

Accelerating Inflation Processes in Kazakhstan: Factors and Economic Consequences

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I. Introduction

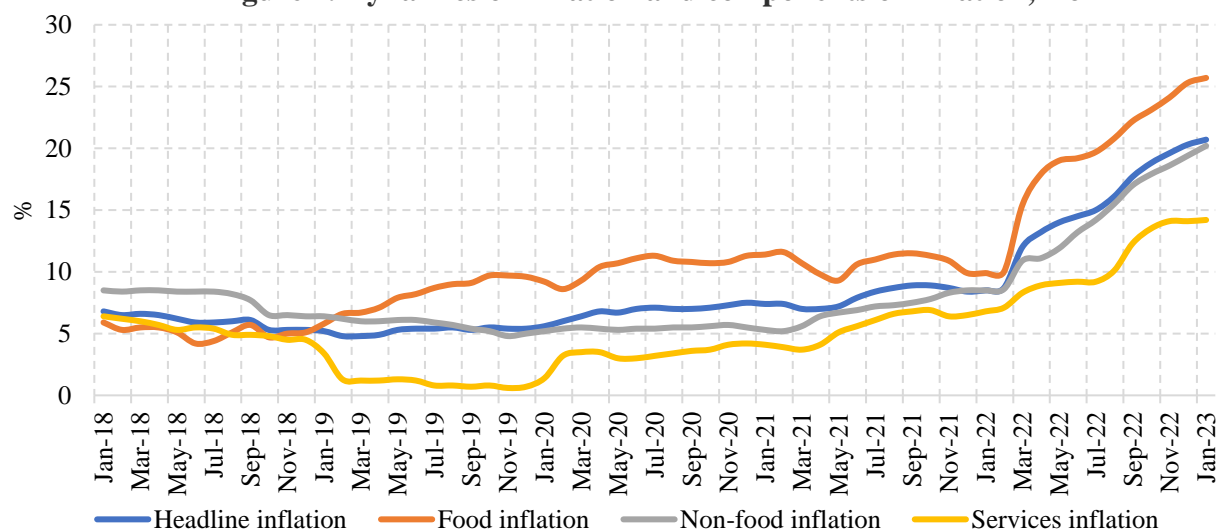
Recently, there has been an acceleration of inflationary processes in Kazakhstan. In January 2023, the annual inflation rate was 20.7%, which is the highest value in the last 26 years. The increase in prices is observed for all the main components of inflation. Thus, in January 2023 as can be seen in Figure 1, the annual increase in food prices amounted to 25.7%, non-food products – 20.2%, and services – 14.2%.

Inflationary pressure on goods and services of the consumer basket is exerted by both external and internal factors.

External factors include the continuing high level of world food prices, high inflation in trading partner countries, as well as the depreciation of the national currency – tenge. Additional pressure on prices is also exerted by a reduction in supplies from Russia, the main trading partner, simultaneously with the strengthening of the Russian ruble against the tenge during 2022. In addition, the restructuring of logistics delivery routes bypassing Russia in most cases is more expensive, which also affects the growth in the cost of the final product.

At the same time, amid mobilization in Russia, there is an influx of Russian citizens, which ultimately led to an increase in demand and, as a result, an increase in prices. Amid high inflation, inflation expectations of the population remain elevated.

Figure 1. Dynamics of inflation and components of inflation, YoY



Source: Bureau of National Statistics of Kazakhstan

II. Description of inflationary processes by components of inflation.

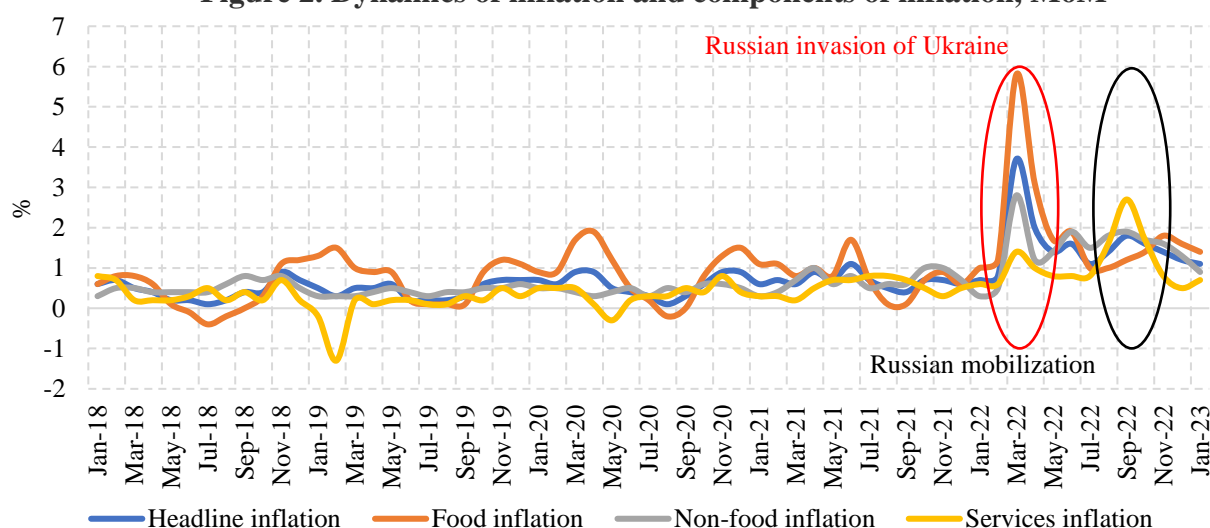
In January 2023 as can be seen in Figure 1, the annual food inflation rate accelerated to 25.7%. Price increases are recorded for a wide range of goods. The main contribution to the price increase is made from the supply side. The rise in the price of raw materials in the world has caused

an increase in domestic prices in Kazakhstan. At the same time, despite the fact that the share of food imports is not significant, some of the raw materials for food production are imported. For the most part, the import of finished food and raw materials was imported from Russia. In 2022, amid a significant strengthening of the Russian ruble, the tenge exchange rate against the Russian ruble weakened by 26%. In addition, in the conditions of depreciation of the tenge exchange rate, the cost of means of production, which are not produced in Kazakhstan, but imported, has increased. Under these conditions, the prices of food and beverage producers in January 2023 in annual terms amounted to 18.6% and 20.7%, respectively.

At the same time, as can be seen in Figure 1 there is a significant increase in prices for non-food products, which accelerated to 20.2% in annual terms by the end of January 2023. Considering that over half of non-food consumer goods are imported, the main reason for the price increase is the depreciation of the tenge exchange rate. Additional pressure on the price increase was exerted by the restructuring of logistics delivery routes bypassing Russia, which in most cases is more costly, due to the lack of access to the sea in Kazakhstan as the cheapest type of transportation. Additional pro-inflationary pressure is associated with increased consumer demand from Russian citizens. Given the strengthening of the Russian ruble and the absence of certain goods in Russia under the imposed sanctions, many Russian citizens living in border areas purchase non-food products in Kazakhstan. In addition, some Russians currently temporarily reside in Kazakhstan. Since the beginning of 2022, about 2.9 million Russians have entered Kazakhstan in total, and since the beginning of mobilization in Russia, 146 thousand of Russians have temporarily moved to Kazakhstan. The increased demand is indirectly confirmed by official statistics. In January 2023, the retail trade index of non-food products increased by 34.2% year-on-year.

In January 2023 as can be seen in Figure 1, the annual service inflation rate accelerated to 14.2%. The factors of price growth are an increase in the cost of providing services in the conditions of rising prices for raw materials and additional demand from Russian citizens for certain services. After the announcement of mobilization in Russia on September 21, 2022, many Russians moved to Kazakhstan. In these conditions, the cost of renting housing, and the cost of hotel accommodation services have increased significantly. At the moment, prices for these services are returning to their equilibrium levels.

Figure 2. Dynamics of inflation and components of inflation, MoM



Source: Bureau of National Statistics of Kazakhstan

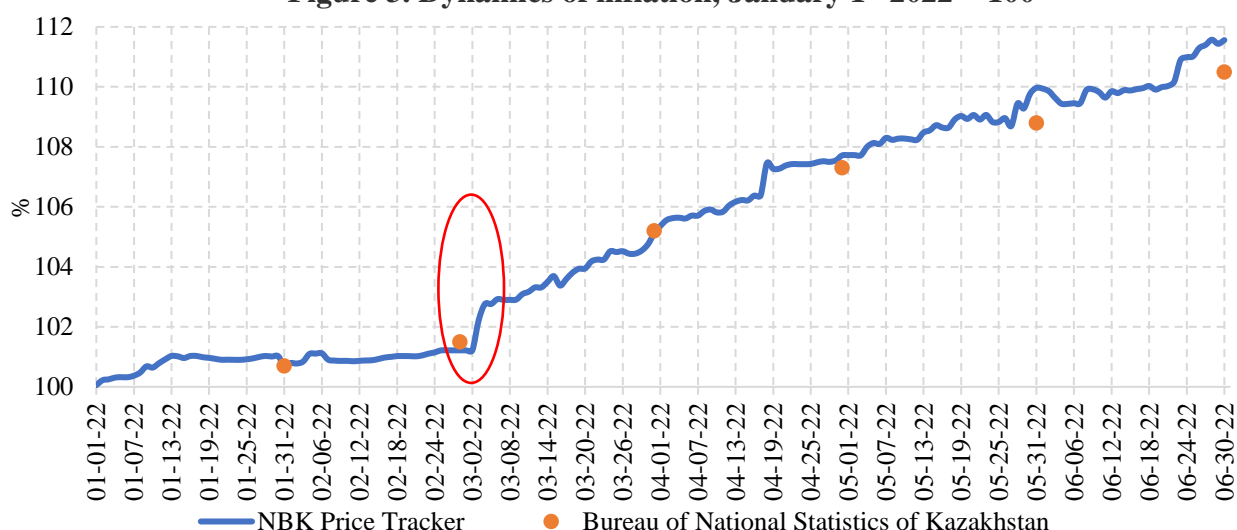
III. Consequences of military actions

The military conflict between Russia and Ukraine immediately affected the growth of prices for consumer goods in Kazakhstan. In March 2022 as can be seen in Figure 2, consumer prices increased by 3.7%. One of the factors of the price increase was the depreciation of the tenge against the US dollar in March 2022 by 14.5%. At the same time, it should be noted that in addition to the influence of the exchange rate, the inflation pressure was also exerted by the price increase in Russia – 7.6% in March 2022, which was partially offset by the strengthening of the tenge against the Russian ruble by 16.2%. An additional factor of a significant increase in prices was the disruption of existing supply chains of products from Russia. In conditions of total uncertainty, sellers could raise prices above the equilibrium values, thereby laying in the final cost the possibility of implementing additional risks.

In such situations, when you do not have operational data on what is happening with the prices of consumer goods, the only source of information is indirect high-frequency indicators. So, since 2018, the National Bank of Kazakhstan has been monitoring prices for consumer goods on a daily basis for internal purposes by collecting prices from online stores. The developed NBK Price Tracker system collects daily prices from about 380 online stores through the use of web scraping technology from all administrative centers of Kazakhstan, followed by the construction of a daily indirect inflation indicator.

The significant price increase observed at the beginning of March 2022 in the conditions of depreciation of the tenge exchange rate and disruption of supply chains demonstrates the critical importance of the system in such periods. As can be seen in Figure 3 as early as March 3, 2022, NBK Price Tracker began to record a significant increase in prices. So, for two days (March 3-4), prices for consumer basket goods increased by 1.5%, then the growth rate slowed down, but still remained significant – 2.3% for the rest of March. Inflation for March 2022 according to the Bureau of National Statistics was 3.7%, and according to NBK Price Tracker 3.8%.

Figure 3. Dynamics of inflation, January 1st 2022 = 100



Source: Bureau of National Statistics of Kazakhstan, NBK Price Tracker

As for the non-food component of inflation, as the most affected by external shocks, according to the NBK Price Tracker system, since the outbreak of conflict in Ukraine and the escalation of the geopolitical situation, the cost of individual non-food products began to rise immediately in response to some depreciation of the tenge exchange rate. So, on February 25, there is an increase in prices for electronics, clothing, and medicines.

IV. Consequences of high inflation.

In response to the acceleration of inflationary processes, the National Bank continued to tighten monetary policy. At its last decision, which took place on January 13, 2023, the Monetary Policy Committee of the National Bank decided to keep the base rate at 16.75%. The decision to maintain the base rate was made in accordance with the actual inflation forecasts of the National Bank. The dynamics of internal and external inflationary processes, as well as the trajectory of economic growth are formed in accordance with the basic scenario.

In conditions of high inflation, the inflation expectations of the population in December 2022 updated their historical highs. The quantified estimate of inflation expectations in a year has risen to 24.1%, which is the maximum since the beginning of the survey. At the same time, in January 2023, inflation expectations fell to 17.3%. Consumer sentiment improved to a greater extent due to an increase in positive expectations.

At the same time, taking into account high inflation and the fact that incomes are not growing at such a high rate, the real incomes of the population have decreased. In December 2022, according to preliminary estimates of the Bureau of National Statistics, the real incomes of the population decreased by 13% compared to the corresponding period of the previous year. The decline in income can have a particularly big impact on those who receive fixed incomes, such as pensioners, government employees, and low-wage workers. In such a situation, they may not have enough money to buy the necessary goods and services, which can lead to a deterioration in their standard of living. Taking this into account, the state announced an increase in the minimum wage by 17%. In addition, the salaries of civil servants and public sector employees are expected to increase.

Starting from January 1, 2023, the salaries of kindergarten teachers, teachers of schools and colleges, as well as specialists in the system of additional education will increase by 25%. In addition, extra payments are set to the salary, which teachers receive. These are surcharges for the qualification category from 30 to 50% of the salary. The salaries of doctors will increase by 30%, and the salaries of secondary medical personnel will increase by 20%. Employees of the Ministry of Emergency Situations will increase salaries from 10-70%, depending on the category of positions. In addition, the salaries of police and military officers are expected to increase. From September 1, 2023, scholarships for university students will increase by 20%. Scholarships for undergraduates and doctoral students will be increased by 15%. The increase in wages should help compensate for the decline in purchasing power and maintain the standard of living at an acceptable level.

V. Expectations and forecast.

According to the National Bank's latest forecasts, inflation will peak in February 2023. In 2023, inflation is expected to slow down to 9-12% in the context of the exit of the calculations of the high base of 2022 and the impact of previous decisions to tighten monetary conditions. In 2024, annual inflation will continue to slow down, but it will still form above the inflation target. In 2023-2025, the dynamics of annual inflation will be influenced by a number of multidirectional factors. On the one hand, the gradual departure of the high base of 2022, the growing real interest rate and declining inflation expectations, the gradual decline in world food prices, a favorable grain harvest in 2022, and the softening of the external inflationary background will cause a slowdown in inflation in Kazakhstan. On the other hand, a positive output gap, as a result of fiscal stimulus, as well as the inertia of inflationary processes will prevent a faster slowdown in inflation.

As for the forecasts of economic growth, by the end of 2023, it is expected that the GDP growth rate will be 3.5-4.5%. This will be facilitated by an increase in the consumption of public administration against the background of an increase in wages in the public sector. Active growth is expected from gross accumulation amid the implementation of infrastructure projects, as well as the completion of construction work at the Tengiz oil field. Imports will show moderate

dynamics in the conditions of positive dynamics of domestic demand. In 2024, due to the increase in oil production at the Tengiz oil field, further export growth is expected, which will accelerate GDP growth to 3.5-4.5%. In 2025, economic growth will continue to be at equilibrium values and will also amount to 3.5-4.5%.

According to the forecasts of the International Monetary Fund, economic growth in 2023-2024 will be 4.5% and then stabilize at about 3.5%. Inflation will peak around the beginning of 2023 and will remain above 6% until 2024.

The Eurasian Development Bank forecasts inflation of 7.8% by the end of 2023, and economic growth in Kazakhstan may accelerate to 4.2%. Analysts note that the government's measures to support the economy, as well as the expansion of production capacities, will help offset the negative impact of the external environment.

VI. Conclusion

Summing up, it should be noted that the current acceleration of inflationary processes is due to the influence of both external and internal factors. The main source of inflationary pressure is the impact of the beginning of the conflict between Russia and Ukraine. The influence of this factor is associated with the rise in the cost of imports from Russia in the conditions of the strengthening of the Russian ruble, the disruption of supply chains, as well as the search for new logistics routes bypassing Russia. Additional inflationary pressure is associated with increased consumer demand from Russian citizens. Given the strengthening of the Russian ruble and the absence of certain goods in Russia under the imposed sanctions, many Russian citizens living in border areas purchase non-food products in Kazakhstan. In addition, after the mobilization began, some Russians arrived and temporarily reside in Kazakhstan.

The consequences of high inflation are an increase in inflation expectations, a decrease in the real incomes of the population, and standards of living. In order to curb inflationary processes, the National Bank of Kazakhstan began to tighten monetary conditions at the end of February 2022. At the moment, the base rate is 16.75%. The last decision to maintain the base rate was made in conditions of compliance with the actual inflation forecasts of the National Bank

According to the latest forecasts of the National Bank, inflation will reach its peak in February 2023. In 2023, inflation is expected to slow down due to the withdrawal from the calculations of the high base of 2022, as well as the impact of previous decisions to tighten monetary conditions. In 2024, annual inflation will continue to slow down, but it will still be above the inflation target.

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