to 3.3% in developed countries, and to 7.3% – in developing countries.**

Over the forecast horizon, growth drivers still include high current food and energy prices, as well as persisting imbalances in supply and demand. The expected deceleration of prices reflects the gradual elimination of supply chain problems and more sluggish consumer demand. Industrial and agricultural prices are expected to decline over the next two years, but will still stay above the pre-pandemic levels of 2019. Among the key risks to inflation, a further faster growth in wages is considered, which in the current environment could inevitably provoke the realization of an inflationary spiral.

**Taking into account the updated inflation forecasts in Kazakhstan's trading partner countries, it is expected that external inflationary pressure on consumer prices in Kazakhstan will remain elevated until the end of the forecast period.**

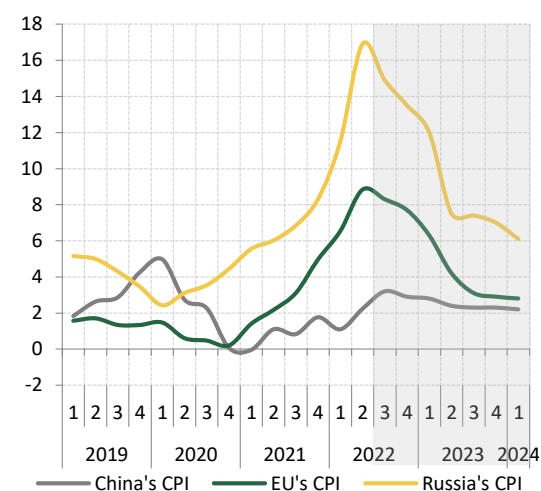
Inflation forecasts for the EU have been significantly raised because of its energy dependence on Russia. In Russia, on the contrary, the forecast was somewhat improved due to the expected reduction in consumer demand and appreciation of the ruble.

**Figure 1. GDP Growth Rates in China, the EU, and Russia in Real Terms, YoY, %**



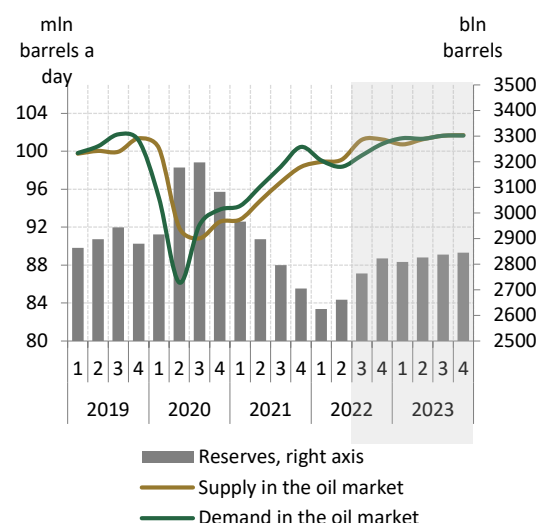
Source: Eurostat, National Bureau of Statistics of China, Rosstat, Consensus Ecs.

**Figure 2. Inflation in China, the EU and Russia, YoY, %**



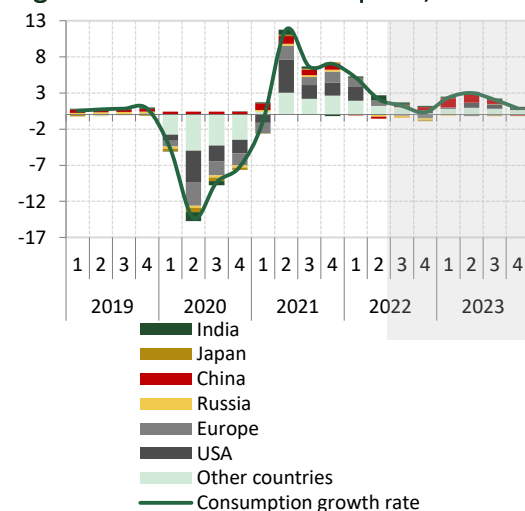
Source: Eurostat, National Bureau of Statistics of China, Rosstat, Central Bank of Russia, Consensus Ecs., European Commission

Figure 3. Dynamics of the Global Oil Market



Source: EIA

Figure 4. Global Oil Consumption, YoY



Source: EIA

In the EU and Russia, inflation is expected to remain above the target during the forecast period. In China, the current rise in pork prices and the anticipated improvement in the economic situation will lead to further inflation. In the short term, inflation may exceed the target (Figure 2).

**In view of persistently elevated inflationary pressure in the world, major central banks led by the US Federal Reserve and the ECB, intend to continue pursuing an active policy of transition to a neutral monetary policy.** According to medium-term forecasts of the US Fed, the policy rate may be raised to 3.5% before the end of this year. However, given the latest speech by the head of the US Federal Reserve, the policy rate may be raised at a faster pace. The ECB, which raised the policy rate for the first time in 11 years, does not rule out that at the upcoming meetings it will continue the cycle of normalization of its monetary policy. Taking into account the rhetoric of large central banks, the risks of increased volatility and capital outflow remain relevant for developing countries, including for Kazakhstan's economy.

**The projected dynamics of world oil prices during 2022-2023 suggests that they would be building about or above 90 US dollars per barrel.**

According to the EIA forecasts, in the near term, due to high prices for gasoline and other energy products, demand is likely to decrease slightly. However, no strong fall of prices is expected. The growth in demand will be supported, on the one hand, by gas with its rising price against the backdrop of an aggravated geopolitical situation, and, on the other hand, by low oil reserves. Oil production will gradually increase but this effect will be offset by the expected weaker oil production in Russia and the Middle East. The oil market will be in a state close to balance by the end of 2023 (Figure 3).

Forecasts of international organizations (EIA, IEA, OPEC) regarding the demand for oil generally remain positive. However, the demand for oil is expected to exceed the pre-pandemic level only by 2023. Therefore, in 2022 the demand for oil will be 99-100 million barrels a day on average,



and in 2023 will amount to 102 million barrels a day on average (for reference – in 2019, the total volume of oil consumption was 100.5 million barrels a day). On a country-by-country basis, it is expected that the main contribution to the growth in global consumption will be secured not by the USA and Europe but largely by China, India and other countries outside of the OECD (Figure 4).

According to forecasts, in 2022-2023, the global oil production will continue to increase. In 2022, the total output will average 100.3 million barrels a day, and in 2023, it will make up 101-103 million barrels a day. The OPEC expects that production in Russia in 2022 will increase by 0.8% and decrease by 3.4% in 2023. The EIA forecasts for 2023 look more pessimistic. The agency predicts a 13.5% decline in 2022. In turn, in the United States, the oil production will reach record-high levels in 2023. In OPEC member countries, production in 2023 will grow to 29 million barrels a day (Figure 5).

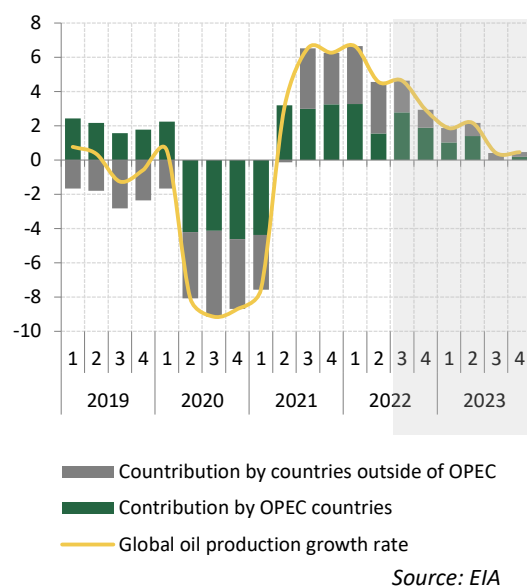
In the near term, oil prices will be supported by a strong demand, low oil reserves, the policy pursued by the US Fed and a relatively sluggish growth of oil production. Once the expected increase in oil production in the USA, Brazil and Europe takes place, oil prices will be slightly declining.

Taking into accounts the forecasts made by international organizations, existing factors of rise and fall in prices, over the forecast horizon under the baseline development scenario for the Kazakh economy, Brent oil price will be 90 US dollars per barrel on average in 2023 followed by a subsequent decline to 85 US dollars on average in 2024.

Under the optimistic scenario, Brent oil price will amount to 110 US dollars per barrel, and under the pessimistic scenario – 50 US dollars per barrel.

The FAO Cereal Price Index fell by 11.5% in July 2022, being caused by an agreement between Russia and Ukraine on the export of grain via the Black Sea ports by Ukraine, as well as the start of a harvest campaign for wheat in the Northern Hemisphere and corn in Latin America. According to international organizations, the grain market is expected to yield slightly above five-year averages. Thus, a seasonal increase in supply of grain in the global market will contribute to a further decline in cereal prices.

Figure 5. Global Oil Production, YoY, %



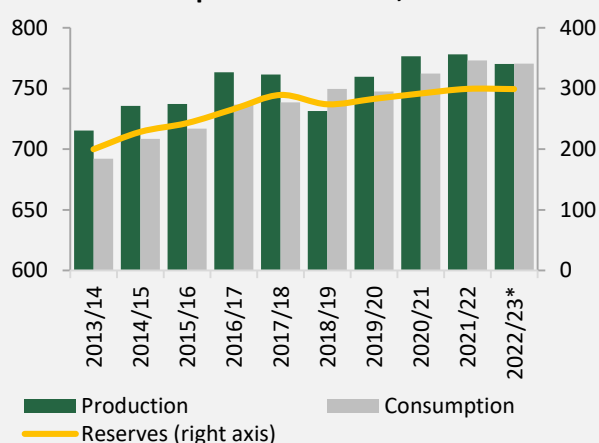
In the meantime, there is uncertainty about harvest prospects in Europe, where heat waves have set in, and despite the decline in fertilizer prices over the past three months, their prices are still at a fairly high level.

In the medium term, cheaper transport costs, coupled with the resumption of supply chains, will put disinflationary pressure on world prices.

### Box 1. Bread is the Staff of Life

Wheat is one of the most important products in the human diet. The use of wheat in the food industry is extensive. Among grain crops, wheat accounts for 29.1% of the total world production. World wheat production has grown significantly over the past 60 years. Thus, if in 1961, the global production was at the level of 222 million tons, in 2020 the harvest reached 761 million tons. Wheat production in 1961-2020 grew slightly faster than the world's population (compound average growth rate of 2.1% versus 1.6%).

**Figure 1. Wheat Production, Consumption and Stocks, mln tons**



Source: UN FAO

\*FAO's estimate

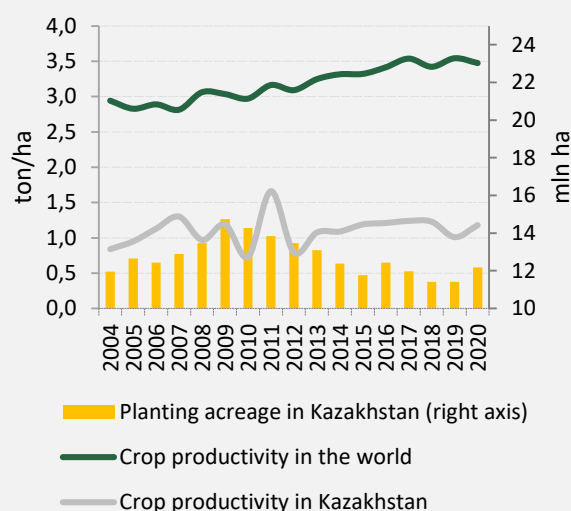
However, over the recent 10 years, consumption has been growing swiftly, catching up with the growth in production, which is so far compensated by a high level of stocks (Figure 1). Meanwhile, since 1961, exports have been growing at a faster rate (2.7%) than production, which is an evidence of the dynamic development of trade. The main suppliers of wheat to the global market are the EU countries, Russia, the USA, Australia and Canada. The top 8 exporters account for 94.9% of the market. The average share of Kazakhstan in world exports is 2.9%.

Since wheat contributes to food security, its global demand is quite extensive, and the top 15 major buyers account for only half of the demand. The main importers are Egypt, Indonesia, Turkey, Algeria and Italy. The Kazakh wheat is mainly purchased by Uzbekistan, Afghanistan, Iran and Tajikistan.

With a significant growth in annual crops since the 1960s, world production has risen to a greater extent due to increased yields. Thus, the yield ramped up by 3.2 times (from 1.1 tons/ha to 3.5 tons/ha), while the acreage during this period increased by 7.6% only (from 204 million hectares to 219 million hectares).

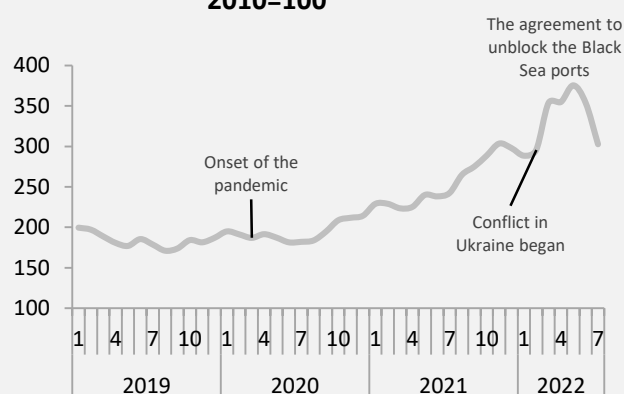
In Kazakhstan, among all agricultural crops, wheat accounts for an average of 61.4% of planting acreage. Wheat acreage has not changed significantly since 2004, as has yield, which peaked at 1.7 tons/ha in 2011 (Figure 2). The reason for the lower domestic yield compared to the world yield is more severe weather conditions, lack of water resources for land irrigation, insufficient use of production technologies and obsolescence of the equipment used. As the results of 2021 showed, the wheat harvest is extremely dependent on weather conditions, the reduction in the gross wheat harvest due to drought amounted to 17% (to 11.8 million tons). In turn, this caused the rise in prices of bread and bakery, macaroni and flour products. At the same time, government programs aimed at supporting the agricultural sector have not exerted a significant effect on the sector's development.

**Figure 2. Planting Acreage in Kazakhstan, Wheat Yield in the World and in Kazakhstan in 2004-2020**



Source: ASPR BNS, FAOSTAT

**Figure 3. Wheat Price Index 2010=100**



Source: IGC

The historical dynamics of wheat prices shows that before the pandemic wheat prices were relatively stable with local fluctuations (Figure 3). With the onset of the pandemic, a cycle of rapid harvests began as countries closed for quarantine, thus leading to a break in the already established trade chains. Moreover, the unprecedented fiscal stimulus to revive the economies of many countries was one of the reasons for acceleration of inflation, which caused the rise in producer costs. Deterioration of the geopolitical situation at the beginning of 2022 contributed to the persisting growth in wheat prices, both due to the increased prices of energy resources and the disruption of transport logistics (blocking of Ukrainian Black Sea ports for the export of grain).

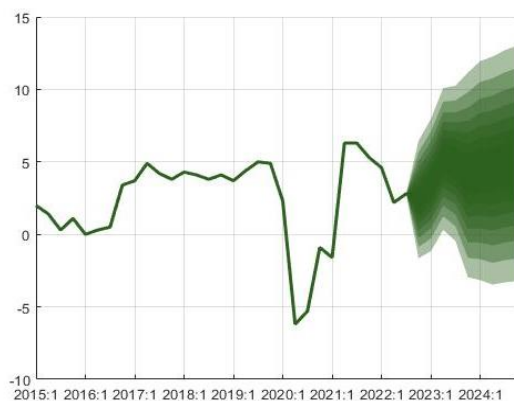
In the 2022/23 agricultural year, the FAO and USDA expect a favorable harvest in major exporting countries. At the same time, Kazakhstan expects a harvest of 13.4 million tons, which is in line with the average for prior years. Thus, in order to strengthen its positions, Kazakhstan needs to increase productivity, which can be achieved using advanced production technologies, with respect to the regional climate and the effective targeted use of public resources.

## 1.2. Dynamics of Economic Development under the Baseline Scenario

**The National Bank has revised its assessments about the economic growth rates until the end of this year slightly downward. This is related to a faster deceleration of the business activity in the real sector than it was expected earlier.**

The main reason for the slowdown was reduction in oil production due to the workover at the Kashagan field and the interruption of work at the CPC, which was underestimated in previous projections. With the reduction in crude oil production and exports, there was a concomitant decline in production in the related pipeline transport and wholesale trade sectors. GDP will be further decelerating until the end of 2022, being driven by a scheduled overhaul at the TCO and Karachaganak fields as well as by the existing uncertainty about future operation at the CPC. **Thus, based on performance in 2022, according to the estimates of the National Bank, the GDP growth rate will be 2.5-3.5% (Figure 6).**

Figure 6. GDP, YoY



Source: NBK's forecast, percentiles at 80%, 70%, 60%, 50%, 40%, 30%, 20%.

The positive dynamics of all components of the demand is anticipated over the forecast period. The contribution by consumer demand will be insignificant in the context of a moderate growth in income of the population resulting from the growth in the national budget spending for the social sphere, measures aimed at increasing the minimum wage and, therefore, an increase in the payroll fund both in the real and public sectors. Moreover, a weaker exchange rate of the tenge against the ruble and high inflation in Russia, and, despite deceleration, in countries of main trading partners in general will become a constraint for acceleration in the consumer demand.

Due to the growing current expenditures of the state budget, a positive contribution on the part of general government is anticipated. Gross formation, owing to moderate dynamics of the investment activity, will be also making a positive contribution to the economic growth.

Real exports will have an upward impact on the dynamics of economic growth. In the first quarter of 2022, because of high prices in the global commodity markets and the implementation of exports via the CPC in stable conditions, real exports accelerated significantly. After a slight decline in the middle of the year, export dynamics are expected to recover and be positive by the end of this year.

Imports, due to a moderate growth in the domestic demand, will have a positive trend, thereby holding back the GDP growth. The withdrawal of international producers from the territory of the Russian Federation, which is observed in the context of geopolitical crisis, will become a constraint for expansion of imports. However, with the adaptation to new conditions in the medium term, the establishment of new supply chains for raw materials, supplies and finished products is anticipated.

In the medium-term, the National Bank's expectations about the GDP growth have been revised upward due to a projected lower base in 2022 as well as additional fiscal stimulus in 2023. **The GDP growth rates in 2023 will be 4-5%.**



The domestic demand will act as a driver for the economic activity owing to a moderate household demand and also to the accelerating investment activity in the economy. Household consumption will be stronger than in 2022 as a result of an ongoing social focus of the budget (indexation of social benefit payments), a persisting policy of wage increases to the public sector employees as well as gradual deceleration of inflationary processes and expectations of the people. The investment activity is expected to accelerate in 2023 due to the scheduled large-scale projects in the mining and manufacturing industries including those projects supported by the fiscal stimuli. In addition, in 2023, implementation of final construction works at a large TCO project will continue.

Exports will become an additional factor for the GDP growth due to the expected ramp-up in domestic oil production, while a stronger increase in oil production will be limited by a projected decline in external demand in the face of weak economic activity in the global economy.

At the same time, a still existing uncertainty about duration of the geopolitical crisis and maximum extent of the impact of such situation on the dynamics of domestic demand and net exports of Kazakhstan is taken into account as a forecast risk.

Thus, in 2022, the path of output gap, compared with the estimates made in the “May-June 2022” forecasting round, has been revised downward, and in 2023 – upward. The revision for 2022 is associated with a downward movement in the forecast dynamics of exports and the economic activity in general. In 2023, GDP will be above potential levels due to the fiscal stimulus and export growth. In 2024, owing to an ongoing ramp-up of oil production and the corresponding growth in exports, the output gap will continue to be in the positive zone, retaining the demand-pull inflationary pressure in the economy.

**According to the National Bank’s forecasts, by the end of 2022, inflation will be building within the range of 16-18%. Inflation will reach its peak in February 2023 (Figure 7).**

Previous estimates of inflation published following the results of the last forecasting round were revised upwards; this was associated with a higher price growth for a wide range of goods and services.

In the short term, inflation will remain in double digits, peaking in February 2023. This will reflect a continuing rise in prices for a number of food products, as well as non-food items, primarily those with a high import content, as well as a persistently high core inflation.

Another factor influencing the balance of demand and supply of goods and services and, therefore, inflation is the increased inflationary expectations. Given a considerable rise in prices for tracer products and the weakening of the exchange rate, they increased significantly.

In the short term, inflation will be remaining at elevated levels also due to depreciation of the tenge exchange rate in the context of a scenario-based decline in world oil prices.

The largest contribution to the formation of inflation will be made by the rise in prices for food and non-food products. The dynamics of these inflation components will be significantly affected by high world prices for food and energy, high inflation in the trading partner countries, as well as interruptions in supplies, including the rising transport costs.

Inflation will be restrained by the implemented monetary policy and government measures to ensure the stability of prices for certain types of fuel and lubricants, as well as positive expectations for the wheat crops this year.

**In 2023, inflation is expected to decelerate to 7.5-9.5% given the exclusion of the high base of 2022 from the calculation, as well as prior decisions about the monetary tightening. By end-2024, the annual inflation will keep slowing down; however, it will be still building above the target within 5.5-7.5%.**

Medium-term inflation estimates have not been revised significantly. Meanwhile, the decline in inflation will be slower than previously expected, thus affecting the process of monetary easing.

In the medium term, the dynamics of annual inflation will be influenced by a number of divergent factors. Thus, the gradual withdrawal of the high base of 2022, a high real interest rate, and the gradual decline in world food prices as well as the faster-than-expected deceleration of inflation in Russia, together with the decreasing inflation expectations, will put downward pressure on inflation in Kazakhstan in 2023-2024.

On the other hand, a positive output gap as a result of fiscal stimulus will be preventing inflation from going down.

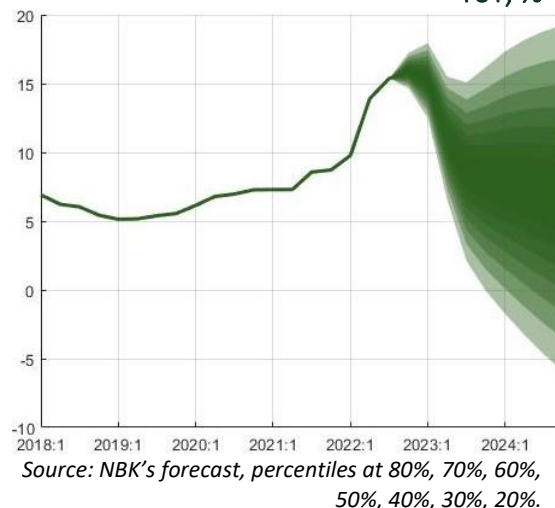
### 1.3. Alternative Forecast Scenarios

**Amid the persisting geopolitical crisis in the world, the development of the world economy is taking place in the environment of high uncertainty. In this regard, in addition to the baseline scenario, the National Bank has designed two alternative scenarios – pessimistic and optimistic.**

The pessimistic scenario is based on the assumption that during the forecast period, Brent oil price will go down from its current price to 50 US dollars per barrel. The anticipated decline in price will be accompanied by a nosedive in the economic activity in major oil importing countries, by a more active transition to the green economy by developed countries and reduction of toxic emissions, by the cancellation of the OPEC+ agreement on reduction of oil production and a concurrent surge in oil production in countries outside of OPEC.

The reaction of the Kazakh economy to such slash in prices for the main export product will be extremely negative. The economic activity in the forecast period will be lower than in the baseline scenario.

Figure 7. Inflation, Quarterly Average, YoY, %



Deceleration will be accompanied by a cut in production of the mining industry, of exports and all related industries (transport, trade). The investment activity will be also characterized by weaker dynamics due to the growing uncertainty and lower profits in the industry. **In 2022-2023, the economic growth will be 2.3-3.3%.**

If this scenario is realized, inflation would be higher than in case of the baseline scenario. Under the pressure of high inflation, real income of the population would be decreasing. This, on the one hand, would put pressure on the expansion in imports and, on the other hand, would support high inflation expectations. **In 2022, inflation will account for 17-19%, and in 2023 – 8.5-10.5%.**

The optimistic scenario implies that world Brent oil prices will be growing from current figures to 110 US dollars per barrel, which will be associated with significant reduction of uncertainty regarding the geopolitical situation in the world, with solution to the problems of supply chains, a faster economic growth in China and other importing countries as well as the monetary easing pursued by major central banks.

Generally, such scenario has a more positive effect on Kazakhstan's economy. The economic growth during 2022-2024 would be above the figures in the baseline scenario. Exports, investments, trade and transport would be the key growth drivers. **The economic growth in 2022 will be 2.6-3.6%, and in 2023 – 4.4-5.4%.**

Inflation in 2022, provided that the optimistic scenario is realized, would be close to the level in the baseline scenario. In the medium term, inflation would be slowing down, however, at a faster pace compared to the baseline scenario. **In 2022, inflation will be building within 16-18%, and in 2023 – 6.5-8.5%.**

#### 1.4. Risks in the Medium Term

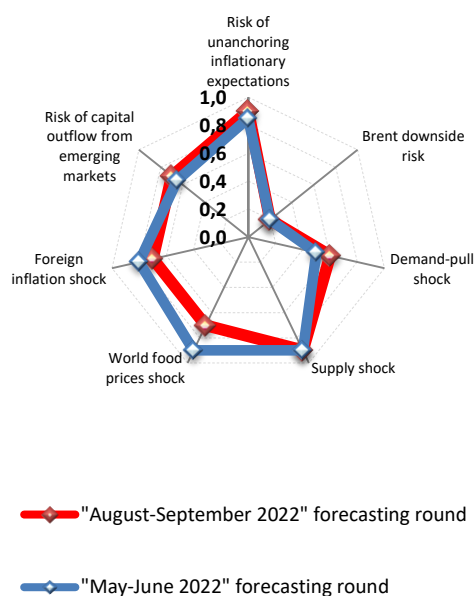
**Compared to the previous forecasting round, risks of inflation acceleration somewhat decreased, however, they remain high because of persisting geopolitical tensions (Figure 8).**

A difficult geopolitical situation in the world continues to bring about a high level of uncertainty in the forecast assumptions of macroeconomic indicators of Kazakhstan, leading to the persistence of risks of inflation deviating from its forecast values at a high level.

Nonetheless, the likelihood of some risks materializing compared to the previous forecasting round has slightly decreased. Thus, the risk of importing high global food inflation has significantly diminished in the context of the conclusion of the UN-backed grain exports deal between Ukraine and the Russian Federation, as well as due to good prospects for the next harvest in the world. At the same time, there is a risk of a second wave of rise in food prices, which is associated with the risk of growth in world prices of fertilizers due to a tense geopolitical situation.

Another risk that also has a lower probability of occurrence is the risk of importing external inflation. Thus, in Russia – the main supplier of imported goods for Kazakhstan – despite that annual inflation is heightened, monthly price changes are of a disinflationary nature owing to appreciation of the ruble and sluggish demand and since a low rate of price growth has been observed for a wide range of goods and services, monthly core inflation is also below the 4% target. These factors somewhat mitigate the risk of importing high external inflation; nevertheless, under the influence of sanctions against the Russian Federation and, therefore, a restructuring of the supply of consumer goods in the medium term, there is a risk of importing high inflation from the Russian Federation.

**Figure 8. Risk Map based on the Expert Judgment**



Source: NBK's calculations

A risk of capital outflow from currencies of emerging market in favor of developed markets remains high. First, because of an elevated inflationary pressure worldwide, central banks of developed countries could tighten their monetary policy in a more aggressive manner. Second, a possible strengthening of sanctions rhetoric in respect of Russia may increase risk premiums in developing countries, which may lead to depreciation of their currencies, including in Kazakhstan. Therefore, risks of inflation acceleration, especially in the short term, remain significant.

In addition, due to dependence of the perceived risk premium of the tenge on the dynamics of the Russian ruble and high volatility of the Russian currency, risks of depreciation of the tenge exchange rate are still high. Apart from that, the embargo on Russian oil exports imposed by the EU may have a negative effect on exports of Kazakhstani oil and reduction in foreign currency proceeds that may also be a negative factor for the tenge exchange rate. Due to the impact of the above factors and persistently high inflation, the risk of unanchoring inflation expectations remains in the medium term.

In the short and medium term, risks of inflation acceleration because of supply shock continue to persist. Possible disruptions in supplies because of the effect of anti-Russian sanctions may result in the increased production costs in Kazakhstan, and the risks of a simultaneous rise in prices for fuel and lubricants and utility services in view of the need to maintain profitability of production and to finance investments in major overhaul remain high in the medium term.

The risk of the demand-pull inflationary pressure has become more pronounced. This was driven by the upward revision of budget spending in 2023. Given the low fiscal discipline and the periodic upward revision of government spending in prior years, it is not excluded that the budget parameters in the years to follow may be further revised towards expanding the expenditure side, which may become an additional source of pro-inflationary pressure in the economy.

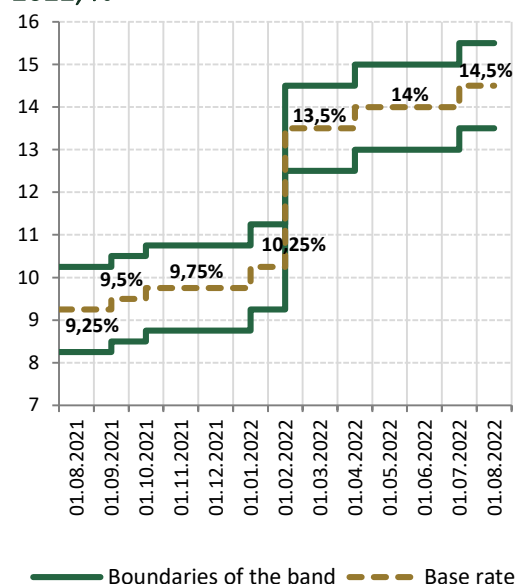


## II. MONETARY POLICY



## II. MONETARY POLICY

Figure 9. The Base Rate Band in 2021-2022, %



Source: NBK

### 2.1. Decisions on the Base Rate

In June-August 2022, the National Bank continued to pursue a disinflationary monetary policy in the environment of accelerating inflationary processes amid persisting external and internal factor of price growth.

After some signs of deceleration in June 2022, since July, inflation again has begun to hit fresh multi-year highs and reached 16.1% in August in annual terms. The main pro-inflationary factors were acceleration of global inflation amid high commodity prices, persisting problems with supply chains, a worsening geopolitical environment, and the impact of the fiscal impulse. Pressure on prices is intensified by high inflation expectations.

In such circumstances, on July 26, 2022, the National Bank made the decision to increase the base rate to 14.5% (Figure 9). This decision was aimed at stabilization and deceleration of inflationary processes and expectations in 2023 and also at approximation of inflation to the target in the medium term.

When making its most recent decision regarding the base rate on September 5, 2022, the National Bank retained it at 14.5%. At the same time, the stability of ongoing inflationary processes and new risks of their acceleration require keeping the base rate around its current values for a long time.

### 2.2. Money Supply

**The growth rate of the money supply accelerated. In the reporting period, the main contribution to the growth in the money supply has been made by the increasing claims on the economy (credits to the population and the business). The money multiplier is declining to the last year level.**

Since the beginning of the year, the money supply in the economy has increased by 1.3 trillion tenge (by 4.3%) and in July amounted to 31.4 trillion tenge (Figure 10). After a significant decline in April and May, in annual terms the money supply went up to 11.2% at the end of July (in July 2022 – 19.8%).

Credits to business and the population, primarily consumer and mortgage loans, keep making the main positive contribution to the growth in the money supply.

In July of this year, apart from credits to the population, the growth in the money supply was secured by an increase in gold and foreign exchange reserves due to larger balances of banks' correspondent accounts.

The reserve money started to grow (after its contraction in May to (-) 4.3% YoY) in annual terms and its increase in July 2022 accounted for 12.4% YoY (0.9% in April, and 13.2% in July 2021). Expansion in the reserve money is associated with a lower volume of liquidity withdrawn by the NBK via short-term notes (YoY) due to the termination of economic support programs.

**The money multiplier** (the ratio of money supply to reserve money), after its growth in April 2022 to 2.91, in July declined to 2.71 and has been at a level comparable with same period of the last year (in July 2021 – 2.74) (Figure 11).

### 2.3. Money Market

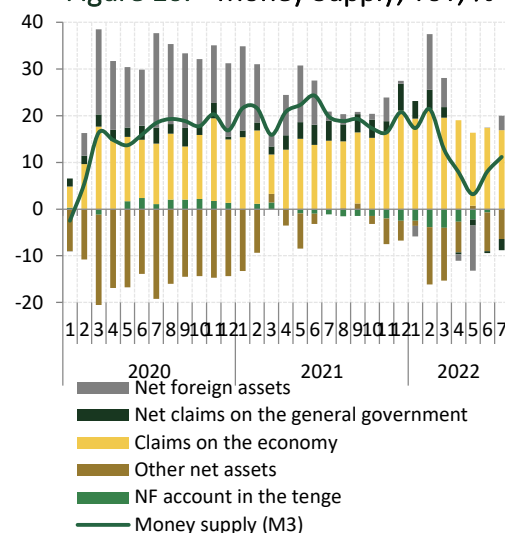
**After a significant decline at the beginning of 2022, the balance of the National Bank operations increased primarily due to the growth in transfers from the National Fund. Therefore, since July of this year, money market rates were setting mainly around the lower boundary of the interest rate band except for the period of an active demand for liquidity during a quarterly tax week.**

The balance of the NBK operations went up by 5.4% compared to May 2022 and amounted to 2.7 trillion tenge at end-August of this year due to an inflow of resources to the banking system as a result of utilization of the expenditure side of the budget.

The bulk is withdrawn via notes (1.9 trillion tenge), deposits (0.6 trillion tenge) and deposit auctions (0.4 trillion tenge) (Figure 12).

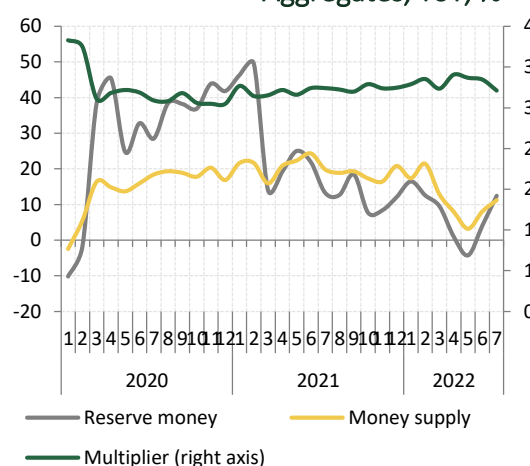
From May 2022, volumes of liquidity withdrawn by the NBK at deposit auctions (except the last day of August), notes and deposits kept growing; their average daily volumes in June- August 2022

Figure 10. Money Supply, YoY, %



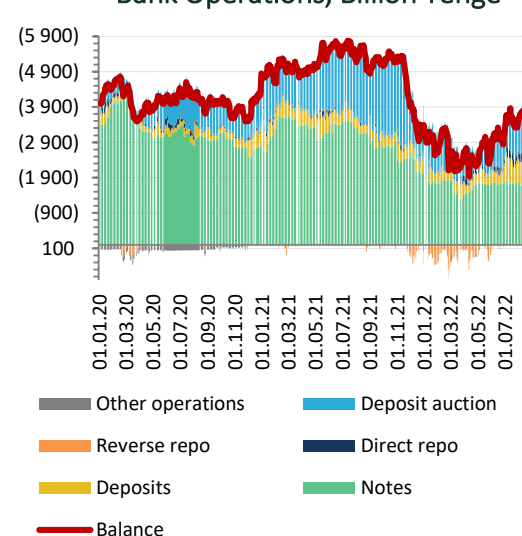
Source: NBK

Figure 11. Growth of Monetary Aggregates, YoY, %



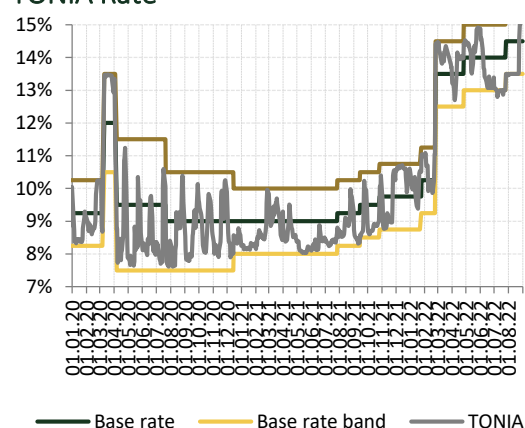
Source: NBK

Figure 12. Exposure on the National Bank Operations, Billion Tenge



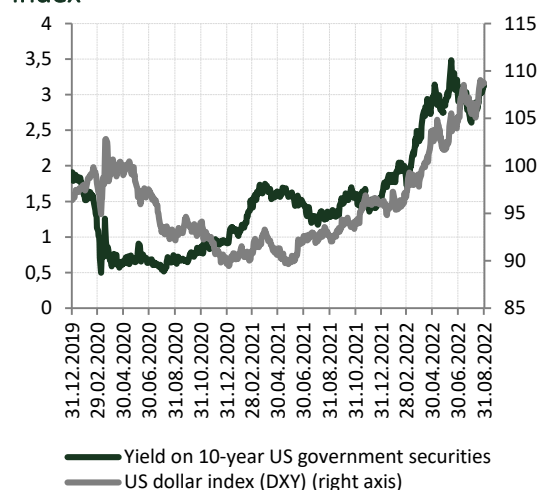
Source: NBK

Figure 13. Interest Rate Band and TONIA Rate



Source: NBK, KASE

Figure 14. Yield on 10-year US Government Securities, US Dollar Index



Source: Refinitiv

amounted to 915.5 billion tenge, 1 769.8 billion tenge and 497.0 billion tenge, respectively (in March-May2022 – 747.3 billion tenge, 1 614.7 billion tenge and 313.9 billion tenge).

The increase of the base rate in July 2022 resulted in a corresponding growth of money market rates (Figure 13). The target money market rate – TONIA (an overnight repo rate) due to excess liquidity in May-August was mainly staying near the lower boundary. As a result, the average TONIA rate in May-August was 13.5%, and the spread between TONIA and the base rate during June-August 2022 had been negative (-0.71pp).

## 2.4. Foreign Exchange Market

**In June-August 2022, the decline in oil prices, and the monetary tightening by developed countries had a downward impact on currencies in developing countries, including on the tenge. However, at end-August, 2022, due to a quarterly tax week, the exchange rate was appreciating.**

In June-August 2022, the dynamics of the tenge exchange rate was developing under the impact of deteriorating situation in the external sector.

Thus, despite recession risks, given that the US annual inflation reached its maximum over the last 40 years, the US Fed raised the interest rate two times: in June – by 75 bp to 1.5-1.75%, and in July – by 75 bp to 2.25-2.5%.

This contributed to the rise in the DXY dollar index to 108.5 in certain periods (Figure 14). In the context of significant pro-inflationary background in July 2022, the ECB, for the first time in 11 years, raised its policy rate by 50 bp – to 0.5%, and the Bank of England – by 50 bp to 1.25%.

Due to an active monetary tightening and geopolitical tensions, the global investors' risk appetite decreased. Thus, at end-July 2022, the share of non-residents' investments in government securities of Kazakhstan went down to 2.5%.

Alongside with external monetary conditions, in June-August 2022, the exchange rate dynamics was developing under the impact of declining oil prices during June-August by 21.5% to 96.49 US dollars per barrel (Figure 15).



Due to appreciation of the US dollar, gold quotes have also experienced a downward pressure. Since end-May, the price of gold has declined by 7.1% from 1843 to 1713 US dollars per ounce, reaching 1687 US dollars per ounce on certain days (Figure 15).

A negative effect of external factors on the exchange rate dynamics was partially offset by foreign exchange sales as part of conversion of transfers from the National Fund to the national budget that appeared to be insignificant by historical standards. During June-August, volumes of transfers amounted to 1.04 billion US dollars.

Taking into account the above factors, in June-August the exchange rate of the tenge was building within the range of 425.41-484.62 tenge.

However, after a significant appreciation at the end of May due to tax payments, in June the tenge depreciated. As a whole, in July-August 2022, in the environment of balance between the demand and supply, the exchange rate was forming within a narrow range of 473-477 tenge per US dollar. At the end of August 2022, the exchange rate strengthened due to the sales of foreign exchange by exporters within the framework of a quarterly tax week (Figure 16).

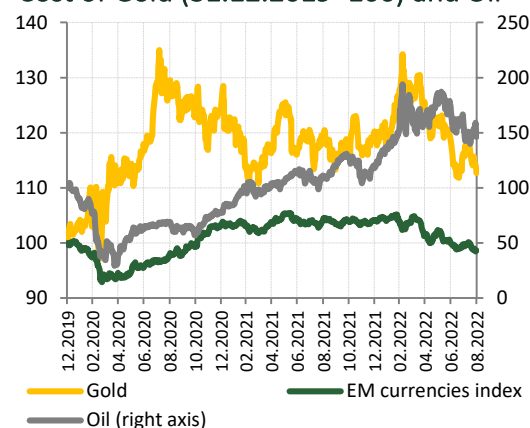
An average daily volume of stock exchange trades in June-August amounted to 98.0 million US dollars and, given the decreased overall level of uncertainty, had been much lower than in March-May of this year (126.2 million US dollars) and June-August 2021 (143.3 million US dollars).

## 2.5. Stock Market

In June-August of this year, a risk-free yield curve due to the decision to raise the base rate grew on a short-term segment. Given lower yields of government securities over a medium- and long-term horizon, the yield curve, based on performance in June and July 2022, became hump-shaped, and at the end of August – inverted.

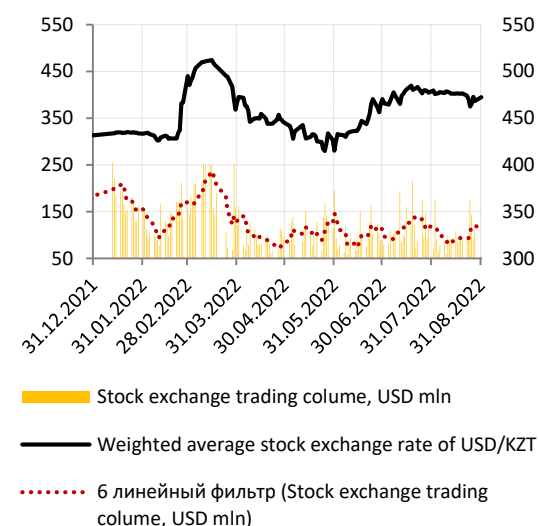
Trading volumes of government securities and corporate bonds demonstrate a recovering growth compared to March-June. However, volumes of attraction on the part of local executive authorities decreased. The KASE BMY Index at the end of August 2022 went up by 35.17 bp to 11.72.

Figure 15. Dynamics of the Emerging Market Currency Index, and of the Cost of Gold (31.12.2019=100) and Oil



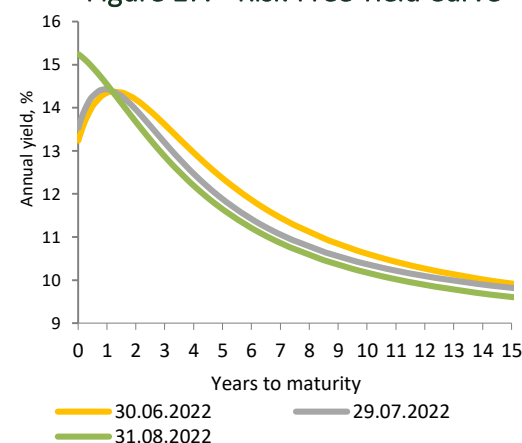
Source: Refinitiv

Figure 16. Dynamics of the Tenge Exchange Rate and Trading Volume



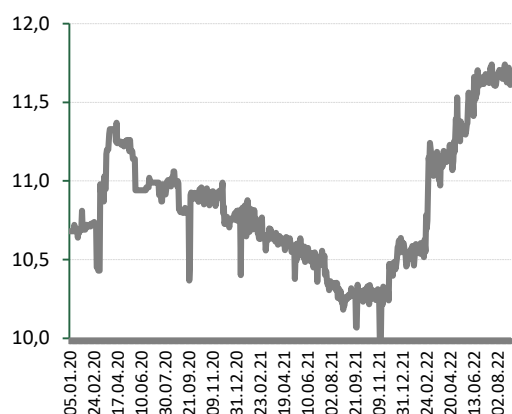
Source: KASE, NBK

Figure 17. Risk-Free Yield Curve



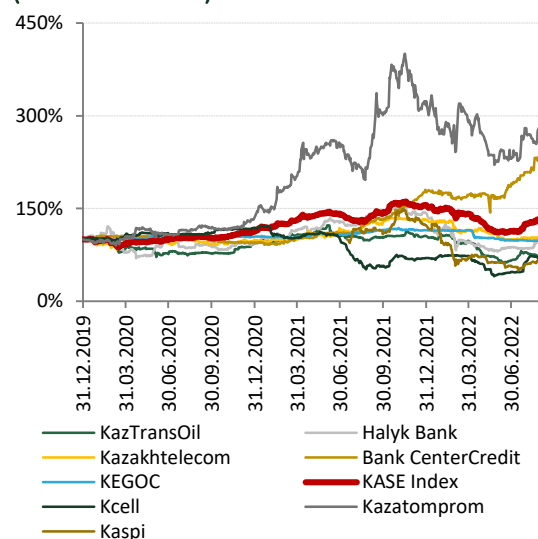
Source: KASE, NBK's calculations

Figure 18. Yield of Corporate Bonds, %



Source: KASE

Figure 19. KASE Index (Dec.2019=100)



Source: KASE

The National Bank's July decision to raise the base rate from 14.0% to 14.5% resulted in an upward shift of the yield curve on a short-term segment (Figure 17). The yields of placed government securities of the MF RK with different maturities, following the raising of the base rate, increased from 12.5-14.5% per annum in March-May 2022 to 13.61-14.79% per annum in June-August 2022.

**In July and August, the yield curve was shifting upwards on a short-term segment.** However, lower yields of GSs had formed over a **medium-term** horizon.

Government securities issuance in the primary market increased significantly from 786.9 billion tenge in March-May of this year to 1 617.7 billion tenge in June-August of this year. Of these, MF RK's borrowings of 1 601.3 billion tenge account for a significant part. Maturities of the MF RK government securities varied from 1 to 5 years. The remaining volume is comprised of borrowings by local executive authorities that reduced significantly from 126.4 billion tenge in March-May of this year to 16.3 billion tenge in June-July of this year (at 0.35-4.24%).

The placement volume in the corporate bond market has grown from 368.67 billion tenge in March-May of this year to 481.4 billion tenge in June-July of this year. The weighted average yield of placed bonds in August went up to 16.08% (14.78% in June 2022). The KASE BMY index has risen from August 2022 by 24.79 bp to 11.62 (Figure 18) at the end of August.

The KASE Index during June-August went up by 18.4% (Figure 19) and kept restoring from the local lows observed in May.

This was furthered by the return of optimism in international markets, the improvement of the leading US and European indices as well as the publication of positive reports from domestic companies.

During the period under review, stock prices of all companies included in the KASE index representative list had a positive trend, except for ordinary shares of such joint-stock companies as Kazakhtelecom - (-)4.1% and KEGOK - (-)3.0%.

## 2.6. Deposit Market

In June-July of this year, deposits kept growing after a decline in March-May of this year.

The overall dollarization level decreased due to the outstripping inflow of funds to the tenge deposits compared to foreign currency deposits.

In view of the increase of the base rate in June-July 2022, deposit rates went up.

The growth of the deposit portfolio, after a significant slowdown in May, recovered in July of this year to 11.3% in annual terms (in December 2021 – 22.7%) (Figure 20). The main contribution to the growth in the deposit base was made by the increase in deposits in the national currency (by 12.4%) both of the population and the business.

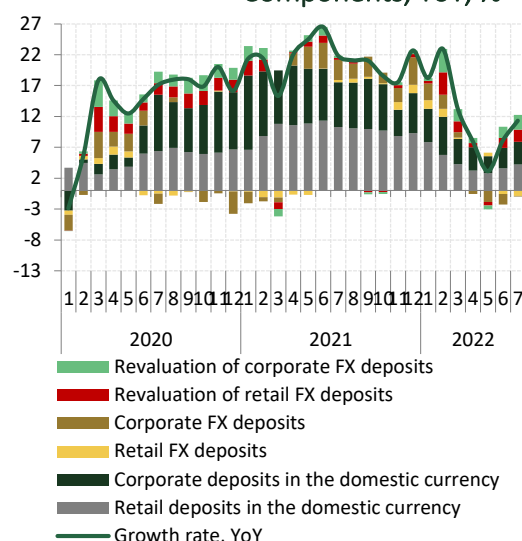
Foreign currency deposits went up by 9.4%. The main factor that led to the increase is deposit revaluations due to the national currency adjustment in February, June and slightly in July of this year. However, deposits decreased by 2.7% in the US dollar equivalent.

The overall dollarization level declined from 36.0% in December 2021 to 35.4% in July 2022 (Figure 21). Appreciation of the national currency in some months, an outflow of resources in foreign currency and an inflow of the national currency contributed to the decline.

Dollarization of the corporate sector at the end of July 2022 decreased from 37.6% in December 2021 to 37.4% (April 2022 – 36.1%), and of individuals – from 34.4% to 33.2% (Figure 21).

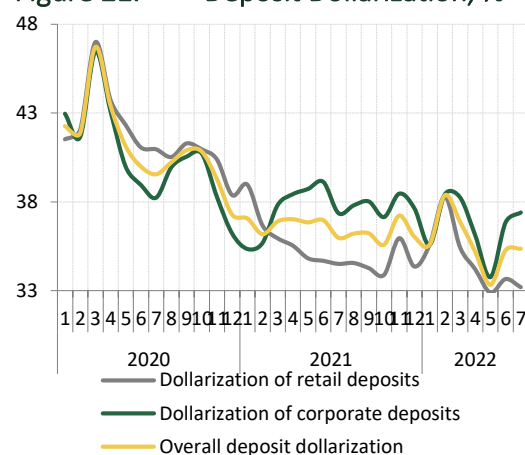
Following the increase of the base rate, weighted average interest rates on retail and corporate deposits went up significantly in July 2022. Thus, interest rates on deposits in the corporate sector with maturity up to 1 month, which account for a major share in attracted deposits (83.5% of all time deposits in the tenge of businesses) increased to 12.4% compared to 7.4% in December 2021 (7.2% in July 2021). Rates on deposits with maturities from three months to one year (with the share of 7.9%) also went up from 7.5% to 11.4% in July 2022. Interest rates on long-term deposits with a maturity from one year to five years (with a share of 0.7%) increased from 8.1% to 9.2% in July 2022 (Figure 22).

Figure 20. Contribution to the Growth in the Deposit Volume by Components, YoY, %



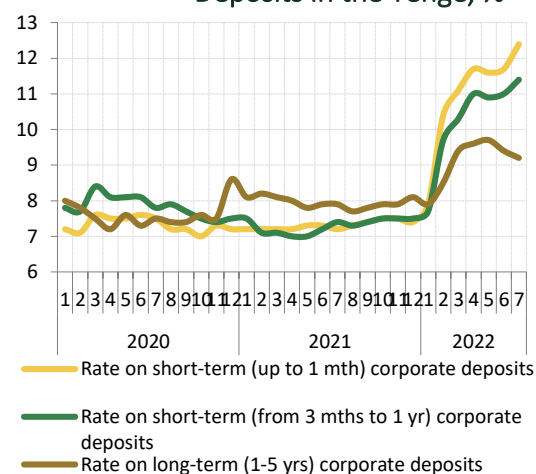
Source: NBK

Figure 21. Deposit Dollarization, %



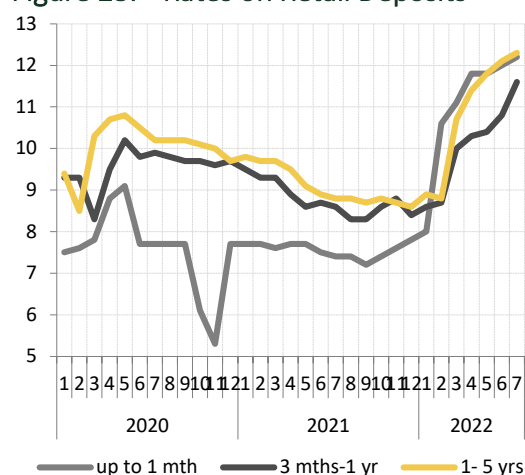
Source: NBK

Figure 22. Rates on Corporate Deposits in the Tenge, %



Source: NBK

Figure 23. Rates on Retail Deposits



Source: NBK

Rates on retail sector deposits also demonstrated growth. Interest rates on short-term deposits with a term of up to 1 month (with the share of 13.0%) went up to 12.2% from 7.8% in December 2021 (7.4%). Rates on deposits from 3 months to one year (with the share of 33.9%) increased to 11.6% in July 2022 from 8.4% in December 2021 (8.6% in July 2021), on deposits with a maturity of 1 year to 5 years (with the share of 47.9%) increased to 12.3% from 8.6% in December 2021 (8.8%). (Figure 23).

### Box 2. “The Historical Analysis of Deposit Dollarization in Kazakhstan”

Dollarization generally refers to the use of US dollars or any other foreign currency by agents for transactions within the country instead of the national currency. There are various types of dollarization, in particular financial dollarization. The level of financial dollarization is usually measured by the ratio of deposits in foreign currency to total deposits, as well as the ratio of loans provided by banks in foreign currency to the total loan portfolio. Due to the fact that the level of loan dollarization in Kazakhstan is low, the National Bank uses dollarization of deposits as the main indicator of dollarization of the economy.

The main reason of dollarization is the unevenly developed structure of Kazakhstan’s economy, oriented at primary exports with a low level of development of other production sectors. Export-oriented countries are exposed to fluctuations in prices for their main export commodities. In turn, external shocks reflected in the foreign currency lead to the fact that economic entities tend to give preference to foreign currency as a store of value.

Deposit dollarization deprives of the possibility to implement a full-fledged and independent monetary policy and also exerts an adverse effect on the financial sector development.

According to the IMF research, a 1% growth of dollarization in deposit organizations reduces the ratio of lending volume to GDP by 0.4% over a short-term and by 2-2.5% in a long-term perspective. According to the IMF assessments, if dollarization is cut to half (for example, from 90% to 45%), it would potentially increase financial depth<sup>1</sup> almost by 20% in the short term.

By August 2015, Kazakhstan adhered to the fixed exchange rate regime, and its use, in the event of deterioration in the external and internal economic situation, in certain periods led to the accumulation of imbalances in the economy. As a result, devaluation expectations and expectations for a one-time weakening of the national currency were growing. Thus, the costs of the previous monetary policy regime, with a significant decline in oil prices, resulted in depreciation of the exchange rate and the corresponding attainment by dollarization of its peak of 69.7% in January 2016 (Figure 1), while the dollarization of household deposits exceeded the general level of dollarization and amounted to more than 2/3 of deposits in total retail deposits.

At the same time, after the transition to the inflation targeting and the floating exchange rate regime, a downward trend in dollarization outlined. By the end of July 2022, dollarization accounted for 35.4%, which is almost two times lower than its historical maximum in January 2016. Moreover, the level of dollarization of individuals, excluding Otbassy Bank and large deposits over 50 million tenge, is significantly lower than dollarization of the population and by the end of July 2022 amounted to 19.1%. Deposits in Otbassy Bank are placed exclusively in foreign currency for the purpose of improving living conditions and cannot reflect changes in the preferences of depositors in terms of the currency of deposit. As for large deposits over 50 million tenge, despite their high share in the total volume of deposits of individuals, the number of such

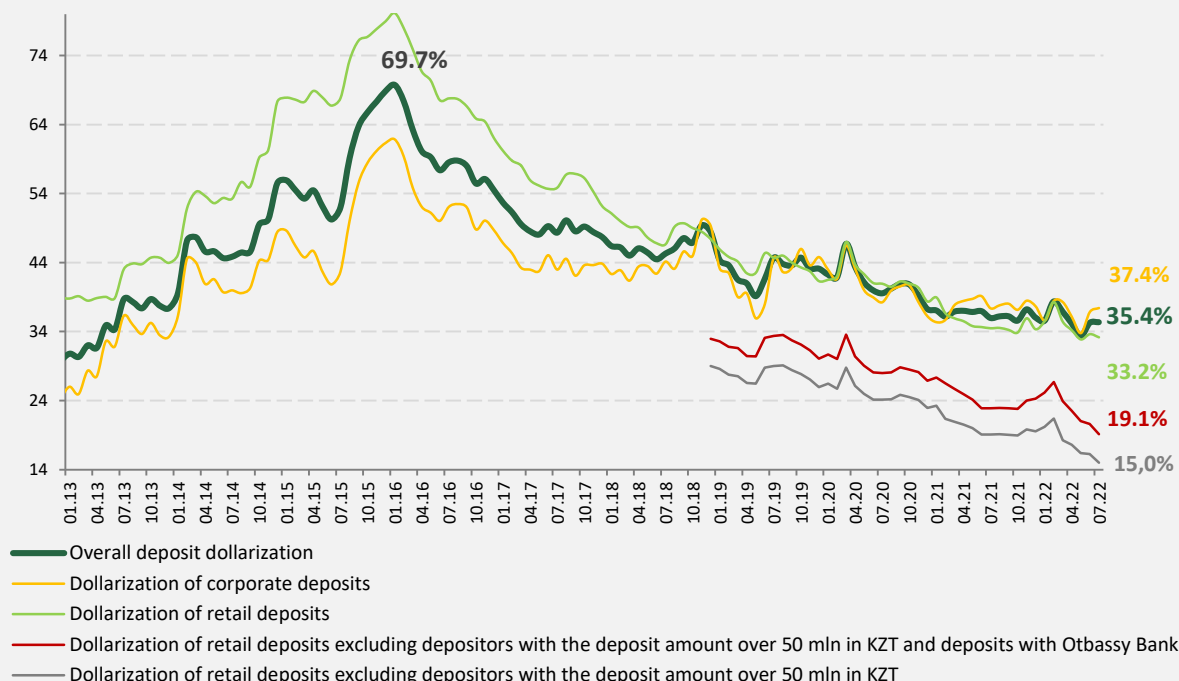
<sup>1</sup> Financial depth of the economy shows to what extent the business, households, and the general government finance their functioning at the expense of capital markets, banks and other financial intermediaries



depositors is insignificant and does not fully reflect the preferences of the majority of depositors. Thus, dollarization of individuals without large deposits over 50 million tenge accounted to 15.0%.

It is worth mentioning that the transition to a new monetary policy regime was also accompanied by the measures to increase attractiveness of the tenge-denominated instruments by setting higher interest rates on such instruments as well as by offering higher insurance rates on the population's deposits in the tenge<sup>2</sup>.

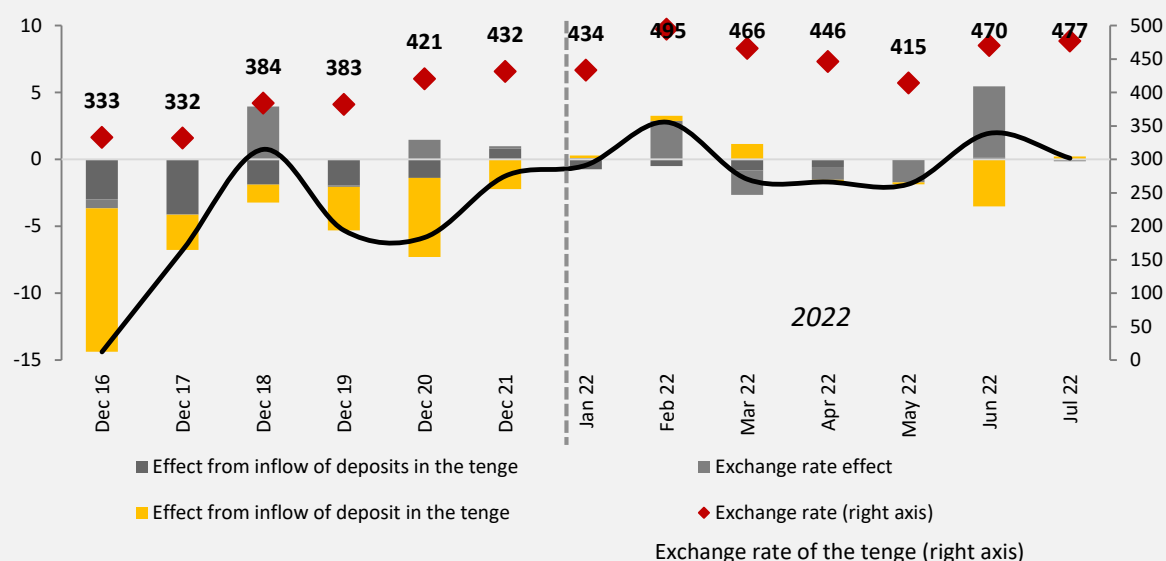
**Figure 1. Deposit Dollarization, %**



From the time of transition to the inflating targeting, given the existing trend for dedollarization, in some periods dollarization was increasing, mainly because of the exchange rate revaluation. In 2016–2021, the only period when the growth of dollarization was observed (at the end of the year), was 2018 (from 47.7% in December 2017 to 48.4% in December 2018). The growth occurred amid depreciation of the national currency by 15.6% from 332.3 tenge to 384.2 tenge. At the same time, without regard to the exchange rate revaluation, a significant differential between interest rates on the tenge and foreign currency deposits and inflows of deposits in the tenge would lead to lower dollarization at the end of 2018. The growth of dollarization in February 2022 to 38.4% (from 36.0% in December 2021) occurred due to depreciation of the national currency by 14.6% from 431.8 tenge to 495.0 tenge (Figure 2).

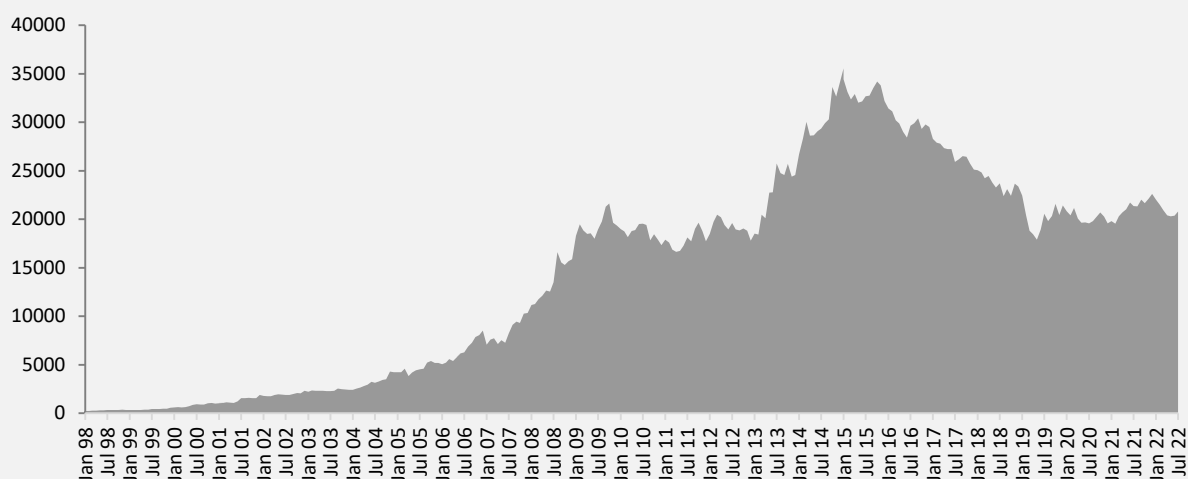
<sup>2</sup> The amount of guaranteed reimbursement by the "Kazakhstan Deposit Insurance Fund" JSC on foreign currency deposits of the population is 5 mln tenge, on deposits in the tenge - 10 mln tenge, on savings deposits in the tenge – 20 mln tenge

**Figure 2. Change in Dollarization in the Banking System, YoY, (MoM, since the beginning of 2022), pp**



It is worth mentioning that the downward trend in the share of foreign currency deposits is seen not only in dollarization figures but also in the volume of foreign currency deposits (in the equivalent of US dollars), which went down by 33.9% from 31.4 billion US dollars in January 2016 to 20.8 billion US dollars in July 2022 due to a more than a three-fold increase in the tenge deposits from 5.0 trillion tenge to 18.1 trillion tenge (Figure 3). Reduction in the total volume of foreign currency deposits was driven by a higher return on the tenge deposits in foreign currency, as well as the increased insurance coverage from the Kazakhstan Deposit Insurance Fund.

**Figure 3. Deposits in Foreign Currency, in US Dollars**



Thus, based on the existing trend for dedollarization in the recent years, pursuing the policy of flexible exchange rate along with the corresponding monetary policy helped increase the attractiveness of assets in the tenge and amplify the inflow of tenge deposits into the banking system.

## 2.7. Credit Market

The loan portfolio continued to increase against the background of the growth of lending to individuals and legal entities in tenge. Against the background of the high base of last year, there was a slight slowdown in the growth of the loan portfolio of individuals.

Despite the tightening of monetary policy conditions and the increase in the cost of borrowing, the loan portfolio of legal entities continued to grow.

The loan portfolio of STB in July 2022 increased by 27.1% in annual terms, amounting to 20.4 trillion tenge.

The main contribution to the growth of the loan portfolio was made by lending to individuals in tenge. Lending to legal entities in national currency also increased (Graph 24).

Against the background of a high base in 2021, the annual growth rate of the portfolio of individuals slowed to 39.7% in July (from 43.2% in April 2022). The annual increase in consumer loans slowed to 32.5% (35.6%), mortgage loans – to 47.9% (49.8%) (Graph 25).

The annual growth of loans to legal entities in July slowed to 11.6% (from 12.1% in April 2022) against the background of negative net lending in June, accompanied by an annual increase in repayment. Despite the increase in demand (according to a survey of banks in the second quarter of 2022), the growth rate of lending to small businesses decreased from 60.4% to 44.8%. The slowdown was accompanied by an increase in uncertainty amid geopolitical tensions.

There was an increase in interest rates on loans, with the exception of consumer loans. The decrease in the cost of consumer loans was influenced by the launch of preferential car loans and the renewal of marketing promotions by banks, as a result of which the cost of consumer loans decreased from 19.9% in July last year to 16.3% in July this year. The weighted average mortgage rate in July was 8.4% (in July 2021 – 8.1%) (graph 17). A high proportion of preferential programs with low rates in mortgage lending limits the impact of the base rate on mortgage rates.

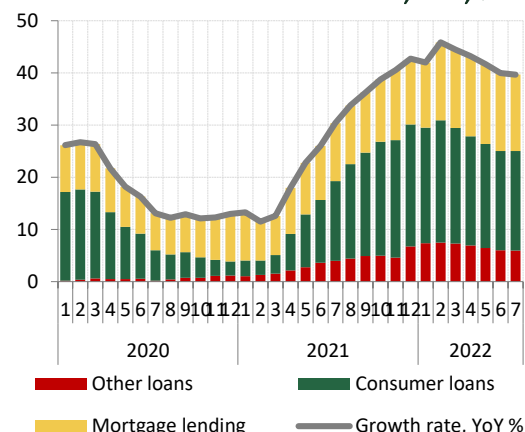
Against the background of tightening monetary policy, the weighted average rate on tenge loans to legal entities in the short-term segment increased to 16.0% in July 2022 (July 2021 – 11.3%). The cost of long-term loans to legal entities increased from 13.1% to 16.3% (graph 26).

Figure 24. Credits to the Economy, YoY, %



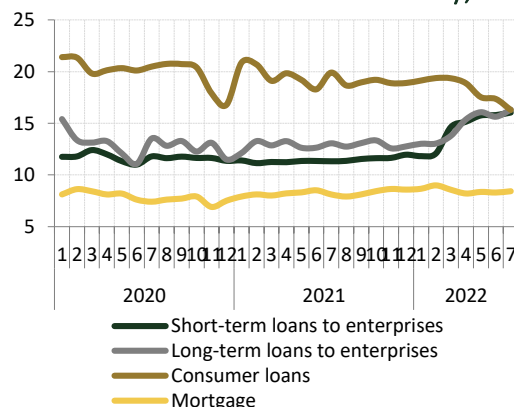
Source: NBK

Figure 25. Contribution by Components to the Annual Growth of Retail Sector Loans, YoY, %



Source: NBK

Figure 26. Rates on Loans in the National Currency, %



Source: NBK



### III. MACROECONOMIC CONDITIONS



### III. MACROECONOMIC CONDITIONS

#### 3.1. External Sector

**The global economic activity started to slow down, while inflationary pressure remains high.**

According to the results of the second quarter of 2022, under the pressure of rising energy prices and growing uncertainty, an almost synchronous slowdown in many economies is observed. Economies of European countries, and Germany in particular, due to high energy dependence, are falling at a faster pace than, for example, the US economy. China is also seeing a rather sharp slowdown, due to recurrent outbreaks of the coronavirus as well as continued problems in the real estate sector (Figure 27).

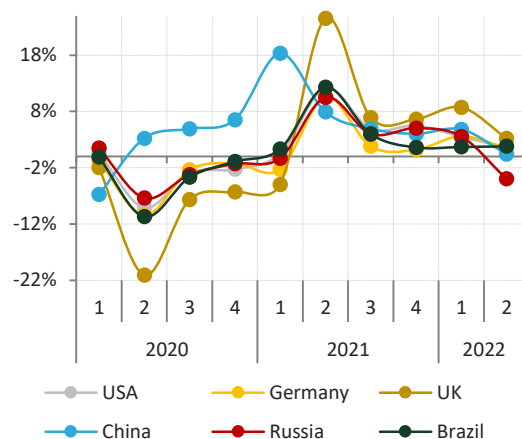
Among the G-7 countries, at the end of July 2022, the UK demonstrated the highest inflation rate. Such inflation rate was observed in the country more than 40 years ago. The main contribution to its growth is continued to be made by food products and energy carriers (Figure 28).

In developing countries, inflation has also been accelerating. Meantime, in a number of developing countries (Russia, Brazil, India and others) inflation started to decelerate. Food products keep making the largest contribution to the inflation growth (Figure 29).

Due to the weakening economic activity in countries, implemented monetary policy of large central banks and the growing risks of a recession in the global economy, the pressure on energy markets has somewhat eased. In July 2022 compared to the preceding month, prices for oil decreased by 8.8%, prices for non-ferrous metals fell from 4% to 17%. Gas prices in Europe have been declining for almost throughout July. At present, given the growing demand, gas prices have broken through the March highs.

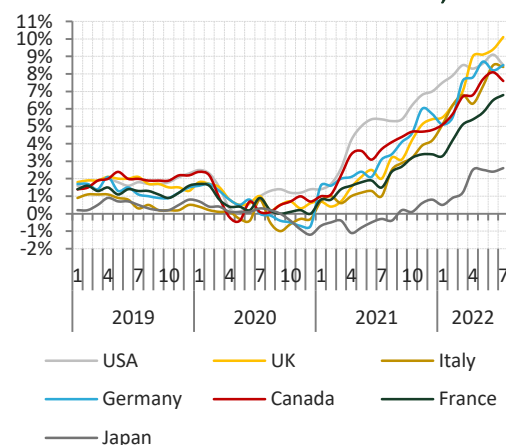
The increased uncertainty in the world has also had a negative effect on the business activity in the industry and service sector. Global Composite PMI at the end of July 2022 decreased from 53.5 points to 50.8 points, which is an evidence of deceleration in production due to the weakening demand and still high prices of raw materials.

Figure 27. Economic Activity in Some Countries, YoY



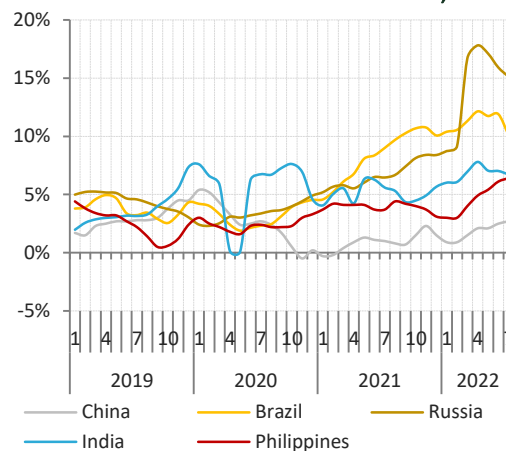
Source: National statistical offices

Figure 28. Inflation in the G-7 Countries, YoY



Source: National statistical offices

Figure 29. Inflation in Developing Countries, YoY



Source: National statistical offices

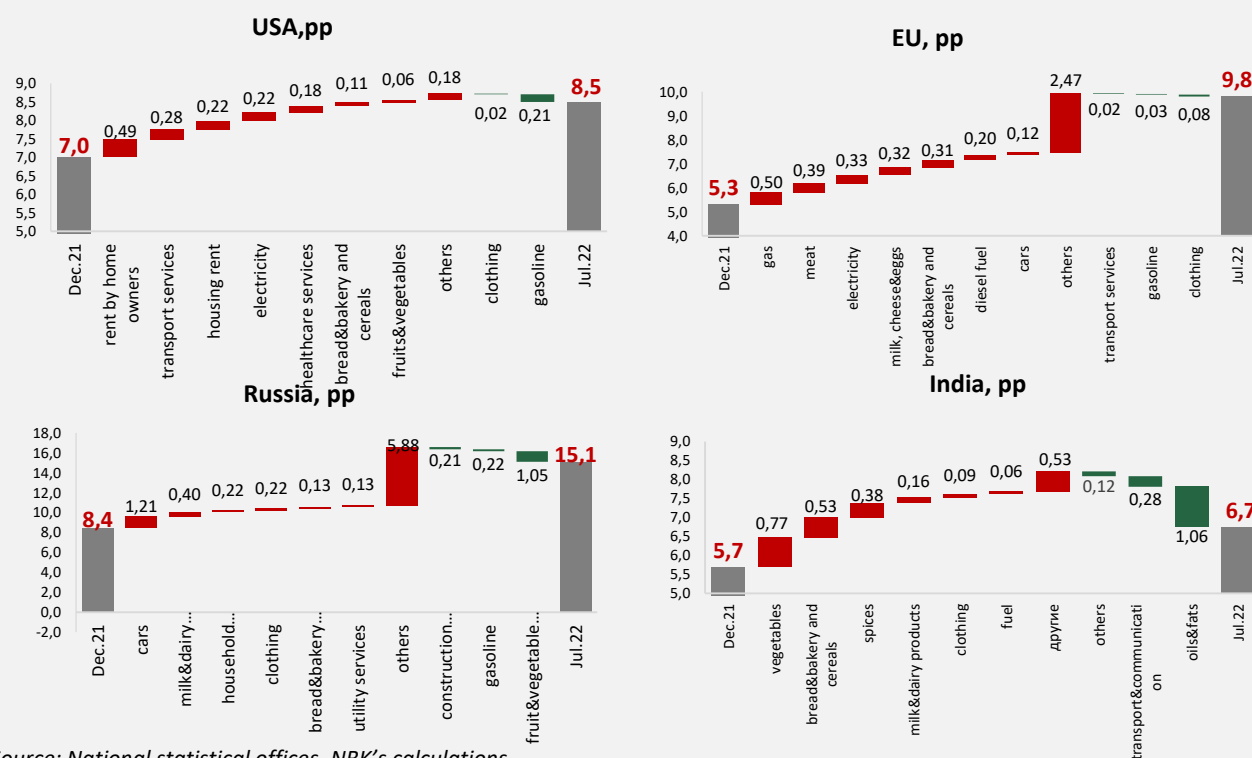
### Box 3. Inflation in Some Countries of the World

Since the spread of the Covid-19 pandemic, the main drivers for acceleration of inflation have somewhat changed in the structure of inflation in countries. Before, due to the restrictive measures, food, medicines, computers, and other items showed a rapid rise in prices. At present, under the pressure of various factors from country to country, a slightly different picture can be observed.

For example, in the United States, from December 2021 to July 2022, the lifting of quarantine restrictions and a significant increase in housing prices provoked a surge in housing rent prices (Figure 1). During this period, the contribution to the housing rent price inflation increased by almost 0.71 pp. In addition, given a rise in world prices for energy resources and grain crops, the growth in prices for transport services, electricity, bread and bakery products and cereals accelerated. At the same time, clothes and gasoline had a disinflationary effect due to weaker consumer demand.

In the EU, due to the aggravation of geopolitical risks worldwide, prices for gas and electricity have risen significantly since the beginning of the year, and their contribution to inflation has increased by 0.83 pp. As a result of a significant increase in world prices of meat, dairy products and cereals, prices for many food products also accelerated. As in the case of the United States, the contribution to inflation by clothing and gasoline has decreased because of the weakening of consumer activity (Figure 1).

**Figure 1. The Change in Prices for Some Goods and Groups in Inflation, by Country**

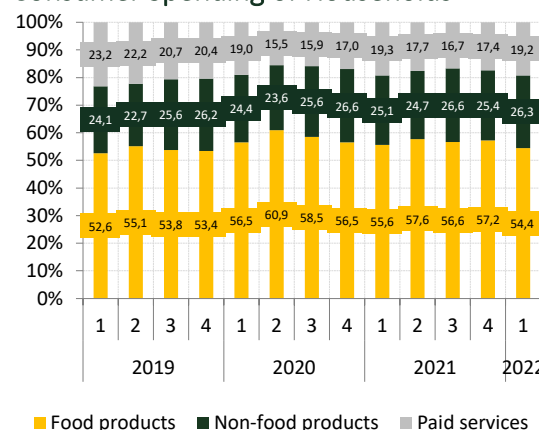


Source: National statistical offices, NBK's calculations

In Russia, because of depreciation of the ruble at the beginning of this year, the shortage of cars from dealers and sanctions from the West, a spike in prices for cars continued. Since the beginning of the year, their contribution to inflation has increased by 1.21 pp. The imposed sanctions also led to the growth in prices of household appliances, their contribution increased by 0.22 pp. Rising prices of these and other goods offset the impact of seasonal disinflationary processes in the vegetable market (Figure 1).

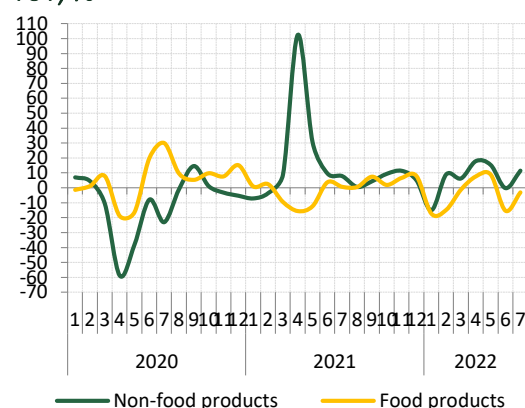
In the inflation structure of India, food prices grew the fastest, their contribution increased by 1.84 pp as a whole. Disinflation in prices for meat, transport and oils had some restraining effect on inflation (Figure 1). International organizations suggest that in the short term, world energy prices will gradually decline. World food prices, due to an anticipated increase in supply, are also expected to decline. At the same time, given that there is still an elevated uncertainty around the world regarding future developments in Ukraine, the risks of further price growth remain heightened. The IMF expects that this year inflation would reach 6.6% in advanced economies and 9.5% in developing countries.

Figure 30. Structure of Nominal Consumer Spending of Households



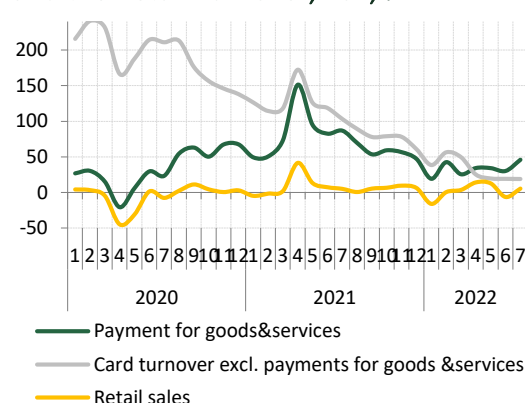
Source: ASPR BNS

Figure 31. Dynamics of Retail Sales, YoY, %



Source: ASPR BNS, NBK's calculations

Figure 32. Cash Flows on Bank Cards of the Population in the 2016 Prices and the Retail Turnover, YoY, %



Source: ASPR BNS, NBK's calculations

### 3.2. Development of the Domestic Economy

**Household consumption in the first quarter of 2022 demonstrated negative dynamics because of a decreased turnover in January in the light of imposition of the state of emergency virtually across the whole country. Nevertheless, proxies for the consumer demand indicate a further recovery of its dynamics.**

The structure of consumer spending that has changed significantly since the onset of the pandemic has not fully recovered. The share of spending on services is still below the pre-pandemic levels (Figure 30).

After the January contraction, the turnover of non-food products, despite a high statistical base of 2021, has quickly recovered, which is an evidence of persisting household consumer demand. On the contrary, the demand for food products had been recovering not so actively retaining its unstable dynamics throughout the year (Figure 31).

At the same time, since the beginning of the year, the monthly dynamics of non-food product turnover have been showing deceleration and some stabilization. Meantime, the turnover of food products has been accelerating its growth rates since February of this year due to the increased demand in the light of high inflationary expectations, feverish demand in certain food markets and moderate income of the population.

Additional indicators of the household demand also show that consumer sentiment of the population is persisting and has a positive pattern. One of such indicators is the dynamics of cash flows on payment cards of individuals that are divided into payments for goods and services and all other operations in the form of transfers and payments. The dynamics of these indicators demonstrate a certain slowdown compared to 2021 and repeat the dynamics of consumer goods turnover (Figure 32). The dynamics of transfers and payments on payment cars of the population in 2020 demonstrated significant growth, which is most likely associated with an active shift of the population to cashless payments (Figure 32).

Due to a more than 40% increase in minimum wage, the growth of payroll fund in the real sector had accelerated this year and, for the first time in a long while, exceeded the growth rates of the payroll fund in the public sector. A sizeable increase in the payroll fund was observed in the construction sector, accommodation and catering services, transport and trade. In this context, the nominal wage growth in the second quarter of 2022 was similar to that in the first quarter of this year. However, due to a higher inflation in the second quarter, real wages decelerated from 12.7% to 8.9% compared to the beginning of the year (Figure 33).

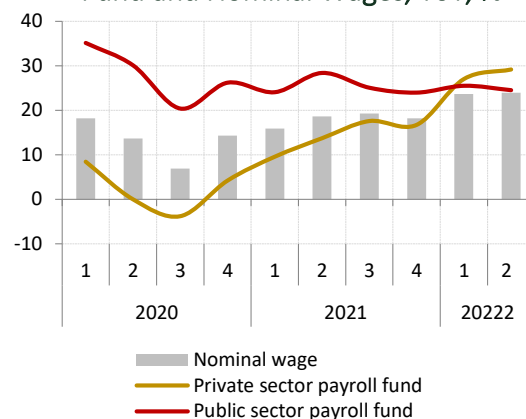
Given a high share of labor compensation in the structure of revenues, the raising of wages supports the growth in real income of the population (61% in earnings at the end of 2021). In the structure of social expenditures, the budget spending for retirement benefits is decreasing and the spending on other transfers, on the contrary, is increasing (Figure 34).

**The investment activity in the economy is accelerating, being associated with a spike in fixed capital investments in the mining industry (Figure 35).** Constructions works, which have been an ongoing source of investments since 2019, remain as a key driver for the investment activity. Investments in renewal of property, plant and equipment and other types of investments still represent an unstable and volatile part of fixed capital investments.

At the industry level, investments are growing in the majority of economic sectors. Investments in the mining industry, trade and the public sector branches have been accelerating.

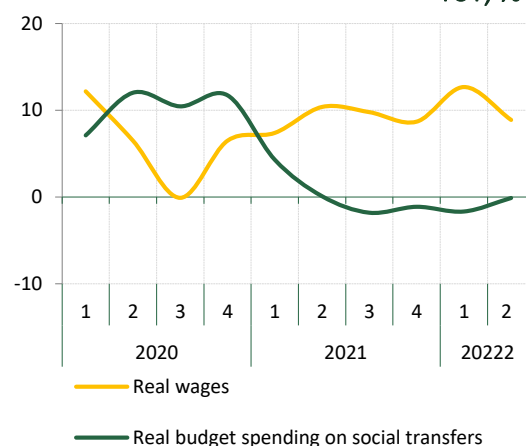
A negative trend in the investment activity is persisting in the electricity supply sector. This industry is characterized by a very sluggish and volatile investment activity. Based on its performance in 2021, the electricity supply industry was the sector with a high wear and tear of its property, plant and equipment and with a low degree of PPE replacement.

Figure 33. Dynamics of the Payroll Fund and Nominal Wages, YoY, %



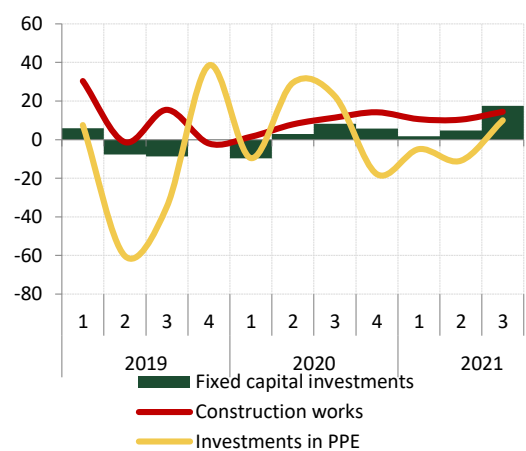
Source: ASPR BNS

Figure 34. Dynamics of Real Income of the Population and its Components, YoY, %



Source: ASPR BNS, NBK's calculations

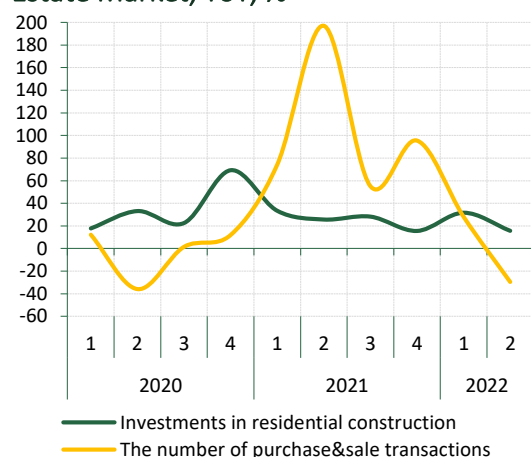
Figure 35. Fixed Capital Investments, YoY, %



Source: ASPR BNS

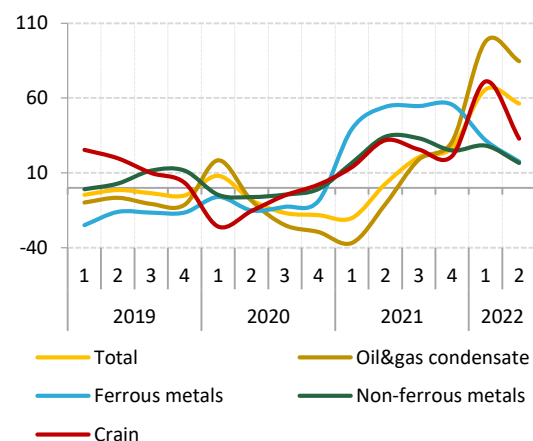


Figure 36. Investments into Residential Construction and Activity in the Real Estate Market, YoY, %



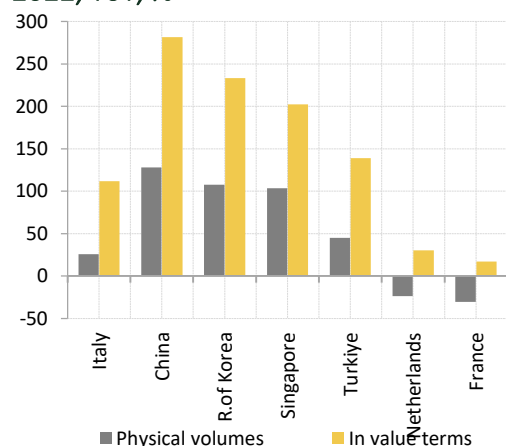
Source: ASPR BNS

Figure 37. Exports by Major Commodity Groups, Cumulative, YoY, %



Source: ASPR BNS

Figure 38. Oil Exports on a Country-by-Country Basis in the First Half of 2022, YoY, %



Source: ASPR BNS

After the boom in the real estate market, this year the market is somewhat cooling, due to the increased sufficiency threshold for withdrawing retirement savings from the UAPF.

Investments in residential construction have been decelerating and purchase/sale transactions in the real estate market have decreased significantly since April 2022 (Figure 36).

Despite decline in activity in the housing market, no significant price reversal is observed. The monthly dynamics throughout the year (and, therefore, the annual dynamics) show that the upward trend of prices in the housing rent market, primary and secondary housing is continuing.

During the first half of 2022, Kazakhstan's foreign trade went up by 39.4% in annual terms mainly owing to the increase in export prices for oil and metals as well as to the growing cost of imported goods in the context of high inflation in trading partner countries, disruptions in logistics and supply chains and depreciation of the tenge.

The annual growth of exports in January-June of this year accounted for 56.3% due to the 84.7% increase in exports of oil, which prevails in total exports (the share – 58.8%) (Figure 38). At the same time, oil supplies in kind went up by 9.6%; on a country-by-country basis, the increase in supplies to Italy by 25.7%, China – by 2.3 times, and the Republic of Korea – by 2.1 times was observed (Figure 39). During the first half of the year, exports of inorganic chemicals, precious, rare earth and radioactive metals expanded due to the 84.7% increase in supplies to Russia.

As regards non-precious metals, there is a trend towards reduction in supplies. Among ferrous metals, exports of zinc to China and aluminum to Turkiye decreased. Supplies of ferro-alloys to China and of flat rolled metal and iron ores to Russia also contracted.

Among food products, exports of flour to Afghanistan increased due to the gradual stabilization of situation in the country, and exports of oils and fats to China and Uzbekistan went up as well. Among agricultural production, exports of wheat and meslin to Iran and Turkmenistan have grown; however, exports of barley to Iran as the major buyer of this grain culture in the prior years have dropped.

In January-June of this year, imports went up by 14.8%, and on a country-by-country basis, imports from the EAEU member countries increased by 7.3%, namely, from Russia – by 7% (the share – 38.5%) and from China – by 25.4% (21.6%) (Figure 40).

In the structure of food products, physical supplies of meat and tea declined whereas imports of milk increased. The export ban imposed by Russia had caused contraction in sugar imports. Imports of alcohol and soft drinks grew significantly.

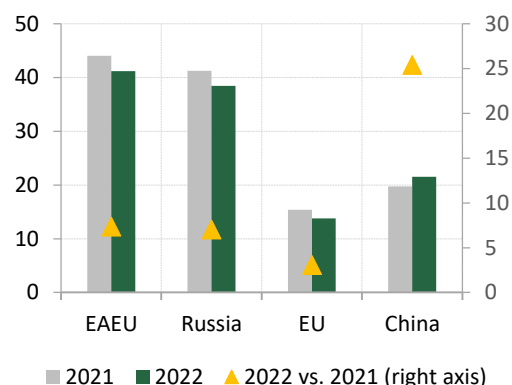
Among non-food products, imports of personal care products, cosmetics, detergents and cleaners decreased. Meanwhile, imports of medications from Germany and Türkiye increased. At the same time, clothing imports decreased due to the reduced purchases from China. The import of cars, computers, monitors and projectors has declined. As regards interim goods, imports of fertilizers from Russia, tires and covers from China went up. In investment goods, shipments of spare parts for motor vehicles are on the rise, while imports of transformers have fallen.

In the second quarter of 2022, the annual growth of export prices decelerated due to a lower rise in prices for minerals and non-ferrous metals (Figure 41).

Export prices for metals were growing at a low pace in the face of coronavirus in China, cut-back in the industrial production in the EU due to high energy prices, the raising of the US Fed rate and concerns about possible disruptions of supplies from Russia. In the agricultural production, prices for wheat and barley decelerated, and prices of flour declined in the flour and cereals industry.

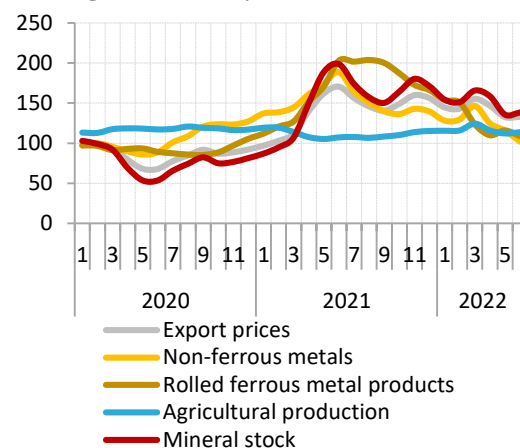
A rise in import prices in the second quarter of this year has slowed down slightly (Figure 42). Among non-food products, prices of medications decelerated a lot and prices of cars decreased. Meantime, the growth in prices for detergents and cleaners, textile and textile articles accelerated. After a significant price deceleration in the first quarter of this year, inflation of construction materials kick started in the light of depreciation of the tenge against the US dollar and the growing demand in the construction season. Apart from that, among food products, prices for meat, cheese, cottage cheese, eggs and sugar accelerated abruptly.

Figure 39. Shares of Countries in Imports and the Change in Volumes of Imports in Annual Terms in the First Half of 2022, %



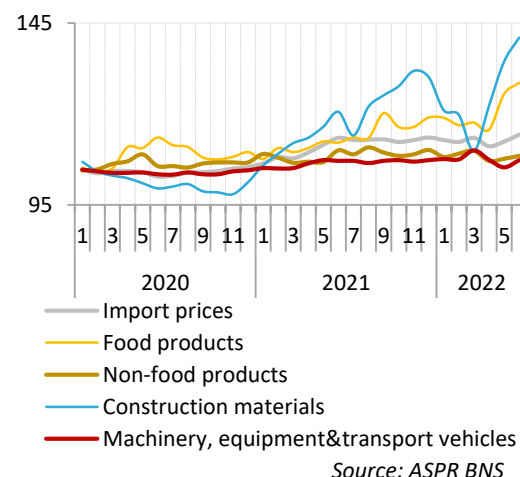
Source: ASPR BNS

Figure 40. Export Price Index, YoY



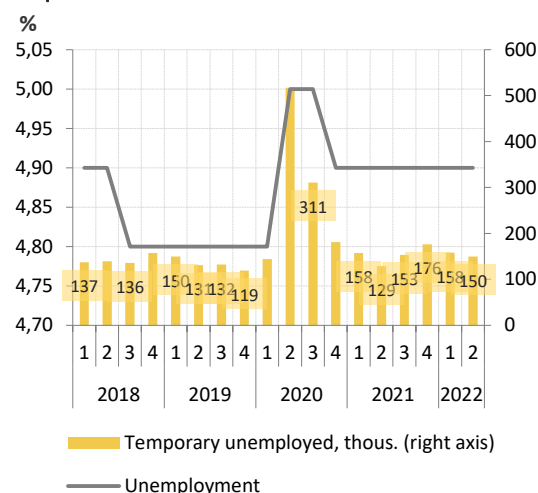
Source: ASPR BNS

Figure 41. Import Price Index, YoY



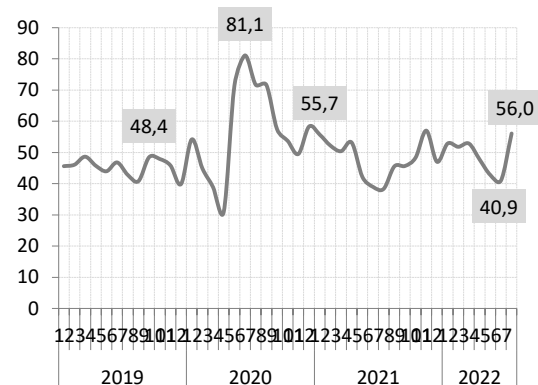
Source: ASPR BNS

Figure 42. Unemployment Rate and the Temporary Unemployed Population



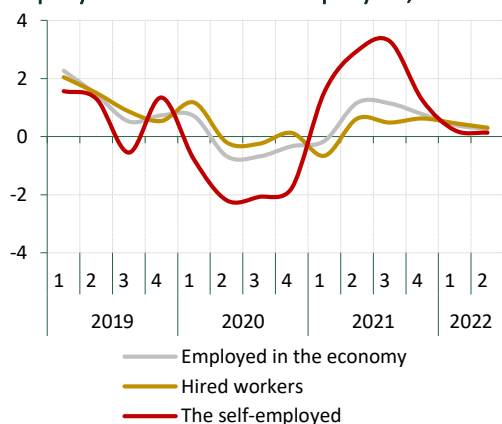
Source: ASPR BNS

Figure 43. People who Applied to the Public Employment Authorities as Job Seekers, Thousand Individuals



Source: ASPR BNS

Figure 44. Employed Population, Employees and the Unemployed, YoY



Source: ASPR BNS

### 3.3 Labor Market

In the second quarter of 2022, the situation in the labor market remained stable. The numbers of labor force increased slightly by 0.26%, with a similar growth in the number of unemployed in the economy (by 0.22%), which led to retention of the unemployment rate at 4.9%.

Given a stable situation in the labor market, the number of temporary unemployed individuals remained at the pre-pandemic level (Figure 42). In this context, the number of applications by the people to the employment authorities in the second quarter was low with some increase in July of this year (Figure 43).

This year, the employment after the downturn periods and the corresponding recovery in 2021 demonstrates the near-zero dynamics. This was nurtured by a respective sluggish growth in the number of employees and the self-employed population (Figure 44).

A sluggish growth in the number of employees in the second quarter of 2022 is related to the downsizing in most sectors of the economy. The downturn in some sectors is persisting and has been lasting for quite a while. Such sectors include agriculture, arts, entertainment and leisure, activities in the area of administrative and ancillary service, and the manufacturing industry. Reduction in the number of employees in the above sectors have been observed for a long time with the periods of short-term restoration in their numbers.

In the construction sector and real estate operations, the ongoing increase in the number of employees have been observed since 2019 and this trend was discontinued in the second quarter of this year.

In general, in many sectors of the economy the unstable dynamics of the number of employees has been observed since 2019.

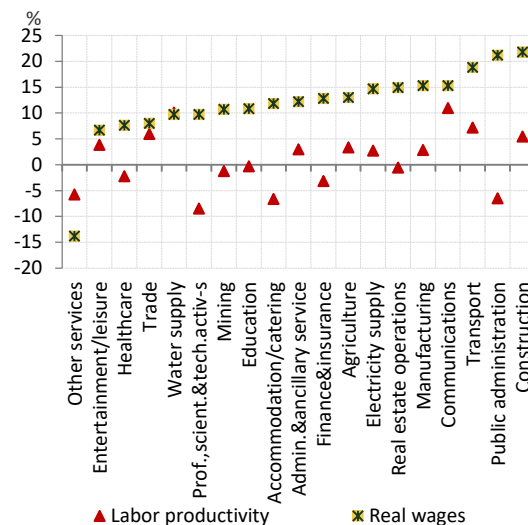
The growth of the self-employed population in the economy is stemming from their increased numbers in the construction sector, trade and transport, which account for 45% of all self-employed in the economy.

A steady outpacing of real wage growth rates over the growth in labor productivity is an evidence of persisting pro-inflationary pressure on the domestic prices from producers.

Thus, in the second quarter of this year, the growth in labor productivity was falling behind the real wage growth virtually in all sectors of the economy except other services (Figure 45). Such increase in real wages not supported by the corresponding growth in productivity creates risks of a pass-through of expenditures onto the end consumer.

According to the reports submitted by large, medium-sized and small enterprises, in the first quarter of this year, there was a significant growth in prime cost across the economy. Specifically, a strong growth in the prime cost was observed in the construction sector, trade and agriculture.

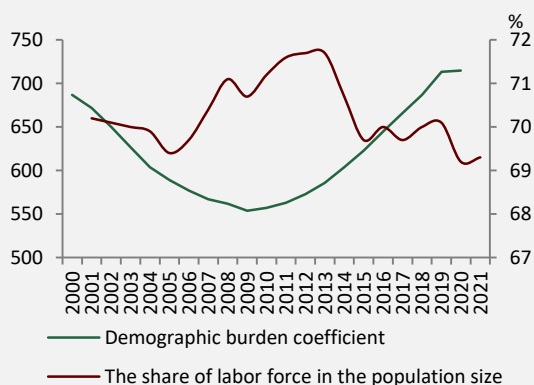
Figure 45. Labor Productivity and Real Wages by Types of Economic Activities in the 2<sup>nd</sup> Quarter of 2022, YoY, %



Source: ASPR BNS, NBK's calculations

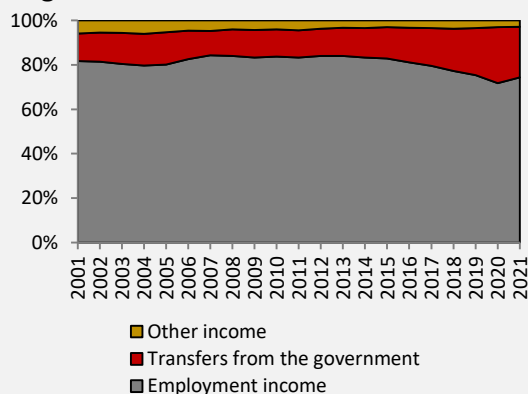
#### Box 4. The Demographic Burden in Kazakhstan

Figure 1. Dynamics of the Demographic Burden Coefficient per 1000 Individuals



Source: ASPR BNS

Figure 2. Structure of Personal Income



Source: ASPR BNS

The demographic burden on the labor force in Kazakhstan has been continuously growing since 2008 and has exceeded the level of 2000. This trend in the coefficient is inversely proportional to the change in the labor force within the population size and is related to the specifics of ongoing demographic processes in our country (Figure 1).

The demographic burden shows the burden on the able-bodied population from children and the elderly. At present, in developed countries, the burden by the elderly prevails, in contrast to developing countries, where the burden from children predominates.

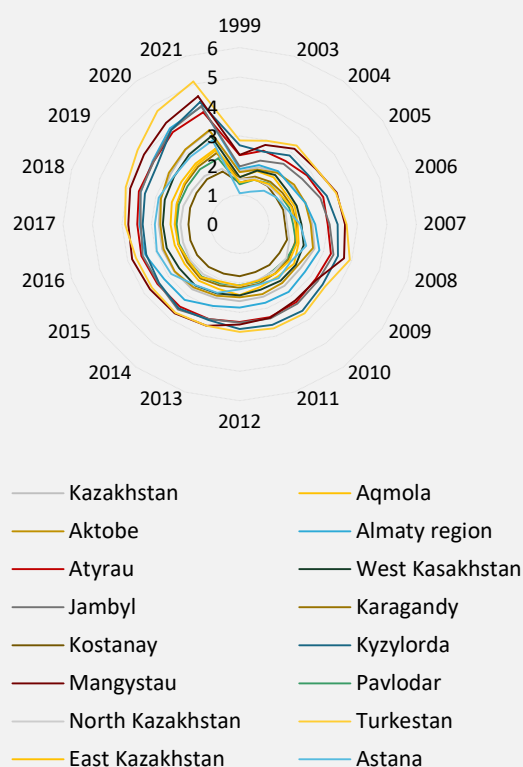
In Kazakhstan, similarly to developing markets, there is a large share of the demographic burden from the youth. However, the dynamics of the burden coefficient on the part of the population above the working age also have an upward trend, and the pressure from the pensioners is growing from year to year. As a result of this trend, a heightened burden on the labor force is formed, which leads to the increased pressure on the budget in terms of social security and the availability of public goods.

This influence is directly manifested through a gradual increase in the share of transfers from the government in the structure of nominal money income of the population. Thus, their share in 2021 compared to 2001 increased by almost 10 pp, along with a reduction in the share of income from employment (payment for hired labor and income from self-employment) (Figure 2). Retirement benefits account for a larger portion of

social transfers and the share of income from public welfare payments and other types of social support from the government has increased over the recent years.



**Figure 3. Dynamics of the Birth Rate Index by Regions**



Source: ASPR BNS

The growing burden on the labor force is a consequence of positive demographic processes, such as an active increase in the total birth rate in the country (to 3.3 in 2021) and an increased life expectancy. Despite the positive factors, the growth of the labor force falls behind the growth rate of the population in the country, leading to an increase in the workload. Such dynamics are connected with the inhomogeneous growth of the birth rate in the population of different generations. For example, the failure of the birth rate in the 1990s, or the boom of the 1980s that resulted in the movements (entry into or out of the structure) within the structure of labor force of such large and small groups of the population and their (future) children<sup>3</sup>. Given the above factors, the numbers of able-bodied population in the long term (until 2050) will grow, but unevenly, and periods of growth in the labor force in the population will be replaced by periods of decline.

At present, the most active birth rate growth is observed in the south of the country, where the maximum total fertility rate is observed in the Turkestan region and is equal to 5.1 (Figure 3). Despite such a high birth rate, the southern regions are characterized by a smaller share of the labor force in the total number of the population, which is partly due to the lowest level of women's participation in the labor force in the country.

Given a high child dependency ratio in Kazakhstan, in order to reduce the pressure on the labor force and, consequently, on the budget, it is necessary to take into account the quality of growing human capital and create conditions for increasing the participation of the population in the labor force. Now, the country experiences imbalances in providing the population with social benefits. A striking example is a decline in the provision of children with pre-school organizations on a national scale, the reduction in the total number of secondary schools, as well as the number of construction projects for building new educational institutions.

<sup>3</sup> Sex and age structure of the population of Kazakhstan until 2050 and its potential impact on the country's economy. Orlov K.V. Economic Review of the National Bank of the Republic of Kazakhstan No. 2, 2017

### 3.4 Inflation

At the end of August 2022, the annual inflation accelerated to 16.1% (Figure 47) amid the growing prices for all inflation components. The largest contribution to acceleration of inflation is continued to be made by food prices, which grew by 20.8% in August of this year. The strongest acceleration is observed in the market of non-food products, where the annual rise accounted for 15.5%. The price growth of paid services accelerated to 10.1%.

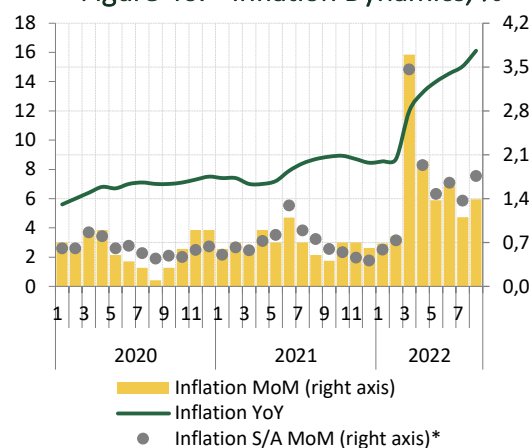
Inflation of **food products** in August of this year accelerated to 20.8% (Figure 48). The exit of high figures of the summer 2021 from the calculation had reflected on deceleration of prices for meat products, oils and fats.

A further rise in prices for food products was offset by deceleration in prices for fruit and vegetable production, apples, grapes and cabbage in particular. Despite a seasonal decline in prices of fruits and vegetables by 4.4% in monthly terms, their annual growth accelerated slightly (14.8%). The seasonally adjusted monthly indicator also points to a relatively high rise in prices for this product category (1.33% MoM).

Prices of dairy products grew by 24.6% given the accelerating growth rates of producer prices (21.8% in July 2022, YoY). Despite lower figures of the FAO Index in July 2022, in annual terms the FAO Dairy Price Index somewhat accelerated and made up 25.4%. On the other hand, prices of forage crops slowed down their growth rate (17.4% versus 23% in June of this year); this may put a downward pressure on prices for animal production in future.

Due to a feverish demand as well as appreciation of the exchange rate of the ruble against the tenge, in August 2022 sugar prices demonstrated considerable acceleration (91.9 YoY, 3.1% MoM). Since this March, prices of this product have gone up by more than 80%. On the other hand, concerns about the prospects for the demand due to expectations of a further global economic downturn in 2022 put a downward pressure on the world sugar price quotes. Thus, in July 2022, the annual increase in the FAO Sugar Price Index slowed down to 3% from 21.6% in April of this year.

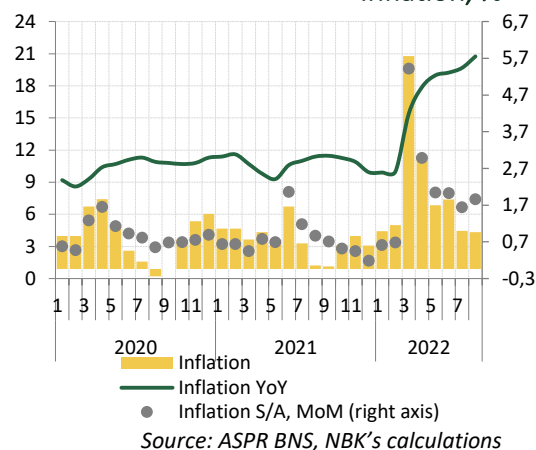
Figure 46. Inflation Dynamics, %



Source: ASPR BNS, NBK's calculations

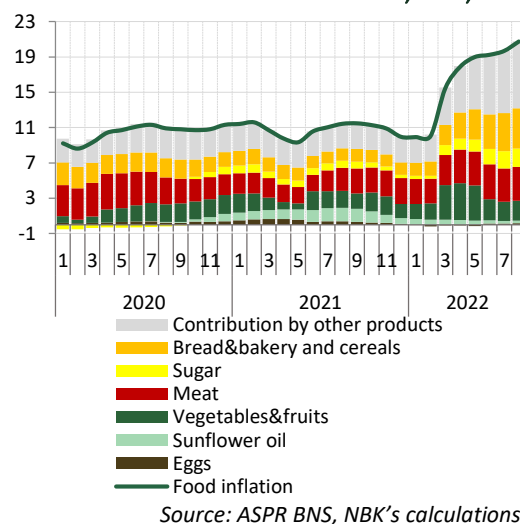
\*- Seasonal adjustment was performed by using the X-12-ARIMA method from 2011 until present

Figure 47. Dynamics of Food Inflation, %



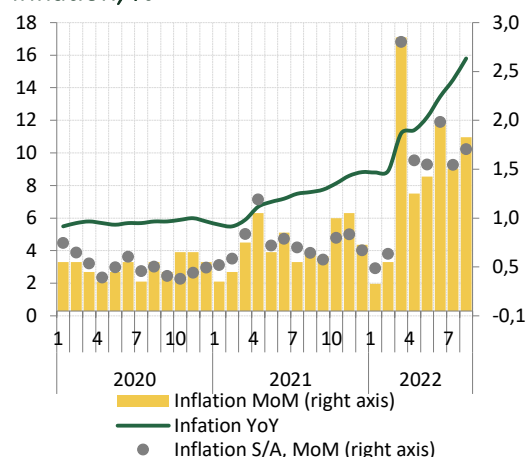
Source: ASPR BNS, NBK's calculations

Figure 48. Contribution of Particular Products to the Food Inflation, YoY, %



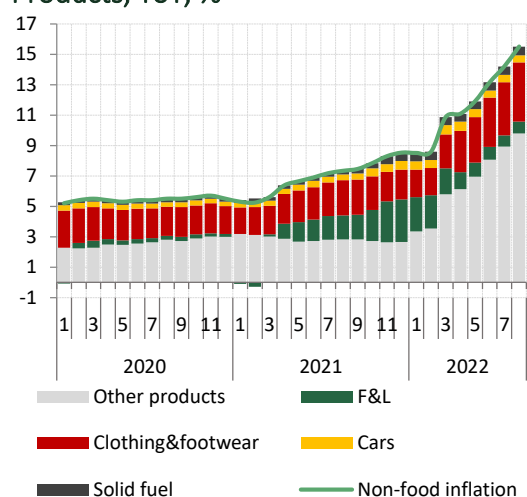
Source: ASPR BNS, NBK's calculations

Figure 49. Dynamics of Non-Food Inflation, %



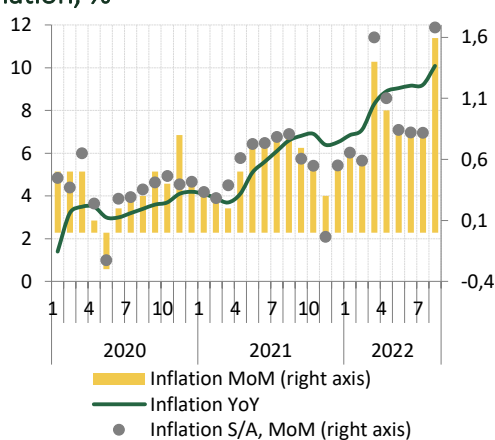
Source: ASPR BNS, NBK's calculations

Figure 50. Contribution by Non-Food Products, YoY, %



Source: ASPR BNS, NBK's calculations

Figure 51. Dynamics of Service Inflation, %



Source: ASPR BNS, NBK's calculations

If the balance between demand and supply in the domestic market comes back to the normal, prices for this product category would decelerate.

Similar to the dynamics of sugar price growth, despite considerable deceleration of cereal prices in global markets (-11.5% MoM; 16.6% YoY), since the beginning of the year, growth rates of domestic prices for flour grinding products and cereals keep accelerating (in August of this year, the accumulated growth since the beginning of the year has amounted to 32.3%; and the annual growth – to 37%) because of limited stocks of wheat at producers of flour and cereal industry and, respectively, acceleration of the producer prices (July – 44.4%).

The annual rise in prices for **non-food products** in August 2022 accelerated to 15.5% (in July 2022 – 14.2%) (Figure 50). Taking into account a high share of the import component in the consumption of non-food products, a stronger price growth was brought about by the pass-through effect from depreciation of the exchange rate of the tenge against the US dollar and the growing cost of transport services (tariffs for cargo transportations by all means of transport grew by 4.9% in July of this year versus 2.7% in June of this year). The largest acceleration of price growth occurred among imported goods. In particular, prices for stationery, personal items, detergents and cleaners, clothing and footwear have accelerated.

Inflation of **paid services** in August 2022 accelerated to 10.1% (Figure 52). High inflationary expectations have led to the rise in prices for some market services. With new academic year starting, there was some appreciation in the price of services of secondary vocational education (12.5%) and university education (18.6%). In the field of culture and recreation, the rise in prices for kiddie rides (14.4%), cinemas (11%) and photographers (19.2%) continued. The cost of services provided by railway transport increased significantly (19.7%). Apart from those, there was an increase in prices for services of hairdressers and beauty salons (13.8%) as well as public catering services (18.4%). Due to the revision by the Government of cap rates for regulated services, in August 2022, prices in this category have been accelerating (1.2%).

### **Inflationary expectations of the population in June-August remained at an elevated level.**

The median assessment of expected inflation over one-year horizon increased from 13.8% in May to 16.5% in August 2022. The respondents who expect the price growth over one-year horizon mainly associate it with the increase in prices of food products, with external developments and the movement of the exchange rate (based on the results of the survey conducted in June 2022). The expectations that associate the price growth with deterioration in the epidemiological situation, a possible crops fail or growing income have heightened.

The median assessment of perceived inflation (for the past 12 months) increased from 21.3% in May to 21.6% in August 2022 (Figure 21).

In general, a perceived rate of inflation has been persistently high over the recent months, having reached its all-time high in June-August (since 2016).

**Inflation expectations of enterprises also increased during the last two quarters (Figure 54).** The percentage of enterprises that expect a more rapid price growth over one-year horizon is 30.3%. In particular, inflation expectations for a year ahead increased in such sectors of the economy as the manufacturing industry, information and communication, and trade.

At the same time, enterprises anticipate deceleration of prices for final products in the third quarter of this year compared to the first half of the year.

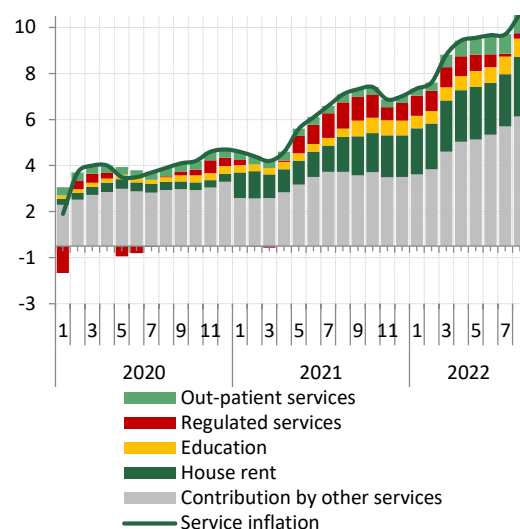
### **3.5. Fiscal Policy**

**In the first half of 2022, given the increase in transfers from the National Fund and the growth in tax revenues, a low budget deficit has been observed.**

In January-June 2022, the national budget deficit amounted to 649.0 billion tenge, having contracted by 42.9% compared to the corresponding period of 2021 (in 6 months of 2022 – 1.6% of GDP). Reduction in the budget deficit, in the first instance, was driven by an outstripping growth of revenues over expenditures (the growth of 39.3% and 18.7%, respectively).

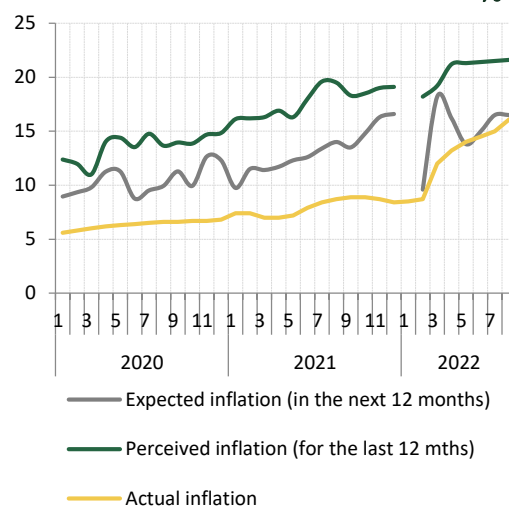
During January-June 2022, the revenue side of the budget received 2 857.9 billion tenge of official transfers, where the guaranteed transfer from the National Fund

**Figure 52. Contributions to the Paid Services Inflation, YoY, %**



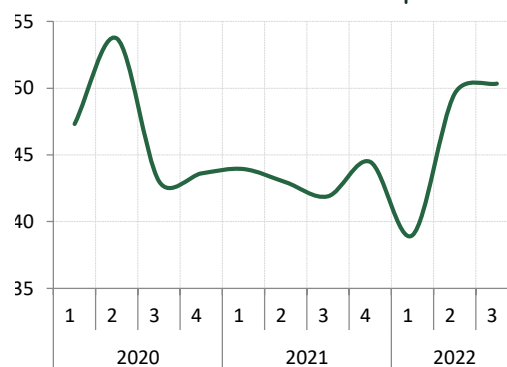
Source: ASPR BNS, NBK's calculations

**Figure 53. Median Assessments of Expected and Perceived Inflation, YoY, %**



Source: ASPR BNS PK, FusionLab: public poll

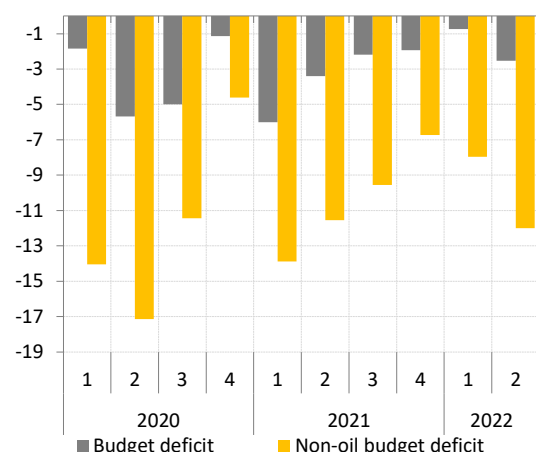
**Figure 54. Inflation Expectations of Enterprises for a Year Ahead, Balance of Responses\***



Source: NBK

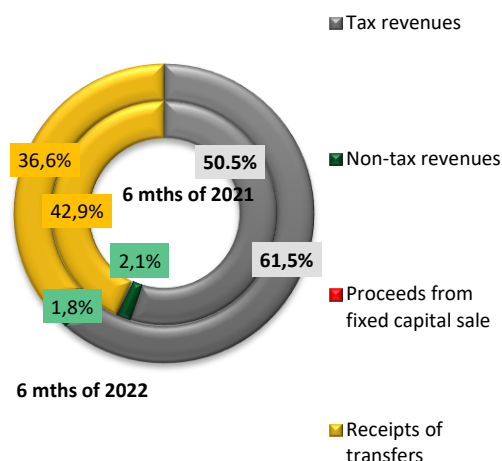


Figure 55. Overall and Non-Oil Deficit of the National Budget, as % of GDP



Source: MΦ PK

Figure 56. Structure of the National Budget Revenues



Source: MF RK

equaled 2 235.5 billion tenge, and the earmarked transfer – 207.7 billion tenge; transfers from subordinate government authorities amounted to 414.7 billion tenge.

In the first half of 2022, the non-oil budget deficit (budget deficit excluding transfers from the National Fund and export customs duties for crude oil), according to the National Bank's estimate, amounted to 3 958.6 billion tenge (10.0% of GDP), which is by 3.4 pp less than in the corresponding period of 2021 (Figure 55). The national budget revenues in January-June 2022 increased compared to the corresponding period of 2021 by 39.3% and totaled 7.8 trillion tenge. The main reason for the growth of revenues is a 56% increase in tax revenues (their share in budget revenues accounted for 61.5%) given the easing of quarantine restrictions, recovery of the economic activity and a rise in prices for major export commodities. The largest growth in taxes in a sector-based breakdown is observed in the mining and manufacturing sectors, the industry and wholesale and retail trade.

The tax revenues structure shows the increased receipts from corporate income tax due to additional tax liabilities paid by large mining and smelting companies as well as from the value-added tax given the growing turnovers on realization of goods, works and services. At the same time, during the first half of 2022, receipts of official transfers went up by 18.9% (the share in the budget revenues accounted for 36.6%) owing to a 51.2% increase in transfers from subordinate government authorities.

The 25.0% increase in non-tax revenues was driven by the growing receipts of other non-tax revenues to the national budget. Reduction of proceeds from fixed capital sale is related to the fact that there were no sales of tangible assets from the state stockpiles (Figure 56).

In January-June 2022, the national budget expenditures amounted to 8.3 trillion tenge, having increased by 18.7% compared to the corresponding period of 2021. The main contribution to the growth in the national budget expenditures was made by: education – a 52.4% increase (the share – 12.0%), debt service – a 27.8% increase (the share – 8.8%) and defense – 38.9% (the share – 5.7%). Along with that, the spending on welfare and social security grew by 10.6% (the share – 25.7%).

**Core inflation** means the inflation, which excludes transitory erratic price changes subject to certain factors of administrative, event-related and seasonal nature. The base rate is the National Bank's key monetary policy instrument that enables to regulate nominal interbank interest rates in the money market. By setting the base rate level, the National Bank determines a target value of the targeted interbank short-term money market rate in order to achieve the goal of ensuring the price stability in the medium term.

**Gross Fixed Capital Formation** is the growth in non-financial assets, which have been used in the process of production for a long time. Gross fixed capital formation includes the following components: a) acquisition, less retirement, of new and existing fixed assets; b) costs for major improvements of tangible produced assets; c) costs for improvement of non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

**Gross Domestic Product (GDP)** is an indicator that reflects the market value of all final goods and services produced during a year in all sectors of the economy within the territory of the country for consumption, exports and saving, irrespective of the national identity of the used production factors.

**Money Supply (M3)** is determined on the basis of consolidation of balance sheet accounts of the National Bank and banks. It consists of cash in circulation and transferable and other deposits of non-bank corporate entities – residents and the population in the domestic and foreign currency.

**Dollarization of the Economy** means the situation where a foreign currency (largely – the US dollar) starts to be used for transactions within a country or in certain sectors of its economy, pushing out the domestic currency from the domestic money turnover, and acting as the means of saving, measure of value and the legal tender.

**Inflation** is an increase in the overall price level of goods and services. In Kazakhstan, inflation is measured by the consumer price index.

**Consumer Price Index** is the change in the overall price level of goods and services purchased by the population for consumption. The consumer basket of Kazakhstan used for calculation of inflation reflects the structure of household spending and contains goods and services, which represent the largest portion in the consumption of population. The CPI is calculated as the ratio of the cost of a fixed set of goods and services in current prices and its cost in the prices of the previous (base) period. The index is calculated by the Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan.

**Inflation Targeting** is a monetary policy regime, which is oriented at achieving a target inflation rate.

**Reverse REPO** is the purchase of a security with the commitment to sell it after a specific period of time and at a specific price. The National Bank conducts reverse repo operations with a view to provide the tenge liquidity to banks against the pledge of securities in accordance with the National Bank's list of collateral. Open Market Operations are regular operations of the National Bank in the form of auctions for liquidity provision or withdrawal in the money market with a view to set interest rates around the base rate.

**Standing Facilities** refer to monetary policy instruments for adjustment of volumes of liquidity, which resulted from the open market operations. Standing facilities are provided as part of bilateral arrangements where the National Bank is one party to the transaction. Such operations are conducted at the initiative of banks.

**Transferrable Deposits** refer to all deposits, which: 1) can be converted into cash at face value at any moment in time without any penalties and restrictions; 2) are freely transferable through a check, draft or endorsement orders; and 3) are widely used for making payments. Transferrable deposits represent a part of the narrow money. Other deposits primarily include savings and time deposits that only can be withdrawn on expiration of a certain period of time, or can have different restrictions which make them less convenient for use in the ordinary commercial transactions and, mainly, meet the requirements established for saving vehicles. In addition, other deposits also include non-transferable deposits and deposits denominated in foreign currency.

**Potential Output.** Reflects the level of output in the economy that can be reached subject to full utilization of inputs and full employment. It reflects the volume of production, which can be manufactured and realized without creating prerequisites for the change in the price growth rates.

**Consumer Basket** means a sample of goods and services, which characterizes the standard level and the structure of monthly (annual) consumption of an individual or a family. Such sample is used to calculate the minimum subsistence level, based on the cost of the consumer basket in current prices. The consumer basket also serves as a comparative basis for estimated and real consumption levels and also as the basis to determine the purchasing capacity of currencies.

**Interest Rate Channel of the Monetary Policy Transmission Mechanism** is the transmission mechanism channel, which describes the impact of the central bank on the economy through the interest rate regulation.

**Direct Repo** is the sale of a security with the commitment to repurchase it after a specific period of time and at a specific price. The National Bank conducts direct repos with a view to withdraw excess liquidity in the tenge.

**Free Floating Exchange Rate.** According to the IMF's current classification, under the floating exchange rate framework a central bank does not establish any pegs including operating ones for the level or the change in the exchange rate, allowing the exchange rate to be determined by the market factors. In doing so, the central bank reserves the opportunity to periodically influence the domestic foreign exchange market in order to smooth out the volatility of the domestic currency exchange rate or to prevent its dramatic movements as well as to ensure the financial system stability.

**Output Gap** is the deviation in GDP expressed as a percentage of a potential output. Expresses the difference between an actual GDP and potential GDP for a certain time interval. Serves as an indicator, which reflects the effectiveness of resources utilized in the country. If an actual output exceeds the potential one (a positive gap), other things remaining equal, the trend of acceleration in the price growth rates would be anticipated because of the overheating of the economy.

**TONIA Rate** represents a weighted average interest rate on one-day repo opening transactions made on the stock exchange with government securities in the automatic repo sector.

**Monetary Policy Transmission Mechanism** is the process, by which monetary policy instruments influence final macroeconomic indicators such as the economic growth, inflation. Narrow Reserve Money is the reserve money excluding other deposits of banks at the National Bank.

## LIST OF KEY ABBREVIATIONS

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**bp** – basis point

**ASPR BNS** – Bureau of National Statistics of the Agency for Strategic Planning and Reforms

**GDP** – gross domestic product

**NOB** – nature of business

**F&L** – fuel and lubricants

**GSs** – government securities

**EIA** – Energy Information Administration

**EM** – emerging markets

**EU** – European Union

**ECB** – European Central Bank

**CPI** – consumer price index

**KASE** – Kazakhstan Stock Exchange

**KSF** – “Kazakhstan Sustainability Fund” JSC

**NBK** – National Bank of the Republic of Kazakhstan

**NF RK** – National Fund of the Republic of Kazakhstan

**OPEC** – Organization of Petroleum Exporting Countries

**pp** – percentage point

**Rosstat** – Federal State Statistics Service of the Russian Federation

**IMF** – International Monetary Fund

**bln.** – billion

**mln.** – million

**MNE** – Ministry of National Economy of the Republic of Kazakhstan

**MF RK** – Ministry of Finance of the Republic of Kazakhstan

**MED** – Ministry of Economic Development of the Russian Federation

**trln.** – trillion

**thous.** – thousand

**TCO** – Tengizchevroil

**CB RF** – Central Bank of the Russian Federation

**FAO** – Food and Agriculture Organization of the United Nations

**Fed** – US Federal Reserve System

