Kazakhstan hikes rates as inflation fears rise

The National Bank of Kazakhstan (NBRK) made a hawkish move by hiking the base rate to 16.50%, reflecting additional inflation risks stemming from tariff liberalisation in 2025 and a VAT hike expected in 2026. Updated inflation forecasts suggest little room for rate cuts over the next two years. Fiscal discipline and KZT performance remain watch factors

A view of Kazakhstan's capital city, Astana

16.5%

Kazakhstan's base rate

a 125 basis point hike

Higher than expected

Kazakhstan's key rate up by 125 basis points on inflation risks

The National Bank of Kazakhstan (NBRK) decided to raise the base rate by 125 basis points to

16.50%, representing a hawkish decision relative to consensus and our expectations of a hold. We had indicated earlier that a spike in the inflation rate above the 9.0% YoY threshold could be a trigger for a hike, and this risk scenario seems to have materialised, as Kazakhstan's CPI accelerated from 8.9% YoY in January to 9.5% YoY the following month. This CPI structure suggests elevated inflationary pressure across the consumer basket, including food, non-food products, and services. A combination of global food price growth, strong domestic demand and continued domestic tariff liberalisation were cited as the primary drivers. An increase in households' inflationary expectations in February, which was also news to the market participants, was also mentioned.

At the same time, we believe the near-term inflation consideration made only a minor contribution to today's hawkish decision. The key reason was in the significant deterioration in the medium-term inflation expectations due to the recent official proposals to increase the VAT rate starting 2026 and continued liberalisation of domestic tariffs. NBRK has significantly increased its official year-end CPI expectations by 3.5 percentage points to 10-12% for 2025 and to 9-11% for 2026 (vs. long-term target of 5%). It has been indicated earlier that the VAT hike could temporarily add 2.5-3.0 percentage points to the expected CPI trajectory in 2026.

Extrapolating the real rate assumptions implied in the previous NBRK forecasts, the new inflation projections correspond to:

- 16.50-18.25% nominal key rate range by the end of 2025 and
- 13.50-17.25% by the end of 2026.

This suggests a very little downside to the base rate in the next two years, even if the CPI trajectory leans towards the lower bound of the forecast range.

The material increase in the NBRK's inflation projections indicates that the parameters of the upcoming tax reform, which is due to be discussed in parliament before the summer, have likely been largely finalised. As we indicated previously, fiscal consolidation was inevitable, one way or another. Although the headline consolidated budget was balanced in 2024, this was thanks to non-tax items of 5.3% of GDP, including privatisation proceeds and investment income of the sovereign fund. Net of non-tax proceeds, the Kazakhstan's budget system required Brent (fiscal breakeven oil) price of $185/bbl in order to be balanced in 2024, up from $141/bbl in 2023. The government expects the tax reform to provide extra revenues of 2.5-3.0% of GDP in 2026, which would allow an increase in savings in the sovereign oil fund (NFRK).

The deterioration in the 2025 CPI forecasts and the general wording of the NBRK commentary suggest that the fiscal policy is likely to remain pro-inflationary this year, as the spending side remains sticky.

We remain constructive on KZT for 2025 but cautious about 2026

We view the decision to hike positively as it highlights NBRK's prudent approach to inflationary risks in the current broad economic policy framework. Fiscal performance in 2025 will be a watch factor as a source of additional inflationary risks. We now see no downside to the base rate in 2025 and for most of 2026, which should be positive for private capital flows all things being equal.

Public capital flows should also be KZT-supportive for 2025. The current fiscal projections correspond to continued FX sales from the sovereign fund (NFRK) in the amount of $0.5-1.0 bn per month to finance current spending of the state budget. Also, as a reminder, starting 2025, the central bank (NBRK) is selling approximately $0.5 bn/month in order to sterilise excess supply of KZT stemming from its domestic gold purchases. Although this will be partially offset by occasional $250mn/month FX purchases for the needs of the state pension fund, the net balance of annual central bank FX operations should turn KZT-positive this year after net annual FX purchases of $1.3bn in 2024.

In the longer run, if the government succeeds in its fiscal consolidation efforts, FX sales from the sovereign fund will be materially reduced from next year. This should make the tenge more dependent on private flows, which would be negative for the exchange rate given Kazakhstan's chronic current account deficit.

Author

Dmitry Dolgin
Chief Economist, CIS
dmitry.dolgin@ing.de

Disclaimer