

# Inflation rush into the new NBRK corridor of 4%-6%

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Assan Kurmanbekov — January 04, 2019

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According to Statistics Committee, inflation slowed in December, in comparison with the previous month to 0.7% (0.9% in November), the annual rate remained at the level of October and November at 5.3% (7.1% in 2017), average per year was 6% (7.4% in 2017). Taking into account the seasonal correction (sa), in our estimation, inflation was 0.9% mom, the main contribution to annual price increases have provided food and non-food products +1.9pp separately, services +1.5pp, in 2017 non-food items dominated +2.7 pp, groceries +2.5pp and services +1.9pp.

Food articles inflation was 1.2% mom, 0.8% moms and provided 0.45pp in overall inflation. Fruits and vegetables grew by 5.2% mom, eggs by 1.8% mom, poultry by 2% mom, milk by 1.1% mom, prices decline was observed for buckwheat (-0.7% mom), sugar (-0.3% mom).

Prices of nonfood products rose by 0.5% mom (0.6% moms), contribution to overall CPI was 0.15 pp. The cost of household goods increased (+0.7% mom), medicine (+1% mom), clothing and footwear (+0.9% mom), diesel price by (0.6% mom).

Services tariffs increased by 0.2% mom (0.5% moms), and 0.1 pp contribution to prices. The main factors of growth of tariffs were railroad transport (+2.9% mom), restaurants and hotels (+1.3% mom), health services (+0.6% mom), recreation and culture (+0.5% mom). A slight decrease in prices happened for individual utilities and education.

Results from population surveys in November, published by the NBRK showed persistence of high inflationary expectations. The percentage of respondents, awaiting acceleration of price growth in the next 12 months showed decline to 22.5% in November (21.3% in November 2017) after reaching a peak of 28.2% in September of 2018. The percentage of respondents who are awaiting either reduction or no change of prices increased slightly to 6.4% (6.7% in November 2017) on its lowest since 2016. In November this year, 66.4% (59.8% in November 2017) of respondents expected the tenge devaluation, although this is still below 70.7% at the peak in September 2018.

## Our opinion

Inflation in 2018 has been unusually low-key and ignored the negative impact of weak tenge, which for the most part of the year, was declining, the average annual value of which amounted to 344 per US dollar (a slump from late March 2018 by 15%), i.e. rolled back to the level of 2016, when there was 2-digit inflation. Inflation expectations reflect sensitively adverse movement in exchange rate, a record number of 28% of respondents expected an acceleration of growth in prices in September, but once again no inflation reflected this factor. It is known that the impact of the weakening of tenge on inflation is asymmetric, i.e. inflation with a slight lag translates into prices, but half-heartedly responds to the strengthening of tenge, but in the past year, inflation behavior was such like tenge hadn't dropped from 320 to 384 tenge per dollar with related high volatility of the exchange rate. In addition to these factors, wages for 10 months, 2018, increased by 2% in real terms, trade turnover of more than 7%, investment by nearly 20% in 11 months, which is also proinflationary in nature, however, inflation has steadily poorly responded to these changes that causes the impression of a managed process of reduction in inflation since the end of 2017.

In our opinion, the main threats to inflation in 2019 from external factors represent accelerating growth of prices in Russia amid the expected increase of VAT and the increase of fuel excises, which will have an impact on local prices through imports, the share of which reaches 40% in total imports of the Republic. As internal sources we consider continuing high inflation expectations, exchange rate volatility and some increase in wages in the first place via raising the minimum wage. Active intervention in the price-setting of State-owned companies in the part of the utility services to the population, by the

State bodies will restrain the growth in prices, given that the weight of these services in the consumer basket is equal to about a third. In our opinion, the weakening of tenge in 2018 at present, not yet fully passed through into prices. Pressure on inflation from the consumer and investment demand in our view to continue. Despite the fact that the budget expenses decline, national fund transfers are replaced by means of extrabudgetary funds - National Bank of ENPF, including at the expense of national holdings. As a consequence we expect inflation at 5.4% in 2019.

At the same time, it is highly likely that this year's price growth will continue being managed, as a result, inflation could easily go below 5% as is known fall in inflation automatically leads to an increase in real wages, incomes, and many other macroaggregates to which establishments have started to pay a lot of attention since last year. Given that inflation advances ahead into the boundaries of new NBRK corridor of 4-6% in 2019.

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