

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

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The forecast of macroeconomic indicators was prepared on the basis of statistical information and the analysis of macroeconomic indicators – as at **01.12.2020**.

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PREAMBLE

On December 14, 2020, the National Bank made the decision to retain its base rate at 9.00% per annum, while narrowing the interest rate band to +/- 1.0 pp.

The global economy is developing under the impact of the COVID-19 pandemic and associated restriction measures. A deep recession in the second quarter of 2020 was followed by recovery trends in many countries in the third quarter. Meantime, restriction measures that were resumed in October 2020 and were driven by a second wave of coronavirus will have a negative effect on the rates of global economic recovery, including the EU and Russian economies. At the same time, the impact of quarantine measures is expected to be less negative than in the spring, owing to a more prepared healthcare system and incomplete restriction for operation of schools, industrial and construction sectors. The Chinese economy continues to recover in the environment of a stabilizing epidemiological situation. In 2021, the economic growth is expected to demonstrate a positive path in the trading partner countries once the epidemiological situation improves and restriction measures are lifted. Amidst a low economic activity and a pent-up domestic demand, inflationary processes in the trading partner countries remain low-key. The annual inflation indicators are maintained at either below the target levels or are equal to targets.

Contraction of Kazakhstan's economy in October 2020, after certain recovery in August-September, appeared to be deeper than anticipated. At the end of January-September 2020, the drop in GDP accounted for 2.8% in annual terms. The major negative effect was exerted by contraction in the mining sector, which was driven by a decline in production of crude oil and non-ferrous metal ores. The negative dynamics is persisting in the majority of branches in the service sector, in trade and transport in particular. The economy is supported by branches of the government sector due to the stimulative fiscal policy.

Deterioration in the economic activity is reflected on the investment performance. At the end of ten months of 2020, contraction of fixed capital investments accounted for 4.7% in annual terms. Reduction in investments is directly connected with the decline of investments in the mining industry because of suspension of a large investment project in the Tengiz oil field. The negative investment dynamics persist in the construction sector and trade. Meantime, a deeper decline of investments is offset by the positive dynamics and sometimes even acceleration of investments in other branches of the real and government sectors of the economy.

In the third quarter of 2020, the consumer demand was slightly recovering, which is an indication of realization of deferred demand. Since August 2020, retail sales indicators are in the positive zone. However, the consumer demand remains being pent-up in the environment of decreasing real money income of the population, the continuing restrictions for operation of trading facilities and a recurrent tightening of quarantine measures on some regions of the country.

In November 2020, the annual inflation accelerated to 7.3%, remaining above the target of 4-6%. However, the dynamics of inflationary processes have been below the National Bank's projections; this is driven by a more moderate than expected growth of prices for food and non-food products in the environment of low business activity and a feeble domestic demand.

In the structure of food inflation, prices for meat and bread and bakery products are decelerating more rapidly. However, despite a general deceleration trend in the food inflation, the growth in prices for certain foodstuffs continued to accelerate. So, in November 2020, the prices of sugar and vegetable oil kept growing.

Since the beginning of pandemic, prices of non-food products were growing moderately. This was determined by the effect of divergent factors. A persistently complicated epidemiological situation in the country is causing the rise in prices for medications; online learning and teleworking increase the demand for household items, which are appreciating in terms of price. Alongside with that, the growth rates of prices for the majority of non-food products remain at the pre-crisis level despite the growing import prices and depreciation of the exchange rate. Largely, this was driven by a feeble consumer demand and a shift in the consumer preferences of the population towards cheaper imported goods, clothes and footwear in particular. A restraining effect on the non-food component is exerted also by the slowing annual growth rates of prices for fuel and lubricants due to a low demand.

The annual inflation of paid services has been accelerating because of the rising prices for regulated utility services. An additional pro-inflationary pressure is put by the increasing prices of certain non-regulated services, specifically services of cobbler shops, repair of cars, hospitals, and education.

Inflation expectations of the population in November 2020 increased, remaining sensitive to imbalances in the food markets (vegetable oil, eggs, and sugar) and to the growing uncertainty against the backdrop of deteriorating epidemiological situation, the tightening of quarantine measures in the country's regions.

At present, there is a minor growth in the oil prices, which is associated with a number of positive news regarding the effectiveness of COVID-19 vaccines, entering into the agreement by OPEC+ member countries on a more moderate increase in supply (oil production will be increased by 0.5 million barrels a day only instead of 1.9 million barrels a day). At the same time, a recurrent imposition of quarantine measures in many countries worldwide amidst the spreading of coronavirus impugn the speed of recovery of the global economy and the demand for oil thus putting a downward pressure on oil quotations.

Given a high degree of uncertainty regarding the recovery of global demand for oil, Brent oil price of 45 US Dollars per barrel on average is considered as a baseline scenario within the frames of the "November-December 2020" forecasting round over the forecasting horizon.

According to the National Bank's forecasts, at the end of 2020 the annual inflation will be at 7.3-7.5%. Certain acceleration of the growth in prices of non-food products and paid services will be offset by the decelerating food inflation. The price growth for foodstuffs will slow down; however, certain foodstuffs will be still putting a pro-inflationary pressure. In the medium-term, inflation will be gradually slowing down to the upper boundary of the target band by the end of 2021 and will be forming within the band until the end of the forecasting period.

In 2020, contraction of the economy is assessed at 2.5-2.7% in real terms. As compared to previous assessments, the forecast was revised towards a minor decline given the deteriorating epidemiological situation in the number of regions of the country and also as a result of the lower actual dynamics of economic activity. The recovery of positive rates of the economic growth will be observed in the medium term as a consequence of the low base of 2020 and a gradual normalization of epidemiologic setting. **In 2021, the economy's growth will account for 3.7-4.0% followed by a minor slowdown in the first half of 2022.**

The key forecast risks include the risk that the situation with the COVID-19 would further deteriorate given the increasing number of infected individuals and an inefficient use of vaccines and the respective tightening of restriction measures within Kazakhstan and abroad. Intensification of the

sanctions rhetoric in respect of Russia after J.Baiden's election as the US President may act as an additional risk. The risk of imbalances between the demand and supply in certain commodity markets also remains high.

I. PROSPECTS OF THE DEVELOPMENT OF THE MACROECONOMIC SITUATION

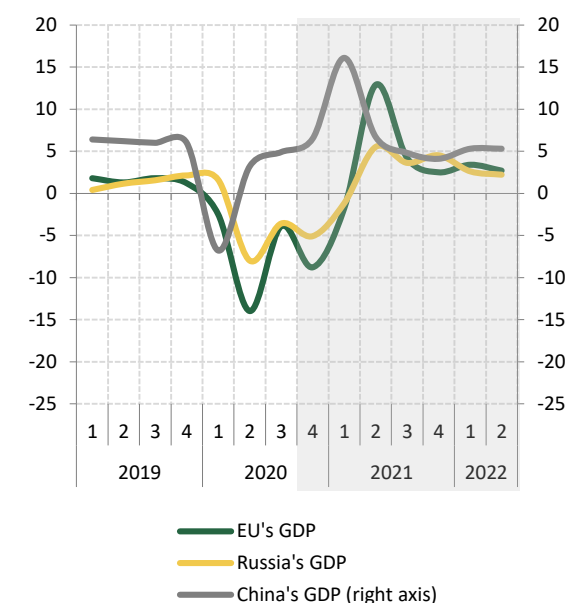
1.1. Forecast Assumptions

The COVID-19 pandemic serves as a determinant for a weaker and erratic development of countries in the nearest future.

Restriction measures that were resumed in October 2020 and were driven by a resurgence of the coronavirus pandemic will negatively affect the recovery rates of the global economy. Meantime, the currently taken measures are less strict as opposed to those undertaken in spring and will have a more limited influence. Due to this reason and based on quite an active recovery of the global economy in the third quarter 2020, forecasts about the economic growth of many countries for 2020 have not undergone considerable changes. However, forecasts for 2021, especially those for the EU member countries, have deteriorated significantly. According to expectations of analysts, the global economy will fully restore the pre-crisis output by 2022-2023 only.

According to forecasts made by Consensus Ecs., in 2020 the EU economy will go down by 7.3%¹ (YoY) on average (a previous assessment of August 10, 2020 – a 7.8% reduction) (Figure 1). The forecast revision was stipulated by new measures on curbing the spread of coronavirus to be implemented in the EU; this will have a negative effect on the GDP growth rates in the fourth quarter of 2020 and, respectively, on the annual growth as a whole. In 2021, as the epidemiological situation improves, a negative effect of quarantine measures will gradually weaken. Along with that, quick recovery of business activity in the EU member countries may be limited by entering into less beneficial trade agreements with the Great Britain. A positive impetus for recovery of the economic upturn will be given by retention of monetary and fiscal stimuli as well as by a rapid recovery of Asian countries, which will be supporting exports in the near future. According to Consensus Ecs., in 2021, recovery of the economy in the EU will be erratic and lengthier than forecasted earlier. Hence, Consensus Ecs. lowered its forecast about the GDP growth from 5.3% (YoY) to 4.5% (YoY) as compared to the previous assessment (assessment of August 10, 2020).

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



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

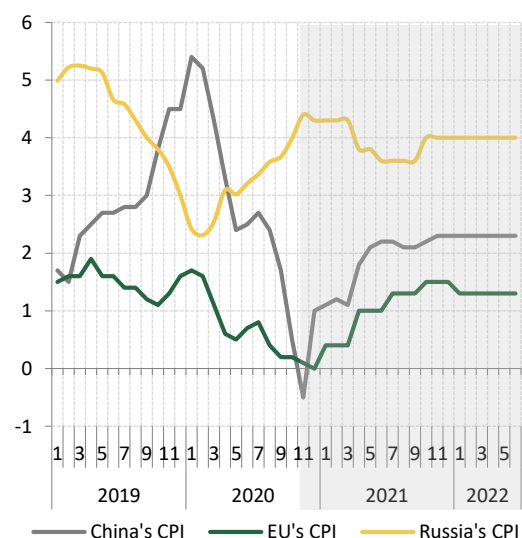
¹ Forecast of November 9, 2020

According to forecasts of international organizations, only China will demonstrate positive growth rates in 2020 among large economies worldwide. According to expectations, before the end of 2020 the economic growth will be supported by the increased industrial output, advancement of lending as well as the resumed uprise in investments and retail trade. Based on the data of Consensus Ecs., China's GDP in 2020 will rise by 2.0%² in real terms (a previous assessment of August 10, 2020 – 2.1%) (Figure 1). The trend for restoration of the economic growth in China will persist in 2021. According to Consensus Ecs., in 2021 the Chinese economy will speed up to 7.9% (a previous assessment of August 10, 2020 – 7.8%). Meantime, a faster recovery may be impeded by potential shock of external demand for exported products as a result of deterioration of the epidemiological situation in the EU and USA which are China's main trading partners. At the same time, mitigation of sanction risks on the part of the USA as a result of J.Biden's winning the elections as well as the anticipated weaker dynamics of the US Dollar against other international currencies may serve as positive growth factors.

In the environment of a faster than expected recovery of exports, relatively stable world oil prices in the second half of 2020 and a strong government support, the downturn of the Russian economy this year is expected to be not so deep as was projected earlier. According to assessments made by Consensus Ecs., the GDP growth rates in Russia in 2020 will decrease by 3.8%³ in real terms (YoY) (a previous assessment of August 17, 2020 – a 5.1% decline) (Figure 1). Thus, in 2021, given a persistently complicated epidemiological situation in Russia and worldwide as well as a feeble domestic demand, the forecast about the GDP growth rates in Russia was revised downwards to 3.1% (YoY) (a previous assessment of August 17, 2020 – 3.4%).

The external inflationary pressure on consumer prices in Kazakhstan because of the pandemic will remain low-key throughout the forecasting horizon (Figure 2).

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



Source: Eurostat, National Bureau of Statistics of China, Rosstat, Central Bank of Russia, Consensus Ecs., European Commission
 * actual inflation in the EU in October 2020 (YoY)

² Forecast of November 9, 2020

³ Forecast of November 16, 2020

In the EU, another quarantine restrictions, falling energy prices and lower VAT rates in Germany will be pre-determining the standing of inflation at extremely low levels until the end of 2020. In 2021 and 2022, the annual inflation will slightly accelerate; however, it will remain suppressed being driven by a relatively low domestic demand, instability in the labor market and anticipated appreciation of the Euro against the US Dollar. Meantime, because of absence of trade deal with the Great Britain the pressure on the part of imported inflation will strengthen.

According to expectations, the decline in food prices that was observed in China in October-November 2020 may persist during the coming few months. Such trend may be of a negative nature since consumers in their expectation of a further drop in prices might keep from purchases thus resulting in a threat of deflation and a feebler economic development. Nonetheless, a recovering consumption and a lower base that have been observed over the most recent months will be supporting an upward path of inflation up to the end of the forecasting period.

In Russia, in the near term, pro-inflation risks will be prevailing over disinflation risks; this is related to an anticipated minor depreciation of the ruble against the US Dollar and high inflation expectations.

In Russia, in November 2020 the annual inflation had unexpectedly accelerated to 4.4%, which was primarily caused by the rise in food prices. In order to ensure the price stability, the Government of Russia has been assigned to undertake appropriate measures including those of administrative nature.

As the business activity in the country normalizes, the annual inflation will slightly decelerate and will stay close to the target level until the end of the forecasting period.

In the environment of a persistently spreading pandemic and the growing uncertainty regarding its further evolution as well as expectations concerning a slower recovery of the global economy, **the policy implemented by central banks will remain adaptive**. Prevalence of disinflation risks in the Russian economy will be also taken into account in the decision-making in the field of monetary policy by the Central Bank of Russia. In turn, the ECB and the US FED will proceed with realization of the long-discussed stimulus

package because of aggravation of the epidemiological situation.

International organizations assess future prospects of the oil market development with caution, since the current positive situation, taking account of fundamentals, is temporary and not well grounded.

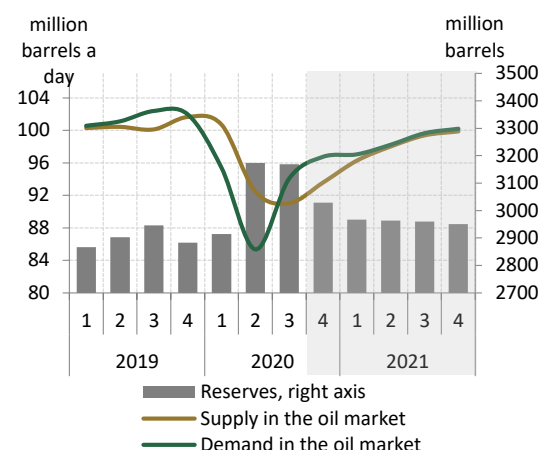
Despite an unfolding situation worldwide because of the pandemic, EIA's expectations about November and December 2020 remain quite positive. By end-2020, the oil deficit is expected to amount to 3.5 million barrels a day. Oil reserves keep going down. The increase in oil consumption and production in December versus October 2020 will account for 3.1% each, respectively. Oil production in the countries outside of OPEC will make up 1.1%, in OPEC member countries – 8.7% (Figure 3).

Therefore, in 2020 the demand for oil is estimated to reach 92.9 million barrels a day, which is by 8.6 million barrels a day less than in 2019. In 2021, the demand is assessed to be at 98.8 million barrels a day, which is by 5.9 million barrels a day higher than in 2020 but lower by 2.7 million barrels a day as compared to 2019 (Figure 4). Oil supply was adjusted slightly downwards for 2020 from 94.6 to 94.4 million barrels a day, and for 2021 – from 98.8 to 98.4 million barrels a day (Figure 5).

Brent oil prices will remain at the existing levels until the end of 2020. Once in 2021 the demand will grow, reduction of global oil reserves will be supporting the rise in quotations. The average annual level of prices in 2021 may make 46.6 US Dollars per barrel.

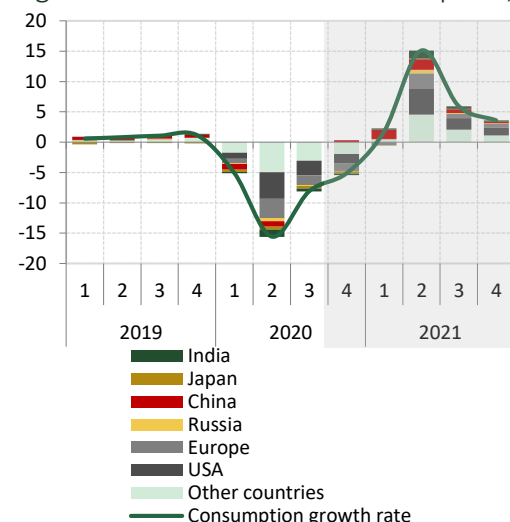
The key risk for the oil market is a further evolution of the COVID-19 pandemic and the associated restriction measures. In December of this year, some countries will start vaccination. In the first instance, the medical staff, patients with acute coronavirus symptoms and elderly people are to be vaccinated. However, a mass vaccination will become feasible after extension of capacities and addressing logistics challenges.

Figure 3. Dynamics of the Global Oil Market



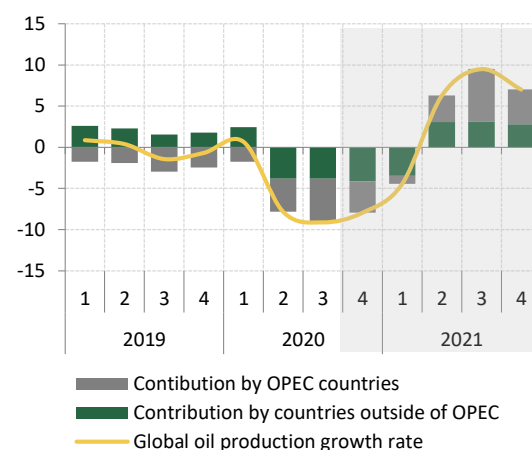
Source: EIA

Figure 4. Global Oil Consumption, YoY



Source: EIA

Figure 5. Global Oil Production, YoY, %



Source: EIA

Alongside with that, the following risks should be highlighted: the risks associated with a possible exit of the member countries from OPEC agreement, followed by a further expansion of oil supply coupled with the US future policy after election of J.Baiden. On December 3, 2020, OPEC+ member countries made the decision about a more moderate increase in a daily oil production. So, if under the previous agreement the rise in a daily production should have been 1.9 million barrels a day beginning from January 1, 2021, under the present agreement oil production will go up by 0.5 million barrels a day only. Meantime, oil demand recovery could be longer because of uncertainties against the backdrop of pandemic.

Taking into consideration the existing situation in the global oil market and the updated forecasts of international organizations, while designing the macroeconomic forecasts for the period from the fourth quarter of 2020 to the second quarter of 2022, the **National Bank has been considering three scenarios for the development of the economy: baseline, pessimistic and optimistic.**

Under the baseline scenario, Brent oil price will be 45 US Dollars per barrel on average and will remain at this level until the end of the forecasting period.

Under the pessimistic scenario, in 2021 the oil price is assumed to go down to 35 US Dollars per barrel on average, being caused by aggravation of the epidemiological situation worldwide, by a longer absence of the vaccine, a longer recovery of the global economy, and by the excess of oil supply over demand.

Under the optimistic scenario, the oil price is assumed to go up to 55 US Dollars per barrel on average in 2021 given a more rapid recovery of the global economy and generation of shortage in the global oil market, thus putting an upward pressure on prices.

1.2 Dynamics of Economic Development under the Baseline Scenario

Dynamics of economic development of Kazakhstan in the third quarter of 2020 was forming below the National Bank's expectations; based on that, the economic growth forecast until the end of 2020 was revised downwards. So, in 2020 the rate of GDP reduction will account for 2.5-2.7%.

This year, a negative contribution is anticipated on the part of all components except general government consumption; this is determined by a countercyclical stance of the fiscal policy. The growth in both payroll expenses and expenditures associated with purchases of goods and services is anticipated.

Consumer demand until the end of 2020 will be gradually recovering in the environment of slight improvement in the epidemiological situation and milder restriction measures as compared to the second quarter of 2020. Along with that, acceleration of the household consumption will be restrained by reduction in real income of the population because of the decreased earnings from self-employment and wages in the real sector related to a sluggish business activity in economic sectors.

The rates of decline in the gross formation are expected to gradually slow down by the year-end due to the recovering investment activity in many sectors of the economy. A continuing reduction of investments in the mining sector will be limiting the gross formation from going into the growth zone.

Exports will be retaining negative dynamics until the end of 2020 due to low oil prices and Kazakhstan's observance of the OPEC+ agreement on reduction of daily production of crude oil. The peak of exports decline will be in the third quarter of 2020 with a minor deceleration of decline by the end of the year. A negative contribution will be also made by the reduced exports of metal ores; however, a certain support to exports of non-ferrous metals will be provided by the growing demand on the part of China.

Imports will be decreasing due to reduction of the domestic demand, thereby limiting a more sizable decline of GDP in 2020.

Forecasts about the GDP growth in the medium term have not undergone significant changes as compared to prior assessments.

In the medium term, as a result of the low base of 2020 and a gradual normalization of epidemic settings, positive rates of economic growth will be recovering. **In 2021, the GDP growth will account for 3.7-4.0% followed by a minor slowdown in the first half 2022.**

Expansion of the consumer activity will be accompanied by economic recovery of real income of the population and consumer lending, normalization of the situation in the labor market and by the improved epidemic settings. Alongside with that, an early withdrawal of retirement savings will additionally support the consumer demand. Investment activity will be demonstrating positive dynamics due to the growing domestic and external demand, government anti-crisis programs and reduction of dependence on imports and also as a result of implementation of postponed investment projects. The recovering dynamics of the investment demand will be more moderate as compared to the increase in household consumption.

A moderate growth of exports will be accompanied by expansion of the consumer demand given a recovery of positive rates of economic growth in countries – Kazakhstan's trading partners. However, a further adherence to the terms and conditions of the OPEC+ transaction, moderate oil output and a high base of exports in the first quarter of 2020 will be restraining the recovering growth of exports of goods and services.

The government consumption, given the allocation of the earmarked transfer from the National Fund of Kazakhstan of 1 trillion tenge in 2021 will continue to demonstrate weakly positive dynamics; however, as compared to 2020, the growth rates will significantly slow down because of reduced expenditures on a major portion of the budget items. A restraining effect on the dynamics of economic activity will be exerted by the growing imports, which will be accompanied by a recovery of the domestic consumer and investment demand. Despite a positive contribution by all components of the aggregate demand (except imports) to the GDP growth, a more active economic growth in the forecasting period will be restrained by a slower than expected recovery of external demand given the downward revision of forecasts regarding development of economies in countries – Kazakhstan's main trading partners. In addition, against the backdrop of another wave of COVID-19 in certain regions of the country, it is anticipated that the processes of normalization of epidemic settings will be lengthier as compared to previous assessments, and they will be limiting a further potential for building up the domestic demand.

In the near term, there will be a negative output gap in the environment of adherence to the OPEC+ transaction, of a limited recovery of the external demand and a weakly positive fiscal impulse. At

the end of 2021, the output gap will come back to the near-zero zone and will be staying at this level until the end of the forecasting period.

Given a more pronounced disinflation effect of the domestic demand, which is intensified because of a recurring imposition of quarantine restrictions in a number of regions, the inflation forecast was revised downwards as compared to the previous assessment.

According to the National Bank's forecasts, by end-2020 inflation will be standing within 7.3-7.5% (Figure 6). Some acceleration of the price growth for non-food products and paid services will be compensated by deceleration of food inflation.

The rise in food prices will slow down by end-2020; however, a pro-inflationary pressure on the part of certain foodstuffs will remain.

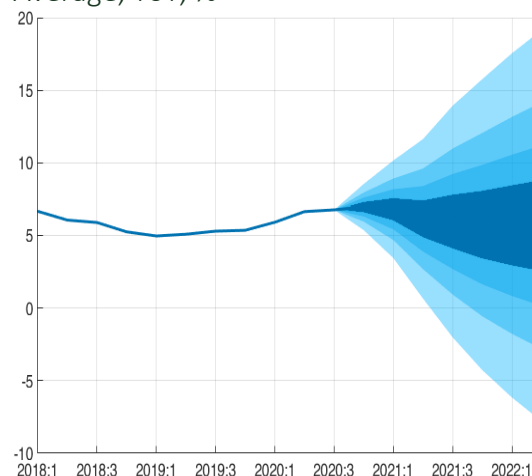
A modest price growth for non-food products in 2020, despite depreciation of the exchange rate and the rise in import prices, was driven by a pent-up demand. In 2021, once the epidemiological situation improves and the economic activity recovers, the consumer demand will be gradually expanding; this, in turn, will put a pro-inflationary pressure. At the same time, a restraining effect on the non-food inflation component will be exerted by a shift in consumer preferences towards cheaper imported goods due to the decreasing purchasing power of the population and real money income.

The rise in prices of paid services will be largely determined by persistence of the current price dynamics for regulated services as well as by the increase of prices for certain types of non-regulated services once the quarantine restrictions are lifted.

The medium-term forecasts of the annual inflation have not undergone significant changes as compared to the previous assessment. **The annual inflation is expected to gradually decelerate to the upper boundary of the target range of 4-6% by the end of 2021 given the persistence of disinflationary effect on the part of domestic demand and its formation within such band until the end of the forecasting period.**

The inflation dynamics will be decelerating due to the runout of the high statistical base of inflation that has formed in 2020 as a result of a surge in prices of food (meat, bread and bakery, vegetable oil, sugar, eggs, buckwheat) and a weak inflationary pressure accompanied by the expectations that inflation in China and the EU will not reach its target levels. In addition, world food prices are assumed to gradually go down after a price hike for certain food items that has been observed in the recent months. The increase in cereal stocks due to the growth in

Figure 6. Inflation, Quarterly Average, YoY, %



Source: NBRK's forecast

their supply will be conducive to the more moderate dynamics of world food prices. A restraining effect on the disinflation dynamics in the economy will be exerted by the comeback of the output gap to the neutral zone given a recovery of the domestic and external economic activity and a gradual growth of external inflation background as compared to the existing levels (Figure 6).

1.3 Alternative Forecast Scenarios

Because of uncertainty regarding the recovery speed of the global economy and the correlation between the demand and supply in the global markets of raw commodities in 2021-2022, in addition to the baseline scenario the National Bank was considering alternative scenarios of oil prices.

The pessimistic scenario considered by the National Bank assumes the **drop in oil prices to 35 US Dollars per barrel in 2021 and their persistence at this level until the first half of 2022.**

Realization of this scenario may be determined by a weaker recovery of the global economy in 2021-2022 given the increasing number of people infected with the COVID-19 worldwide and an insufficient effect of the developed vaccines and their availability. The increased supply in the oil market as a result of a failure to fully observe the OPEC+ agreement by the member countries may serve as an additional factor for the drop in prices.

If the pessimistic scenario is realized, the negative dynamics of the external demand on the part of Kazakhstan's main trading partners (the EU, China, and Russia) will limit the recovering dynamics of exports. A subsequent decline in revenues of enterprises in the mining sector will cause a cutback in production and investments, which will have a negative impact on the sectors of construction, transport, trade and other services, and further on the economy as a whole. Weak dynamics of real money income of the population (because of the decreasing economic activity and growing inflation) will be negatively affecting the consumer demand. As a result, Kazakhstan's economy will be recovering in 2021-2022 more modestly as compared to the baseline scenario. **The real GDP growth given the low base of 2020 will account for 3.3-3.6%.**

This scenario assumes the greater dynamics of inflationary processes as compared to the baseline scenario given depreciation of the exchange rate of the tenge, possible disruption in supplies of import products and the corresponding growth of inflation expectations. Nonetheless, because of a more suppressed state of the economy, the inflationary pressure on the part of demand will be limited. Over the forecasting horizon, the annual inflation will be building above the target band.

In turn, the optimistic scenario assumes that oil prices will go up to **55 US Dollars per barrel in 2021 and will stay at this level until the end of the forecasting period.** The rise in oil prices may be driven by a faster attainment of the equilibrium in the oil market as a result of recovered demand given the suppression of COVID-19 pandemic and strict adherence to the OPEC+ agreement on reduction of oil production by its member countries.

If the optimistic scenario is realized, the growth rates of Kazakhstan's economy are assumed to be higher than under the baseline scenario. **In 2021, the economic growth will account for 4.1-4.4%.** This will be driven by the more positive dynamics of exports and the domestic demand. However, the associated growth of imports will be curbing the economic recovery.

In case of realization of the optimistic scenario, inflation will be decelerating more rapidly as compared to the baseline scenario. This will be promoted by the stronger dynamics of the exchange rate of the tenge and a weaker external inflationary pressure, mainly due to deceleration of inflation

in Russia. By mid-2021, inflation will enter into the target band of 4-6% and will stay there throughout the forecasting horizon.

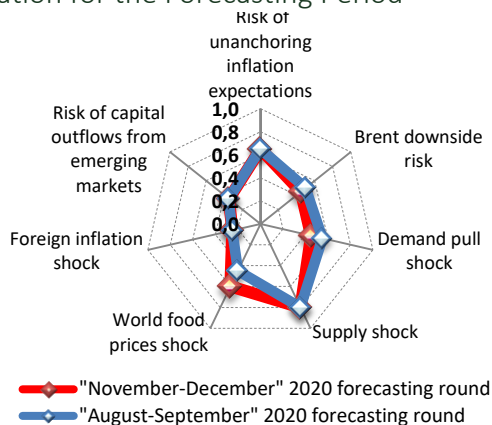
1.4 Risks in the Medium Term

As compared to the previous forecasting round, the risk profile for inflation has not generally changed but certain risks are still high (Figure 7). Resurgence of morbidity with coronavirus worldwide and potentially incomplete availability or poor effectiveness of various COVID-19 vaccines may have a negative effect on the speed of economic recovery in the majority of countries, can cause the drop in energy prices, lead to limitations in the delivery of goods and services resulting in a significant acceleration of inflation in Kazakhstan.

Good news about development of COVID-19 vaccines and a not so rapid growth in oil production globally in line with the OPEC+ agreement serve as significant factors for maintaining the oil prices at above 40 US dollars per barrel.

Among internal factors, the risk of inflationary pressure on the part of demand slightly decreased given a lower than expected economic activity. Nonetheless, in the environment of continuing government support measures to the population and the economy in 2021 and the deferred consumer demand, inflationary pressure in the economy over the forecasting horizon may intensify. In addition, withdrawal of retirement savings in 2021, first of all, for home renovation and repayment of mortgage loans, may become a significant factor for acceleration of inflationary processes that could exert both a direct effect (increase in prices of construction materials and repair services) and an indirect effect (through an increase in disposable income).

Figure 7. Judgement-Based Risk Map of Inflation for the Forecasting Period



Source: NBRK's calculations

In turn, the growth of external inflation on the part of countries – Kazakhstan's main trading partners is not so well pronounced. In Russia, despite acceleration of inflationary processes, inflation keeps close to the target and there are also disinflation factors of a low demand over the forecasting horizon. This factor, along with a low food inflation in the EU and China, reduces the risk of intensification of external inflationary pressure.

Despite a possible resolution of trade disputes between the USA and China after J. Biden's election as the US President, the strengthening of sanctions against Russia should not be excluded. These factors may lead to depreciation of currencies of emerging economies including Kazakhstan.

Among internal factors, the risk of inflationary pressure on the part of demand slightly decreased against the backdrop of a low than expected economic activity. Nonetheless, in the environment of continuing government support measures to the population and the economy in 2021 and the deferred consumer demand, the inflationary pressure in the economy over the forecasting horizon may intensify. Besides, withdrawal of retirement savings in 2021, first of all, for home renovation and repayment of mortgage loans, may become a significant factor for acceleration of inflationary

processes that may exert both a direct effect (increase in prices of construction materials and repair services) and indirect effect (through an increase of disposable income).

Given the rise in prices of certain foodstuffs (eggs, sugar, and vegetable oil) and a possible strengthening of restriction measures within Kazakhstan and abroad, the risk of imbalances between the demand and supply in certain commodity markets and of acceleration of inflation remains high.

As a consequence of the abovementioned rise in prices of certain foodstuffs and correlation of inflation expectations and the exchange rate dynamics, risks of their unanchoring in the target band remain.

II. MONETARY POLICY

2.1. Decisions on the Base Rate

In the third quarter of 2020, the National Bank twice made decisions about the base rate (Figure 8).

On July 20, 2020, the base rate was lowered to 9.0% with the narrowing of interest rate band to ± 1.5 pp. The decision was determined by the weakening of pro-inflation risks and a stronger than expected contraction of the economic activity.

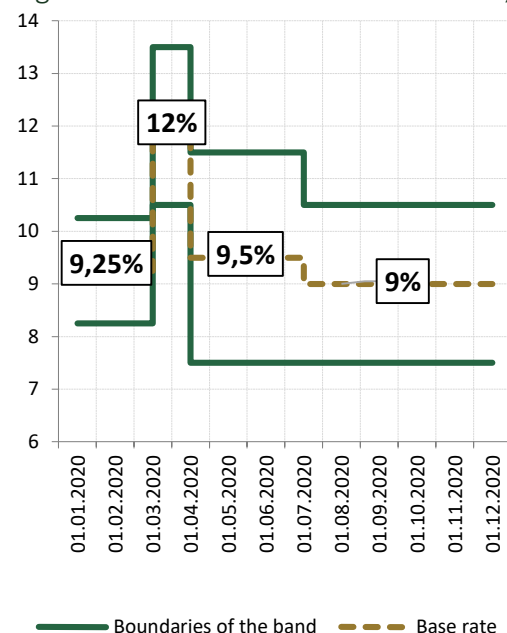
The decision of September 7, 2020 to retain the base rate was made taking account of the balance of inflation risks in the near term and the medium term perspective. Poorly anchored inflation expectations, the increasing volatility in the financial markets amidst the escalation of sanctions rhetoric against Russia, expectations regarding a slower recovery of the demand for oil and the possibility of a further stimulation of the economic activity through fiscal and quasi-fiscal measures served as pro-inflation risks. Along with that, the effect of disinflation factors went on associated with contraction of the economic activity (during 9 months of 2020, Kazakhstan's GDP declined by 2.8% in annual terms), a slowdown in the consumer demand and an anticipated decline in prices of foodstuffs in the global markets.

On October 26, 2020, the National Bank also made the decision to retain the base rate at 9%. The decision was associated with uncertainty and an enhanced probability of external risk realization against the new outburst of morbidity worldwide and the imposition of quarantine restrictions, increased volatility in the oil market as well as the growing geopolitical risks.

2.2. Money Supply

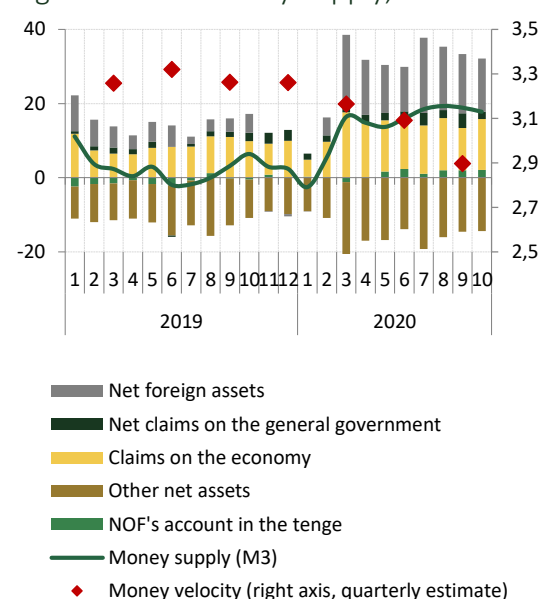
High rates of annual growth in the money supply persist in the environment of the anti-crisis measures implementation. The boost in the money supply occurs in case the money velocity slows down, as well as in case if the money multiplier decreases due to the outstripping growth of the reserve money. In the medium term perspective, this creates the risks of a deferred pass-through of the growing money supply onto prices once the business activity in the economy recovers.

Figure 8. Base Rate Band in 2020, %



Source: NBRK

Figure 9. Money Supply, as % YoY



Source: NBRK

The money supply, after a sharp increase in March 2020 amidst external shocks which resulted in revaluation of foreign assets and capitalization of the “Kazakhstan Sustainability Fund” JSC in order to support the economy, retains high growth rates in annual terms (in October 2020 a 17.8% growth, YoY). During the reporting period, as part of expansion of the concessional lending program to businesses, an additional capitalization of the “Kazakhstan Sustainability Fund” JSC was conducted (Figure 9).

A positive contribution to the growth in the money supply is also made by the increasing claims on the Government as a result of an active placement of Government securities by Kazakhstan’s Ministry of Finance of as well as retail and corporate lending.

Due to the growing money supply as well as a low business activity, the money velocity is slowing down.

The reserve money has been retaining its high growth rate since March 2020 (in October 2020 – a 36.9% increase, YoY) primarily owing to bank deposits at the NBRK. Cash outside NBRK is gradually reducing its contribution to the increase in the reserve money (Figure 10)

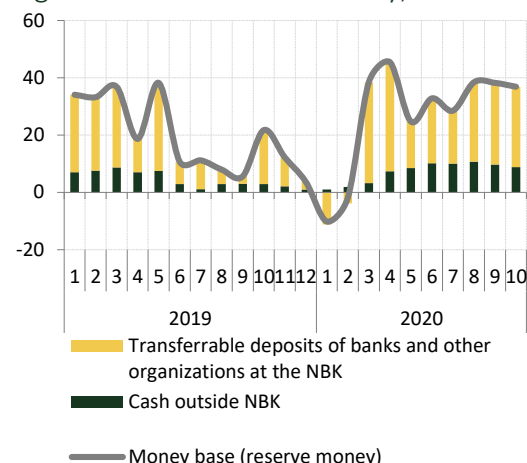
The expansion in the reserve money is nearly twice larger than the growth in the money supply, thus resulting in a low level of the money multiplier (2.6 in October 2020) (Figure 11).

2.3. Money Market

Liquidity surplus keeps going down smoothly given the reduction in the issuance of notes. The targeted money market rate is setting within the target band with an on-and-off approximation to the upper boundary due to the growing demand for the tenge liquidity. In order to increase efficiency of liquidity management and reduce transaction costs, changes to the calculation of TONIA indicator had been introduced from August 2020 in connection with a transition to a new trading system ASTS+ by the KASE.

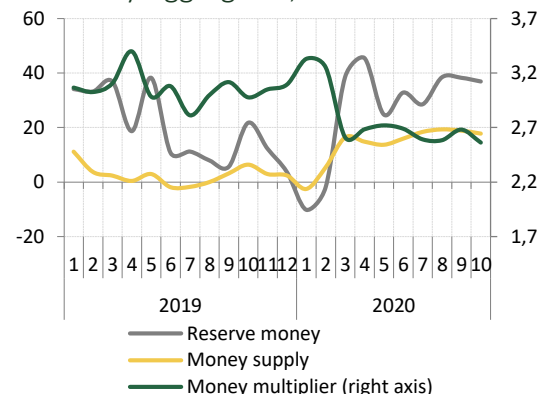
The money market continues to function under liquidity surplus. Liquidity is primarily withdrawn via short-term notes and deposit auctions (Figure 12).

Figure 10. Reserve Money, as % YoY



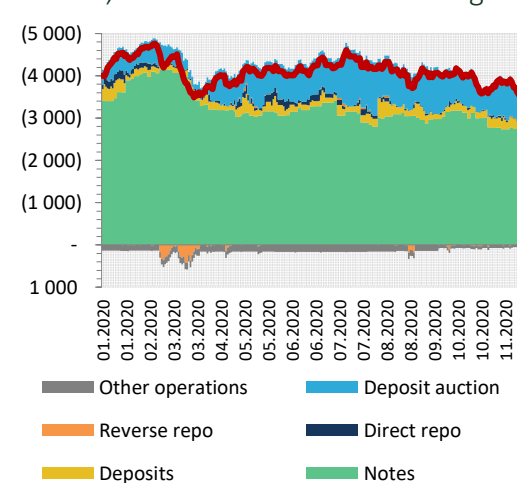
Source: NBRK

Figure 11. Growth of Monetary Aggregates, YoY



Source: NBRK

Figure 12. Exposure on the NBRK’s Operations in the Domestic Market, billion tenge



Source: NBRK

The downward trend in liquidity surplus continued from July 2020 after suspension of issuance of one-year notes in the third quarter of 2020. At the end of November 2020, a net balance on the NBRK's operations amounted to 3.5 trillion tenge. At the end-November 2020, the share of three-month and six-month notes mase up 53%. In the structure of the National Bank's operations, deposit auctions account for a significant portion (17.7%) after notes (77.5%).

TONIA has been setting within the target band of the base rate. Interest rates on 1-day repo transactions are growing closer to the upper boundary in the periods of tax payments, which is typical for a month-end (Figure 13).

Since August 3, 2020, transactions at the KASE have been conducted in a new trading system – ASTS+, where the repo market is divided into the repo with a central counterparty and repo with gross settlements. The TONIA is calculated by taking into account repo transactions with a central counterparty only in order to increase effectiveness of liquidity management and to reduce transaction costs.

Interest rates on swaps were setting under the impact of the situation in the external markets and dynamics of the exchange rate of the tenge. During the periods when the demand for the tenge liquidity was growing, the spread was increasing (Figure 14).

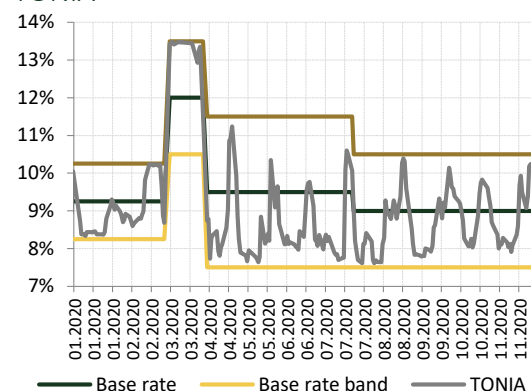
2.4. Foreign Exchange Market

The exchange rate of the tenge against the US Dollar has been appreciating given positive external factors related to the development of vaccine as well as the increasing certainty about the presidential elections in the USA.

In September-October 2020, there was a high degree of uncertainty in the external markets caused by a recurring growth of coronavirus in Europe, USA and the forthcoming presidential elections in the USA.

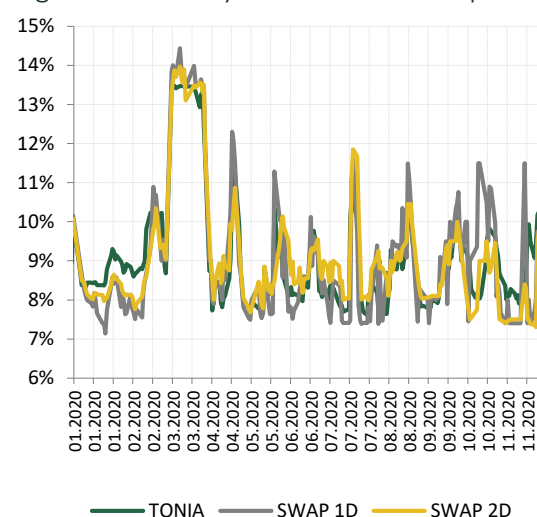
In November, when preliminary results of the presidential elections in the USA and messages about successful vaccine trials appeared, the investor sentiment improved leading to reduction in the Dollar index and the cost of gold in November 2020 (Figure 15).

Figure 14. The Base Rate Band and TONIA



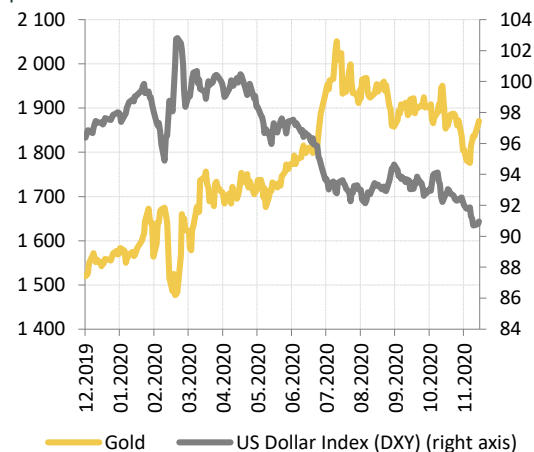
Source: NBRK, KASE

Figure 15. Dynamics of the Swap Rate



Source: NBRK, KASE

Figure 13. Dynamics of the US Dollar and Gold Index, US Dollars per Ounce



Source: Thomson Reuters

Oil quotations, after their decline to 37.5 US Dollars per barrel at the end of October 2020, started to recover and at the end of November, Brent oil price reached 47.6 US Dollars per barrel as a result of positive news about coronavirus vaccine (Figure 16).

After depreciation of EM currencies in September-October because of deterioration of the global risk sentiment, in November EM currencies started to recover.

The exchange rate of the tenge, being influenced by external factors, after its depreciation to 434.62 tenge per US Dollar, appreciated by 1.8% to 425.7 tenge per US Dollar in November 2020 (Figure 16).

Depreciation of the tenge in the third quarter of 2020 was induced by a trade deficit (-1.0 billion US Dollars in the third quarter of 2020), and as a consequence, by expansion of the current account deficit (-5.5 billion US Dollars) because of a nosedive of exports of goods as compared to the decrease in exports.

The balance between the demand and supply in the domestic foreign exchange market was secured by a conversion of the National Fund's assets within the frames of the guaranteed transfer allocation to the national budget as well as by measures on the sale of a part of export proceeds by companies of the quasi-government sector.

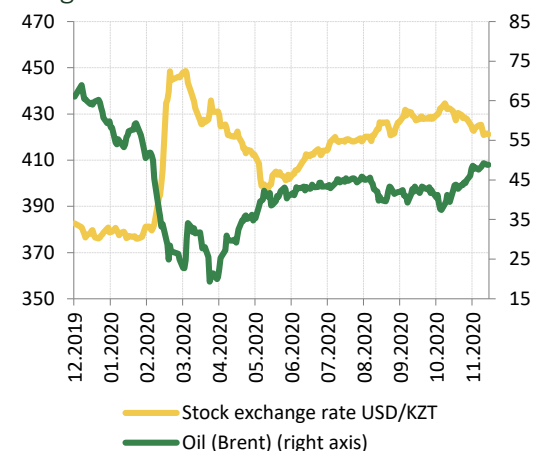
With a view to reduce excess volatility of the exchange rate of the tenge, on certain days of September-October the NBRK conducted foreign exchange interventions, which amounted to 232 million US Dollars and 91.3 million US Dollars, respectively, on a net basis.

2.5. Stock Market

The yield curve on the government securities has been shifting to the pre-crisis level. Yields on corporate bonds, after high values in March-April 2020, are decreasing following the base rate. The equity market has been growing due to the improved global risk sentiment.

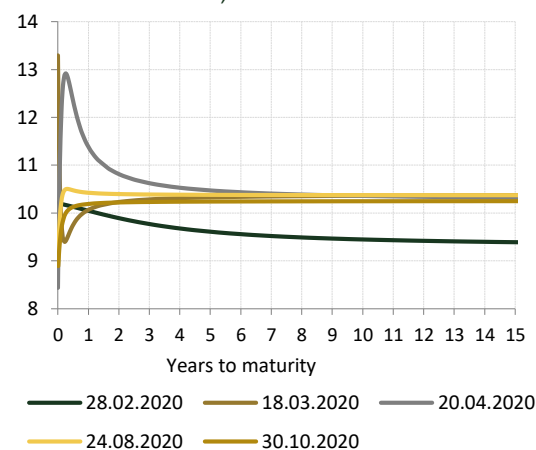
The MoF of Kazakhstan continued to issue short-term government securities and their overall volume during May-October 2020 reached 0.8 trillion tenge while the plan for 2020 was 1 trillion tenge.

Figure 16. Dynamics of Brent Oil Prices and the Exchange Rate of the Tenge



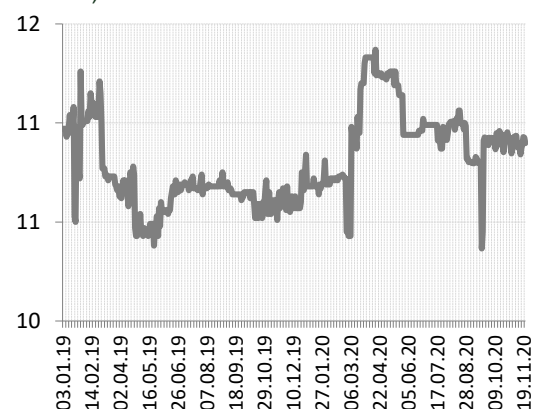
Source: Bloomberg, KASE

Figure 17. Change in the Risk-Free Yield Curve, %



Source: KASE

Figure 18. Yields on Corporate Bonds, %



Source: KASE, NBRK

A significant contribution to the growth of government securities in the primary market is made by the local executive authorities as part of implementation of the Employment Roadmap.

At the end of October 2020, the yield curve on government securities went down in the medium-term segment as compared to August 2020 (Figure 17).

Corporate bond performance index is smoothly going down due to easing of monetary conditions (Figure 18).

In October 2020, the weighted average interest rate decreased to 9.2%, primarily owing to the bond issuance of the “KMC” JSC at the rate (at 6.02%) well below the market. Excluding the “KMC” JSC, the weighted average yield on issued corporate bonds made up 11.85%. In November, the weighted average interest rate accounted for 11.3% (Figure 19).

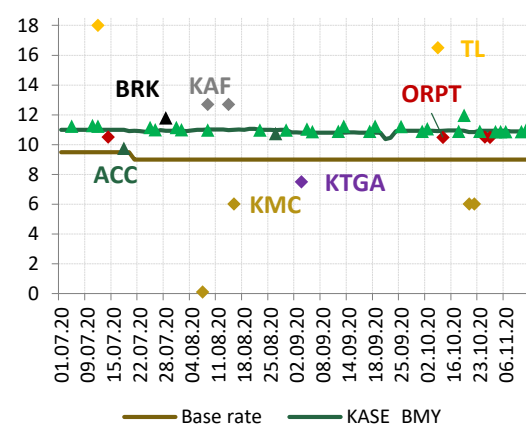
The equity market continued to grow after a decline in September-October 2020 due to the improved global risk sentiment amidst the news about the results of presidential elections in the USA and the development of effective COVID-19 vaccine (Figure 20).

2.6. Deposit Market

Deposit rates are softly going down following the base rate. Deposits demonstrate a growth in annual terms. Deposit dollarization has stabilized at 40-41%.

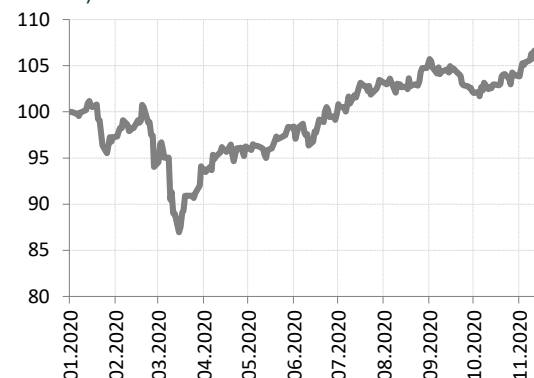
After reduction of the base rate in July 2020, the weighted average interest rate on short-term deposits of businesses in the tenge (less than one month) that account for a major portion in the corporate sector deposits (88.5% in October 2020), went down from 7.5% in July to 7.0% in October (Figure 21).

Figure 19. Annual Returns of Issuers, %



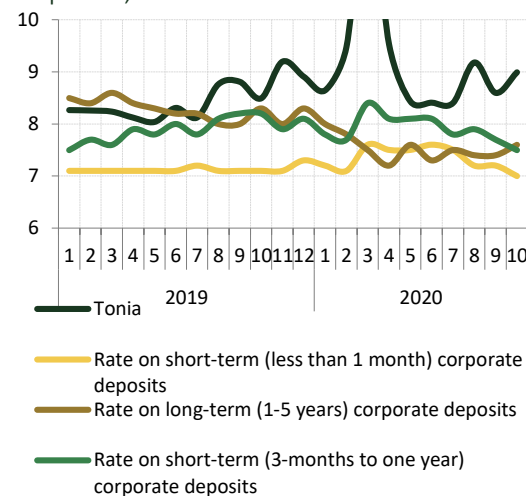
Source: KASE, NBRK

Figure 20. KASE Index (31.12.2019 = 100%)



Source: KASE

Figure 21. Rates on Corporate Deposits, %



Source: NBRK

The interest rate on retail deposits continued to smoothly go down given reduction of the base rate and appropriate measures on interest rate regulation on the part of the Kazakhstan Deposit Insurance Fund (Figure 22).

The deposit volume is going up owing to deposits in the tenge as well as because of the exchange rate revaluation of foreign currency deposits (Figure 23).

Deposit dollarization, after reaching the minimum in 2020 (39.5% in July), increased as a result of exchange rate depreciation in September-October 2020. Because of the growing uncertainty and volatility, there were conversions into foreign currency deposits, however, their volumes were insignificant. Hence, deposit dollarization at the end of October 2020 accounted for 40.8% (Figure 24).

The share of foreign currency deposits of the population and businesses had been at the level of overall dollarization (40.9% and 40.7%, respectively).

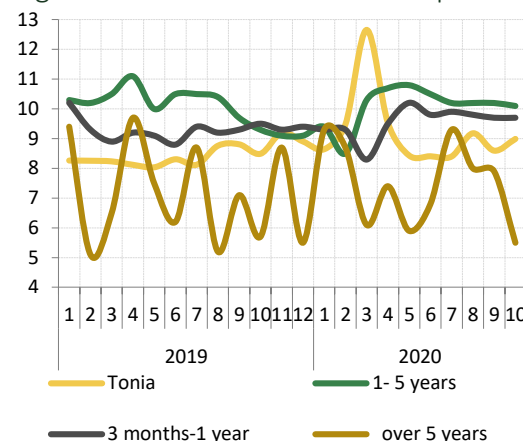
2.7. Credit Market

A stimulative monetary policy was expressed in reduction of loan rates. There was a minor growth of the credit portfolio in the corporate segment. In the retail sector, mortgage lending acted as the main growth driver.

The weighted average interest rate on loans in the tenge to entities in the real sector of the economy in October 2020 went down to 11.8% from 12.0% in October of the last year. The dynamics of interest rate were influenced by a reduction of the base rate, government business support programs as well as the increasing demand for credit resources on the part of SMEs that was largely secured owing to the pent-up demand as quarantine measures were gradually eased.

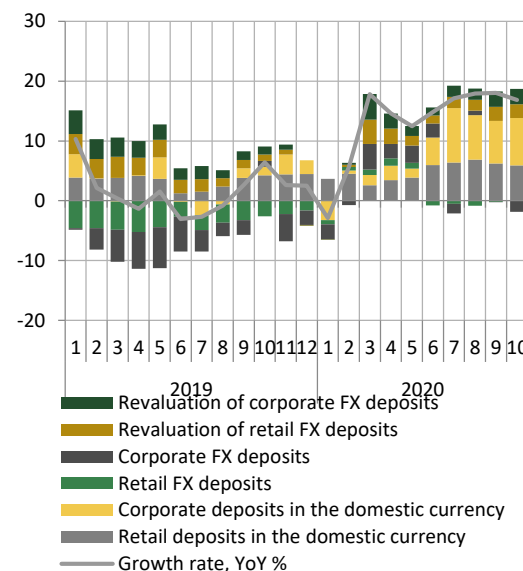
Interest rate on short-term loans in the tenge to enterprises that account for a major portion in the volume of provided loans accounted for 11.6% in October 2020 (in October 2019 – 11.8%) (Figure 25).

Figure 22. Rates on Retail Deposits



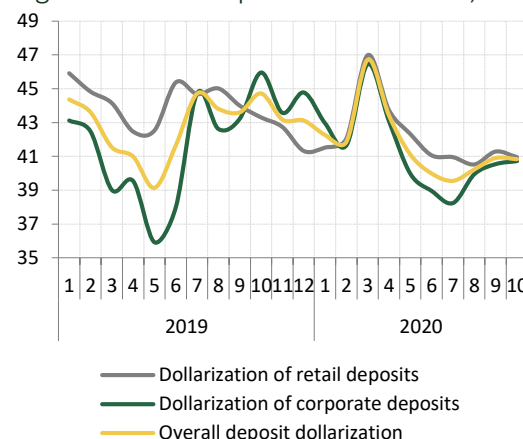
Source: NBRK

Figure 23. Contribution to the Growth in the Deposit Volume by Components



Source: NBRK

Figure 24. Deposit Dollarization, %

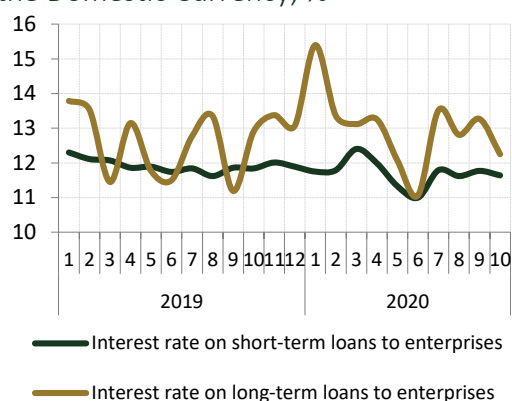


Source: NBRK

Loans to the real sector continue to grow. The main contribution is made by loans to the industry (Figure 27). Provision of retail loans was slowing down since March 2020 because of the decreasing earnings, thus causing a slowdown in the growth of loans to the retail sector (Figure 26).

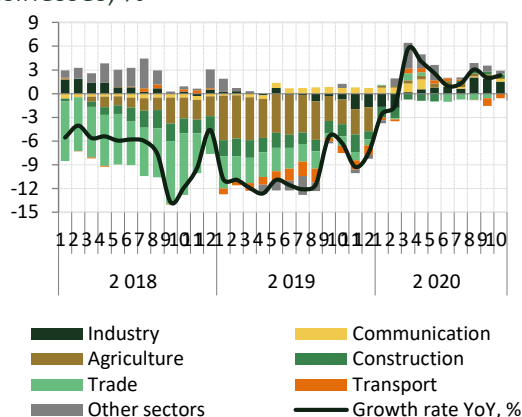
Suspension of deceleration on consumer loans has a positive influence on the total loan portfolio. Also, lending to the real sector has been gradually restoring its positive contribution to the loan growth. As a result, the annual growth of loans in the economy in October has stabilized at 7%.

Figure 25. Interest Rates on Loans in the Domestic Currency, %



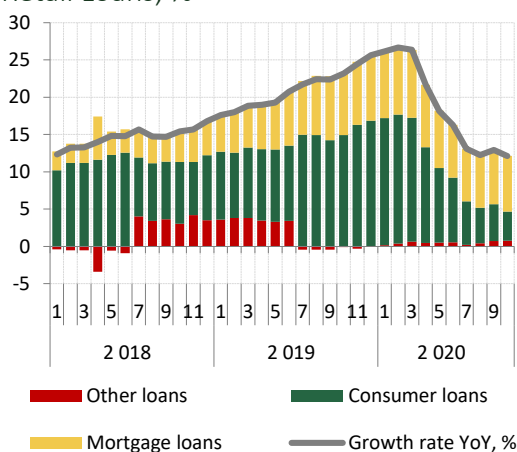
Source: NBRK

Figure 27. Contribution by Sectors to the Annual Growth in Loans to Businesses, %



Source: NBRK

Figure 26. Contribution by Components to the Annual Growth in Retail Loans, %



Source: NBRK

III. MACROECONOMIC CONDITIONS

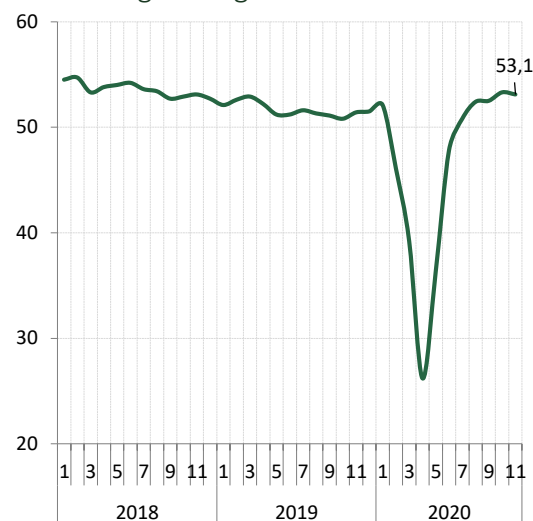
3.1. External Sector

In the third quarter of 2020, the global economy continued to recover. Based on leading indicators of the business activity, the industrial sector and the service sector have been demonstrating growth since July 2020 (Figure 28). Given the increased volumes of exports in China, deceleration of decline in the global trade was noted. Similar tendencies are observed in the dynamics of global air transportations, especially cargo transportations and domestic flights. So, domestic flights in Russia have been completely resumed, and in China the decline rates in the sector have slowed down. The US unemployment rate, which increased significantly during the first wave of the pandemic (April 2020 – 14.7%), went down to 6.7% in November 2020.

The present situation in countries-Kazakhstan's trading partners has been generally positive. Amidst persistently positive dynamics in the industry and foreign trade, the recovering growth in investments and retail sales in the third quarter of 2020, the Chinese economy showed a 4.9% (YoY) boost. In the EU and Russia, after a dramatic decline in the second and the third quarters of 2020, the economic situation improved considerably. The GDP reduction in the EU accounted for 3.9% in real terms (YoY), and in Russia – 3.6% (YoY).

The global oil market demonstrates a positive stance, which is associated with the news release about effective trials of COVID-19 vaccine and the decision made by OPEC+ member countries on December 3, 2020 about a gradual reduction of oil production. Oil prices, for the first time since the beginning of March 2020, approached 50 US Dollars per barrel⁴ (Figure 29). Since June 2020, oil consumption has been steadily outrunning oil supply. In October 2020, oil shortage went up to 3.4 million barrels a day.

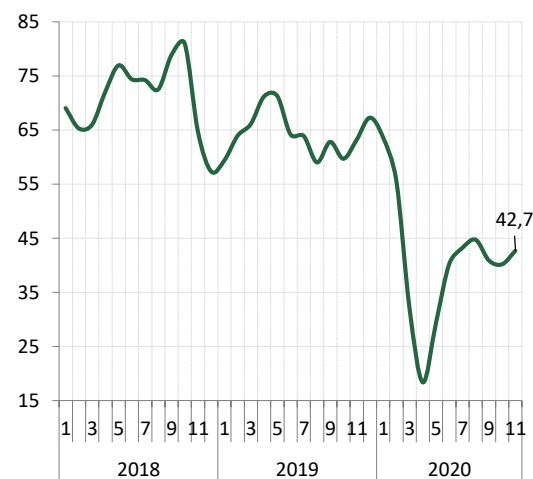
Figure 28. Global Composite Purchasing Managers' Index



Source: Bloomberg

* – when the index is above 50, it means its growth, when it is less than 50 – its decline, and when it is equal to 50 – its invariance

Figure 29. Brent Oil Price, US Dollars (monthly average)



Source: U.S. Energy Information Administration (EIA)

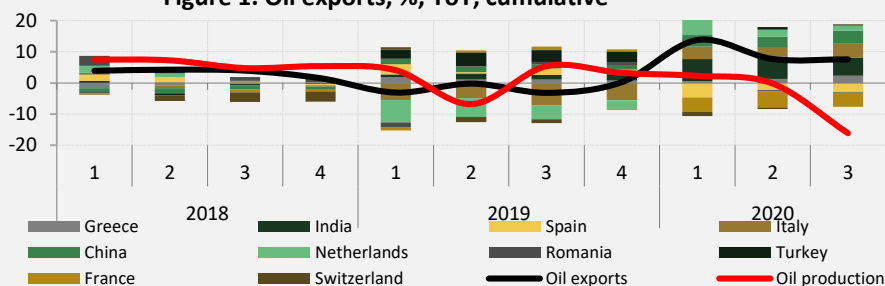
⁴ The date of statistical data truncation – December 1, 2020.

Box 1. Global Demand for Oil in the Time of the COVID-19 Pandemic

The COVID-19 pandemic resulted in a biggest-ever fall in prices in the global oil market. A concurrent shock of demand and supply has realized. Global oil quotations plummeted to the minimum after the global financial crisis of 2008-2009. All that is happening this way or the other affected the economies of many countries, especially those where oil is the main export item.

In Kazakhstan, the present crisis led to a sharp contraction of oil production (Figure 1). In the third quarter of 2020, the fall accounted for 16.2% (YoY). At the same time, growth rates of oil exports decelerated in kind from 13.8% in the first quarter of 2020 to 7.6% in the third quarter of 2020. A downward pressure on the dynamics of exports was produced by a reduced consumption of oil on the part of France, Switzerland, and Spain. However, exports were supported by the increased supplies of raw commodities to India, China,

Figure 1. Oil exports, %, YoY, cumulative



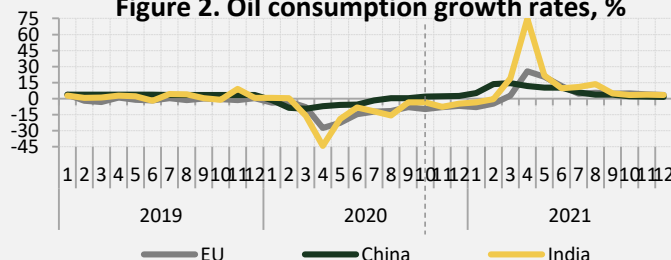
Source: BNS ASPR

countries. To that end, the current growth of exports to China and India may be of a temporary nature given the fact that these countries are mainly importing oil from Russia, the Middle East and African countries.

According to EIA's projections, oil consumption in the EU countries and in India will be decreasing until the end of the first quarter of 2021 (Figure 2). In future, due to the anticipated gradual recovery of the economic activity, oil consumption will begin to go up. It is worth mentioning that an abrupt increase in the oil consumption rates in the EU and India in the second quarter of 2021 was driven by the low base of 2020. At the same time, consumption will not come back to the pre-crisis levels until the end of 2021. Despite the expanding demand in China, throughout 2021 it will be more sluggish than in 2019.

According to the IMF's forecasts (October 2020), expectations about the economic growth for 2020-

Figure 2. Oil consumption growth rates, %



Source: EIA

2021 in Italy, Switzerland, France and Greece have been revised downwards (Table 1), being related to anticipations of a further growth in the government debt in Italy, to the reduced employment immediately after cessation of the ban for dismissals and fringe on the part of the government, to feeble recovery dynamics in the aviation and travel business as well as to a sluggish domestic demand and investments.

An anticipated weaker and longer recovery of the EU member countries will most likely have a negative effect on the level of consumption. Accordingly, this will limit the recovery of demand for Kazakhstan's oil on the part of traditional trading partners.

Table 1. Forecast of Economies Growth Rates, YoY, %

	2020	2021
Italy	-10.6 ↑ (-12.8)	5.2 ↓ (6.3)
Netherlands	-5.4 ↑ (-7.5)	4.0 ↑ (3.0)
Switzerland	-5.3 ↑ (-6.0)	3.6 ↓ (3.8)
France	-9.8 ↓ (7.2)	6.0 ↓ (7.3)
Greece	-9.5 ↑ (-10.0)	4.1 ↓ (5.1)
Spain	-12.8 (-12.8)	7.2 ↑ (6.3)
China	1.9 ↑ (1.0)	8.2 (8.2)
India	-10.3 ↓ (-4.5)	8.8 ↑ (6.0)

Source: IMF

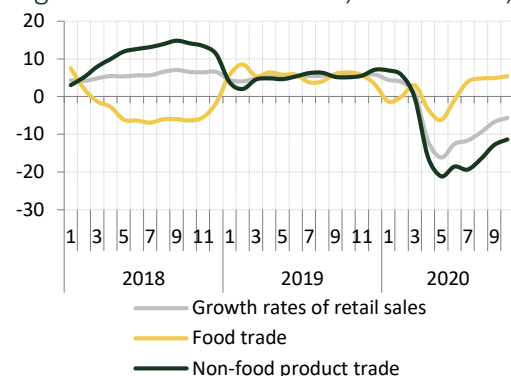
3.2. Economic Activity and Domestic Demand

In the third quarter of 2020, due to a gradual lifting of quarantine restrictions and resumption in operation of sales outlets, a real household consumption, after a considerable downfall in the second quarter (a 16% decline), is gradually reviving.

A certain recovery of the consumer activity is proved by the retail sale performance, which demonstrated growth in August, September and October 2020 (as compared to the corresponding month of 2019). In doing so, the upturn was secured by the food trade. So, in January-October 2020, retail sales of foodstuffs recovered significantly and went up by 5.4%. It was supported by the growth in production (by 3.4%) and imports (by 3.3% in January-September 2020) of foodstuffs. The trade turnover of non-food products against the decreasing consumer lending (in the third quarter 2020 – a decline of 22%, YoY) still retains the negative dynamics, however, the decline rates are slowing down (Figure 30).

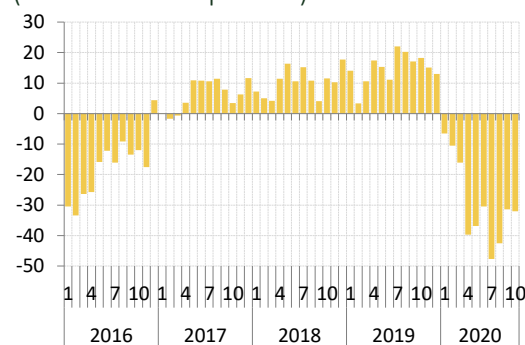
Consumer sentiment of the population was demonstrating the minimum level in the periods of strict lockdown. At present, they are less negative (Figure 31). A similar situation is typical for the people's expectations concerning the development prospects of the economic activity over the short term. People's assessments were especially negative in the periods when quarantine restrictions were tightened. At the same time, people's expectations about the economy's development for a longer period (5 years) remain stable (Figure 32).

Figure 30. Retail Sales, Cumulative, YoY, %



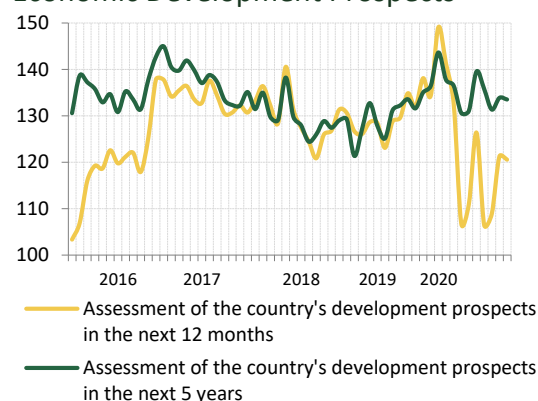
Source: BNS ASPR

Figure 31. Assessment of the Ease of Big Purchases (Balance of Responses)⁵



Source: Fusion LAB

Figure 32. Assessment of Economic Development Prospects⁶



Source: Fusion LAB

⁵ The assessment of the ease of big purchases is conducted on the basis of the question: "In your opinion, is the present time generally good or bad for big purchases/expenditures?"

⁶ The assessment of the economic development prospects is conducted on the basis of questions: "Speaking about the country's economic conditions in general, what kind of time would be the next 12 months and the next 5 years for the country, in your opinion?" The numerical value represents the balance of responses that are calculated as the difference between the percentage of positive responses and negative responses +100. The values of indices may change within the range from 0 to 200. The value above 100 – predominance of positive assessments, below 100 – of negative assessments.

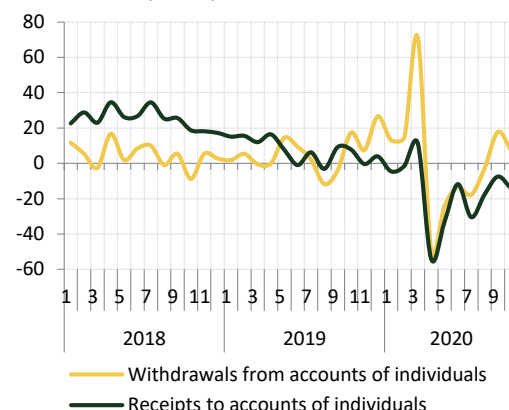
The consumer activity of the population may be also traced through the dynamics of circulation volumes of monies at accounts of individuals with banks. In the second quarter, in the environment of tightened quarantine measures and unrealized consumer demand, withdrawals from and receipts to accounts of individuals decreased significantly. So, withdrawals from accounts of individuals went down by 50% in annual terms in April 2020, and receipts – by 54% (Figure 33).

In July 2020, because of a new lockdown, reduction of withdrawals from and receipts to accounts of individuals intensified again (by 30% and 18%, respectively) after some slowdown in May-June. A step-by-step easing of restrictions from mid-August was accompanied by a gradual recovery of growth in withdrawals from accounts of individuals, which is an indication of certain revival of the population's consumer activity from the middle of the third quarter of 2020.

However, population's income in the third quarter retained their negative dynamics, having decreased by 2.5% in annual terms. In the structure of nominal income of the population, income from self-employment and from hired labor decreased to the larger extent. So, real wages in the economy contracted by 0.1%, where wages at large and medium-sized enterprises decreased by 1.1%; as for small businesses, the growth rates of real wages decelerated to 5.3% (Figure 34).

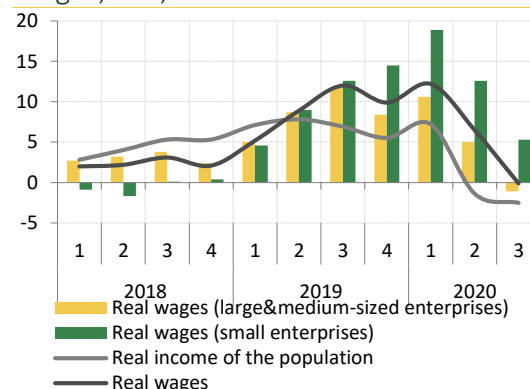
The growth of real wages persists in the branches of the government sector (Figure 35). Along with that, given deceleration in the growth of the state budget spending for wages (from 38.6% in the second quarter to 16.8% in the third quarter 2020), labor remuneration in the sectors of education and general government also decreased. Positive dynamics in the labor remuneration was also observed in such sectors as information and communication, accommodation and catering services, in the industry and agriculture. In other branches of the real sector, wages demonstrate negative dynamics in real terms.

Figure 33. Withdrawals from and Receipts to Bank Accounts of Individuals, YoY, %



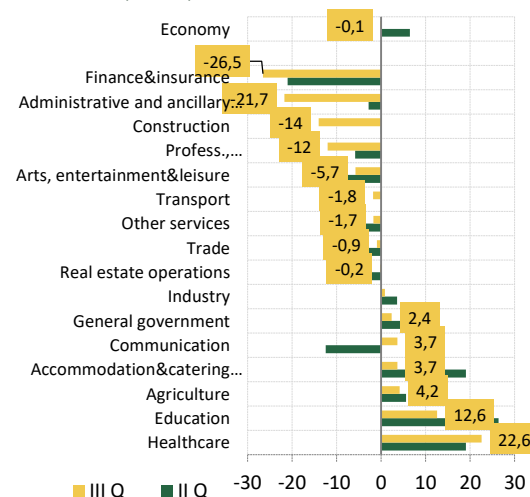
Source: NBRK

Figure 34. Real Income of the Population and Real Wages, YoY, %



Source: BNS ASPR

Figure 35. Real Wages in the Second and Third Quarters, YoY, %



Source: BNS ASPR

In the structure of people's income, other income and income from social transfers (retirement benefits, student scholarships, allowances) demonstrated growth owing to the social focus of the existing government's policy. During January-September 2020, the national budget spending for social welfare and social security went up by 18.3%. However, the number of recipients of the subsistence allowance in January-October continued to decrease, with the annual reduction of 59%, and an average size of subsistence allowance went down by 39%.

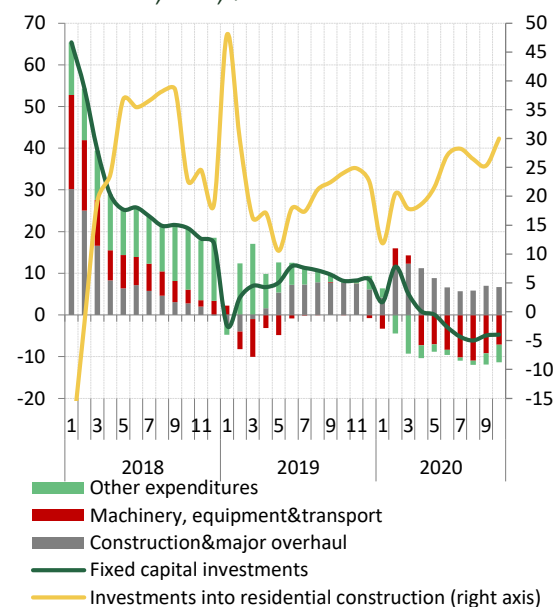
The investment activity keeps suffering from negative implications of the COVID-19 pandemic. At the end of January-October, fixed capital investments decreased by 4.7% (Figure 36).

Contraction in investments is directly related to the decline of investments in the mining industry (by 25.6% at the end of January-October 2020) because of a temporary suspension of a large investment project in the Tengiz oil field. In this context, the share of the mining industry in total investments reduced significantly by 1.5 times (from 57% in the first quarter of 2020 to 37.5% in the third quarter of 2020). The negative trend of investments into construction (a 41.7% decline in January-October 2020) and trade (by 22.9%) persists. A deeper fall of investments is curbed by positive dynamics and sometimes by acceleration of investments in other segments of the real and government sectors of the economy (Figure 37).

In the structure of fixed capital investments at the end of January-October 2020, expenditures on construction and major overhaul continue to grow (by 6.7%), and investments into machinery, transport, equipment and other investments are still in the negative zone.

Various mortgage programs, which are under implementation at present ("7-20-25", "Baspana Hit", Housing Construction Savings Bank) encourage a high growth of investments into residential construction

Figure 36. Investment Activity Indicators, cumulative, YoY, %



Source: BNS ASPR

that increased by 30% in annual terms from the beginning of the year. It's only the Atyrau region that showed a decline in investments (by 45%) due to the decreased commissioning of new residential buildings (by 11.6%). The share of the government in investments into residential construction accounted for 20%, whereas the larger portion falls on own funds of developers and monies of the population – 39% and 33%, respectively.

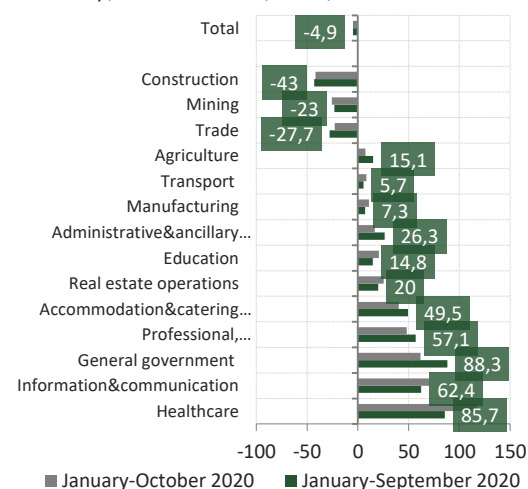
Due to the growing investments, the total floor area of commissioned residential buildings increased by 9.7%. Leaders in terms of growth on a region-by-region basis are the city of Nur-Sultan (a growth of 54.6%), Eastern Kazakhstan (by 16.7%) and Turkestan Region (by 12.5%).

The spreading of coronavirus infection led to a disruption in supplies of goods and reduction in the trading volumes worldwide, including in Kazakhstan. The foreign trade turnover during 9 months of 2020 amounted to 62.8 billion US Dollars, which is by 12.9% lower than during the same period of 2019.

Exports had demonstrated a decline of 18% (Figure 38), with a largest drop of 35.6% in the third quarter of 2020. In the structure of goods, the following exports decreased: of mineral products (by 23%), metals (lead – by 46%, zinc – by 22%, aluminum – 9%, titanium – by 32%), of construction materials (hard brick – by 69%, ceramic tiles – by 31%), textile and its products (30%). Meantime, it is worth mentioning that exports of ground means of transportation and air vehicles increased (18%).

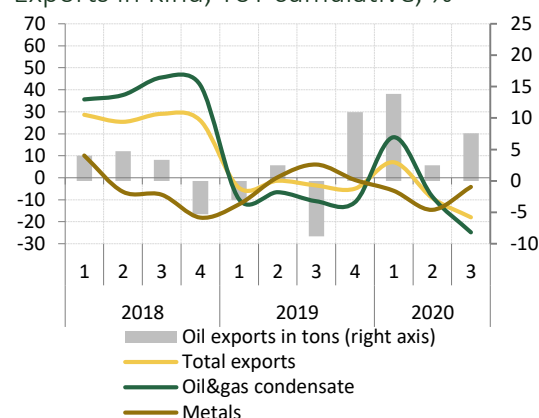
Crude oil and gas condensate still account for a major portion of Kazakhstan's exports. Since May 2020, Kazakhstan, with a view to observe limitations of the OPEC+ agreement on reduction of oil production, reduced a daily production of crude oil (Figure 39). However, in spite of this fact, exports of oil and gas condensate in physical volumes increased by 7.6% at the end of January-September 2020, and value exports of oil decreased by 24.8% (Figure 38). On a country-by-country basis, oil exports in kind increased: to Italy – by 19.2%, to the Netherlands – by 15.8%, Greece – by 56%, China – by 2.2 times, and to India – by 3 times. However,

Figure 37. Fixed Capital Investments by Type of Economic Activity, cumulative, YoY, %



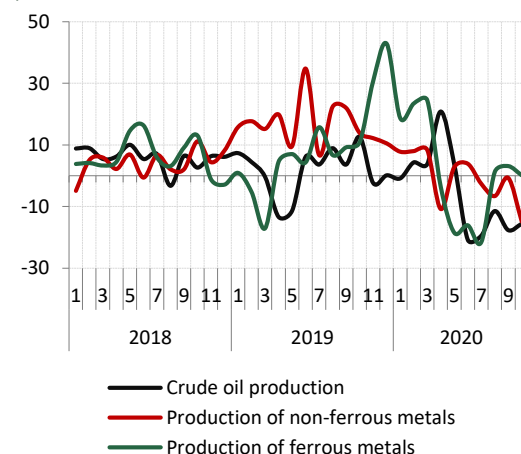
Source: BNS ASPR

Figure 38. Exports in Value Terms Broken Down by Commodities and Oil Exports in Kind, YoY cumulative, %



Source: NBRK

Figure 39. Production of Crude Oil, Ferrous and Non-Ferrous Metals, YoY, %



Source: BNS ASPR

there was a decline in exports to France – by 40.7%, The Republic of Korea – by 61.3%, and Spain – by 43%.

In addition to crude oil, contraction of production volumes of non-ferrous and ferrous metals is observed. Along with that, in January-September 2020 exports of copper and aluminum increased. A 6.4% growth of copper exports was driven by the increased purchases on the part of China (a 24.9% growth), of aluminum by 1.2% – due to larger supplies to Turkey (by 36.8%) and to Georgia, whose share increased from 0 to 14%. On the other hand, a 12.2% contraction in exports of lead and 4.1% of zinc should be pointed out.

During January-September 2020, imports went down by 5.1%, with the maximum drop occurring in the second quarter (a 9.8% reduction). In the structure of imports, contraction of investment imports is observed, namely combustion engines (by 60.3%, YoY in kind), machinery and industrial equipment (by 38.2%), agricultural equipment (by 21.5%).

At the same time, imports of foodstuffs in kind increased, specifically meat (13.8%), milk (20.7%), cane sugar (20.1%), water and soft beverages (31.8%), ethanol and alcohol beverages (68.6%) and tobacco (19.7%). In the structure of non-food products, there was an increase in imports of medications (17.8%), personal care products, cosmetic products (51.5%) and detergents (28.6%), clothes (15.5%). Alongside with that, imports of cooling and freezing equipment went up by 2.1 times, fluid pumps – by 3.7 times.

Box 2. Business Cycle Clock

The National Bank, as part of its effort of an expedite business cycle assessment, since September 2016, along with the Purchasing managers' index, has been also calculating the Business climate index (the "BCI") according to the methodology designed by the IFO⁷, which specializes in conducting applied studies in the field of economics and provides advisory and research services for the German Government, businesses and different organizations.

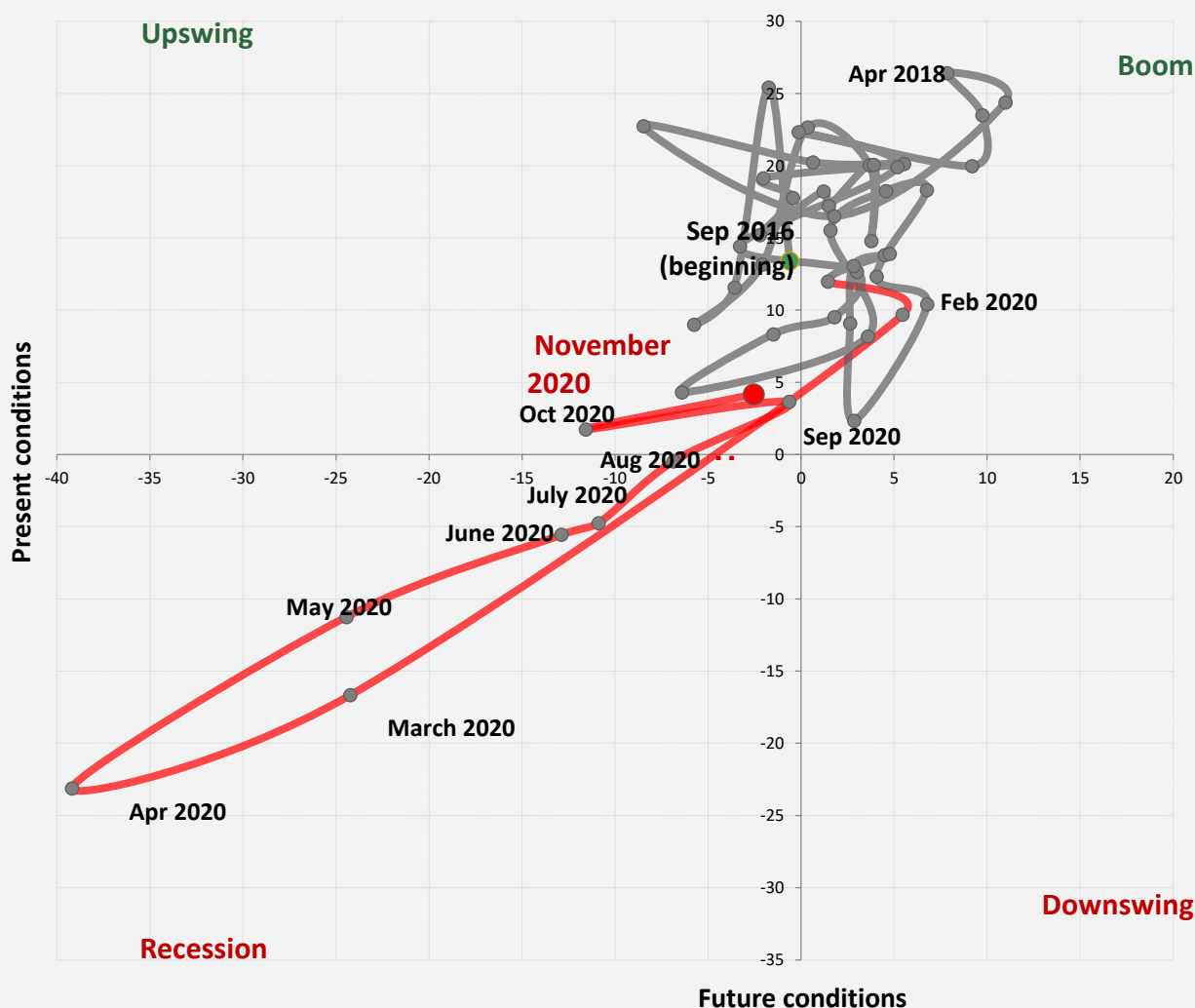
In order to design the BCI, two indicators from monthly enterprise surveys are used:

- 1) assessment of the present business environment by managers of enterprises (options of responses: "good", "satisfactory" and "bad");
- 2) assessment of the future business environment by managers of enterprises (options of responses: "more favorable", "unchanged" and "less favorable").

BCI is calculated as the geometric average of the difference between positive and negative responses. If the index is above 0, it speaks for an improvement, if it is below zero – it means deterioration of the situation. Its dynamics are published on the NBRK's Internet resource on a monthly basis.

In order to have a better insight into the phase of the cycle where the economy had been or is now, the IFO has designed the IFO Business Cycle Clock. To build such cycles, series on estimation of present conditions (along one axis) and future conditions (along other axis) are used.

Figure 1. Business Cycle Clock



Source: NBRK's calculations

⁷ IFO – an abbreviation from *Informationen und Forschung*, which translates from German as *Information and Research*

The diagram is divided into four quadrants with the help of the overlapping of two zero lines, which, in terms of the business situation, denote four stages of the economic cycle: upswing, boom, downswing, and recession. If the assessment of present conditions is negative and expectations are positive, the economy is at the stage of upswing, if both the assessment and expectations of present conditions are positive, the economy is at the phase of boom, and so on.

Using the data from monthly surveys where at present 451 enterprises from the sector of services, industry and construction participate. The similar Business Cycle Clock was designed for Kazakhstan's economy (Figure 1). The balance of responses⁸ on present and future conditions, in turn, are calculated by using weights of enterprises and undergo the procedure of deseasonalization. Then the assessment of present and future business conditions in the economy is aggregated taking account of weights of sectors in line with the share of their GVA in the GDP.

Based on this "clock", one may conclude that in 2016⁹-2017 the economy was at the stage of upswing, and in 2018-2019 – in the boom area, whereas in March 2020 the economy of Kazakhstan has abruptly shifted to recession after imposition of restriction measures in connection with the spreading of coronavirus infection, which had affected the economic activity of enterprises in a negative way. In April 2020, a record-high decline in the business activity was observed: assessments of both present and future business conditions deteriorated. In May 2020, after easing of quarantine measures, the economic activity was recovering: assessments of present and future business conditions were gradually improving although they were still negative in general. Beginning from September 2020, the economy moved to the stage of upswing. From the beginning of autumn, expectations of enterprises were positive though present conditions were still assessed as negative. In November 2020, despite significant advancement of the present situation as compared to October and a minor improvement of expectations for December, the economy remained at the upswing stage.

⁸ difference between positive and negative assessments

⁹ the beginning of observations - September 2016

Box 3. Effect of the Pandemic on the Transport Sector of Kazakhstan

Figure 1. Dynamics of the Volume of Transport Services and Warehousing, Contributions by Regions, YoY, as %

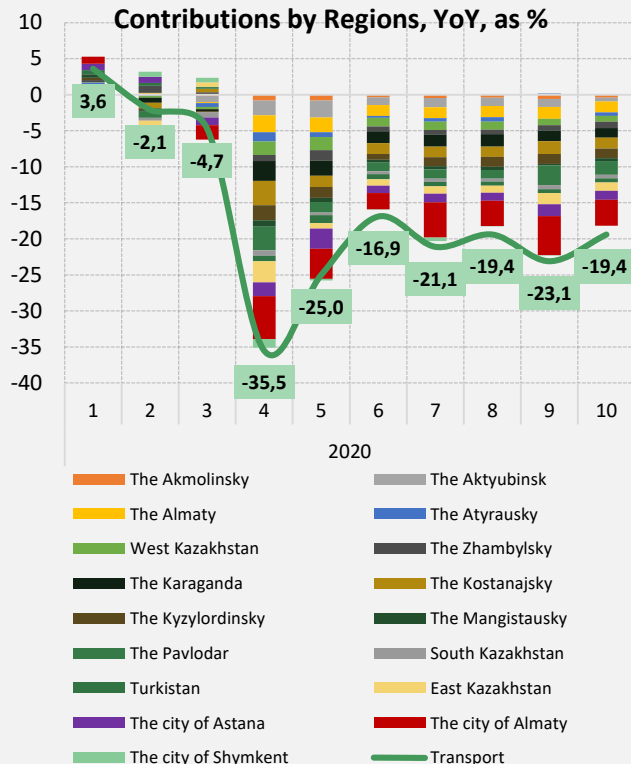


Figure 2. Quantum Index of Cargo Transportations, as % YoY

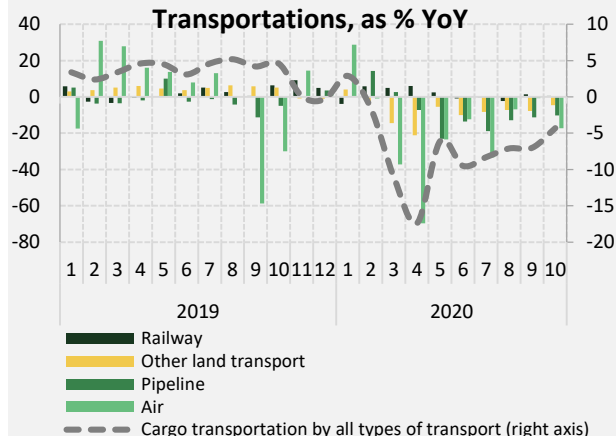
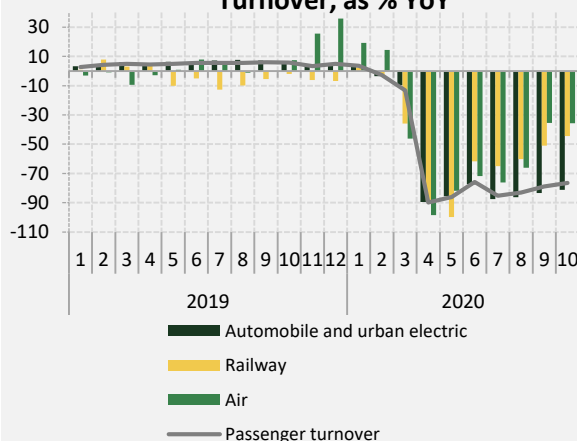


Figure 3. Quantum Index of Passenger Turnover, as % YoY



Source: BNS ASPR

In 2020, most of economies worldwide appeared to be negatively affected by factors associated with the coronavirus infection. Occurrence of first COVID-19 cases in Kazakhstan had necessitated the imposition of the state of emergency in the country and lockdown in the cities and towns. The list of cities and regions, which were hit by the lockdown was extending as new cases of infection had been detected, paralyzing the operation of the majority of entities in the real sector of the economy. The transport sector became one of the most affected branches by the pandemic and by the associated restrictions.

A similar situation was also observed in Kazakhstan. A temporary suspension of operations by the majority of enterprises and restrictions regarding the movement of people resulted in reduction of the volumes of cargo and passenger transportations. Transport has become the sector, which demonstrated the largest decline in 2020. The peak of decline in transport services in Kazakhstan occurred in April (a 36.6% contraction) and May (by 25.0%) 2020 (month versus the corresponding month of the last year). Along with the sector of trade, transport sector made the main contribution to reduction in the GDP.

In January-October 2020, volumes of services in the sector of transport and warehousing went down by 17.3% in annual terms. Given a 2.9% contraction in GDP over 10 months of 2020, a negative contribution to such decline by the transport sector made up 1.3 pp. The last time when the similar dynamics had been observed was in 2009. On a region-by-region basis, the main contribution to contraction of transport services was made by reduction in volumes in the city of Almaty (by 22.7%, YoY), and in Kyzylorda (by 21.5%, YoY), Karaganda (by 24.5%, YoY), West-Kazakhstan (by 25.9%, YoY) regions (Figure 1).

Cargo transportations by all means of transport in January-October 2020 contracted by 7.1% (YoY) for the first time since 2016. Less cargo had been transported by the air transport – a 18.5% decline (the share in the total volume of transportations – 0.4%) as well as by other overland transport – by 7.9% (8.1%). Given the contraction of business activity in the trading partner countries caused by the spreading of COVID-19, the demand for energy resources from Kazakhstan decreased resulting in the reduced export volumes of oil and gas condensate. This had a negative impact on the dynamics of pipeline transport where the volumes went down by 8.4% (the share in the total volume of transportations – 51.4%) (Figure 2). Alongside with that, contraction in the volumes of oil production as part of observance of the OPEC+ agreement contributed to decline in performance of the pipeline transport.

On a region-by-region basis, contraction in volumes of cargo transportations was observed virtually within the entire territory of Kazakhstan, except West-Kazakhstan Region, the cities of Almaty and Shymkent.

As a result of imposed restrictions on movements within cities and towns and operation of the public transport as well as because of the closed borders and transition to the teleworking by people, volumes of passenger turnover had reduced by 60.4% (YoY) since the beginning of the year. Contraction occurred in all types of transport and in all regions of Kazakhstan. The passenger turnover by the railway transport decreased by 52% (the share in the total volume of passenger turnover – 13.5%), by road transport – by 61.5% (the share – 70.5%), by air transport – by 52.1% (the share – 15.5%) (Figure 3).

Box 4. Consumer Demand in the Time of COVID-19 Pandemic

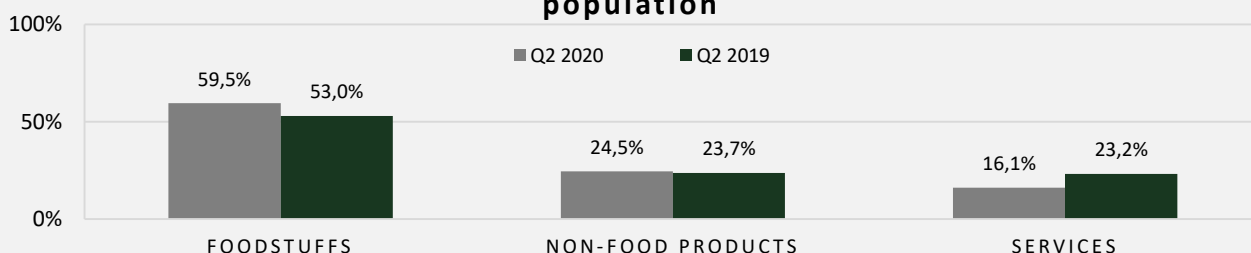
The COVID-19 pandemic brought significant changes to the consumer preferences and the people's expenditures all over the world. The change in the structure of spending is closely related to limitations of mobility and activity imposed by governments of different countries in order to prevent the spreading of coronavirus.

The main factors for changes in the consumer spending of households appeared to be the imposition of quarantine restrictions, closures of hotels, restaurants, beauty salons and a transition to an online mode of working and learning. This was also driven by a temporary or permanent loss of income and a more cautious health-seeking behavior of people.

All over the world, the demand for travel and transport services, public catering services, services of beauty salons, cultural and sport activities have decreased significantly since the beginning of pandemic. An online form of work and study, together with the closure of shopping facilities have resulted in a reduced demand for some types of clothes and footwear. At the same time, expenditures for foodstuffs went up, especially at the beginning of pandemic, being related to the roaring demand of the population and hedge buying as well as a need to cook at home¹⁰.

Such changes in consumer preferences and spending are also observed in Kazakhstan. According to the BNS ASPR, in the structure of household spending in the second quarter of 2020 the share of food expenses increased to 59% (the second quarter of 2019 – 53%) in parallel with a reduction to 16% in the share of expenditures for paid services to the population (23%). The percentage of expenditures for non-food products has not changed (24%), being driven by divergent trends in the demand for goods in the structure of this group (Figure 1).

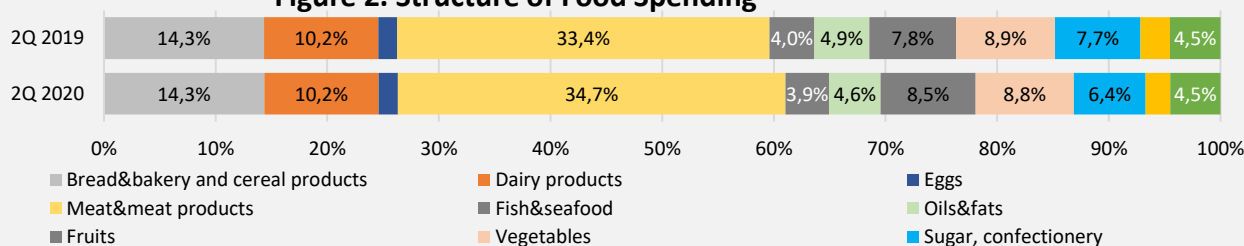
Figure 1. Structure of the consumer spending of the population



Source: BNS ASPR

Within consumer spending, the largest growth was observed among food expenses (by 15% in nominal terms, YoY). However, the structure of food spending has not undergone significant changes (Figure 2). There is a minor increase in spending on meat and meat products because of growing consumer prices. The increased spending on fruits is also worth mentioning; this may be caused by a hike in prices and a heightened demand in the period of pandemic for immunity-boosting products. In turn, spending on sugar and confectionery products decreased being connected with a drop in prices of sugar that has been observed since the end of 2019. In the environment of decreasing people's spending on food outside home due to the existence of quarantine restrictions, food spending increased as a whole.

Figure 2. Structure of Food Spending



Source: BNS ASPR

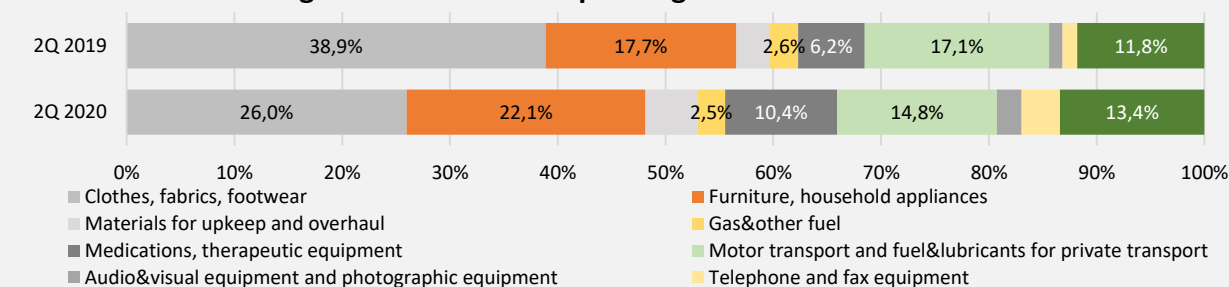
As opposed to foodstuffs, the impact of COVID-19 pandemic has largely reflected on spending for non-food products and services (Figure 3). There was a significant reduction in the share of spending on clothes

¹⁰ The IMF's research of August 17, 2020, Special Series on COVID-19 «CPI Weights and COVID-19 Household Expenditure Patterns».

and footwear (to 26%), fuel and lubricants (to 14.8%), being driven by a transition to teleworking, by imposed restrictions for movements within the country and flights abroad. Alongside with that, the working and studying from home resulted in a heightened demand for information and communication hardware, specifically computers as well as furniture and household appliances that most likely was dictated by the necessity to arrange a working place and provide comfortable conditions for working and studying. Given the rise in the cost of goods of that category caused, among other things, by depreciation of the exchange rate of the tenge, the percentage of household spending on furniture and household appliances went up to 22.1%.

The share of expenditures on medications increased because of a significant aggravation of the epidemiological situation, a rise in the number of infected individuals as well as appreciation of medications in terms of price both as a result of a higher demand and the depreciation of the exchange rate of the tenge.

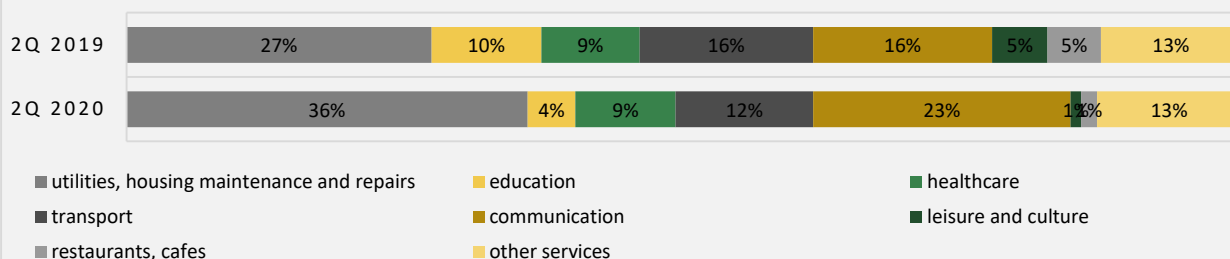
Figure 3. Structure of Spending on Non-Food Products



Source: BNS ASPR

The sector, which had been affected by the coronavirus pandemic most of all was the sector of paid services. Reduction in the share of household spending was observed among all services related to travelling, trips, leisure, sports and culture, eating in restaurants and cafes as well as to personal care services (Figure 4). Expenditures related to education went down since studying was moved to the online format as well as due to the opening of a free access to many of educational platforms. However, expenditures on communication and healthcare services went up because of a heightened demand. Expenditures for utilities increased accounting for 36% in the second quarter of 2020, despite the fact that tariffs had been lowered in the period of lockdown and the state of emergency; such increase could be caused by the growth in consumption of utility services on the whole given that people were staying at home under self-isolation.

Figure 4. Structure of spending on Services



Source: BNS ASPR

3.3. Inflation

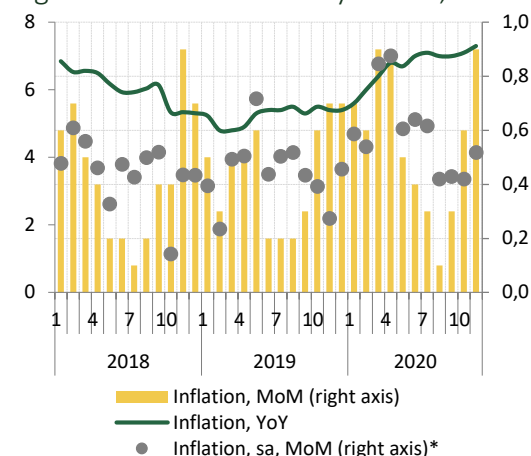
In November 2020, the annual inflation accelerated to 7.3%, while staying above the target of 4-6% (Figure 40). Along with that, the dynamics of annual inflation have been below the National Bank's projections, being driven by a more moderate than expected rise in prices of food and non-food products.

The rise in prices of **foodstuffs** has been demonstrating deceleration since August. Nonetheless, this group of goods continues to make the main contribution to formation of inflationary processes. At the same time, in November 2020 the annual growth in food prices accounted for 10.8% against deceleration in the growth rates of food producer prices as well as due to the exclusion from calculation of high monthly rise in prices for meat, bread and bakery, and cereals of the last year (Figure 41).

The annual inflation of meat and meat products was decelerating amidst a more moderate rise in producer prices of processed meat and meat in live weight. A downward pressure on consumer prices of meat was also put by the decline in world prices in the environment of a feebleness demand (Figure 42).

A slowdown of the annual price growth rates for bread and bakery occurs against the decelerating growth in wheat prices that is related to a richer harvest of 2020 and the increase in stocks¹¹. At the same time, the FAO Cereal Price Index has been accelerating for the fourth consecutive month as a result of the rise in export prices of wheat, thus reflecting an active global demand. Along with that, there is a decline in export supply caused by adverse weather conditions in Argentina, in some regions of Europe, North America and the Black Sea region (Figure 43). The rise in the world prices of wheat creates additional risks for the growth of domestic wheat prices and all bread and bakery products.

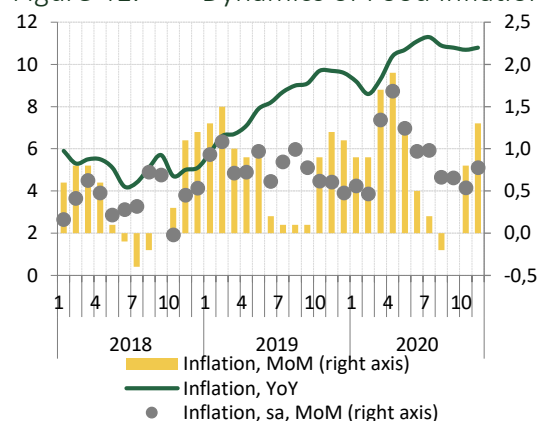
Figure 40. Inflation Dynamics, %



Source: BNS ASPR

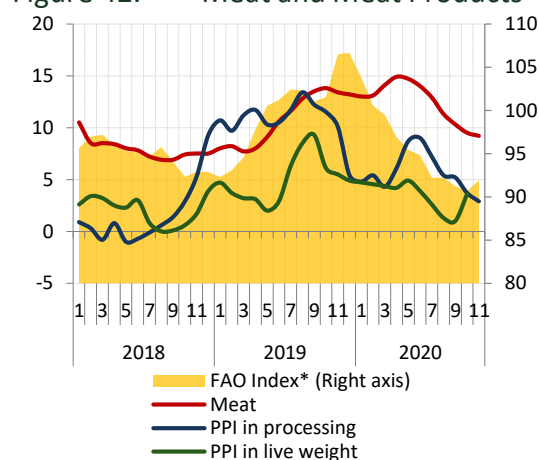
* Seasonal adjustment has been performed by using the X-12-ARIMA method from 2011 till present.

Figure 41. Dynamics of Food Inflation, %



Source: BNS ASPR

Figure 42. Meat and Meat Products



Source: BNS ASPR

¹¹ According to the data from the Committee of the Government Inspection in the Agro-Industrial Complex with the Ministry of Agriculture of the Republic of Kazakhstan, the quantity of cereals threshed in 2020 exceeded that of 2019 by 5.6%.

At the same time, it should be noted that the annual growth in prices of buckwheat decelerated as a result of stabilization of a monthly increase in prices and a gradual exhaustion of the high base effect of 2019. A high rise in prices of buckwheat in the last year was driven by reduction of planted acreage of buckwheat and a nearly double reduction of a gross yield because of a low profitability and labor intensiveness of buckwheat harvesting.

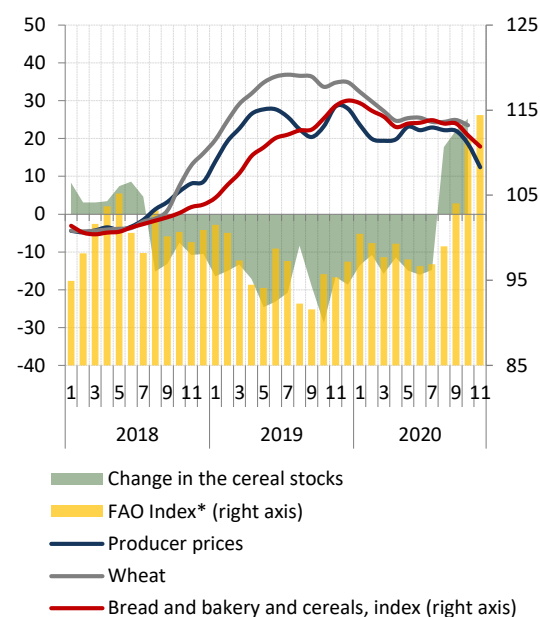
The dynamics of prices for fruit and vegetable production remain stable. Acceleration in the growth rates of prices for vegetables is offset by disinflation of fruits. In November 2020, the price growth rates for all fruits represented in the consumer basket were decelerating. In the structure of vegetables, the growth in prices of tomatoes and cucumbers decelerated, whereas other items demonstrate acceleration of price growth rates.

Despite the overall deceleration trend of the food inflation, the growth in prices of a number of products kept accelerating. So, in November 2020, the annual inflation of eggs accounted for 16.6%. The growing cost of eggs is associated with the accelerating growth in producer prices caused by the increased price of forage as well as by consequences of the bird's flu.

The rise in prices of vegetable oil that has been observed recently is caused by the growth in producer prices and appreciation of import prices, specifically for products imported from Russia where the price growth is observed because of a bad crop of sunflower seeds in 2020.

According to the BNS ASPR, in January-September 2020 about 84% of consumed refined white sugar in Kazakhstan was secured by imports, with a significant portion being delivered from Russia. A high share of Russian imports increases dependence of domestic prices on prices in Russia, where a considerable rise in prices of sugar caused by a decline in supply has been observed lately (in October 2020, the growth in prices of sugar in Russia accounted for 39.8% YoY).

Figure 43. Bread and Bakery and Cereals



Source: BNS ASPR,

It is worth mentioning that according to the data from public polls about inflation expectations, in November 2020 the percentage of respondents who noted the growth in prices of sugar, vegetable oil and eggs increased sharply (Figure 44).

In November 2020, the **non-food inflation** accounted for 5.7% in annual terms (Figure 45). The growth rates of prices for the majority of non-food products remain at the pre-crisis levels, despite a rise in prices of import deliveries. This is driven by a sluggish consumer demand caused by reduction in real money income of the population, by existence of quarantine restrictions for operation of trading facilities and imposition of the lockdown in certain regions of the country.

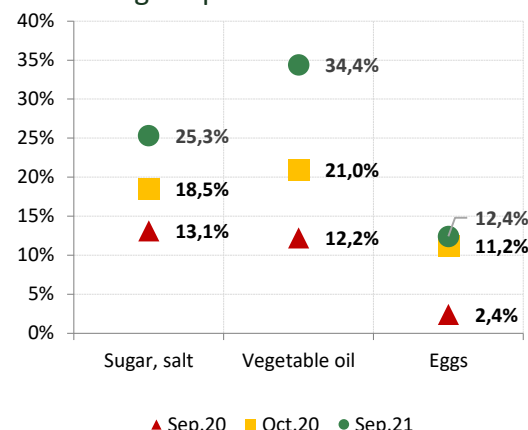
At the same time, the growth rates of prices for non-durable goods accelerated. The rise in prices of pharmaceutical products accelerated to 9.7% (YoY) in the environment of a heightened demand, despite a slowdown in the growth rates of import deliveries to 0.2% (YoY) in September 2020 (Figure 46).

The annual rise in prices of detergents and scouring products accelerated to 10.2% because of a persistently high demand for these products during a complicated epidemiological situation. Household utensils appreciated in terms of price in response to depreciation of the nominal exchange rate of the tenge and a heightened demand during the quarantine.

Low values of annual price growth rates of fuel and lubricants keep putting a downward pressure on the non-food inflation (November 2020 – an annual growth of 1.7%) in the environment of a modest demand and the growing domestic production (Figure 47).

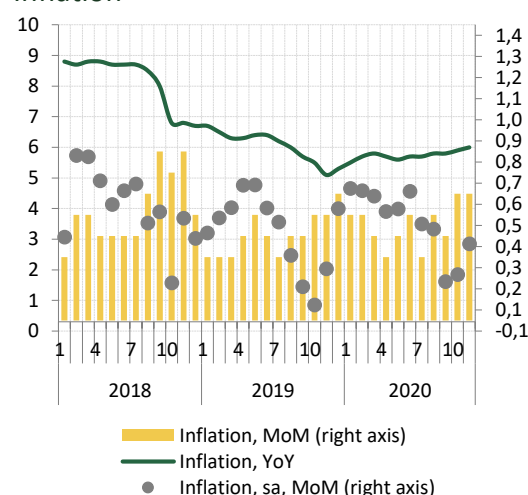
However, it should be noted that there is still a tendency of shifted consumer preferences towards cheaper imported goods, specifically clothes and footwear; this puts an additional disinflationary pressure. So, according to the CS MNE, in January-September 2020 as compared to the same period of 2019, physical import volumes of non-food products (clothes, footwear, medications, furniture and household appliances) were growing faster than value imports. Along with that, the reduced income of the population, teleworking and e-learning determined a lower demand for these goods.

Figure 44. Perceptions of Price Changes for Sugar, Eggs and Vegetable Oil Among Respondents



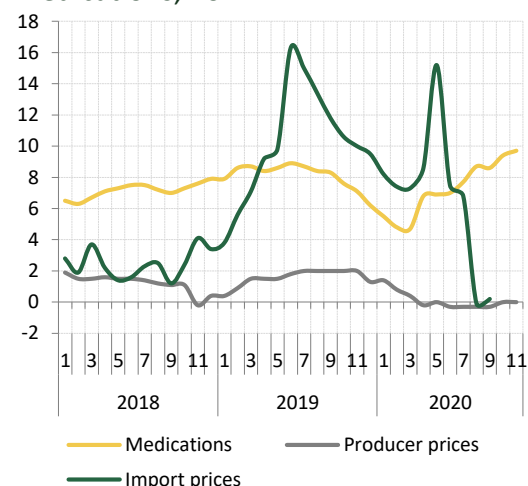
Source: Fusion Lab

Figure 45. Dynamics of Non-Food Inflation



Source: BNS ASPR

Figure 46. Dynamics of Prices for Medications, YoY



Source: BNS ASPR, NBRK's calculations

In November 2020, the **annual inflation of paid services to the population** accelerated to 4.1% (Figure 48).

In the structure of service inflation, the annual growth in tariffs for regulated utility services accelerated to 2.4% (Figure 49).

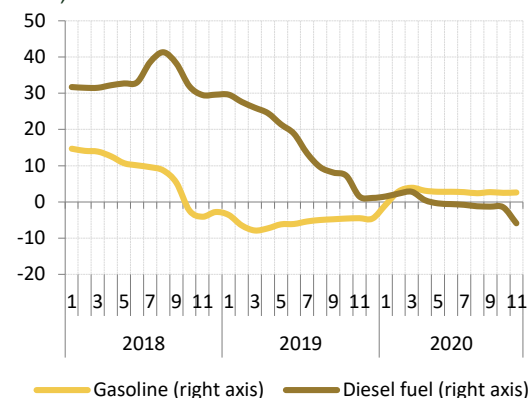
So, in November 2020, there was a significant acceleration of the annual inflation on waste collection services (to 20.5%), and electricity (to 6.6%). The Ministry of Energy from July 1, 2020 approved new marginal tariffs for electricity producing companies (a growth within the range of 0.7%-44%) in connection with the need to upgrade and renew assets as well as with the growth in spending¹². This fact creates risks for further acceleration of the service component through a direct effect as well as through an indirect effect via the increase in the producer prime cost.

In addition to utility services, inflationary pressure in August-November 2020 was put by the increased cost of services on footwear repair (November 2020 – a 8.3% growth, YoY), funeral services (6.1%), car repairs (5.6%), services of hospitals (5.3%) and university education (4.2%).

In October 2020, the annual **core inflation** (excluding prices of fruits, vegetables regulated services and fuel and lubricants) accounted for 7.4% (Figure 50). The differential between the headline and core inflation is shrinking, which is related to exhaustion of a disinflation impact by goods that are excluded from the calculation of core inflation and that had a downward pressure on the headline inflation (Figure 50).

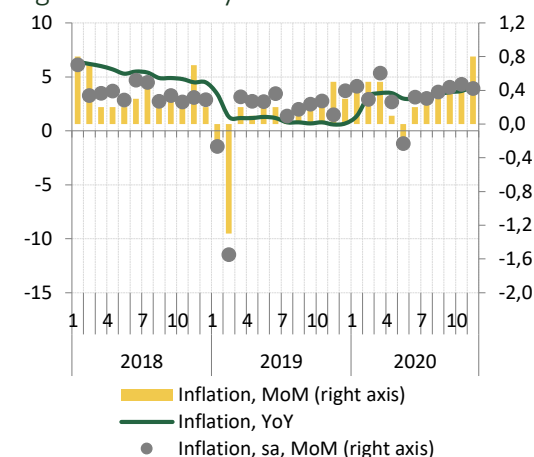
Core inflation trimmed mean (excluding eight per cent of maximum and minimum price values), after its acceleration in the first half of 2020, in September-October had stabilized at 6.1% in annual terms, which reflects the offsetting of disinflation factors by pro-inflationary factors.

Figure 47. Gasoline and Diesel Fuel, YoY, %



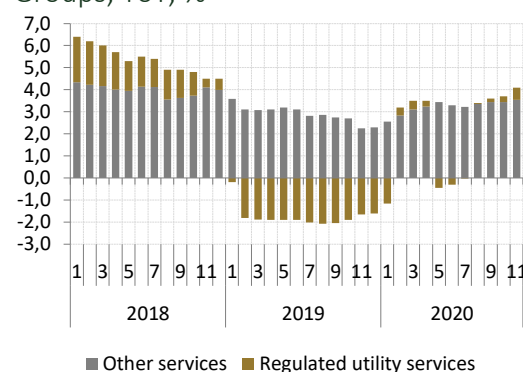
Source: BNS ASPR

Figure 48. Dynamics of the Service Inflation



Source: BNS ASPR

Figure 49. Contributions to the Service Inflation by Groups, YoY, %



Source: BNS ASPR, NBRK's calculations

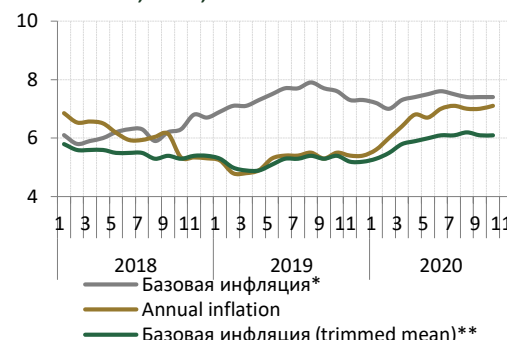
¹² The Order of the Minister of Energy of the Republic of Kazakhstan of June 29, 2020 No. 243 "On a Change to the Order of the Minister of Energy of the Republic of Kazakhstan of December 14, 2018 No. 514 «On Approval of Marginal Electricity Tariffs»"

Assessments of inflation expectations by the population in October increased. A tense epidemiological situation in the country and the strengthening of quarantine in certain regions of the country served as the key factors that influenced the outcome of the public poll.

In November 2020, a quantitative assessment of inflation for a year ahead made up 7.8% (Figure 51). The percentage of respondents who anticipate that the price growth will remain at the existing level or will be faster within the next 12 months went up to 52% (in September – 49%). In October – November, respondents noted acceleration of the growth in prices of certain foodstuffs, including vegetable oil, eggs and sugar.

The boost in inflation expectations was accompanied by the increased degree of uncertainty in answers of respondents. About one third of the interviewed found it difficult to assess their expectations, which is the maximum number for the entire history of the polls.

Figure 50. Inflation and Core Inflation*, YoY, %

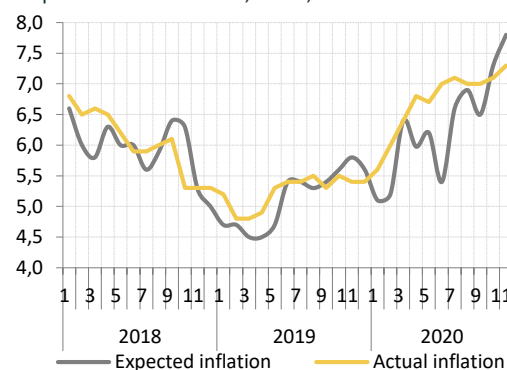


* Excluding prices of fruits and vegetables, utilities (regulated), railway transport, communication, gasoline, diesel fuel and coal

** All goods and services excluding the price changes of eight percent of maximums and minimums
Core inflation; Core inflation (trimmed mean)

Source: BNS ASPR

Figure 51. Inflation and Expected Inflation, YoY, %



Source: BNS ASPR

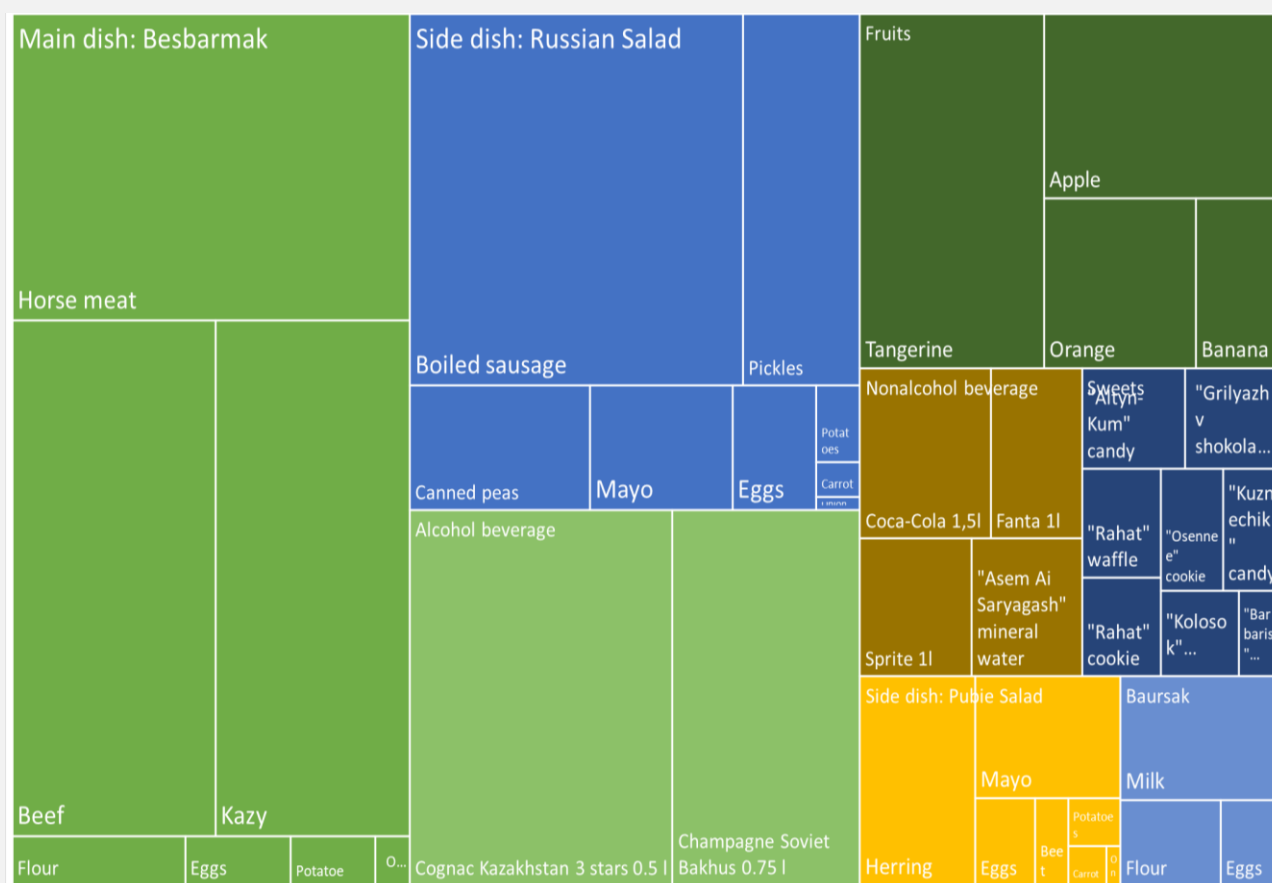
Box 5. Assessment of the Cost of Products to be Used for Arranging the New Year Table Based on the Web-Scrapping

A forced development of the information technology sector in the time of pandemic led to emergence of new channels of sale and a transition to the online sales by many retailers. So, purchases of goods and services in the Internet via a retailer's web-site have received a significant development. The development of online shopping enabled to expand the database considerably with a higher frequency for analysis of consumer prices with the use of elements of computer-assisted learning. Web-scraping is one of the most popular methods for collection of pricing information. It represents a technology of obtaining the web-data by deriving such data from pages of web-resources. The scrapping of web-pages in combination with methods of processing and analyzing big data allows evaluating more individualized and effective indicators that are comparable in quality with official statistics. Web-scraping technologies expand research capabilities by allowing the collection and interpretation of socio-economic data. They also allow you to create new analysis metrics, change frequency and focus on specific product and service groups.

The web-scraping method is quite popular in central banks worldwide as an instrument of an alternative inflation assessment¹³. As opposed to the use of data from BNS ASPR, this method allows reviewing information and all its components with a greater level of detail as well as working with data from original sources.

Since 2017, the National Bank of Kazakhstan has been working on the development and implementation of the system of consumer price monitoring and analysis called "Galymzhan", which collects and aggregates all products from the consumer basket that are available in the Internet and their prices. At present, the "Galymzhan" system collects the data on prices in 6 cities and towns of Kazakhstan (Nur-Sultan, Almaty, Shymkent, Karaganda, Ust-Kamenogorsk, Pavlodar), which is related to the absence of technically acceptable online shops in other towns and regions¹⁴.

Figure 1. The Recipe for a Festive Table



¹³ At present, an own system of alternative calculation of inflation (based on the web-scraping) is applied in central banks of India, Poland, Sweden, Armenia, Ukraine.

¹⁴ Representation of towns in the system will be extended with the development of digitalization in the regions and the appearance of online shops acceptable for the web-scraping.

On the cusp of the New Year, an estimate of the cost of “a new year table” was made on the basis of the data gathered by the “Galymzhan” system. Thus, the cities and towns available in the system were included into the sample while the new year menu was compiled based on expert judgement (Figure 1).

Figure 2. Comparison of the Cost of a New Year Table and Nominal Wages, on a Town-by-Town Basis

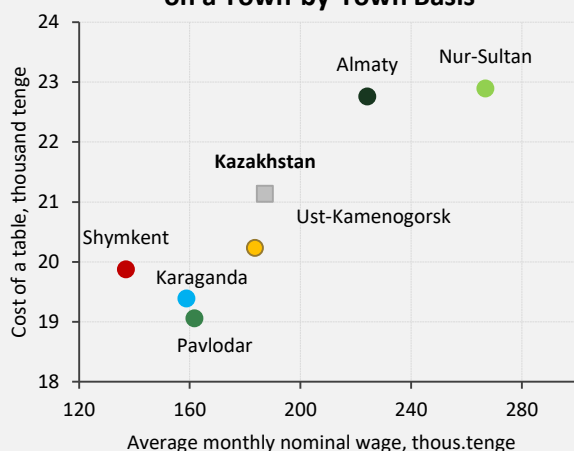
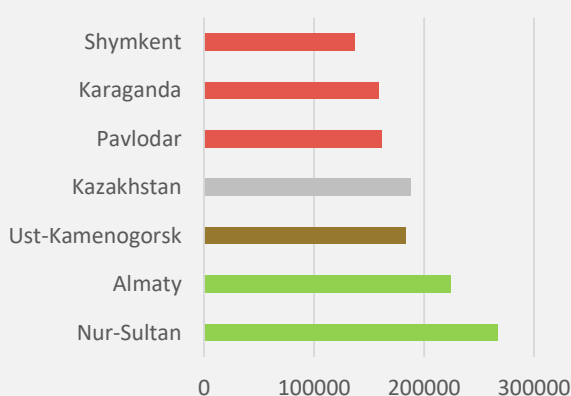


Figure 3. Purchasing Capacity, According to "Galymzhan" System



Source: BNS ASPR, NBRK's calculations

The cost of “a new year table” was calculated taking account of an average number of individuals in a household in Kazakhstan (4 persons). Average prices from the “Galymzhan” system as at December 20, 2020¹⁵ in combination with the data from BNS ASPR were used as the price of foodstuffs.

The analysis showed that the cost of a new year table will be 21 108 tenge on average for the country (Figure 2). The largest amount for the feast will be spent by people living in the capital city (23 117 tenge), and the smallest – by residents of Pavlodar (19 195 tenge) where the price of meat is one of the lowest in the country. Among the towns presented, the city of Shymkent should be pointed out where wages in nominal terms are the lowest among the reviewed towns, however, “the new year table” will be more costly than in Karaganda and Pavlodar.

Alongside with the assessment of the cost of “a new year table”, an indirect purchasing power index of the population was calculated on a regional basis; it represents the number of “new year tables” which could be bought for an average monthly nominal wage in a region. The highest purchasing power is observed in Nur-Sultan (11.54 tables), and the lowest – in Shymkent (6.73 tables). It should be mentioned that in Ust-Kamenogorsk where the average monthly nominal wage is below the country's average, residents of the town could afford to lay 9.44 “new year tables”, which is above the country's average index calculated.

¹⁵ Prices for meat and meat products and alcohol beverages were taken from the data of BNS ASPR because of their absence in the Galymzhan system.

3.4. Labor Market

In the labor market, negative trends are persisting, being caused by consequences of restriction measures undertaken to fight the spreading of COVID-19.

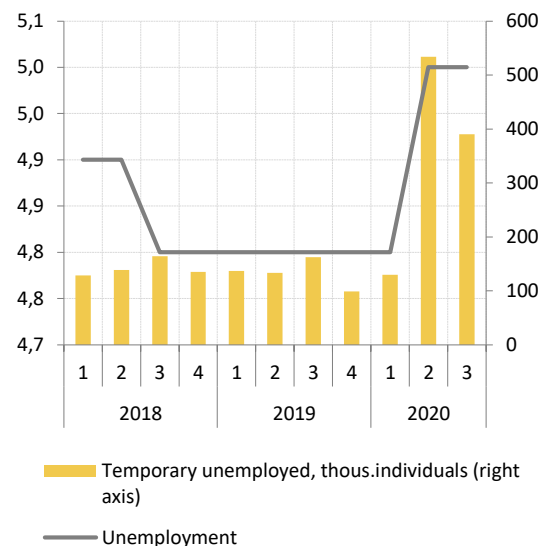
The unemployment has been standing at 5% for the second consecutive quarter (Figure 52). The numbers of the employed population decreased by 0.7% in annual terms whereas the numbers of the unemployed population increased by 2.9%.

In the structure of employed population, there was reduction both in the number of employees (by 0.2%, YoY), and in the self-employed population (by 2.1%, YoY). At the same time, in the third quarter of 2020 a certain positive trend had outlined: the numbers of temporary unemployed population reduced significantly as compared to the previous quarter but are still above the pre-crisis level (Figure 52). So, if in the first quarter of 2020 the number of temporary unemployed individuals was 129 000, in the second and in the third quarters more than 500 000 and 390 000 individuals, respectively, happened to be temporary unemployed.

The number of individuals who applied to the public employment authorities in connection with the growth of the temporary unemployed and unemployed population slightly increased as compared to the periods of strict lockdown. The highest demand was recorded in June 2020, when the number of individuals who applied to the public employment authorities amounted to 92 000, and in September, given a partial lifting of restrictions and resumption of operations by enterprises in the real sector, the number of applications fell below 70 000 individuals (Figure 53).

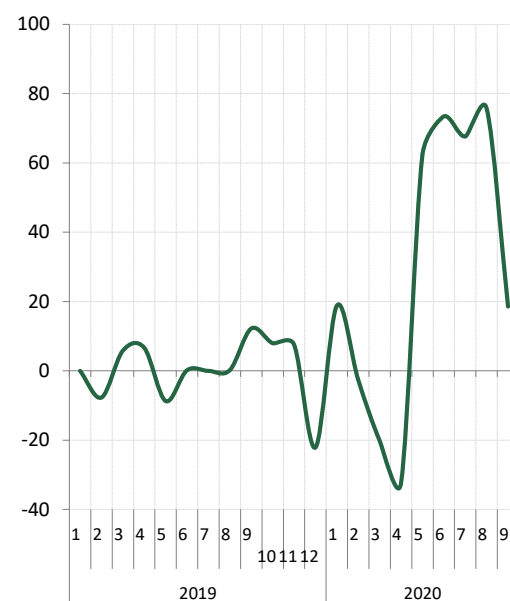
A decline in employment in annual terms was observed in many branches of the real sector (Figure 54). The largest reduction was observed in the area of accommodation and catering services (by 8.3%), and arts, entertainment and leisure (by 7.8%), where the number of employees and self-employed population is decreasing concurrently (Figure 54).

Figure 52. Unemployment Rate and the Temporary Unemployed Population



Source: BNS ASPR

Figure 53. Individuals Who Applied to the Public Employment Authorities as Job Seekers, YoY, %



Source: BNS ASPR

A significant reduction of employment as a result of the decreased number of employees was recorded in the activities of administrative and ancillary service (by 6.7%) and transport (by 5%) while the self-employed population in these sectors increased. Branches of the government sector remain stable in terms of the growing employment, where the number of employees is increasing but the number of self-employed is decreasing (except the general government where there is no self-employed population).

In the sector of information and communication, the numbers of employees are going up against a concurrent reduction in the employment; this may indicate an overflow of the self-employed population to the employee category due to acceleration of the economic activity in this sector (Figure 54).

Reduction of employment has been observed in all regions except Turkestan Region and cities of national status.

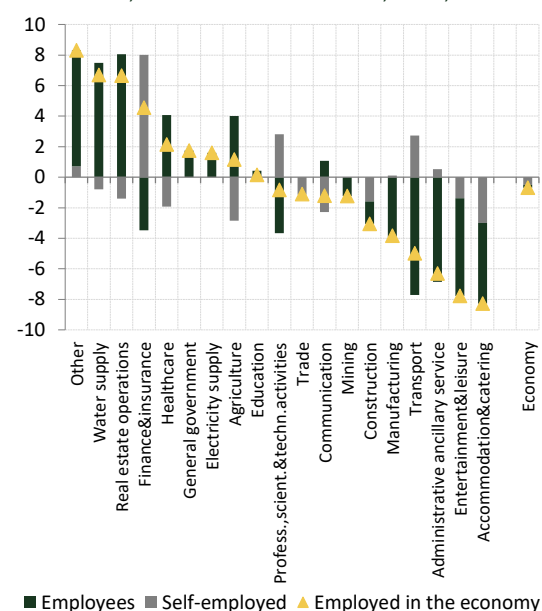
According to the National Bank's assessments, based on the data from the CS MNE, over 9 months of 2020 the labor productivity has decreased with a concurrent reduction of the gross value added in the economy and the employment (Figure 55).

The growth in labor productivity was observed in the construction sector, information and communication, in the manufacturing industry, accommodation and catering services, activities on administrative and ancillary service along with positive dynamics of added value in the branches (Figure 55, Group I).

In the sectors of agriculture, education, general government and electricity supply, the labor productivity was growing along with the increasing employment.

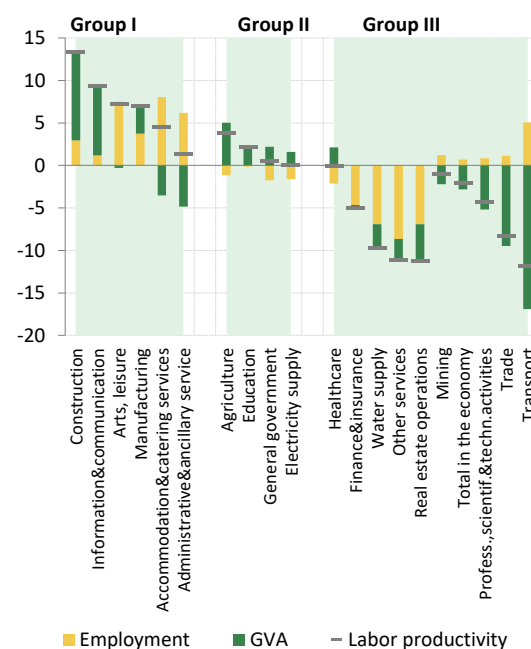
Branches in the third group were showing the decreasing labor productivity. The decline in healthcare, finance and insurance, water supply, real estate operations, and other services resulted from a drop in gross output against the growth of employment. At the same time, reduction of labor productivity in the rest of sectors of the third group was accompanied by the growing employment along with the declining gross output in the sectors.

Figure 54. Employed Population, Employees and Self-Employed Population by Types of Economic Activities, for the 3rd Quarter, YoY, %



Source: BNS ASPR, NBRK's calculations

Figure 55. Labor Productivity by Types of Economic Activities for 9 Months of 2020, %



Source: BNS ASPR, NBRK's calculations

3.5. Fiscal Policy

Given deterioration of the macroeconomic situation, imposition of the state of emergency and restriction measures with a view to prevent the spreading of coronavirus infection in Kazakhstan, the fiscal policy had a social stance.

The budget for 2020 envisaged the increase in expenditures, first of all, for social welfare and social security, education and healthcare. During January-October 2020, in order to support the economy and implement the anti-crisis measures, a guaranteed transfer of 4.3 trillion tenge was allocated from the National Fund to the budget (in 2020, the total planned amount of the guaranteed transfer from the National Fund was 4.8 trillion tenge), whereas in 2019 the guaranteed transfer was 2.4 trillion tenge and the earmarked transfer amounted to 370 billion tenge.

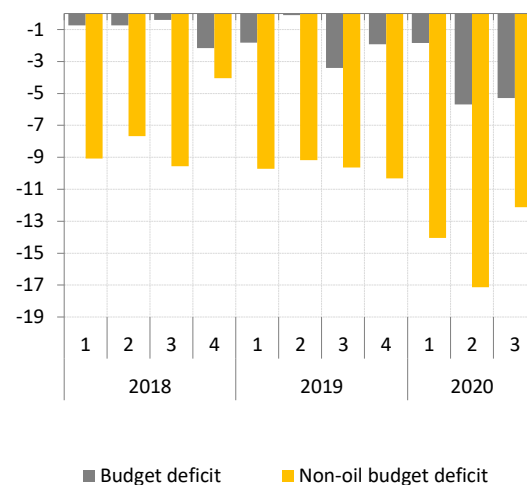
In January-October 2020, the national budget showed up a deficit of 2.2 trillion tenge or 3.2% of GDP, having nearly doubled as compared to the corresponding period of 2019. Expansion of the budget deficit, in the first instance, was driven by a high growth of expenditures against a moderate increase in revenues.

The non-oil budget deficit (the budget deficit excluding transfers from the National Fund and export customs duties for crude oil) during January-October 2020 amounted to 7.0 trillion tenge, which is by 55.1% greater than in the corresponding period of 2019 (Figure 56).

During January-October 2020, the national budget revenues went up by 7.6% as compared to 2019 and amounted to 9.0 trillion tenge. The main reason for the growth in revenues is the increase in receipts of **official transfers** by 53.6% (the share in the budget revenues accounted for 52.8%) and in **non-tax revenues** by 96.2% (the share – 2.9%).

The rise in non-tax revenues was ensured by a significant increase in dividends on the government blocks of shares in public ownership.

Figure 56. Overall and Non-Oil Deficit of the National Budget, as % of GDP

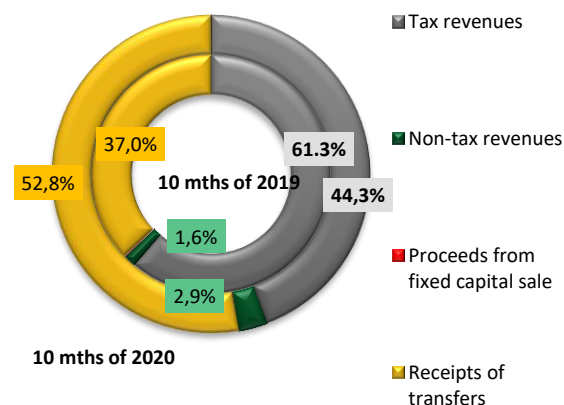


Source: RK's Ministry of Finance, NBRK's calculations

Against the backdrop of imposed restriction measures to fight the spreading of coronavirus and due to the decreased economic activity, **there was a reduction in tax revenues** (by 22.3%) and **proceeds from fixed capital sale** (by 77.1%). In addition, a decline in tax revenues occurred as a result of measures taken by Kazakhstan's government to support businesses and income of the population; as part of such support, small and medium-sized businesses in the mostly affected sectors of the economy had been exempted from taxes and other mandatory payments from the payroll fund (Figure 57).

During January-October 2020, the national budget spending went up by 19.1% as compared to the corresponding period of the last year and amounted to 10.8 trillion tenge. The main contribution to the increase in the national budget spending has traditionally been made by expenditures for social welfare and social security (the share – 29.7%), with their growth accounting for 19.5%. A 44.6% rise in spending on healthcare (the share – 11.9%) was driven by anti-epidemic measures taken as part of the struggle with the spreading of coronavirus and by the raising of labor compensation for the medical staff. Also, there was an increase in expenditures on education – by 47.2% (the share – 6.2%) due to the pay boost to teachers, on official transfers – by 31.2% (the share – 16.9%), and debt servicing – by 13.4% (the share – 6.5%).

Figure 57. Structure of the National Budget Revenues



Source: RK's Ministry of Finance

Box 6. Analysis of the Fiscal Stance in 2020

Fiscal Impulse and Budget Deficit. In 2020, deterioration in external and internal conditions coupled with the spreading of COVID-19 pandemic, conducted the cooling of the economic activity in Kazakhstan. In order to mitigate negative implications for Kazakhstan's economy, alongside with the monetary measures, counter-cyclical fiscal policy measures were accompanied with a positive impulse.

Fiscal impulse is an indicator which determines the fiscal policy nature (contractionary, stimulative or neutral). According to the IMF's methodology, first of all, an operating balance is calculated which is determined as a difference between the budget revenues and spending and which is a proxy of the budget deficit. Then an operating primary balance is estimated, which assumes exclusion of interest expenses. Exclusion of interest payments from total expenditures allows reflecting the present policy of the general government sector since the amount of interest expenses reflects fiscal policy decisions of prior periods.

Then, a potential GDP and output gap are calculated. After calculation of potential GDP with the help of the Hodrick-Prescott filter, budget revenues are adjusted for the output gap in order to obtain a potential value of revenues. Contrary to revenues, the budget spending is assumed to be inelastic to cycles of the economic activity (actual or planned expenditures from the "Law on the National Budget" for a three-year period are used).

After the expenditure side of the budget is cleaned from interest expenses and potential revenues are obtained, the structural (primary, operating, cyclically-adjusted) balance is calculated that is determined as a difference between potential budget revenues and spending net of interest payments. Fiscal impulse is determined as a difference between the structural balances in the periods t and $(t-1)$. If the structural balance at the time t is greater than the balance at the time $(t-1)$, fiscal impulse is negative (contractionary fiscal policy), if the operating balance at time t is smaller than its previous value – fiscal impulse is positive (stimulative fiscal policy). If balances in the periods of t and $(t-1)$ are equal, fiscal balance is neutral.

Figure 1. Fiscal Impulse and the National Budget Deficit, as % of GDP

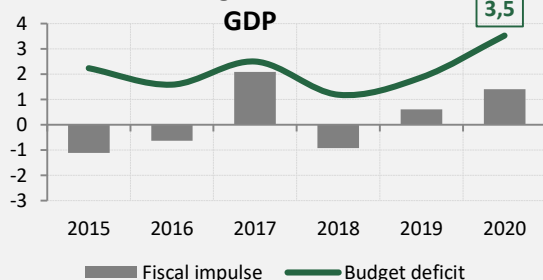
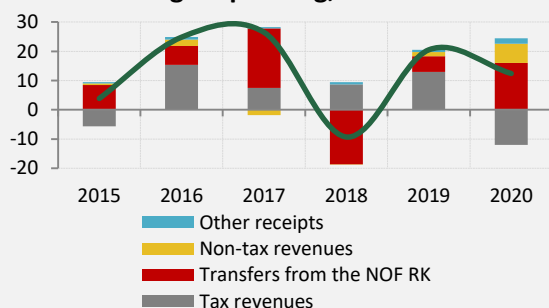


Figure 2. Structure of the National Budget Spending, YoY as %



Positive fiscal impulse in 2020 reflects both the impact of automatic stabilizers (reduction in tax revenues and the increase in expenses for subsistence allowances due to the growing unemployment rate) and implementation of the discretionary fiscal policy (appropriation of payouts of 42500 tenge to those individuals who lost their income, the expanded financing of government programs for stimulation of the economic activity, increase in retirement benefits). Implementation of the counter-cyclical fiscal policy will be accompanied by expansion of the national budget deficit to 3.5% (Figure 1). The abovementioned budget deficit number will be the maximum since 1999. The outstripping growth of expenditures over the revenue side will be conducive to the increase in the national budget deficit.

The budget deficit will be traditionally financed with the borrowed funds. So, according to the Government's projections¹⁶, the spending on debt servicing in 2020 will go up by 13.5%. It is worth mentioning that without an additional allocation of a significant volume of transfers from the NOF RK, the projected deficit would have demonstrated a much higher number (the non-oil budget

deficit is expected to be at 11.1% of GDP).

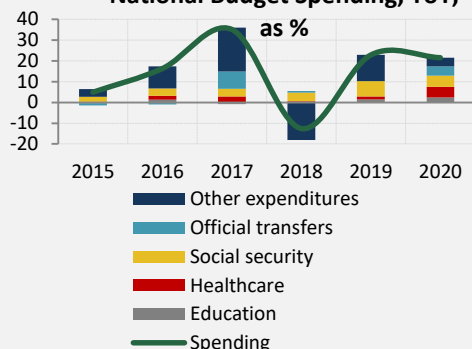
Revenues. According to the Law on the National Budget, in 2020 the budget revenues were increased by 12.4% owing to the growth of transfers from the National Fund of the PK by 55.4% (the "NOF RK") and the lower-level government authorities (50.2%) and to non-tax revenues (249.5%). Dividends on government blocks of shares in public ownership are supporting the increase in non-tax revenues. A negative contribution

¹⁶The growth rates of expenditure items of the budget for 2020 are calculated on the basis of the Law "On the National Budget for 2020-2022", No.372 of 03.11.2020 (the Presidential Edict of the RK).

to the dynamics of revenues is made by a 18.7% reduction in tax revenues due to a price decline in the commodity markets and the cooling business activity in the majority of industrial sectors.

Spending. The national budget spending in 2020 went up by 21.6%. On the expenditure side, the spending on the majority of items of the functional structure is anticipated. A larger contribution is made by

Figure 3. Structure of the National Budget Spending, YoY, as %



the increased spending on the social block (by 18.8%) as a result of increase in retirement benefits and student scholarships. Also, there is an intention to raise expenditures on healthcare by 49.4% due to the spreading of coronavirus infection and benefits for the medical staff. A 44.3% increase in expenditures on education is accompanied by a raise in salaries to certain categories of teachers.

Therefore, the following conclusions can be made:

- in order to mitigate negative implications from deterioration of external and internal environment, a stimulative counter-cyclical fiscal policy is implemented that is manifesting itself as positive fiscal impulse;

- positive fiscal impulse is accompanied by a significant expansion in the budget deficit (3.5% of GDP). Such a high value of the national budget deficit has been observed for the first time since 1999 and has been followed by an increase in the government debt. In turn, the expected increase in the government debt not only reflects the scale of negative effect of the coronavirus crisis and considerable measures for its mitigation but also a limited room for the budget deficit financing with transfers from the NOF RK.

- the growth in the national budget revenues is secured by a larger allocation of transfers from the NOF RK while tax revenues have decreased significantly. The increase in the budget spending reflects the measures of the counter-cyclical stimulative policy aimed at mitigation of negative consequences from deterioration of the external and internal market environment.

BASIC TERMS AND DEFINITIONS

Core Inflation – means the inflation which excludes transitory 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 which 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 tangible non-produced tangible assets; d) expenses in connection with the transfer of title for non-incurred costs.

FX Swap means a foreign exchange transaction which involves the concurrent purchase and sale of a certain amount of one currency in exchange of another currency with two different value dates.

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.

Reserve Money includes cash issued into circulation by the National Bank, other than cash at the cash departments of the National Bank, transferrable and other deposits of banks, transferrable deposits of non-bank financial organizations and current accounts of government and non-government non-financial organizations in the tenge at the National Bank.

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.

Composite Indicator – is a generalizing indicator which is used to reflect short-term trends in the development of the real sector of the economy. Composite indicator as possessing the forward-looking feature is used to reflect a cyclical change and to identify turning points when recovery and downturns in the economy occur and change. A composite indicator is built on the basis of the outcomes of survey among enterprises which participate in the market research conducted by the National Bank.

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 line 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.

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.

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 intervene in the 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.

Output Gap. 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.

Narrow Reserve Money is the reserve money excluding other deposits of banks at the National Bank.

LIST OF KEY ABBREVIATIONS

bp – basis point

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

GDP – gross domestic product

GPIID - the Government Program for Industrial and Innovation Development

EU – the European Union

ECB – the European Central Bank

CPI – consumer price index

KASE – the Kazakhstan Stock Exchange

KSF – the “Kazakhstan Sustainability Fund” JSC

NBRK – the National Bank of the Republic of Kazakhstan

VAT - value-added tax

OPEC – Organization of the Petroleum Exporting Countries

Rosstat – the Russian Federal State Statistics Service

REER – real effective exchange rate

IMF – the International Monetary Fund

bln. - billion

mln. - million

MNE – the Ministry of National Economy

MoA RK – the Ministry of Agriculture of the Republic of Kazakhstan

MED – the Ministry of Economic Development of the Russian Federation

thous.– thousand

TCO - Tengizchevroil

CB RF – the Central Bank of the Russian Federation

FAO – Food and Agriculture Organization of the United Nations

US Fed – the Federal Reserve System