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INFORMATION DISCLOSURE

This Review includes a detailed description of the current internal and external macroeconomic setting and an agreed set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB jointly with the EEC using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled “Forecasting System for the Eurasian Economic Union”.

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LIST OF ABBREVIATIONS

EDB – Eurasian Development Bank

EEC – Eurasian Economic Commission

GDP – Gross Domestic Product

JSC – Joint-stock company

KZT – kazakh tenge

NBRK – National Bank of the Republic of Kazakhstan

OPEC – Organization of the Petroleum Exporting Countries

pp – percentage point

Q – quarter

RK – Republic of Kazakhstan

U.S. or USA – United States of America

% – percent

% YoY – year-over-year growth rate
SUMMARY

In 2019, GDP growth in the Republic of Kazakhstan accelerated to 4.5% YoY, thereby exceeding even optimistic expectations. Strong consumer and investment demand, supported by a stimulative fiscal policy, helped offset the adverse effects of the external environment (a weak price situation in global goods and commodity markets and the global economic slowdown). Zero growth in the oil industry, after production was suspended at key oilfields for planned repairs, was also a constraint.

Domestic consumer demand was stimulated by growing social expenditures from the Republic’s budget and by an expansion of retail lending. Investment activity remained concentrated mainly in the mining industries.

Inflation stayed within its target range (4.0–6.0% as of the end of 2019). Its temporary slowdown in 1Q2019 was caused by the reduction of utility charges. Starting from 2Q2019, inflation accelerated again as world food prices grew and domestic demand expanded, and was 5.4% as of the end of 2019.

The current account deficit increased, largely due to a trade balance deterioration. The weak price situation in the world oil and metals markets manifested itself in a decrease in export revenue, while growth of imports resulted from increased domestic investment demand.

The State budget deficit was 1.9% of GDP in 2019 according to our estimates, vs. 1.3% of GDP the year before. Income growth was driven by greater transfers from the National Fund and increasing tax revenues. Expenditures grew mainly on account of additional funds allocated for the implementation of the Government’s social initiatives.

The monetary policy measures taken in 2019 aimed to maintain price stability. In April 2019, the National Bank of Kazakhstan reduced its policy rate by 25 basis points, to 9.0%, as consumer price growth slowed down at a quicker rate than it had expected. In the second half of 2019, inflation risks increased, and the monetary regulator responded by raising its policy rate to 9.25% in September 2019. The National Bank estimated the monetary conditions to be slightly contractionary towards the end of 2019.

Economic activity is projected to slow down in 2020. The fall of world oil and metal prices and the adverse consequences of the coronavirus spread will both weaken demand for Kazakh exports and restrict domestic economic activity. Monetary policy tightening will also put downward pressure on the economic growth rate. The economy will be supported by a stimulative fiscal policy and by Government measures aiming to maintain macroeconomic and financial stability. Economic activity will recover
in 2021 and 2022 as the world economy and commodity markets stabilize and the Government’s development programs are implemented.

The inflation acceleration trend of 2019 will intensify due to the sharp weakening of the Kazakh tenge in March 2020. According the EDB’s baseline scenario, 2020 inflation will find itself near the top of the target range. In the medium term, domestic price growth is expected to gradually weaken as the pass-through of tenge weakening to inflation peters out and a contractionary monetary policy is pursued.
STATE OF THE ECONOMY IN 2019

Economic Activity

Economic Growth Accelerates

In 2019 GDP grew by 4.5% YoY, up from 4.1% the year before. Economic activity increased as both consumer and investment demand expanded and output recovered at ArcelorMittal Temirtau JSC after the accident that had occurred in late 2018. It was held back by a temporary decrease of output in the mining industries as oil production was suspended at the Kashagan, Tengiz and Karachaganak oilfields for planned repairs, and partially suspended occasionally for technical reasons.

Household demand continues to strengthen, supported by a buildup of consumer lending, increasing pensions and wages, tax loosening and utility charge reductions. Retail sales grew by 5.8% in 2019, even though inflation accelerated in the food sector. The public sector’s consumption remains high, though its growth slowed down in the 2nd half of 2019 after significant acceleration in the 2nd quarter as the Government implemented new social initiatives.

Physical exports in 2019 were held back by decreased exports of ferrous metals and wheat, and by weak demand for oil in the key trade partner countries. Real imports increased, mainly as domestic investment demand grew.
Investment Trends Stay Positive

Investment activity continues to expand (by 8.5% in 2019). In 2019, the main volume of investment went to the mining industries, mainly to the Tengiz capacity expansion project.

Construction of housing, roads, and oil and gas pipelines, supported by the implementation of Government programs, acted as an additional driver of investment activity.

Industrial Growth Decelerates

Industrial output growth slowed down to 3.8% YoY in 2019, down from 4.1% YoY the year before. Oil product output increased by 0.2%, and output in ferrous metallurgy grew by 1.3%.

New oil refineries that began operation in 2018 expanded the output of light petroleum products, which raised the industry’s growth rate to 6.6% in 2019. The sector was also supported by non-ferrous metallurgy (with 6.8%) and machine-building enterprises (20.9%).
Agriculture Shows Weak Performance

Gross agricultural output increased by 0.9% in 2019 (vs. 3.5% the year before). The sector’s positive growth rate was driven by livestock farming (4.0%). The harvest reaped in 2019 was 98.2% of the 2018 level. The poor crop farming performance resulted from a lower gross output of grain crops due to unfavorable weather conditions.

The Labor Market

Household Incomes Still on Growth trend

In 2019, real incomes grew by 5.5% as nominal wages increased by 14.5%. Accelerated growth of average monthly wages was observed in virtually all sectors of the economy. Their positive performance was particularly fostered by the increase of salaries in the State budget funded sector and the 50% minimum wage raise.

The recorded unemployment level was 4.8% as of 30 December 2019.

Figure 4. Real Disposable Incomes and Average Wages (period’s growth rate year-on-year)

Inflation

Inflation Stays Within Target Range

2019 inflation (5.4%) fell into the upper band of the NB RK target range of 4.0–6.0%. Starting from 2Q2019, the consumer price index has been stable, which is partly due to the overall effect of accelerated appreciation of the food basket and depreciation of regulated services.
Core Inflation Above Target

Core inflation, excluding the appreciation of fruit and vegetables, housing and utility charges, railway and telecommunication tariffs, petrol, diesel fuel and coal, was 7.3% YoY in 2019.

Figure 5. Inflation (last month in quarter vs. last month of same quarter a year before)

Food is Main Contributor to Inflation

Food prices increased in 2019, mainly on account of the appreciation of bread and bakery products (16.1% YoY) and meat products (13.2% YoY). Further, fruit and vegetables were additional contributors from October 2019. Cereals, bread and bakery products grew in price as the grain harvest was low in the RK and world rice prices increased. Meat products appreciated as global demand for them grew while supply was insufficient.

The prices of goods in other segments of the consumer basket held inflation back during 2019. Thus, non-food price growth slowed down from 6.4% YoY in January 2019 to 5.0% YoY in December 2019, while service tariffs decelerated from 3.4% YoY to 0.7% YoY, respectively.

Figure 6. Inflation Components (last month in quarter vs. last month of same quarter a year before)

Source: Statistics Committee of the RK Ministry of National Economy, NBRK
The External Sector

Current Account Deficit Expands

As provisionally estimated by the NB RK, in 2019 the current account posted a deficit of USD 5.5 billion (vs. USD 0.3 billion the year before). It expanded due to a weak price situation in the world markets of oil and metals, which worsened the trade balance. The decline of foreign direct investors' income and decrease of the services deficit slowed down the growth of the current account deficit to some extent.

Capital Outflow on Financial Account Transactions

A net capital outflow via financial account transactions (excluding reserve assets) was recorded in 2019, mainly as commercial banks placed their assets abroad. Foreign assets increased on account of portfolio investment and short-term instrument transactions.

The inflow of foreign direct investment to the RK continued to grow in 2019. The country attracted further capital via State Eurobond placements.

Figure 7. Balance of Payments

The consolidated international reserves\(^1\) amounted to USD 90.9 billion as of the end of December 2019, a 2.2% increase since the beginning of the year.

Gross international reserves (excluding the RK National Fund’s assets) amounted to USD 29.0 billion as of the end of December 2019, a 6.4% decrease. The share of monetary gold increased in their structure, to 65.2%, from 46.5% as of the beginning of 2019. The gross international reserves cover 7.1 months\(^1\) worth of imports of goods and services.

\(^1\) These comprise international reserves of the NB RK and assets of the National Fund.
According to preliminary data from the State Revenue Committee of the RK Ministry of Finance, the decrease in the trade surplus in 2019 resulted from both increased imports and decreased exports compared with 2018.

The decrease in export revenue in 2019 was mainly caused by declining exports of fuel and energy commodities (down 7.7% YoY) and metals and metal products (down 1.0% YoY). Exports were supported by growing supplies of machines and equipment (1.7 fold). Food export growth (5.9% YoY) was restricted by a 2.4% decrease in cereal exports.

The growth of imports in 2019 resulted primarily from greater imports of machinery and equipment (a 28.8% YoY increase).
The Fiscal Sector

State Budget in Greater Deficit

We estimate the State budget deficit to have expanded in 2019 to 1.9% of GDP, the level planned by the Government. In the preceding year, the State budget’s negative balance was 1.3% of GDP.

Budget Income Increases

The increase of the budget’s income in 2019 was driven by the growth in both transfers (18.1% YoY) and tax revenues (16.8% YoY). Transfers from the National Fund accounted for 24.1% of the budget’s revenues.

Greater Expenditures

The State budget’s expenditures increased in 2019, mainly as welfare expenses grew (by 26.0% YoY), public sector employees’ wages and salaries increased and more funds were allocated for the implementation of the Government’s social initiatives.

Figure 10. The State Budget (the period’s cumulative balance)

Nominal Public Debt Increases

Public debt was 16.5 trillion tenge as of the end of December 2019, 7.1% more than at the beginning of 2019. The decrease of the debt to GDP ratio resulted from economic growth outrunning the increase in public sector debt. In 2019, the Government’s domestic liabilities mainly grew due to the placement of long Government treasury bonds (up 28.7% compared with the beginning of 2019). The Government’s external debt increased by 2.9% in the period under review as two tranches of Eurobonds were issued, one for EUR 500 million with 7-year maturity and a 0.6% coupon rate, and another for EUR 650 million with 15-year maturity and a 1.5% coupon rate.

Source: RK Ministry of Finance, calculations by the authors
Interest Rate Policy  
Still Neutral  
The NBRK reduced its policy rate by 25 basis points, to 9.0%, in April 2019. As estimated by the regulator, inflation in February and March 2019 slowed down more rapidly than it had expected, which was one of the reasons behind the policy rate reduction. In September 2019, the rate was raised to 9.25% amid mounting inflationary pressure in the food sector and quicker tenge depreciation.

Interbank Market  
Rates Rise in Late 2019  
Trends in the short-term interbank loan rates in 2019 were consistent with the trajectory of the NBRK policy rate. Given a structural liquidity surplus, they kept near the bottom of the NBRK interest rate band (the policy rate ±1%) most of the time. In November and December 2019, the TONIA rate rose to the upper limit of the interest rate band as banks’ demand for tenge liquidity grew.

The average rate on new tenge deposits was 7.3% in 2019, virtually the same as in 2018 (7.4%). The average annual interest rate on credit resources in national currency was 13.8% in 2019 (vs. 13.6% the year before).

The share of non-performing loans in the banks’ loan portfolio was 8.1% as of the end of 2019, up from 7.4% at the end of 2018.
Quality of Banks’ Assets Assessed

Between August and December 2019, international consultants and audit firms carried out an independent audit of the quality of second-level banks’ assets. They found no capital shortage at a consolidated level and the capital adequacy ratios were met throughout the system. The RK Financial Market Regulation and Development Agency reviews banks’ individual performance and, if necessary and jointly with the deposit organizations, develops an action plan for the given bank to upgrade its loan portfolio.

Lending Grows

In 2019 the deposit base grew by 5.5% on account of a 14.2% increase of deposits in national currency, while foreign currency deposits decreased by 4.5%. The loan portfolio grew by 7.1% YoY, largely on account of the retail sector. Thus, new retail loans issued in 2019 increased by 26.8% YoY, while new commercial loans increased by 4.5% YoY.

Tenge Weakens Against U.S. Dollar

In January to September 2019, the tenge was on a downward trend against the U.S. dollar as demand for foreign currency was high, peaking in June 2019. In 4Q2019 the Kazakh currency began to strengthen and to adjust towards its equilibrium level. In 2019, the tenge weakened by 11.0% versus the U.S. dollar. The real effective tenge exchange rate decreased by 3.9% YoY in 2019. Weakening was recorded for all the currency pairs in the tenge’s real effective exchange rate basket.
Figure 13. 
Tenge Exchange Rate
(period’s growth rate
year-on-year, + = tenge
strengthening)

Source: NBRK, calculations by the authors
ECONOMIC OUTLOOK

Background

Economic growth in Kazakhstan’s main trade partner countries decelerated in 2019. Russia’s GDP increased by 1.3% that year, after 2.5% the year before. Economic growth in the 1st half of the year was constrained by the increased fiscal load and weak external demand. In the 2nd half, Russian output began showing signs of recovery, supported by the easing of tax and budgetary policy and bank lending conditions.

The Eurozone’s aggregate GDP growth declined to 1.2%, from 1.9% in 2018; the U.S. economy grew by 2.3% after 2.9%, and China’s grew by 6.1% after 6.6%. The slowing global trade and worsening economic sentiment amid mounting trade protectionism constrained production and investment activities and were only partially offset by stimulative domestic policies.

The external environment remained highly uncertain early this year. On the one hand, the Phase 1 trade agreement entered into by the USA and China reduced the risk of global recession. On the other hand, the spread of the coronavirus may offset the positive effect of emerging progress in the settlement of their trade conflict. The EDB’s baseline scenario projection is for the epidemic to gradually stabilize this year but that it will still depress economic activity worldwide.

Russian GDP is projected to grow by 1.3% in 2020, like the year before. Domestic demand will be supported by the implementation of the national projects passing into their main stage and by household income stimulation measures. Russian non-energy producers may derive additional competitive advantages from a weakening ruble. On the other hand, the said factors’ positive contribution to economic growth may be offset by the adverse consequences of the spread of coronavirus and falling oil prices, resulting

from the weakening of external demand for Russian exports, worsening economic sentiment and the disruption of production chains. In 2021 and 2022, Russia’s annual economic growth will accelerate to 1.9% as the world economy and commodity markets stabilize and domestic structural reforms are implemented.

We estimate China’s economic growth to slow down to 5.0% in 2020. The key factor will be the coronavirus epidemic’s effects on consumer and manufacturing activities. The shock is supposed to be temporary and the Chinese economy should begin recovering this year, supported by monetary and fiscal stimuli. It should be noted that the assessment of the current situation’s impact on business activity is far from certain.

Economic growth in the Eurozone is projected to slow down in 2020. Late 2019 and early 2020 data point to continued weakness of the German industrial sector, and the consequences of the spread of coronavirus will have an additional negative effect. The Eurozone’s economy will stay supported by its soft monetary policy; in conjunction with a recovery of global trade, projected for the medium term, this will serve to accelerate the zone’s GDP growth.

The weaker fiscal impetus will slow U.S. economic growth in the medium term and cause it to stabilize at its near-potential level. The worsening global economic situation and the problems faced by Boeing Corporation\(^3\) may be additional constraints in 2020. We estimate U.S. monetary policy to retain its stimulative nature throughout the projection period.

Lower Oil Prices in 2020

The uncertain global outlook put pressure on commodity prices in 2019, with most of them depreciating. The fall of energy prices accelerated early this year because of the negative effect of the spread of coronavirus on energy consumption predicted by international organizations, as well due to the unexpected outcome of negotiations in the OPEC+ Ministerial Committee, which failed to reach consensus to extend the oil production reduction agreement. We expect a weak price situation in the world energy market to prevail in the coming months. In the medium term, the weakening of the coronavirus epidemic’s negative effects and recovery of demand for hydrocarbons will support oil prices.

\(^3\) In December 2019 Boeing Corporation announced the suspension of production of its 737 MAX airliners. According to the company’s latest statements, it expects to resume production in mid-2020. For more information see Boeing Statement Regarding 737 MAX Production and Boeing Statement on 737 MAX Return to Service.
Inflation in Russia slowed down to 3.0% YoY in 2019, which is below the Central Bank's target of 4%. This was facilitated by a strengthening ruble, moderate consumer activity and increasing supply of food. The EDB projects the said factors' impact to gradually weaken in the current year as household demand strengthens and the Russian currency's exchange rate decreases. The resultant 2020 inflation is estimated at 3.8%, while in 2021–2022 inflation is projected to be close to the target set by the Bank of Russia.

Consumer price index growth in the Eurozone and USA is projected to be lower than the European Central Bank’s and Federal Reserve’s targets throughout the time horizon, amid moderate economic activity, decreasing energy prices and low inflationary expectations. Inflation in China is expected to slow down gradually after accelerating in 2019 as the meat price shock effect peters out.

### Table 1. Forecast Key Foreign Economic Indicators

<table>
<thead>
<tr>
<th>Year</th>
<th>Average annual Urals oil price (USD per barrel)</th>
<th>Metals price index, 2010=100</th>
<th>Russia’s real GDP growth rate, %</th>
<th>Euro Zone real GDP growth rate, %</th>
<th>China’s real GDP growth rate, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>2020</td>
<td>44.1</td>
<td>73.5</td>
<td>1.3</td>
<td>0.7</td>
<td>5.0</td>
</tr>
<tr>
<td>2021</td>
<td>49.8</td>
<td>74.8</td>
<td>1.9</td>
<td>1.3</td>
<td>6.6</td>
</tr>
<tr>
<td>2022</td>
<td>52.8</td>
<td>75.0</td>
<td>1.9</td>
<td>1.4</td>
<td>5.9</td>
</tr>
</tbody>
</table>

Source: calculations by the authors, EEC

The projection's baseline scenario envisages fiscal policy retaining its stimulative nature in the medium term. According to the targets set by the RK Ministry of Finance, in 2020 its budget deficit will be widened to 2.1% of GDP, in particular as social support expenses increase and the Government’s development programs are implemented. In later years, the State budget deficit will be steadily reduced, to 1.5% of GDP in 2021 and 1.0% in 2022.

Monetary policy will remain focused on the maintenance of price stability. In the medium term, the regulator intends to follow a disinflationary strategy aiming to keep inflation within the 4.0–6.0% target range in 2020–2021 and, eventually, to reduce it to 3.0–5.0%.
Economic Activity

Economic Growth to Slow Down

Economic activity is projected to slow down in 2020. The fall of world oil and metals prices and the adverse consequences of the coronavirus spread will weaken external demand for Kazakh exports. The state of emergency imposed in mid-March 2020 will limit the real and service sectors’ output. A tightened monetary policy will also constrain economic growth.

The economy will be supported by a stimulative fiscal policy.

Public expenditure on the implementation of social initiatives, planned for 2020, will promote the improvement of the population’s welfare; the extension of the Nurly Zhol program till 2025 will support the construction industry, and the implementation of the State industrial and innovative development program will enhance the manufacturing industries’ capacity. Moreover, a preferential lending program worth KZT 600 billion has been developed to support small and medium-sized enterprises as well as individual entrepreneurs harmed by the state of emergency. Kazakh non-energy manufacturers may derive additional competitive advantages from the tenge weakening.

Short-Term Risks Shifted Towards Slower Growth

Risks of a more moderate economic performance prevail in the short run. This primarily results from the fact that the consequences of the coronavirus spread for the world economy are currently hard to predict due to uncertainty as to the scale and duration of this epidemic. We expect its adverse effects to be concentrated on the demand side and to have no significant impact on production capacity. Otherwise it may have stronger and more protracted consequences for the Kazakh economy. There is also a probability of oil prices staying low for a long time and exerting a stronger impact on economic agents’ expectations and investment demand than assumed in the baseline scenario.

Figure 14. Real GDP* (period’s growth rate year-on-year)

* Here and elsewhere the chart ranges correspond to the 10%, 50% and 75% confidence intervals.

Note: seasonally adjusted data.
Source: calculations by the authors, EEC
In 2021 and 2022, economic growth will recover as the world economy and commodity markets stabilize and domestic structural reforms are implemented. As global economic growth recovers, increasing external demand will promote the improvement of exports, primarily in non-energy goods.

The mid-term risks to Kazakh GDP emanate from both the external sector and the domestic economy. There remains a probability of a stronger global slowdown than assumed in the baseline scenario that will probably lead to a weakening of Kazakh exports and investment activity. The stimulative effect of the domestic fiscal policy measures may be limited, in particular, due to reserved economic sentiment.

Inflation

Inflation in the country rose early this year. The growth of the consumer price index accelerated to 6.0% YoY in February 2020, up from 5.6% YoY the month before. That resulted from the appreciation of food items and the rise of petrol excises in January 2020. National currency depreciation will be an additional pro-inflationary factor in the 1st and 2nd quarters of 2020. As a result, inflation may overshoot the upper limit of the target range in the first half of this year.

We expect food inflation to decelerate in the 2nd half of 2020 as world prices of grain and meat products stabilize. On the other hand, pro-inflationary factors resulting from the effects of Kazakh tenge weakening passed through to prices will limit consumer price deceleration.

In the medium term, inflationary pressure will weaken amid contractionary monetary policies and low inflation in the main trade partner countries. The exchange rate will exert a neutral effect on the consumer price index.
Monetary Conditions

Contractionary Monetary Policy

In March 2020 the NB RK raised its policy rate from 9.0 to 12.0% and widened its interest rate band to ±1.5 pp. The decision was taken amid increased volatility in the world financial and commodity markets. The EDB baseline scenario projection envisages the rate to gradually decrease in the 2nd half of this year as exchange rate trends stabilize and help reduce inflation risks and push inflation down.

The potential for a policy rate reduction to 6–7% may be realized as the global financial and commodity market situation stabilizes.

Figure 16. TONIA Rate (the period’s average)

![Image of Figure 16]

Source: calculations by the authors, EEC

National Currency to Weaken

Early this year, the Kazakh tenge was pressurized by the fall of oil prices and mounting fears of a negative impact of the coronavirus epidemic on the world economy. Those factors are likely to persist in the coming months, and the national currency’s exchange rate versus the U.S. dollar will stay close to its current levels. Then we expect the tenge to partially regain lost ground, as hydrocarbon prices gradually recover and the world economy stabilizes. The national currency will be supported by the authorities’ domestic economic policy aiming to maintain macroeconomic and financial stability. As a result, we expect the year’s average exchange rate of the Kazakh tenge versus the U.S. dollar to be around 409.2 KZT per USD.

5 To stabilize the foreign exchange market after the external terms of trade changed drastically and supply became scarce, the NBRK carried out sale interventions and was sometimes the only seller. On 20 March 2020, the regulator set limits on the divergence between the selling and buying rates for transactions conducted at currency exchange offices for the duration of the state of emergency.
Table 2. Key Macroeconomic Indicators of the RK

<table>
<thead>
<tr>
<th>Indicators</th>
<th>2017</th>
<th>2018</th>
<th>2019</th>
<th>2020P</th>
<th>2021P</th>
<th>2022P</th>
</tr>
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<tbody>
<tr>
<td>GDP in constant prices (% growth YoY)</td>
<td>4.1</td>
<td>4.1</td>
<td>4.5</td>
<td>3.1</td>
<td>3.4</td>
<td>3.6</td>
</tr>
<tr>
<td>Consumer price index</td>
<td>7.1</td>
<td>5.3</td>
<td>5.4</td>
<td>6.0</td>
<td>5.0</td>
<td>4.1</td>
</tr>
<tr>
<td>(% growth in December to previous year’s December)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>TONIA rate (the year’s average % per annum)</td>
<td>9.9</td>
<td>8.4</td>
<td>8.4</td>
<td>11.1</td>
<td>9.4</td>
<td>7.1</td>
</tr>
<tr>
<td>Nominal Kazakh Tenge to U. S. Dollar Exchange Rate, KZT per USD (the year’s average)</td>
<td>326.0</td>
<td>344.7</td>
<td>382.8</td>
<td>409.2</td>
<td>423.3</td>
<td>446.5</td>
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Note: P – Projected
Source: calculations by the authors, EEC