NBK retains base rate amid increasing inflationary risks

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On 3 June 2019, the National Bank of the Republic of Kazakhstan (NBK) decided to maintain the base rate at 9.0% with a band of liquidity provision and withdrawal at the level of +/- 1%.

The rate remains unchanged amid rising inflation from 4.9% yoy in April to 5.3% yoy in May. Food prices contributed the most to consumer inflation, having increased from 7.1% yoy a month earlier to 7.9% yoy in May (5.8% yoy at the beginning of the current year). Non-food price dynamics increased from 6.0% yoy a month earlier to 6.1% yoy. Payable services prices made 1.3% yoy in May and are commensurate with the price dynamics in February this year, when the state administered the prices for services of natural monopolies down from 3.4% yoy in January to 1.3% yoy in February.

Forward-looking inflation expectations of the population as per the NBK's statement are low. However, a survey for March-April evidenced that the number of respondents who believed that food, non-food and payable services prices in the next 12 months will increase at a rate of 6% to 10% increased from 28.4% to 30.7 %. The number of respondents who determined the inflation rate within the range from 1% -5% (within the target inflation band of the NBK for 2019 from 4% -6%) decreased from 12.8% to 10.7%. The number of respondents who believed that prices would grow at a rate of 16-20% has not changed and amounted to 20.5% (for three months in a row). Along with this, the number of respondents who believed that the US dollar FX rate will grow relative to the tenge increased from 63.6% to 65.3%. The statistics evidences, that the NBK's current monetary policy has not yet succeeded to form low forward-looking inflation expectations of the population, which ultimately affect the growth of inflation in the country.

Our opinion

Among external inflationary risks, the NBK stated oil quotes volatility and trade stumbles between China and the United States. Trade disputes between the world's largest economies, according to the regulator, will have a negative impact on the slowdown of the global economy, commodity and stock markets. The regulator also mentions the growth of pro-inflationary pressure in the countries-trading partners (in the Russian Federation (RF), China and the EU) in terms of inflation.

The observed downward correction in energy prices to current levels of 60-61 dollars per barrel of Brent brand is comparable to the movement of the quotes at the end of last year, when oil prices plunged to USD50.5bbl, followed by an upward correction to USD74.6bbl in May this year. We believe that too cheap oil is unprofitable for oil-producing countries that will maintain oil prices above USD60bbll by regulating its supply in the global market under the OPEC + agreement.

Certainly, a slowdown in the growth of the world economy and especially Europe (the share of Kazakhstan's exports to European countries is 49% January-March 2019) will affect the growth of Kazakhstan's economy and, as a result, foreign trade. However, the probability of a recurrence of the crisis of 2015-2016 seems to us hardly likely.

The NBK indicates that external monetary conditions, i.e. Inflation in the main trading partner countries remained unchanged, although it points to an increased external pro-inflationary pressure. Thus, in the Russian Federation, the inflation rate was 5.2%, in China - 2.5% and in the EU -1.9%. Currently, we do not expect import of inflation trough the trade channels from the EU (16-17% of imports), China (13-14% of imports) and the Russian Federation (38-41% of imports) since inflation rate in those countries is either lower than that in Kazakhstan or comparable to it. However, in a past press release, the regulator expressed concerns about importing inflation from the Russian Federation, the likelihood of which, in our opinion, will persist throughout 2019.

The NBK sees the main risks in the growth of aggregate supply and domestic demand. The regulator estimates the economic performance above the potential level, which creates a pro-inflation background. The growth of real income of the population (9.7% yoy in March), the growth of consumer lending (14.6% yoy at the end of April), the increase in the size of social payments and wages to public sector employees (wages will be raised to the state employees only from June 2019). If we compare the rhetoric of the regulator with the previous press release, when the NBK decided to cut the rate from 9.25% to 9.0%, the main macroeconomic risks profile has not much changed since then. In January-March, the short-term economic indicator made 4.2% yoy, against 4.1% yoy in January-April, the growth of real income of the population was 9.4% in January-February, and the rate of consumer lending was 13.5%. The NBK was also well aware of the pending increase in social payments and wages of public sector employees. In fact, the current parameters of domestic demand have not undergone major changes, however, after two months, the regulator identified aggregate supply and domestic demand as the main risks for further slowing inflation in the forecast horizon by 2020, emphasizing the risk balance shifting to higher trajectory of rates development.

We believe that in 2019-2020 the main risks of inflation, which the NBK regulates through the base rate and inflation expectations, will be limited to an unregulated transmission of the effect of national currency weakening (current and accumulated last year) on food prices, for which state administration of prices seems highly unlikely. Food price hike that have been observed seven consecutive months (from 4.7% yoy in October 2018 to 7.9% yoy in May 2019) reflects the effect of a transfer from the tenge weakening from 318 tenge to 380.9 tenge (in April-September 2018) and up to 382.6 tenge per US dollar at the time of the last decision on the rate and will be the main determinant of inflation in the country this year. If we exclude the effect of the state administration of prices for payable services, the annual CPI rate would be formed at the upper ceiling of the NBK target band (4% -6%) at the level of 5.8-5.9% yoy.

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