NATIONAL BANK OF KAZAKHSTAN

MARKET REVIEW
Finding of Enterprise Surveys in the Real Sector of the Economy
The Third Quarter of 2016

CONTENTS

PRIMARY DEVELOPMENT TRENDS IN KAZAKHSTAN'S REAL SECTOR

In the third quarter of 2016, feeble external and domestic demand keep affecting the business activity of enterprises in the real sector of the economy. In the third quarter of 2016, the demand for final products continued to decline and prices of raw materials and supplies increased. Price and non-price terms and conditions of lending were deteriorating.

At the same time, some slackening of negative processes is associated with stabilization of oil prices and the decreasing volatility of the exchange rate. The negative impact from the change in the exchange rate of the tenge versus the USD, EURO and RR diminished. Performance ratios of enterprises improved:

- the production output increased;
- the percentage of enterprises which did not cut the number of the employed personnel increased.

Primary Trends in the Real Sector	
Market Demand and Prices for Final Products, Raw Materials and Supplies	**Assessment of Business Activity among Enterprises and of Production Efficiency**
The demand for final products continued to decline ⬇	The production output increased ⬆
Prices of raw materials and supplies are growing ⬇	Investment activity of enterprises improved ⬆
	Production efficiency indicators improved ⬆
Assessment of the Financial and Economic Standing of Enterprises	
Enterprises' liquidity ratios improved ⬆	**Impact by the Banking System**
Profitability ratios deteriorated ⬇	The percentage of enterprises that were rejected a loan has decreased ⬆
The percentage of enterprises with arrears decreased ⬆	Price and non-price terms and conditions of lending for property, plant and equipment and working capital deteriorated ⬇
The Effect from Changes in the Exchange Rate	
The degree of negative impact of the change in the exchange rate of the tenge versus the USD, EURO and RR is decreasing. ⬆	The gap between an actual and an acceptable interest rate on the tenge loans increased ⬇

⬆ - positive change   ⬇ - negative change

BEHAVIOR OF THE DEMAND FOR FINAL PRODUCTS

In the third quarter of 2016, the demand continued to decline in the real sector as a whole; the diffusion index (DI) made up 47.6 as compared to 46.9 in the second quarter of 2016. In the third quarter of 2016, rates of decline in the demand for goods and services slowed down (to 49.1 and 45.8, respectively). In the mining industry, the demand for final products declined (DI=43.7), and in the manufacturing industry, the demand for final products remained virtually unchanged (DI=49.3).

Demand for the finished goods, DI*

Answers of enterprises, %		2015				2016			
		Q1	Q2	Q3	Q4	Q1	Q2.	Q3	Q4 exp.
Increase	1	9.8	23.1	22.2	18.4	12.1	26.1	26.7	18.6
No changes	2	43.2	46.0	47.1	45.1	47.0	48.0	49.9	37.4
Decrease	3	47.0	30.9	30.6	36.4	40.6	25.8	23.4	16.8
Diffusion index, DI=line1+0.5*line2	4	31.4	46.1	45.8	41.0	35.8	50.2	51.7	50.9
DI, seasonal adjusted	5	36.9	43.2	42.3	41.0	42.3	46.9	47.6	50.9

Demand for finished goods, DI *
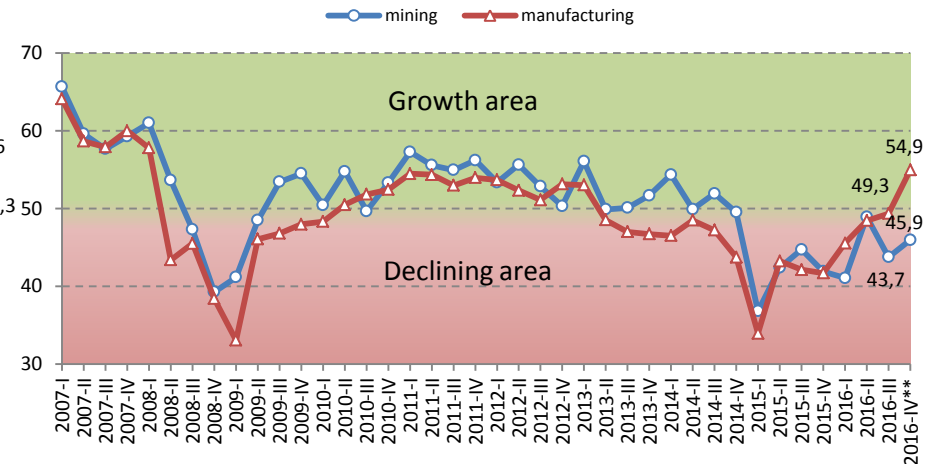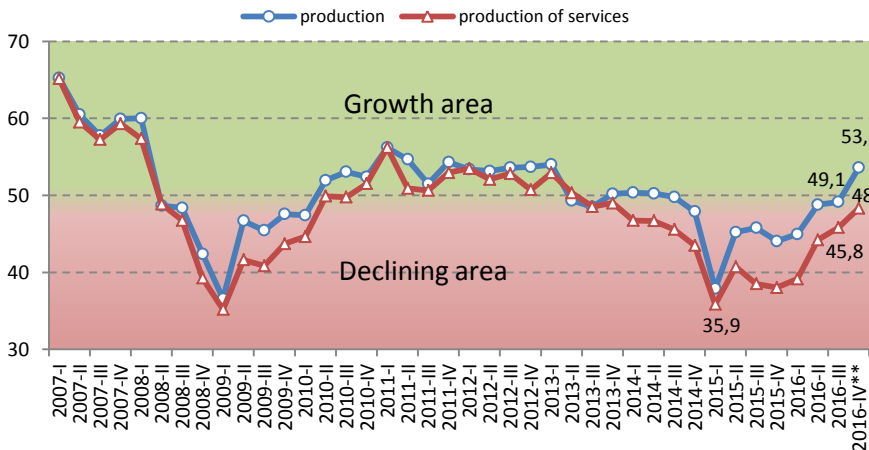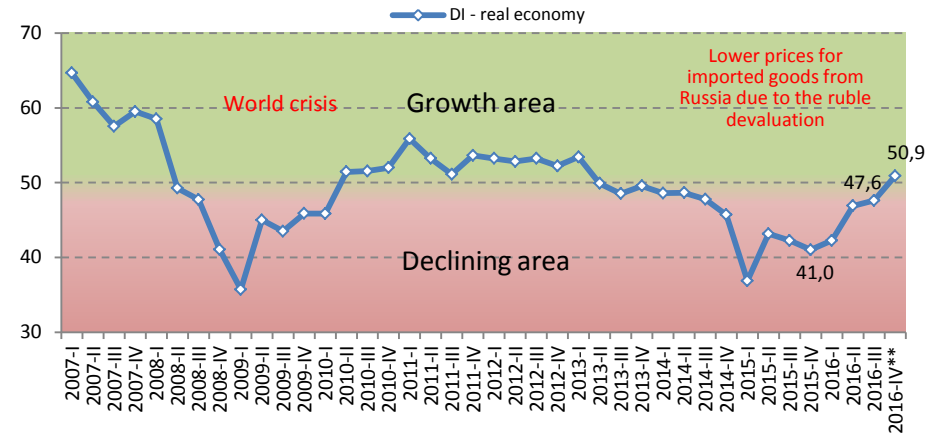
*The higher (the lower) the DI deviates from 50, the higher (the lower) are the rates of growth (decline) in the demand; the level of 50 means the absence of any change
**The Figures show expectations of enterprises regarding the change in the parameter in the fourth quarter of 2016.

CHANGE IN PRICES IN THE REAL SECTOR

In the third quarter of 2016, rates of growth in prices for final products in the real sector slowed down (the DI was 56.3). In the mining and in the manufacturing industry prices had increased (to 54.5 and 58.1, respectively). The growth trend in prices of raw materials and supplies persists (DI=74.6).

In the fourth quarter of 2016, the growth in prices of final products, raw materials and supplies is expected to slow down (from 56.3 to 54.4 and from 74.6 to 65.1, respectively).

Prices for finished goods, DI*

Prices for raw materials, DI*
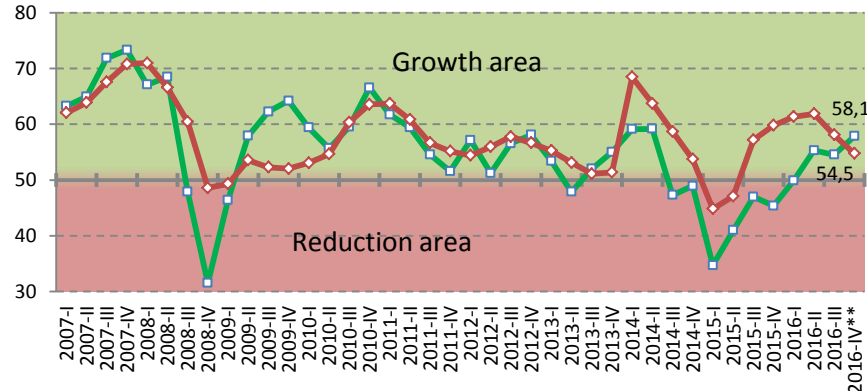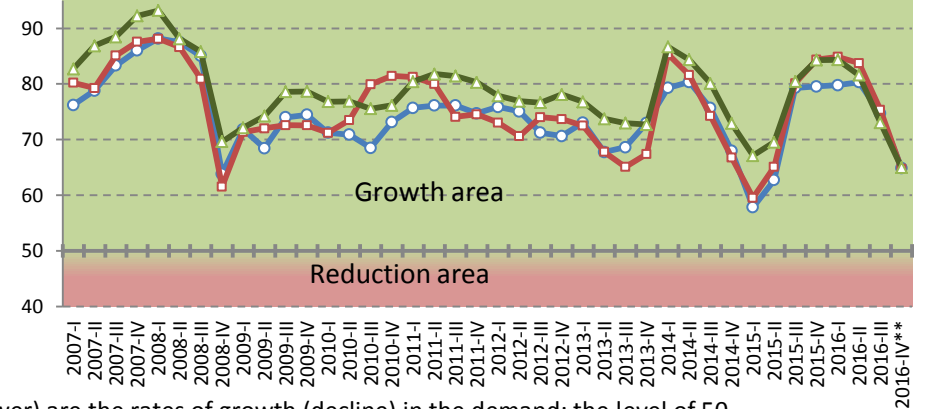
*The higher (the lower) the DI deviates from 50, the higher (the lower) are the rates of growth (decline) in the demand; the level of 50 means the absence of any change
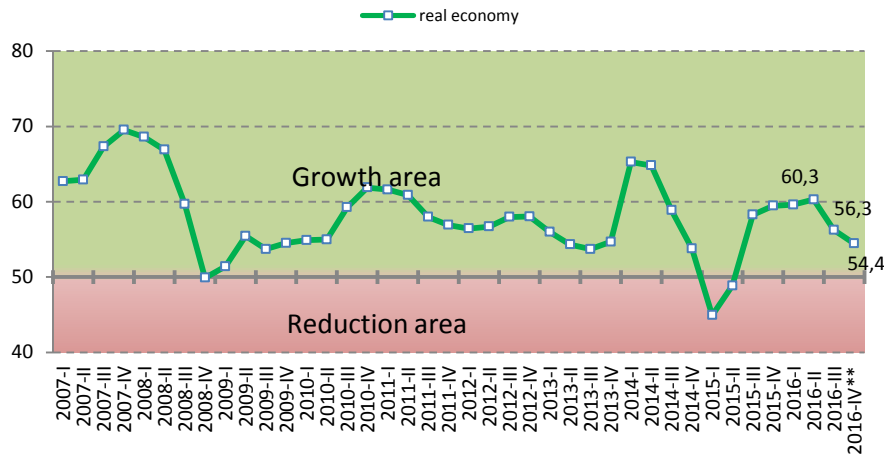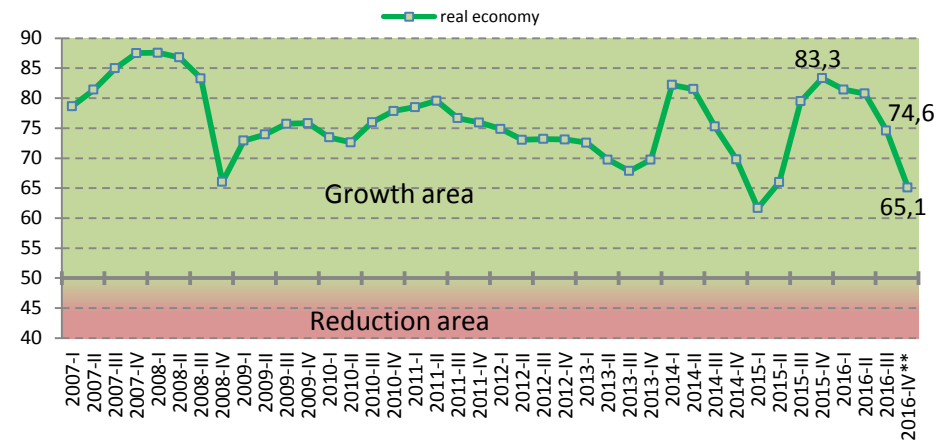
**The Figures show expectations of enterprises regarding the change in the parameter in the fourth quarter of 2016.

CHANGE IN THE PRODUCTION OUTPUT

In the third quarter of 2016, the production output was growing (DI = 53.0), and in the fourth quarter of 2016 enterprises anticipate a minor increase in the production output (DI = 50.5).

In the third quarter of 2016, the percentage of enterprises with the capacity utilization of more than 90% decreased to 12.9%. The percentage of enterprises where the capacity utilization is below 50% slightly decreased to 36.5%.

Changes in output volume

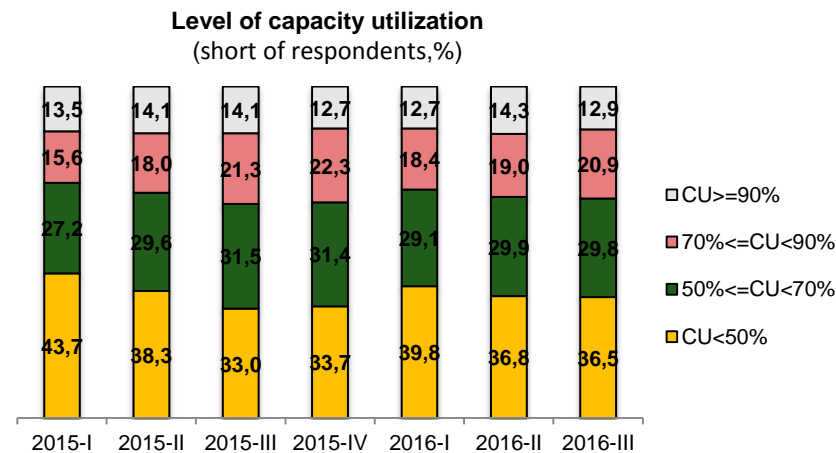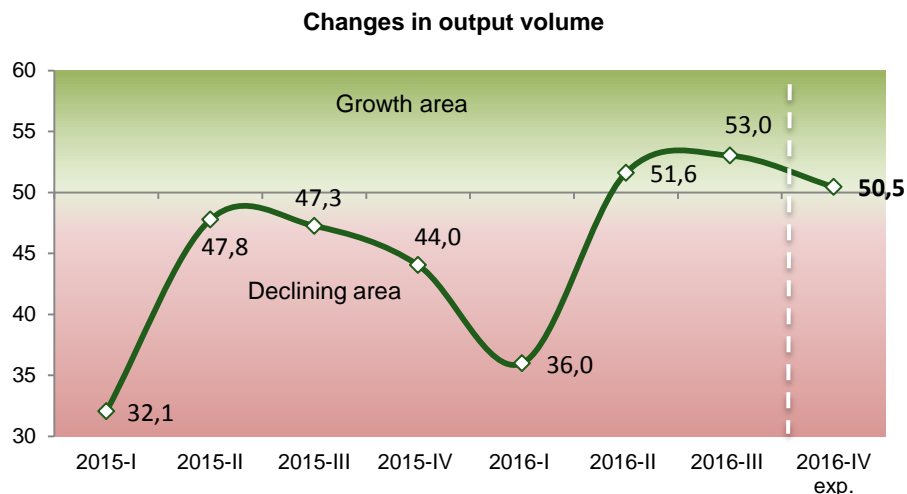**Level of capacity utilization**
(short of respondents,%)

* The higher (the lower) the DI deviates from 50, the higher (the lower) are the rates of growth (decline) in prices; the level of DI=50 means the absence of any change

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THE STRUCTURE OF A BALANCE SHEET: ASSETS

In the asset structure of companies operating in the real sector the percentage of current assets increased from 33.8% in the second quarter of 2016 to 35.9% in the third quarter of 2016. In the structure of current assets, the percentage of short-term receivables decreased from 43.7% in the second quarter of 2016 to 40.3% in the third quarter of 2016, and the percentage of inventories decreased from 22.3% in the second quarter of 2016 to 18.2% in the third quarter of 2016.

Turnover of assets and working capital decreased to 12.6% and 35.0%, respectively. The percentage of working capital within assets increased (to 35.9%).

Structure of assets

Structure of short-term assets

Indicators of assets turnover
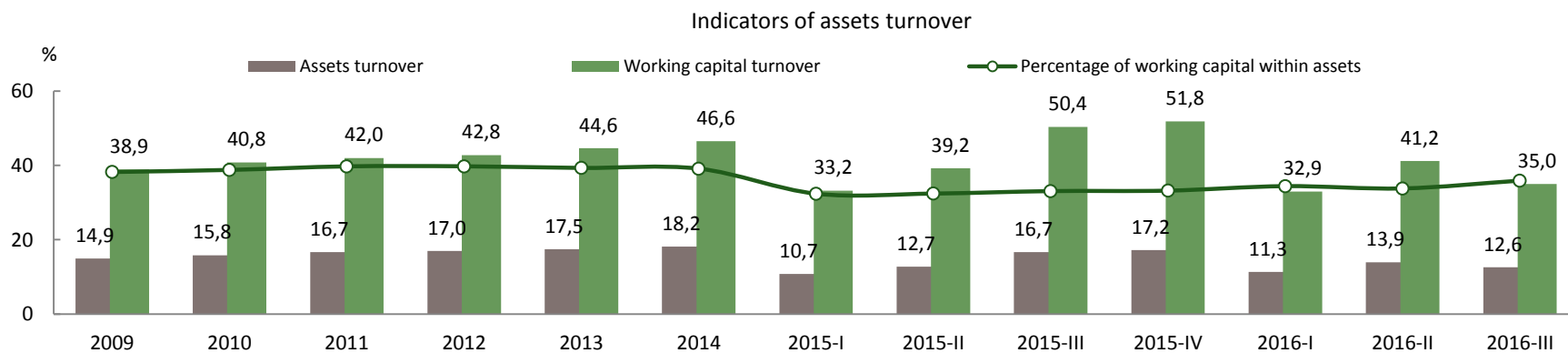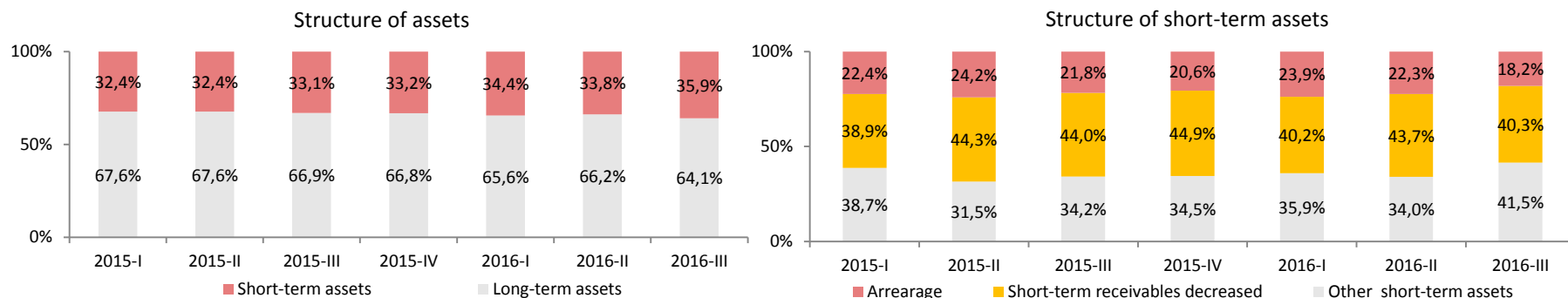
THE STRUCTURE OF A BALANCE SHEET: LIABILITIES

In the structure of liabilities, the percentage of net worth decreased from 49.7% in the second quarter of 2016 to 47.9% in the third quarter of 2016. The decrease in the percentage of net worth was offset by the growth in non-current liabilities (their share increased from 28.1% to 29.3%), and the percentage of current liabilities also increased from 22.2% to 22.8%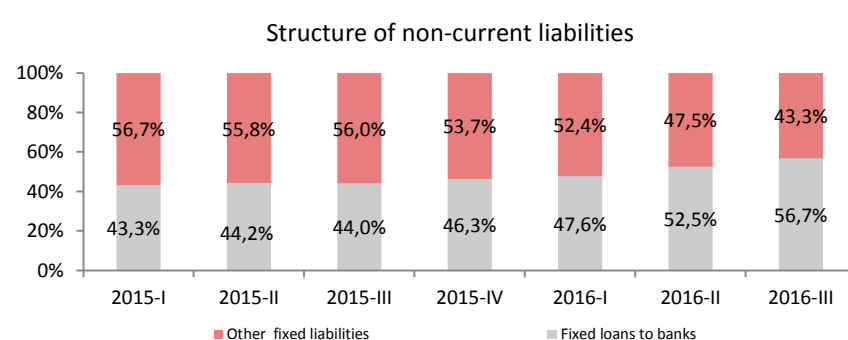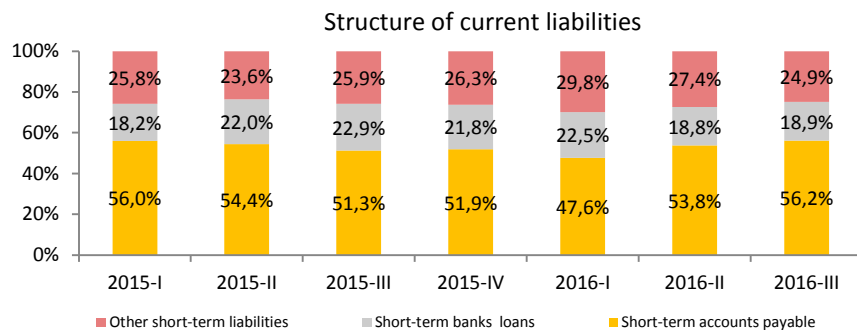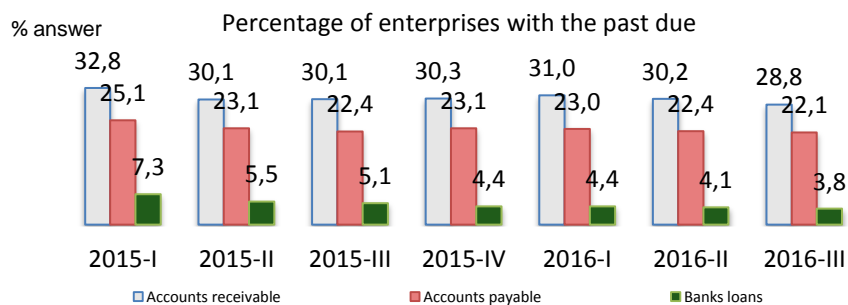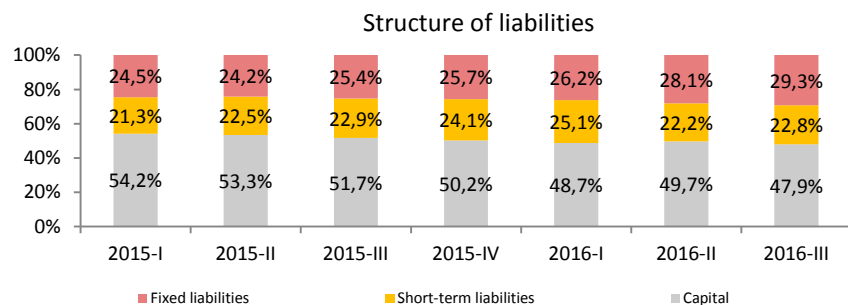. The situation with arrears slightly improved: the percentage of enterprises with the overdue payables decreased to 22.1%. Among enterprises which participated in the monitoring process, the percentage of enterprises with the past due on bank loans accounted for 3.8%.

In the structure of current liabilities, the percentage of short-term payables increased from 53.8% in the second quarter of 2016 to 56.2% in the third quarter of 2016, and the percentage of bank loans remained virtually unchanged (18.9%). In the structure of non-current liabilities, the percentage of long-term bank loans increased from 52.5% in the second quarter of 2016 to 56.7% in the third quarter of 2016.

Structure of liabilities

	2015-I	2015-II	2015-III	2015-IV	2016-I	2016-II	2016-III
Fixed liabilities	24,5%	24,2%	25,4%	25,7%	26,2%	28,1%	29,3%
Short-term liabilities	21,3%	22,5%	22,9%	24,1%	25,1%	22,2%	22,8%
Capital	54,2%	53,3%	51,7%	50,2%	48,7%	49,7%	47,9%

Percentage of enterprises with the past due

% answer

	2015-I	2015-II	2015-III	2015-IV	2016-I	2016-II	2016-III
Accounts receivable	32,8	30,1	30,1	30,3	31,0	30,2	28,8
Accounts payable	25,1	23,1	22,4	23,1	23,0	22,4	22,1
Banks loans	7,3	5,5	5,1	4,4	4,4	4,1	3,8

Structure of current liabilities

	2015-I	2015-II	2015-III	2015-IV	2016-I	2016-II	2016-III
Other short-term liabilities	25,8%	23,6%	25,9%	26,3%	29,8%	27,4%	24,9%
Short-term banks loans	18,2%	22,0%	22,9%	21,8%	22,5%	18,8%	18,9%
Short-term accounts payable	56,0%	54,4%	51,3%	51,9%	47,6%	53,8%	56,2%

Structure of non-current liabilities

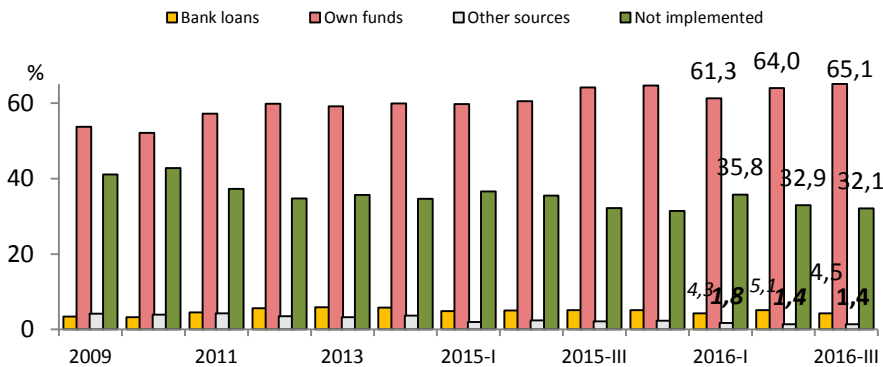|	2015-I	2015-II	2015-III	2015-IV	2016-I	2016-II	2016-III
Other fixed liabilities	56,7%	55,8%	56,0%	53,7%	52,4%	47,5%	43,3%
Fixed loans to banks	43,3%	44,2%	44,0%	46,3%	47,6%	52,5%	56,7%

INVESTMENT ACTIVITY

The investment activity of enterprises in the third quarter of 2016 slightly improved: the percentage of enterprises which did not finance their investments decreased to 32.1%. At the same time, the percentage of enterprises which used their own funds for these purposes increased to 65.1%.
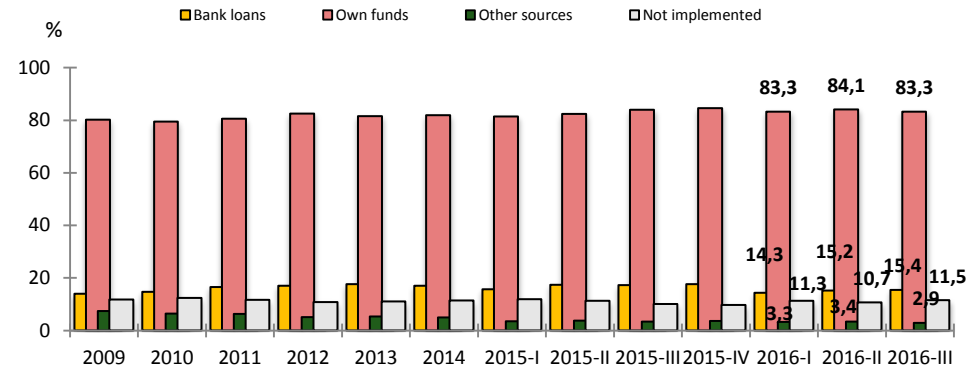
The main funding source for the working capital is still represented by own funds of enterprises (83.3%). The number of enterprises which use bank loans to replenish their working capital in the third quarter of 2016 slightly increased (to 15.4%).

The main factors that limit financing opportunities of enterprises are the shortage of financial resources, the state of the Kazakh economy, insufficient demand for their products and market competition on the part of other enterprises.
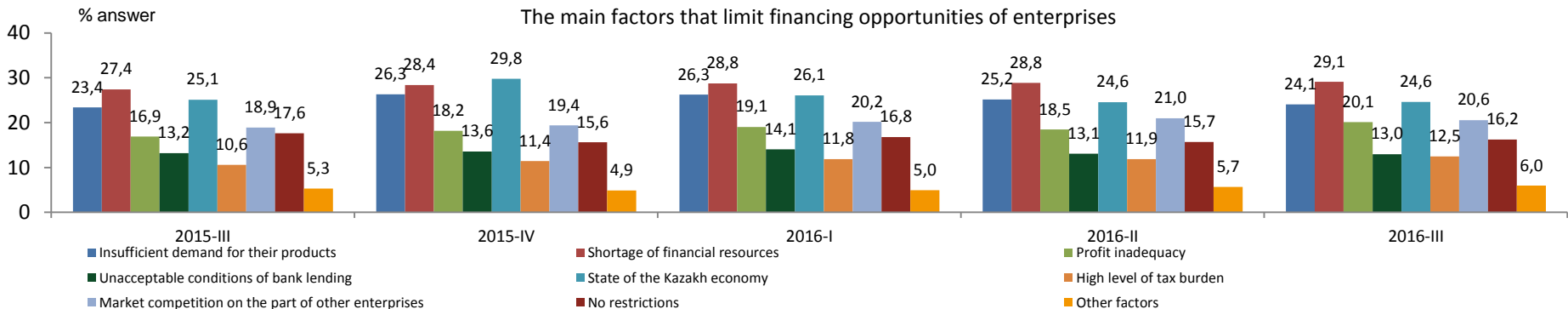

Funding source for the fixed assets

Bank loans   Own funds   Other sources   Not implemented

Values shown: 61,3 · 64,0 · 65,1 · 35,8 · 32,9 · 32,1 · 4,3 · 1,3 · 5,1 · 1,4 · 4,5 · 1,4

Funding source for the current assets

Bank loans   Own funds   Other sources   Not implemented

Values shown: 83,3 · 84,1 · 83,3 · 14,3 · 15,2 · 11,3 · 10,7 · 15,4 · 3,3 · 3,4 · 2,9 · 11,5

The main factors that limit financing opportunities of enterprises

% answer

- Insufficient demand for their products
- Shortage of financial resources
- Profit inadequacy
- Unacceptable conditions of bank lending
- State of the Kazakh economy
- High level of tax burden
- Market competition on the part of other enterprises
- No restrictions
- Other factors

|	2015-III	2015-IV	2016-I	2016-II	2016-III
Insufficient demand for their products	23,4	26,3	26,3	25,2	24,1
Shortage of financial resources	27,4	28,4	28,8	28,8	29,1
Profit inadequacy	16,9	18,2	19,1	18,5	20,1
Unacceptable conditions of bank lending	13,2	13,6	14,1	13,1	13,0
State of the Kazakh economy	25,1	29,8	26,1	24,6	24,6
High level of tax burden	10,6	11,4	11,8	11,9	12,5
Market competition on the part of other enterprises	18,9	19,4	20,2	21,0	20,6
No restrictions	17,6	15,6	16,8	15,7	16,2
Other factors	5,3	4,9	5,0	5,7	6,0

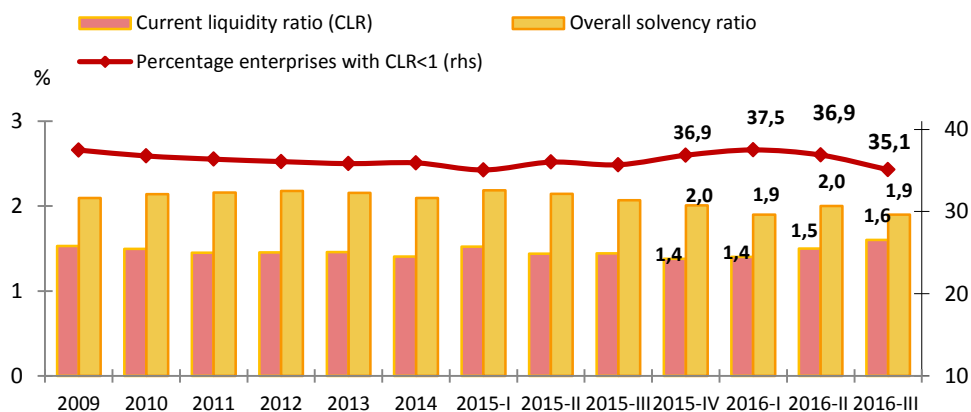# CHANGE IN THE FINANCIAL AND ECONOMIC PERFORMANCE

In the third quarter of 2016, production performance indicators were divergent. The percentage of enterprises which did not reduce their production output increased to 68.7%. The percentage of enterprises which did not reduce the total number of the employed also increased to 63.6%. However, the percentage of enterprises which did not reduce the labor productivity decreased to 68.5%.

In the third quarter of 2016, the current liquidity ratio of enterprises in the real sector increased to 1.6. The percentage of low liquidity enterprises (CLR<1) decreased to 35.1%, and the overall solvency ratio decreased to 1.9.

Indicators of production performance

- Percentage of enterprises which did not reduce the labor productivity
- Percentage of enterprises production output
- Percentage of enterprises which did not reduce the total number of employces
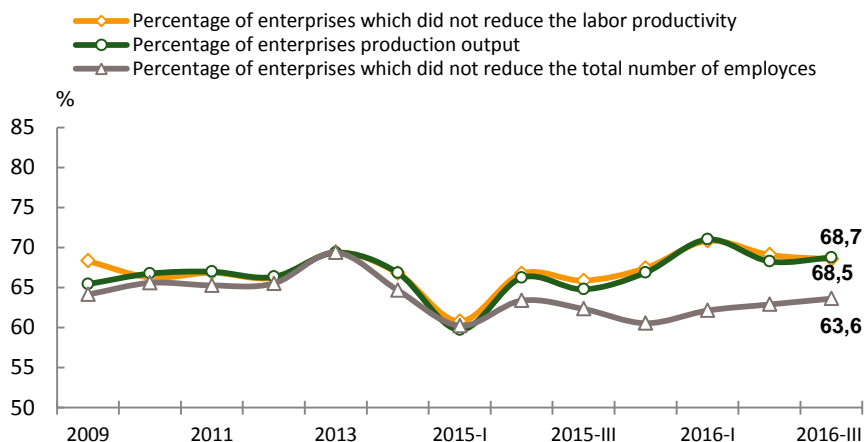
Indicators of liquidity and solvency of enterprises

- Current liquidity ratio (CLR)
- Overall solvency ratio
- Percentage enterprises with CLR<1 (rhs)

CHANGE IN THE FINANCIAL AND ECONOMIC PERFORMANCE

The return on sales (before tax) of enterprises in the real sector decreased to 24.6% (42.9% in the second quarter of 2016), being caused by the decreased return on sales in the mining industry and the professional, scientific and technical activity. However, the return on sales in agriculture and in the manufacturing industry increased (by 2.3 pp and by 0.6 pp, respectively).

In the third quarter of 2016, the percentage of loss-making and low profitable enterprises did not change and accounted for 22.5% (22.4% - in the second quarter of 2016). At the same time, the percentage of highly profitable enterprises increased to 36.2% (from 35.9% in the second quarter of 2016), and the percentage of enterprises with medium profitability decreased to 40.8% (from 41.4% in the second quarter of 2016).

Return on sales, in %
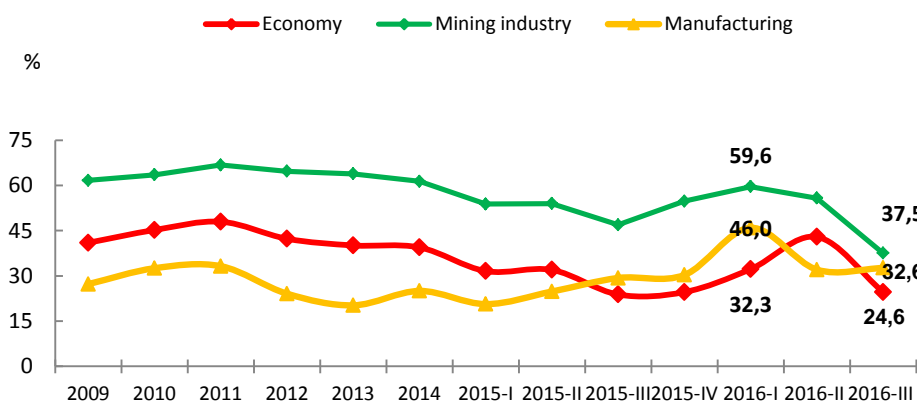
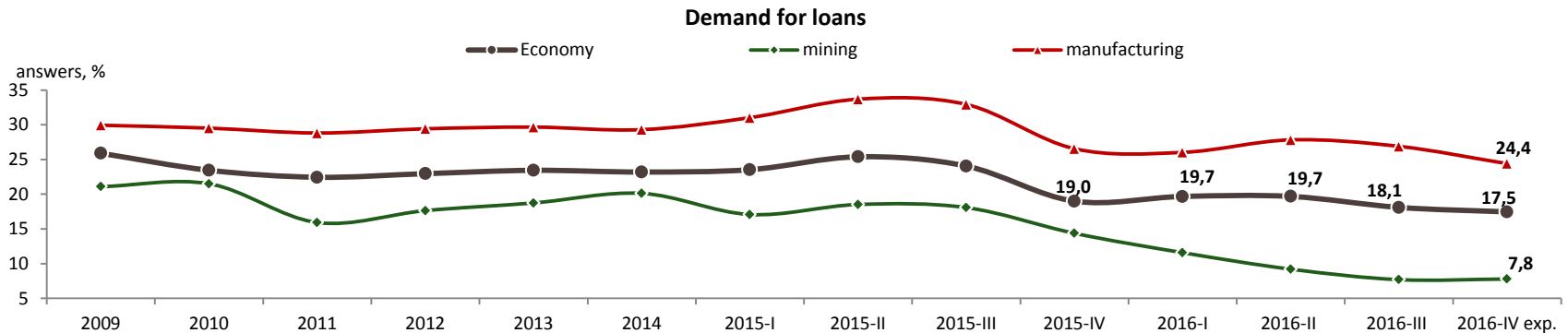Classification of enterprises in terms of return on sales
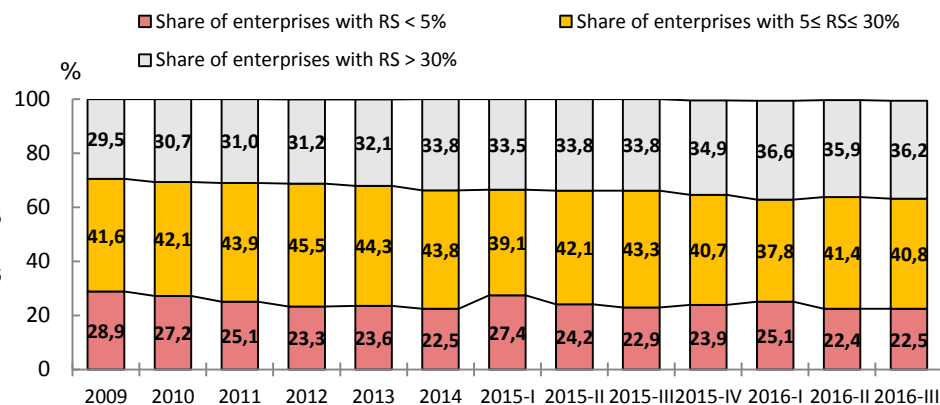
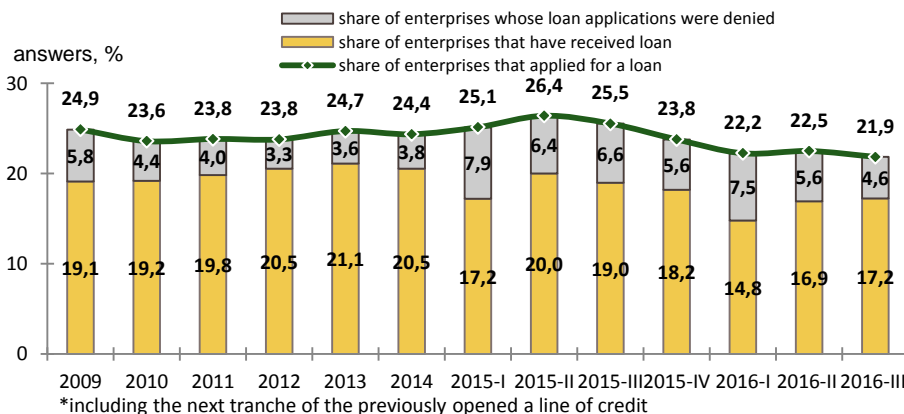# IMPACT ON THE REAL SECTOR OF THE ECONOMY BY THE BANKING SYSTEM

In the third quarter of 2016, the demand of enterprises for bank loans decreased in the economy as a whole.

In the third quarter of 2016, the percentage of enterprises which applied for a bank loan decreased to 21.9% (from 22.5% in the second quarter of 2016). The percentage of enterprises which obtained loans (including a regular tranche on an earlier credit line) increased to 17.2% (16.9% in the second quarter of 2016). The percentage of rejected loans decreased: the percentage of enterprises that were rejected a loan decreased to 4.6% (from 5.6% in the second quarter of 2016). The percentage of large enterprises which failed to obtain a loan also decreased, to 5.0% (from 6.0% in the second quarter of 2016).
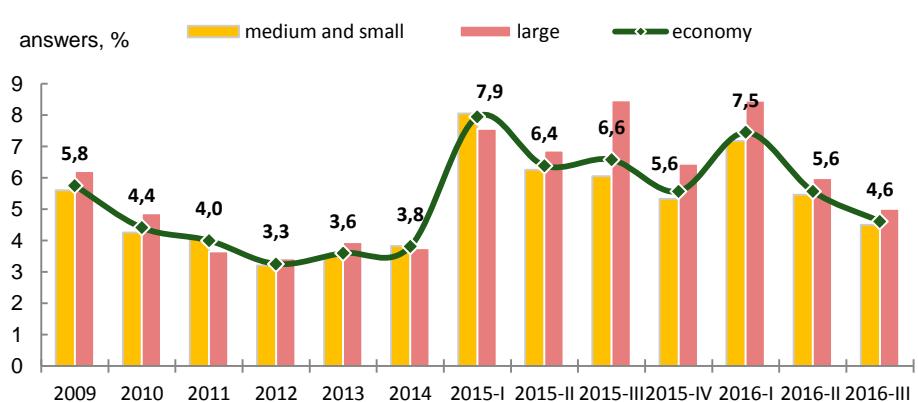
The percentage of enterprises which intend to get a loan in the fourth quarter of 2016 decreased to 17.5%. The loan demand of enterprises in the manufacturing industry decreased to 24.4%. In the mining industry, the loan demand did not change (7.8%).

Demand for loans

Economy — mining — manufacturing

answers, %

Consideration of loan applications by banks

- share of enterprises whose loan applications were denied
- share of enterprises that have received loan
- share of enterprises that applied for a loan

answers, %

*including the next tranche of the previously opened a line of credit

Share of enterprises whose loan applications were denied

medium and small — large — economy

answers, %

# IMPACT ON THE REAL SECTOR OF THE ECONOMY BY THE BANKING SYSTEM

In the third quarter of 2016, price terms and conditions of lending (interest rates on loans, amount of additional fee) an non-price terms and conditions of lending (maximum amount and tenor of a loan, requirements to a borrower's financial standing, collateral requirements) regarding loans for working capital and property, plant and equipment, slowed down their deterioration.

The average interest rate on loans in the tenge in the third quarter of 2016 increased to 15.2% per annum (14.6% in the second quarter of 2016). The gap between an actual and an acceptable interest rate on the tenge loans increased: acceptable interest rates accounted for 9.4% per annum. An actual loan tenor for loans in the tenge decreased as compared to the previous quarter and was 18 months, and an acceptable loan tenor for enterprises – 33 months. Interest rates on foreign currency loans remained unchanged (9.4%), and interest rates acceptable for enterprises increased to 5.9%. Actual tenors on foreign currency loans were 20 months, and acceptable tenors – 35 months (in the second quarter of 2016: 26 and 32 months, respectively).
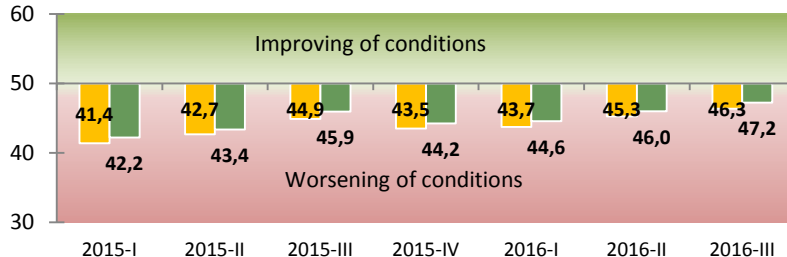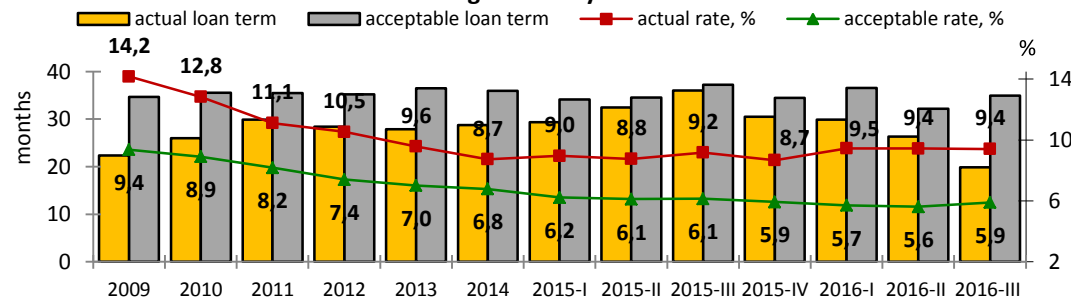
Changes in the conditions of lending
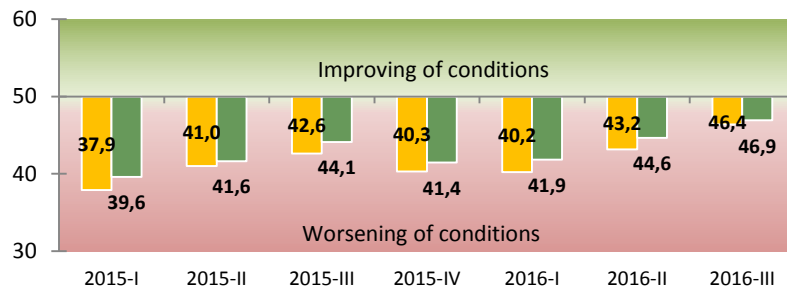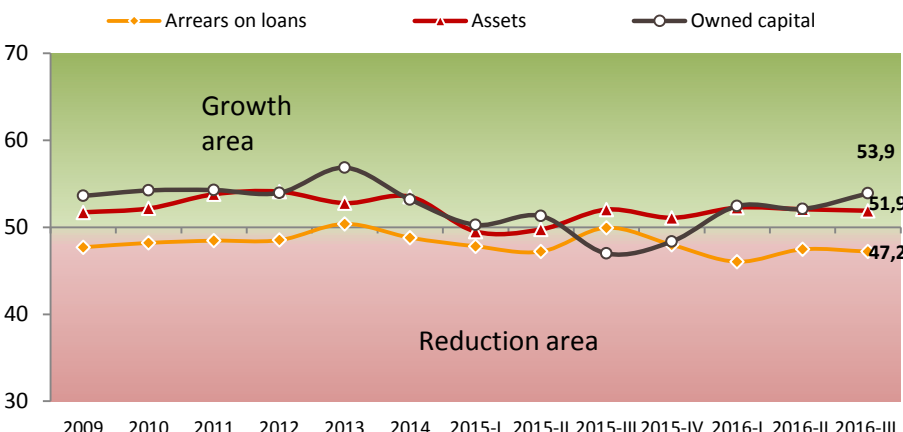
Loan rates and loan terms

* The higher (the lower) the DI deviates from 50, the higher (the lower) are the rates of growth (decline) in the indicator; the level of DI=50 means the absence of any change

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# IMPACT ON THE REAL SECTOR OF THE ECONOMY BY THE BANKING SYSTEM

In the third quarter of 2016, the debt of enterprises on bank loans continued to decrease: DI=47.2. Assets and net worth of enterprises were growing: the DI of assets and net worth made up 51.9 and 53.9, respectively.

In the third quarter of 2016, volume of deposits held by enterprises with banks increased in the economy as a whole (DI=51.1). The increase is noted both on deposits of large enterprises as well as small and medium-sized enterprises: DI = 52.1 and 50.8, respectively. According to expectations of enterprises, in the fourth quarter of 2016 no growth in deposit volumes in the economy as a whole is expected (DI= 50.0).

Credit, assets and owned capital

Volume of deposits of enterprises
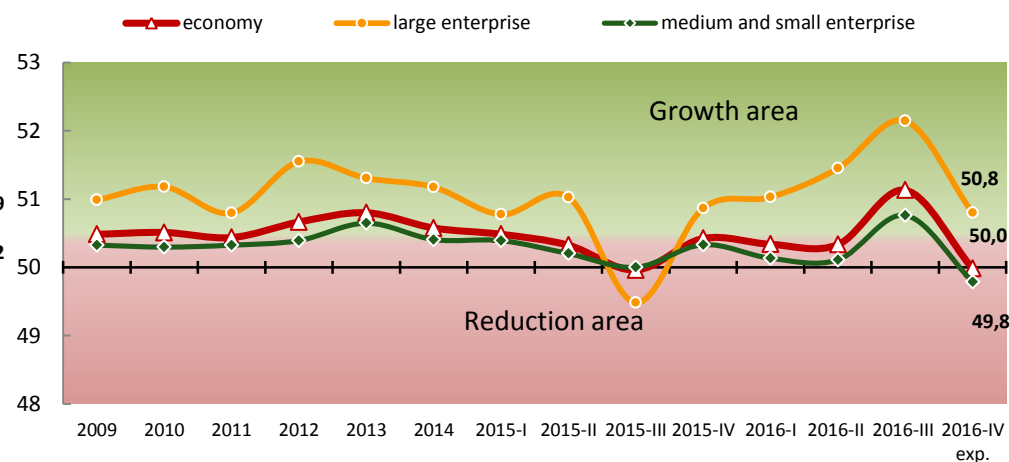
* The higher (the lower) the DI deviates from 50, the higher (the lower) are the rates of growth (decline) in the indicator; the level of DI=50 means the absence of any change
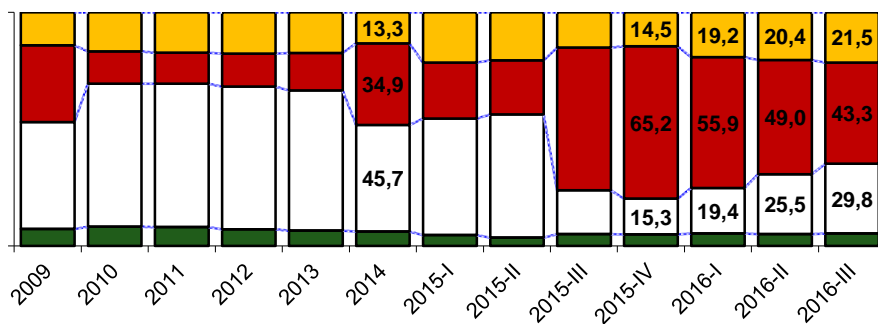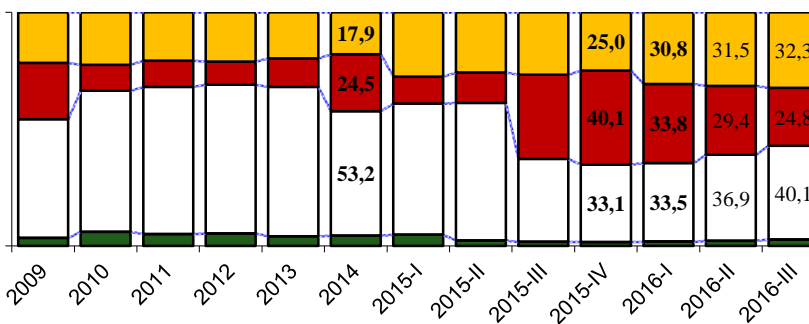
IMPACT OF CHANGES IN THE EXCHANGE RATE

The survey conducted based on performance in the third quarter of 2016 showed the downward trend in the change in the exchange rate of the tenge versus foreign currencies; this fact may serve as an indicator of a gradual adaptation of entities operating in the real economy to the free floating exchange rate regime. The percentage of enterprises which were negatively affected by the change in the exchange rate of the tenge versus the US Dollar decreased from 49.0% in the second quarter of 2016 to 43.3% in the third quarter of 2016; versus the Russian ruble – from 43.4% to 38.4% and versus the Euro – from 29.4% to 24.8%, respectively.

The distribution of the foreign currency use by enterprises in the third quarter of 2016 generally remained unchanged, except for an insignificant increase of the number of enterprises which use the Russian ruble in settlements with their trading partners.

USD/KZT, answer %

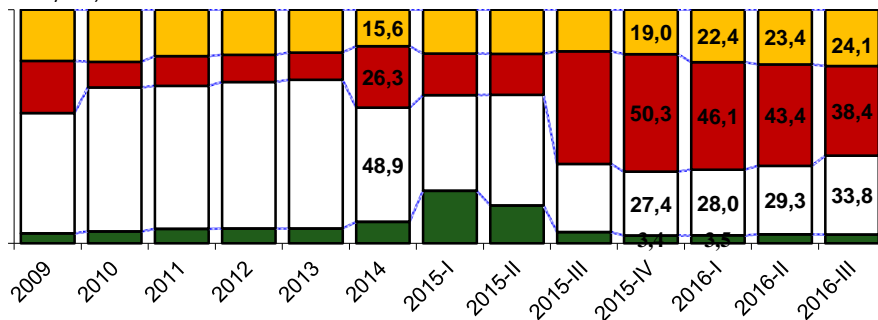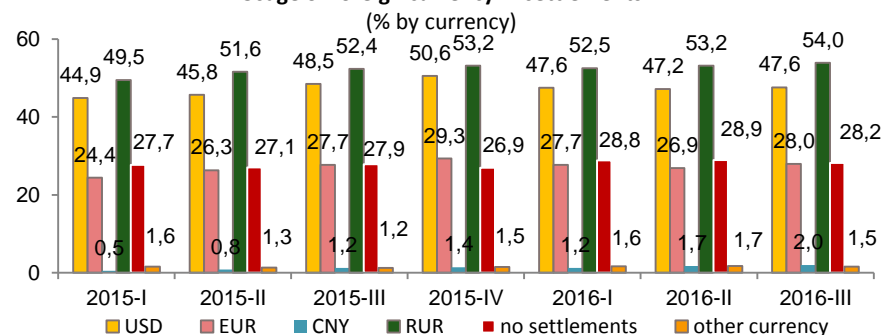EUR/KZT, answer %

RUB/KZT, answer %

Usage of foreign currency in settlements
(% by currency)

Legend: positive (green), negative (red), no impact (white), I don't know (yellow)

Legend: USD, EUR, CNY, RUR, no settlements, other currency

COMPOSITE INDICATOR*

Based on findings from the market research of enterprises in the real sector of the economy, in the third quarter of 2016 the composite indicator (CI) retained its positive trends. So, in the third quarter of 2016 the CI remained in the area of growth versus the long-term trend of GDP behavior (zero point) and made up 0.7, indicating a gradual recovery of the economic activity.

In the third quarter of 2016, enterprises in the agricultural sector, in the manufacturing industry, trade and transport sector as well as enterprises operating in the sphere of production of goods and provision of services of consumer nature noted the increased demand for their products. In particular, a positive trend is observed in the sector of trade where the demand for final products has increased for the first time since the end of 2014. However, in the mining industry and in some branches of the services sector (information and communication, real estate operations) parameters of the demand were still declining in the third quarter of 2016.

Based on the survey, the increased production output and the improved investment activity in the real sector of the economy may be mentioned among factors which helped improving the business activity. Apart from those, according to respondents, in the third quarter of 2016 the lending activity improved *(the percentage of enterprises which obtained loans increased and the percentage of enterprises which were rejected loans decreased; the share of long-term bank loans within the structure of non-current liabilities of enterprises increased).* A negative impact made by the change in the exchange rate of the tenge versus the US Dollar and the Russian ruble on business activities of enterprises decreased; this is largely associated with stabilization of oil prices and the decreasing volatility of the exchange rate of the tenge in the third quarter of 2016.

It is worth mentioning that expectations of respondents about the 4th quarter of 2016 remain positive, despite a minor slowdown. Enterprises anticipate that a positive pattern of the economic activity (the CI made up 0.5), as evidenced by the improved parameters of the demand for final products expected in the next quarter.
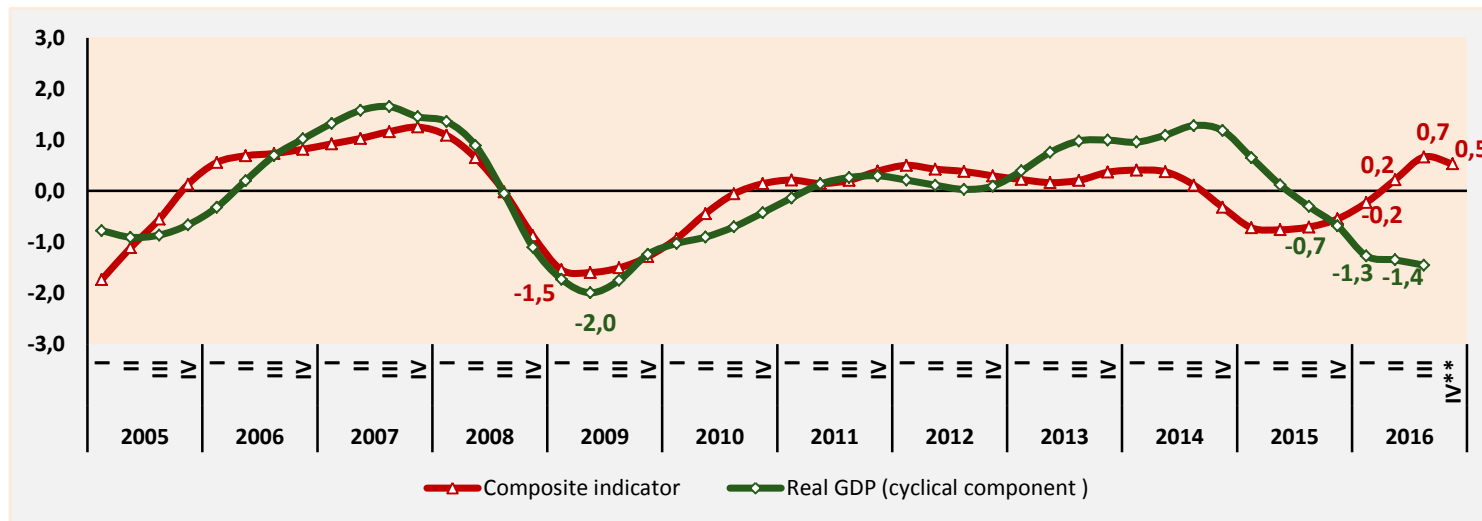
* A composite indicator is used to identify turning points in the business cycle and provides good quality information about the state and directions of trends in the economic activity. A composite indicator reflects a summarized evaluation of opinions of managers of the interviewed enterprises regarding the existing and anticipated situation in their enterprises and possesses the forward-looking feature of the real GDP behavior for 1-2 quarters. The indicator and the real GDP (in terms of average annual prices of the year 2005) are designed including the clearing of seasonality and the detrending by using the Hodrick-Prescott method. For comparability purposes, the resulting cyclical components are standardized. In addition to the market survey parameters, in the third quarter of 2016 the calculation of the CI included the following macroeconomic indicators: price of oil (Brent), nominal exchange rate of the tenge versus the US Dollar and volumes of credits to the economy.

** The CI parameters for the fourth quarter of 2016 are calculated on the basis of expectations among enterprises in the real sector that participated in the survey.

METHODOLOGICAL COMMENTS

➤   The diffusion index (DI) as reflected in tables and in figures is calculated as a sum of positive responses and a half of "no change" responses. This index is a generalized indicator which characterizes the behavior of the reviewed indicator. If its value is above 50 – this means a positive change, if it is below 50, then the change is negative. In doing so, the further (the higher) the value of the diffusion index deviates from 50, the higher are the rates of change (increase or decrease) of the indicator.

➤   The indicator of "an acceptable interest rate on bank loans" is calculated as the average of interest rates indicated by enterprises participating in the monitoring process as acceptable rates for these enterprises in terms of the existing level of profitability of production.

➤   Numbers reflecting financial ratios are provided as average values calculated based on the whole sample of interviewed enterprises as well as broken down by sector, where necessary, based on estimates of the quarter-end balance sheet numbers received from enterprises. In doing so, the evaluation data as well as the averages calculated on their basis are not aiming at obtaining the absolute precision of their values (since they are not the reporting ones) but rather serve for obtaining updated estimates and for analyzing the trends of the change in the state of the non-financial sector of the economy and its branches.

➤   The composite indicator (CI) possesses the forward-looking feature of the real GDP behavior for 1-2 quarters. The time series of the CI and the real GDP (in terms of prices of the year 2005) are cleared of seasonality and do not contain the trend, i.e. they only include a cyclical component as determined by short-term fluctuations of the economic market environment. For comparability purposes, the resulting cyclical components are standardized, i.e. they are reduced to one (non-dimensional) unit of measurement.

The CI serves to reflect short-term development trends in the real sector of the economy as a whole. It possesses the following features: 1) it has a forward-looking mature; 2) it reflects a cyclical nature in the development of the real sector of the economy; 3) it is quickly designed since it is built on the basis of on-the-spot interviews of enterprises.

Out of indicators built up based on interviews of enterprises, the following leading indicators were included as the CI components:

1)   The DI of the change in the demand for final products in economic sectors
2)   a group of indicators that reflect the change in prices :
•   the DI of the change in prices in the real sector as a whole;
•   the DI of the change in prices for raw materials and supplies.
3)   a group of indicators that reflect the change in the investment and lending activity:
•   the percentage of enterprises which obtained loans to finance their property, plant and equipment (including governmental programs);
•   the percentage of enterprises which use other sources apart from own funds and bank loans to finance their property, plant and equipment and working capital;
•   the percentage of enterprises which obtained a loan;
•   the percentage of enterprises which want to get a loan;
•   the level of actual interest rates on loans in the tenge and in foreign currency.
4)   the employment rate indicator: the percentage of enterprises where the number of employees decreased
5)   the indicator of the impact on activities of enterprises by the change in the exchange rate of the tenge (versus the US Dollar, Euro and Russian ruble)

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