



NATIONAL BANK OF THE  
REPUBLIC OF KAZAKHSTAN

AGENCY OF THE REPUBLIC OF  
KAZAKHSTAN ON REGULATION AND  
SUPERVISION OF THE FINANCIAL  
MARKET AND FINANCIAL  
ORGANIZATIONS



# FINANCIAL STABILITY REPORT OF KAZAKHSTAN

*December 2010*

## Foreword

Since 2006, the National Bank of the Republic of Kazakhstan involving the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations (Financial Supervision Agency) prepares the Kazakhstan's Financial Stability Report on an annual basis.

In line with the Concept for the Financial Sector Development in the Republic of Kazakhstan approved in November 2009, the government policy in the post-crisis period will aim to implement the system of macro-prudential regulation and, hence, to enhance the role of the National Bank of the Republic of Kazakhstan as a central authority responsible for ensuring financial stability and implementing macro-prudential regulation.

According to the Memorandum of Financial Stability made between the Government of the Republic of Kazakhstan, National Bank and the Financial Supervision Agency on November 10, 2007:

*«financial stability shall be defined as the absence of disproportions in the economy that may result in the subsequent negative correction of financial markets, systemic crisis and inability of financial institutions to ensure an ongoing functioning of the financial system as well as to maintain business activity in the real sector of the economy»*

As part of the Kazakhstan's Financial Stability Report representing one of the tools of the comprehensive systemic risk analysis, the following aspects determining financial stability are assessed:

- (1) How efficiently and timely financial resources are reallocated among those who save and invest money;
- (2) Whether risks are adequately assessed and managed;
- (3) Whether financial shocks can be absorbed by the financial system without significant upsets.

The Kazakhstan's Financial Stability Report is focused on the financial market participants as well as the audience interested in the financial stability topics. The National Bank aims to disseminate the outcomes of the research and risk analysis as well as specialized studies in the area of financial stability.

*The Kazakhstan's Financial Stability Report has been prepared by the National Bank of the Republic of Kazakhstan involving the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations.*

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## **List of Abbreviations:**

<b>CIS</b>	Countries of the Commonwealth of Independent States
<b>RF</b>	Russian Federation
<b>USA</b>	United States of America
<b>IMF</b>	International Monetary Fund
<b>NBRK</b>	National Bank of the Republic of Kazakhstan
<b>CB</b>	Central banks
<b>OPEC</b>	Organization of the Petroleum Exporting Countries
<b>MoF</b>	Ministry of Finance of the Republic of Kazakhstan
<b>MEBP</b>	Ministry of Economy and Budget Planning of the Republic of Kazakhstan
<b>FSA</b>	Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations
<b>ASRK</b>	Agency of Statistics of the Republic of Kazakhstan
<b>NFRK</b>	National Fund of the Republic of Kazakhstan
<b>NWF</b>	JSC “National Wealth Fund “Samruk-Kazyna”
<b>ISMT</b>	Kazakhstan Interbank System of Money Transfer
<b>SM</b>	Securities market
<b>KASE</b>	Kazakhstan Stock Exchange
<b>KDIF</b>	Kazakhstan Deposit Insurance Fund
<b>RFCA</b>	Regional Financial Center of Almaty
<b>KMC</b>	JSC “Kazakhstan Mortgage Company”
<b>CSD</b>	JSC “Central Securities Depository”
<b>JSC</b>	Joint-stock company
<b>APF</b>	Accumulation pension funds
<b>HU</b>	Housing and utilities
<b>FEC</b>	Fuel and energy complex
<b>GDP</b>	Gross domestic product of the Republic of Kazakhstan
<b>M3</b>	Money supply
<b>GED</b>	Gross external debt
<b>LIBOR</b>	London interbank offered rate
<b>OIS</b>	overnight interest rate swap
<b>CDS</b>	credit default swap
<b>GES</b>	Government equity securities
<b>NES</b>	Non-government equity securities
<b>MRR</b>	Minimal reserve requirements
<b>REER</b>	Real effective exchange rate
<b>PPP</b>	Purchasing Power Parity
<b>VAT</b>	Value added tax
<b>Un.</b>	unit
<b>KZT</b>	Tenge
<b>USD</b>	United States Dollar
<b>ths.</b>	thousand
<b>mln.</b>	million
<b>bln.</b>	billion

## I. General Conclusions

The developments in the economy and the financial sphere in 2010 proved that accents in the Financial Stability Report of Kazakhstan for 2009 were correct in the sense that they were made on the most important, from the financial stability standpoint, risks and factors affecting soundness of the financial system. The following may be highlighted among such factors:

1) Successful restructuring of three Kazakh banks – in the first instance, restructuring of foreign liabilities of BTA Bank in view of its systemic importance –served as a signal for international investors and Kazakhstani economic agents about decreased level of systemic risk in the Kazakh banking system and retaining its soundness at an acceptable level.

2) Credit conservatism of banks remains one of the critical factors that reduce their credit activity.

3) The process of displacement of foreign funding by the domestic funding due to the growth in the deposit base goes virtually smoothly owing to the governmental funding provided to banks through deposit placements as part of measures for the support of first-priority sectors of the economy and temporary available resources of national companies and other subsidiaries of the National Welfare Fund “Samruk-Kazyna” in banks.

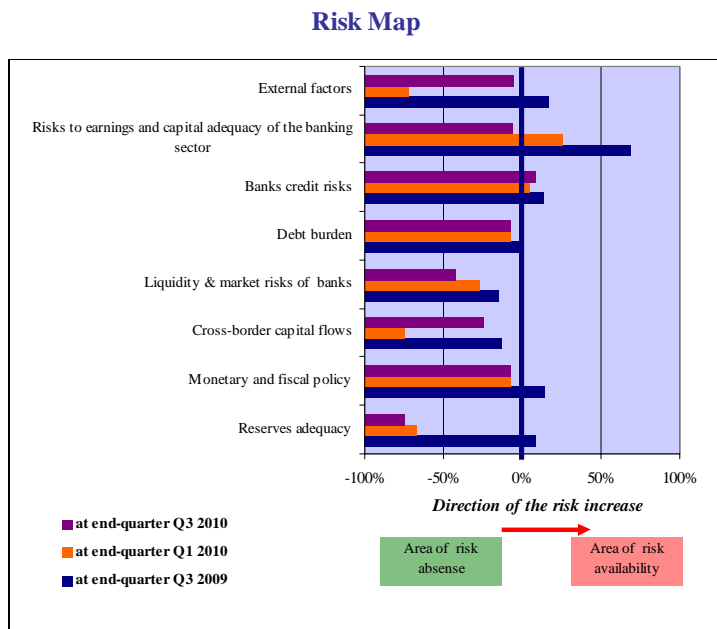
4) Low credit portfolio quality of banks is still a critical risk factor for financial system.

5) Establishing clear benchmarks for the exchange rate was conducive to the stabilization of expectations in the foreign exchange market. At the same time, a flexible exchange rate policy in the mid-term, depending on fundamental factors, remains as a priority aspect of the National Bank’s exchange rate policy.

Based on results of 9 months of 2010, the majority of risk factors affecting the financial stability became less significant: the only risk factor which demonstrates a threatening extent is credit

risk of the banking sector. Due to unstable situation in the largest world economies, a number of external risk factors demonstrate significant growth, however, this indicator estimated within the risk assessment map doesn’t exceed the threshold which would warn about a dangerous risk level. So, the decrease in foreign liabilities of the banking sector as a result of restructuring resulted in diminished debt burden, risks of reserve adequacy, risks of profitability and capital adequacy, since the significant volume of problem loans was charged off the balance sheet.

A favorable environment on the global commodity markets had a positive effect on the current account balance; however, significance of risks associated with the foreign economic activity maintains



Source: NBRK

its relevance because of the prices volatility on the commodities.

The recovery of economic growth rates during the period from Q4 2009 through Q3 2010 occurred primarily due to the output growth in the extracting industries owing to a favorable environment in the global commodity markets and energy markets. The growth in output in

manufacturing industries which was mainly ensured by the effect of governmental anti-crisis programs is also worth mentioning.

In the short term a further output growth in non-oil and gas sectors is limited by the lack of access to credit resources, and in the long-term – by the lack of fixed capital investments and a further obsolescence of production capacities. At the same time, a composite leading indicator of the development of the Kazakh economy indicates that the processes of economic recovery in Kazakhstan will continue next 2011 year.

One of the negative implications of anti-crisis measures was enhancement of budget risks. In 2010 a liberal budget policy was still implemented and in consequence affected to high budget deficit and public debt growth. The increased risks to fiscal soundness amidst the lack of growth in non-oil and gas revenues to the budget should be encouraging the government to be focused on increasing the efficiency of budget resources and seeking for new sources of sustainable growth.

Despite the decrease in foreign liabilities, including in the banking sector, a gradual increase in short-term liabilities against the decrease in long-term liabilities enhance the risk of speculative capital inflow amidst a high level of liquidity in foreign markets resulting from massive injections as part of implementation of the anti-crisis package. In this context, additional regulatory measures discouraging a speculative capital inflow into the country may be required to mitigate the “contagion risk”.

A positive growth rate in the deposit base of individuals in the first-third quarters of 2010 demonstrates preserving population’s confidence in the domestic banking system. The finalization of the foreign debt restructuring in three Kazakh banks also contributed to the growth in confidence. A level of the deposit reallocation by depositors among banks goes down in the search for acceptable profitability and reliability within the entire banking system. Thus, the percentage of deposit reallocation among banks as of the end of Q3 2010 decreased to 3% as compared to 5% in the previous year.

It is worth mentioning that active deposit-taking from individuals may result in the increase of the latent liquidity risk which could materialize in case of loss of confidence of population to the whole banking system.

Recovery of the country’s economy and revival of business activity led to the growth in demand for credit resources from the side of the corporate sector and households sector. Currently banks maintain low volumes of new lending which are in the first instance explained by a low “risk appetite” among the majority of banks and, in a number of cases, overestimation of risks associated with borrowers. At the same time, in the second half of 2010 there was resumption in lending, however, this process is related to the short-term and consumer loans market only. In order to maintain a steady economic growth revitalization of long-term lending is required, which is so far at a low level because of non-existence of matching funding sources.

In its turn, normalization of the condition of the corporate sector (decreased probability of bankruptcies and improved financial performance of enterprises in the majority of industries) and a high bank liquidity level create prerequisites for a downward reassessment of borrower risks and further recovery of lending.

Restructuring of problem loans implemented by banks doesn’t allow them to manage the quality of their credit portfolios to the full extent. According to banks’ information, they changed lending terms and conditions in respect of about 25% of their loans portfolio in order to improve

customers' creditworthiness. The main ways of reducing the debt burden appeared to be the provision of deferral for past due repayment, prolongation of the total loan term and modification of maturities. Some growth in the volumes of written offs of bad loans was largely caused by the change in the policies of banks which have by now restructured their foreign debt.

A prerequisite for many regulatory measures taken in 2010 was in essence an intention to mitigate risks similar to those which resulted in the critical condition of a number of Kazakh banks, BTA Bank in the first instance. Risks related to the quality of banks capital and possibility of their fictitious capitalizations as well as risks associated with transparency of bank operations and operations with related parties may be referred to such risks.

Experience gained in Kazakhstan in the crisis period showed the importance of interaction between institutions in the policymaking for the financial system regulation. At present a two-tier system of macro-prudential regulation is in place:

- Strategic approaches to macro- and micro-prudential regulation are elaborated by the Council on Financial Stability and Development of the Financial Market of the Republic of Kazakhstan.
- Resolutions passed by the Council are implemented by the taskforces established under the Council to address various aspects pertinent to the development of different segments of the financial system.

In addition, to ensure communication between the National Bank and the FSA with regard to formulation and implementation of the regulatory policy a standing taskforce for macro-prudential regulation is being established.

## II. Macroeconomic and Financial Environment

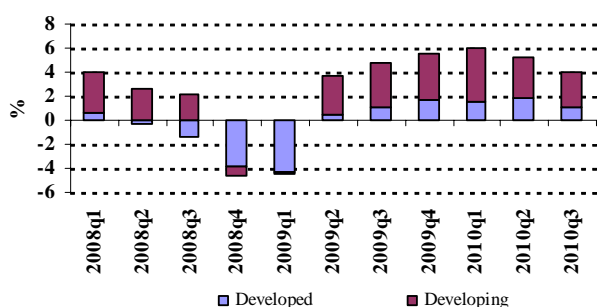
### 2.1 Macroeconomic Environment and its Sustainability Factors

#### 2.1.1 Current External Risks

*Economic activity of the global economy continued recovering in the first half of 2010, however, this process is not even in the regional breakdown. The leaders in such growth are the emerging countries; the USA and Japan had faced a notable slowdown of growth already in the second quarter of 2010 whereas the growth in Europe has just started to show itself after the turbulent. The global financial stability was cut short by shocks in the sovereign debt markets in the second quarter. Despite that, financial conditions started again to normalize although institutions and markets are still exposed to potential risks. As a whole, volatility in the foreign exchange, financial markets and the commodity market declined but still remains high.*

Figure 2.1.1

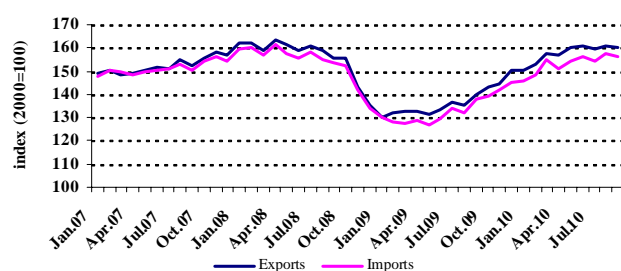
Global growth driven by the developing countries



Source: OECD calculations

Figure 2.1.2

Global trade recovery



Source: Thomson Reuters (Datastream)

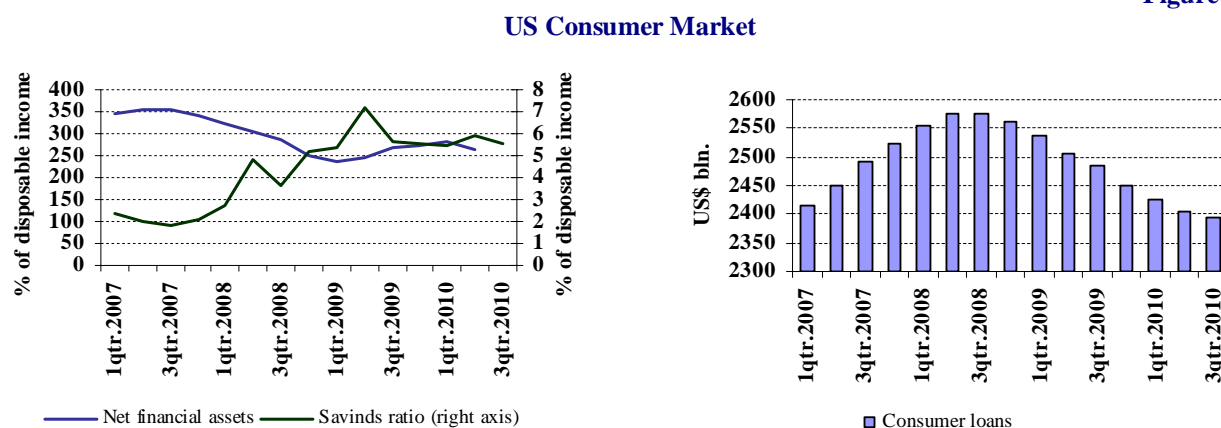
Generally, in the global economy the processes of recovering economic growth started in the first half of 2009 continued worldwide, due to the effect of anti-crisis measures and growth in the global trade. According to the IMF, the global economy during the first half of 2010 showed the growth of 5.25%, which was contributed mainly by the developing economies (Figure 2.1.1). Industrial output and trade increased by 15% and by over 40%, respectively, during the period (Figure 2.1.2).

However, the recovery is not progressing evenly across different regions. Developed countries demonstrated growth of about 3.5% in the first half of the year and are still below the potential level. It is especially true in relation to the USA, Japan and the European countries. Growth in the US in the first quarter of 2010 (3.7%) had virtually reached its pre-crisis period level, but slowed down again in the second quarter (1.7% in annual terms), despite unprecedented anti-crisis injections. The slowdown in the recovery rates can be explained by a slow growth in private consumption as the critical factor of economic growth in the USA.

The main reasons for sluggish growth in consumption are the decrease in net assets of households, high unemployment level (9.6% as of August 2010) and low level of credits to the population. Also, there is an increase in savings among the population due to uncertain expectations about the prospects for the labor market and the need to service the debt accumulated in the pre-crisis period. On the other hand, there is a hope that business investments will grow a lot due to the growth in external demand, corporate profit increase and normalization of financial conditions; however their effect, according to experts, so far is not sufficient for resolving the problems in the labor and real estate markets (Figure 2.1.3).



Figure 2.1.3



Source: US FRS

In Japan and the Eurozone the economic growth has not yet reached the pre-crisis levels and is still dependent on external demand. Owing to fiscal incentives and the growth of international trade, the Japanese economy started to recover from the 2<sup>nd</sup> quarter of 2009, increasing its growth in the beginning of 2010. In the second quarter, against the backdrop of slowed down growth in the US and appreciation of Yen due to the inflow of capital looking for a safe shelter from the volatile European markets, exports and, accordingly, the growth in Japan had decreased. The Eurozone, led by the German economy, started to demonstrate a significant rate of recovery only in the 2<sup>nd</sup> quarter of 2010, following the turbulent spring. The dependence of the European region on lending activity stipulates a limited domestic demand, since given uncertain situation banks became very cautious about lending. A notable depreciation of the Euro from the last peaks, which supported the sector of tradable goods, as well as a stable recovery in investment growth served as the positive factors for the European economy.

**Table 2.1.1**  
**Growth forecast of the countries worldwide**  
(annual percentage change)

	2 009	2010 <sup>a</sup>	2011 <sup>b</sup>
<b>Developed countries</b>			
USA	-2.6	2.6	2.3
Euro zone	-4.1	1.7	1.5
Japan	-5.2	2.8	1.5
<b>Developing countries</b>			
Asia	5.8	9.2	7.9
China	9.1	10.5	9.6
India	5.7	9.7	8.4
Latin America	-0.2	6.3	4.1
Brazil	-0.2	7.5	4.1
Eastern Europe	-3.6	3.7	3.1
CIS	-6.5	4.3	4.6
Russia	-7.9	4	4.3
Kazakhstan	1.2	5.4	5.1
Middle East and South Africa	2	4.1	5.1
Oil exporters	1.1	3.8	5

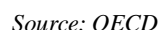
Note: a-estimate, b-forecast

Source: IMF

<sup>1</sup> According to the International Labor Organization, from the beginning of the crisis the number of unemployed increased by 30 million worldwide, of which ¾ falls on the developed countries.

<sup>2</sup> According to the UN economists, USA will need at least 4 years to bring up its employment level to that of the pre-crisis time.

### High unemployment level and low inflation



### Discount rates of developed countries



**Figure 2.1.6**

### Share in the global GDP, %



On the other hand, monetary measures of quantitative easing normalized financial markets and encouraged investments but have virtually exhausted their capacities given that discount rates are close to zero and further liquidity injections are limited due to the expectations of possible inflationary surges in case of a sudden vent of the economies to a self-sustaining growth (Figure 2.1.5).

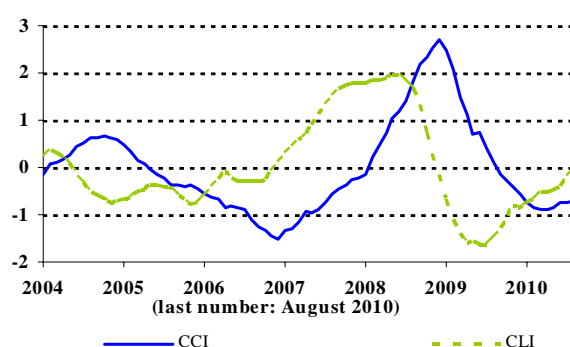
The emerging economies became an important factor of the global economic growth due to their growing economic influence and higher growth rates as compared to the developed economies; this ensured the growth in their share in the global GDP (Figure 2.1.6). During the first half of the year the developing economies demonstrated y-on-y growth by approximately 8% on average. Just like among the developed countries, here the rates of recovery of economic growth are also uneven.

The Asian and Latin-American regions appeared to be the leaders in the growth rates (in the first half of the year the y-on-y growth was 9.5 and 7%, respectively). Both regions, while recovering quickly from the overall cyclic decline, demonstrated strong growth in investments and consumer demand. Foreign economic environment of the leading countries of the policy of relatively tight regulation of the money in the time of turbulences. Apparently, the world took into consideration the lessons learned from the lack of sustainability of those economies to external shocks. It is noteworthy that China is quite capable of maintaining high growth rates in the times when the external demand decreases, by effectively substituting the export-leading growth with the domestic demand- leading growth (in 2009 the increase in the consumer demand accounted for 13% versus the prior year).

In the Eastern European and the CIS countries the growth recovery is slower under the pressure of unsolved problems in the banking sector and a close integration with sluggish European financial markets. Growth in the CIS is estimated at 4.3% in 2010, according to the IMF. Despite high oil prices,

2010 between Belarus, Kazakhstan and Russia can give an additional impetus to trade and, hence, to the growth of the economies within the Union.

**Figure 2.1.7**  
**Leading and coincident indicators of the Kazakh economy<sup>3</sup>**



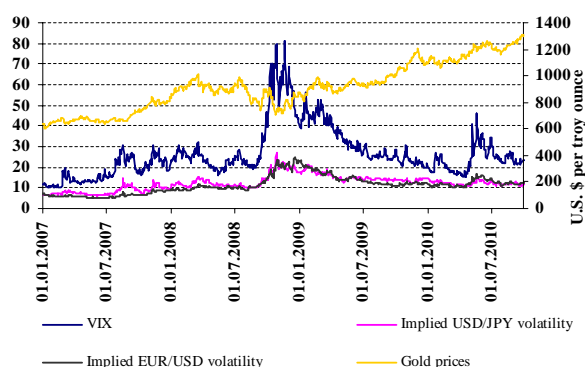
Source: NAC, NBRK calculations

CLI quite accurately determined the turning point of the economic recovery with a lag of one year approximately. Current values of CLI mean that in the absence of significant external shocks the Kazakh economy should attain self-sustainable growth by the end of 2011.

***The situation in the global financial markets is improving but risks are still high.***

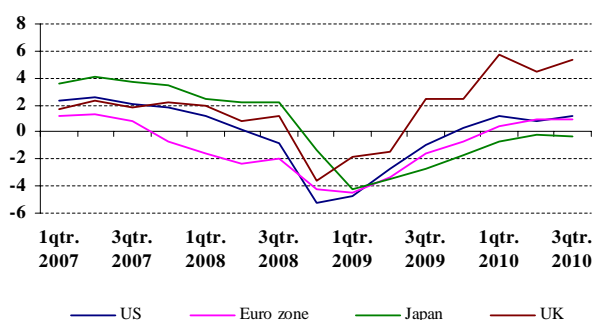
According to the IMF's Global Stability Report for October 2010, risk indicators show that the current uncertainty is diminishing but is going to increase in the mid-term.

**Figure 2.1.8**  
**Individual risk indicators in the markets**



Source: Bloomberg

**Figure 2.1.9**  
**Indicators for financial conditions in developed countries**



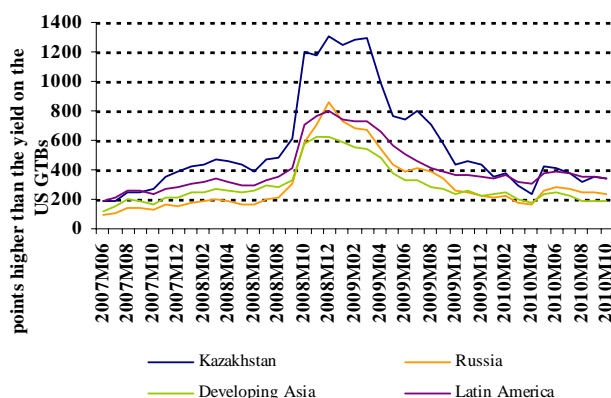
Source: OECD

<sup>3</sup> The composite leading indicator (CLI) is constructed on the basis of 5 quantitative indices: oil price index, composite index of business activity in the US, IFO World Economic Survey, money supply (M2) index, asset price index; and 3 qualitative indicators characterizing expectations about the growth in the industrial output, demand for final products and goods in stock, based on the corporate polls conducted by SARK.

Composite coincident index (CCI) characterizing the dynamics of economic development is constructed on the basis of 4 indices: index of production, employment index, real wage index, and trade volume index (Source: National Analytical Center).

Figure 2.1.10

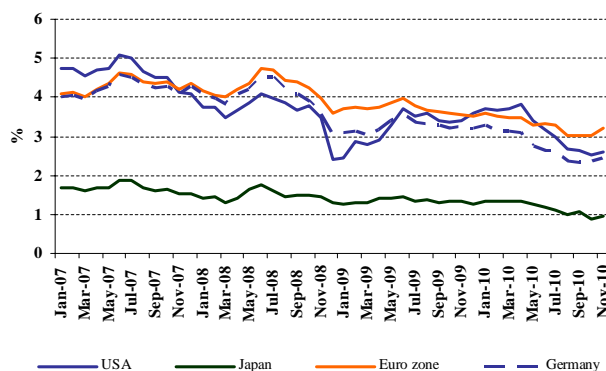
## Spreads of the bond yield



Source: World Bank

Figure 2.1.11

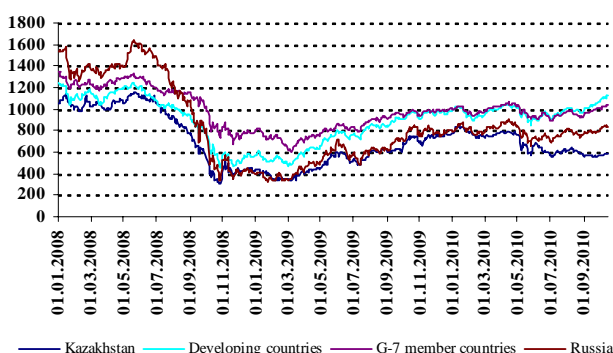
## Yield of long-term bonds



Source: Thomson Reuters (Datastream)

Figure 2.1.12

## MSCI index



Source: Thomson Reuters (Datastream)

Simultaneous transition of the countries from the policy of fiscal stimulus to fiscal consolidation may have negative implications in the event if the financial market is not prepared for self-sustainable growth.

Specifically for Kazakhstan the problems of the banking sector in Europe are the most critical since the main portion of cross-border credit flows to the domestic banking sector was coming from Europe (Figure 2.1.13).

In the mid-2010 normalization of the financial markets was interrupted by sovereign debt defaults in some European countries; as a result, volatility in the markets still is higher than the pre-crisis level even though it somewhat declined after the summer upturn (Figure 2.1.8). In 2010 financial conditions in the developed countries have stabilized, according to the aggregated OECD indices (Figure 2.1.9). Volatility in the developed markets also decreased significantly, which is evidenced by narrowing spreads of the bond yields (Figure 2.1.10).

The following processes were conducive to the stabilization:

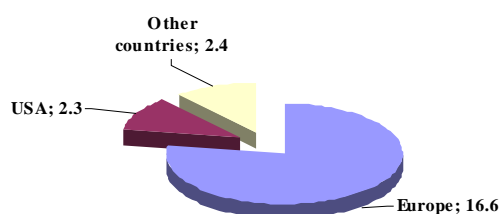
- Easing monetary policies in the developed countries resulted in the increase of liquidity in the financial markets and decreased interest rates as well as yields on government bonds (Figure 2.1.11).
- Financial conditions in the developing countries also improved under the impact of low interest rates and increasing volumes of capital inflow from the developed countries thus activating the growth of stock market indices.
- Low interest rates enable corporations to benefit from cheap borrowings in the bond market, which encourages investments.
- Owing to a low cost of borrowings, banks in the developed countries increased their profitability in the second quarter of 2010. In the third quarter, according to international surveys, US banks continued to liberalize lending conditions whereas the European banks tightened them to a certain extent because of new adopted capital requirements.

High risks of a new crisis in the US mortgage market and risks of shrinking liquidity amidst decreasing fiscal and monetary injections represent the negative factors in the financial market development in the near-term.

In case of a further tightening of lending conditions and persisting problems in the European markets the Kazakh banks would have to look up to other financing sources that could be time-consuming.

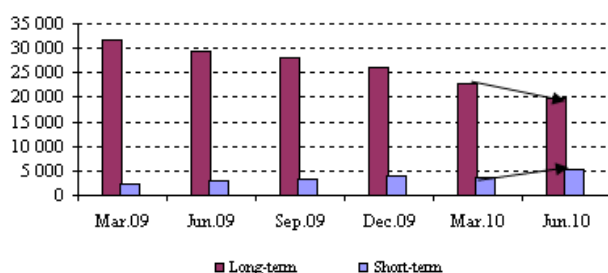
Also, as the Kazakh economy recovers its growth rates, there is a potential risk of a speculative capital inflow stirred up by excessive liquidity in foreign markets. This process has already started to show up. According to the

**Figure 2.1.13**  
**Claims of foreign banks on the Kazakh banks, as of end-March 2010, (USD bln.)**



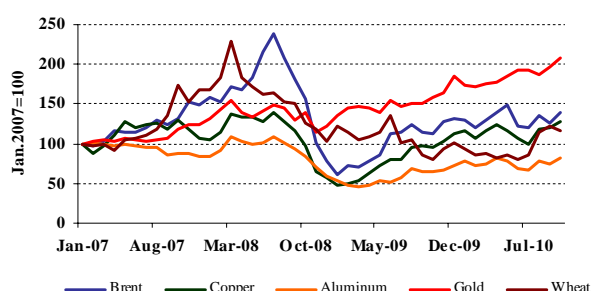
Source: BIS

**Figure 2.1.14**  
**Foreign liabilities of the Kazakh banks, (USD mln.)**



Source: NBRK

**Figure 2.1.15**  
**Dynamics of basic commodity prices (indices)**



Source: Bloomberg, NBRK calculations

the part of the emerging countries in order to satisfy the growing domestic demand will continue having even more wide-scale impact on the commodity market.

On the other hand, some analysts note the monetary factor in oil pricing, where the dynamics of the USD exchange rate plays a key role. According to certain recent studies<sup>4</sup>, a statistically significant positive correlation has established between the oil price and USD exchange rate during

recent data on the external debt, the growth in short-term liabilities of the Kazakh banks at end-June 2010 as compared to end-March 2010 amounted to about USD 1.7 bln., while medium- and long-term bank liabilities to non-residents decreased by USD 2.7 bln. during the same period (Figure 2.1.14). This fact may also evidence that banks try to refinance a part of maturing long-term debt by new short-term liabilities. To this end, a timely introduction of tightened counter-cyclical regulatory principles and enhanced flexibility of the Tenge exchange rate must increase the financial sector's sustainability to speculative capital inflows.

*Probability of the dramatic reduction of commodity prices during the current period is remote; however, the price dynamics shall remain volatile*

In the second quarter of 2010 the commodity prices have been corrected (except for the price of gold, the traditionally safe haven asset during the times of uncertainty) after a strong rise during the initial stage of the global economic recovery (Figure 2.1.15).

According to the experts, the factors that encourage the price increase include the growth in demand on the part of the developing countries (first of all China, India and Brazil), while the mature economies have demonstrated decrease in consumption of the energy resources.

According to IEA data, in 2009 China outran the USA in terms of the energy consumption level and became an important propellant of the demand for energy resources. The increasing demand for raw materials on

<sup>4</sup> For example, James Hamilton "Why 90\$ Oil Should Worry Bernanke" <http://www.businessinsider.com/why-90-oil-should-worry-bernanke-2010-11>



the recent periods. Moreover, increase in the oil price occurred during the period when liquidity increased due to the quantitative easing measures, which resulted in a cheaper USD.

**Table 2.1.2**  
**Forecast of commodity prices**

(USD)					
Items	4 кв.10	1 кв.11	2 кв. 11	3 кв. 11	4 кв. 11
Brent, per barrel	80.5	81.6	83.4	84.3	87.9
Wheat, per ton	251.9	241.0	238.7	226.0	221.7
Gold, per troy ounce	1308.0	1343.0	1345.0	1351.0	1395.0
Copper, per ton	7787.6	7834.8	8034.7	8150.3	8585.9
Aluminium, per ton	2196.5	2255.1	2358.9	2399.5	2468.3

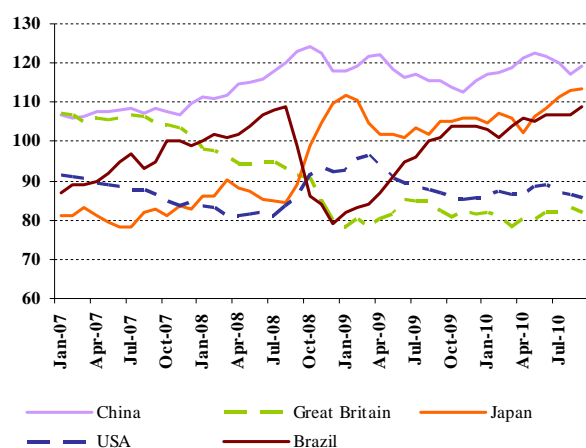
Source: Bloomberg

Kazakhstani economy, as Kazakhstan is dependent on the commodity export. According to IEA, oil production in Kazakhstan should double by 2025, after the rich deposits of Kashagan are put into operation. This will make Kazakhstan the fourth largest oil producer in the world. However, in real life the difficulties in financing, the need to establish a transport infrastructure that crosses several countries, complex investment climate and uncertainty of the demand for oil put obstacles on the path of the project implementation in the nearest future. According to the opinion of analysts from Renaissance Capital, significant increase in cashflow from the implementation of this project will be possible only by 2020. Accordingly, at least within next 5-7 years Kazakhstan economic growth led by oil production will be limited, which would further increase the country's dependence on the external price-related environment.

### *Increasing frequency of the currency interventions may lead to the worldwide growth of protectionism*

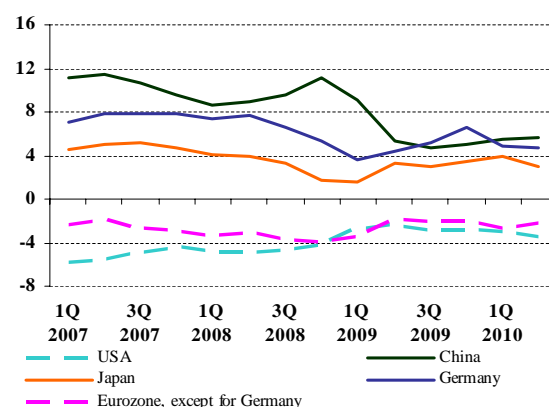
In view of the low domestic demand in the mature economies, many countries seek to better growth through improvement of trading terms, pursuing the cheap foreign exchange policy (Figure 2.1.16). In this regard the quantitative easing carried out by the USA, United Kingdom and lately by Japan may be considered as implicit currency interventions. A measure to reduce the current accounts imbalance by setting the net surplus limit at the level of not more than 4% of GDP offered by the USA failed to meet a positive response from China, Japan and Germany, the countries running the largest surpluses (Figure 2.1.17).

**Figure 2.1.16**  
**Nominal effective exchange rates**



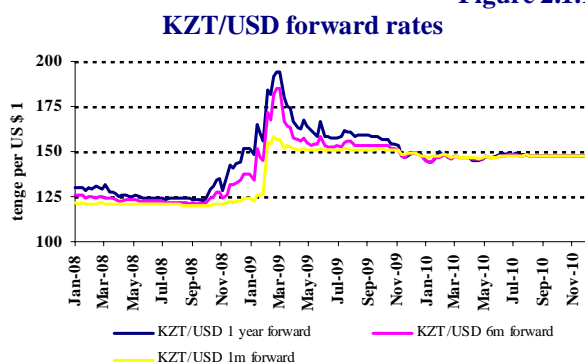
Source: World Bank, NBRK calculations

**Figure 2.1.17**  
**Global disbalance, current accounts in % of GDP**



Source: OECD

Figure 2.1.18



Source: Thomson Reuters

Recovery of the economy growth rates is strongly dependent on the state of trade balance and preservation of the sufficient capital inflows, and slowdown in the international trade would impair

The Big Twenty leaders at their meeting in South Korea in the mid of 2010 also failed to reach agreement on the coordinated actions in this area. The main question at issue is the more countries are involved in the “currency wars”, the more cases of non-tariff protectionism would take place, which eventually would results in slowdown international trade and, accordingly, in slowdown of economic recovery rates in the current complex situation.

Such scenario for Kazakhstan would be extremely undesirable notwithstanding even the Customs Union with Russia and Belarus. Stabilization achieved in 2010.

Table 2.1.3

**Forecast of main currencies Bloomberg Composite, as of 13 December 2010**

	Spot	1qtr. 11	2qtr. 11	3qtr. 11	4qtr. 11
<b>EURUSD</b>					
Forecast		1.35	1.34	1.34	1.32
Current forward	1.32	1.32	1.32	1.32	1.32
<b>USDJPY</b>					
Forecast		85	86	89	90
Current forward	84	84	84	84	84
<b>GBPUSD</b>					
Forecast		1.59	1.6	1.6	1.57
Current forward	1.57	1.57	1.57	1.57	1.57
<b>USDCHF</b>					
Forecast		0.99	0.99	1.01	1.03
Current forward	0.98	0.98	0.98	0.98	0.98

Source: Bloomberg

to the regime of controlled floating exchange rate (Figure 2.1.18) in 2011. Should the general external recovery environment is preserved in 2011, the positive trends in Kazakhstan balance of payment are expected to be continued as well (Box 1).

**Box 1**

**Forecast of the Balance of Payments for 2010-2011\***

**The most probable base scenario** of the balance of payments dynamics for 2010 has been developed on the basis that the oil prices in the current year are preserved at the level of USD 80 per barrel and real GDP growth is 4.7%, which are consistent with the main foreign forecasts of the oil price and Kazakhstan growth for 2011.

It has been initially estimated that the current account in 2010 and 2011 will have surplus of 2.4% and 1.6% to GDP. Balance of trade in 2010-2011 will be approximately 17-20% of GDP. In this case the main changes in export and import in 2010 will be caused mostly by the price factor and not the quantitative factor.

Financial account in 2010 will show surplus of more than USD 3 billion, while in 2011 the surplus will decrease up to USD 1.5 billion due to a large amount of revenues to the NFRK.

It is expected that eventually the total balance of payments in 2010 will have surplus of about 5% of GDP and in 2011 – surplus of 2.6% of GDP.

According to the estimates in 2010 the National Bank's gold and foreign exchange reserves will grow by more than USD 6 bln. and increase thereof by USD 4 bln. is forecasted for 2011.

According to the trends in demand for energy resources and due to high liquidity in the financial markets it is unlikely that the oil price in 2011 will drop under USD 70 per barrel; however, due to uncertainty in the recovery dynamics of the world economy and international trade, the oil price volatility may increase next year. Accordingly, **the risk of the balance of payments deterioration under the influence of the world prices is assessed as moderate**. The accumulated international reserves will allow preserving the coverage level of the import of goods and services for 9 months.

**Table 1**

**Forecast of Kazakhstan Balance of Payments for 2010 – 2011, USD bln  
(as at November 2010)**

	2008	2009	2010 (estimate)	2011 (forecast)	
				65\$	80\$
<b>A. Current account</b>	<b>6 279</b>	<b>-4 248</b>	<b>3 191</b>	<b>1 312</b>	<b>2 458</b>
<i>in %of GDP</i>	4.7	-3.7	2.4	0.9	1.6
Balance of trade	33 519	15 159	27 409	24 343	26 404
Export (fob)	71 971	43 972	56 729	54 232	59 043
Import (fob)	-38 452	-28 813	-29 320	-29 889	-32 639
Balance of services	-6 691	-5 778	-6 023	-5 634	-6 570
Balance of income and transfers	-15 247	-13 630	-18 196	-17 397	-17 376
<b>B. Capital and financial transaction account*</b>	<b>-4 091</b>	<b>6 710</b>	<b>3 212</b>	<b>2 679</b>	<b>1 560</b>
<b>B-1. Capital and financial transaction account (less short-term capital)</b>	<b>6 751</b>	<b>10 234</b>	<b>4 870</b>	<b>8 391</b>	<b>5 460</b>
Direct investments (net)	14 783	10 501	10 829	7 639	8 065
Portfolio investments**	-9 323	2 989	-1 413	-4 550	-6 902
Other long-term investments (net)	1 291	-3 256	-4 545	5 301	4 298
<b>B-2. Short-term capital**</b>	<b>-10 842</b>	<b>-3 523</b>	<b>-1 658</b>	<b>-5 712</b>	<b>-3 900</b>
<b>C. Total balance</b>	<b>2 189</b>	<b>2 462</b>	<b>6 403</b>	<b>3 991</b>	<b>4 018</b>
<i>in % of GDP</i>	2.1%	2.1%	4.9%	2.8%	2.6%
National Bank reserve assets	-2 189	-2462	-6403	-3991	-4018
<i>For reference only:</i>					
Oil prices (USD/bbl)	<b>96.9</b>	<b>61.9</b>	<b>80</b>	<b>65</b>	<b>80</b>
GDP (real growth, in %)	103.3%	101.2%	105.0%	103.1%	104.7%
GDP (USD bln)	133.4	115.3	131.3	144.3	154.2

Note: \*including errors and omissions

\*\* including the National Fund assets

\*\*\*including derivatives, capital transfers and errors and omissions

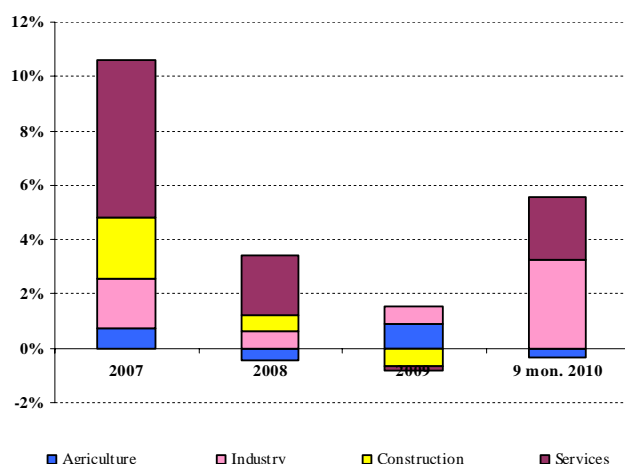
Source: NBRK



### 2.1.2. Internal Risks

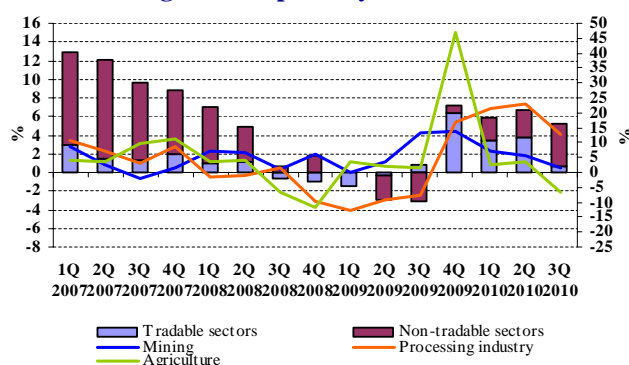
*Recovery of Kazakhstan economy growth rates during the period from the 4<sup>th</sup> quarter of 2009 till 3<sup>rd</sup> quarter of 2010 took place due to increase in net export against the background of favorable external market environment and growth of domestic demand, which responded positively to the fiscal stimulus. The tradable sector was the first to come out of recession being guided by the outstripping growth rates of the processing industries. As the consumer demand started increasing beginning the 1<sup>st</sup> quarter of 2010, the growth of the service sector started recovering as well. At the same time the notable slowdown in the growth rate of the tradable sector was observed in the 3<sup>rd</sup> quarter of 2010, which in addition to other factors may be the evidence of weakening impact of the anti-crisis measures. The constraining factor for the economic growth in the mid-term is the low level of investments in tradable sector of the economy.*

**Figure 2.1.19**  
Contribution by industries to GDP growth



Source: ASRK, NBRK calculations

**Figure 2.1.20**  
Contribution of tradable and non-tradable sectors\* and growth of primary sectors\*\*



Note: \* contribution to added value growth

Tradable sectors cover agriculture, mining and processing industry. Other sectors not covered by tradable sectors are included into non-tradable sectors.

\*\* growth of sectors have been calculated as % of change to the same quarter of last year

Source: SARK, NBRK calculations

the 3<sup>rd</sup> and 4<sup>th</sup> quarters of 2009 to the normal value of 1.7% in the 3<sup>rd</sup> quarter of 2010 as well as by alarming slowdown of the growth rate in manufacture from more than 20% in the 1<sup>st</sup> and 2<sup>nd</sup> quarter

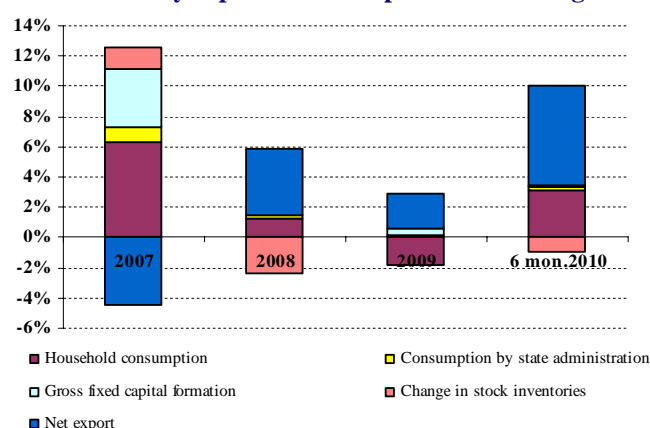
Recovery of the commodity prices beginning from the mid of 2009 made possible for the economy to preserve positive growth at the end of 2009 due to the primary sector and agriculture. Manufacture and services sector started recovering from the 4<sup>th</sup> quarter of 2009, which proved the positive effects of the anti-crisis measures on the domestic demand. According to the preliminary results of 9 months of 2010, the economic growth reached 7.5% on an annualized basis thanks to the manufacture and trade surprising growth rates (19.1% and 12.9%, respectively). A sharp growth thereof is explained, aside domestic demand factor, by the base effect (Figure 2.1.19).

Construction and financial activities that were the key drivers of the economic growth during the booming years are still in recession. At the same time, due to the financial inflows as a part of the government anti-crisis programs, a positive growth has been observed in construction, according to the results of the 3<sup>rd</sup> quarter (4% on the YoY basis).

Despite the general positive growth, a slowdown in the tradable sector recovery rate was observed in the 3<sup>rd</sup> quarter of 2010. One of the factors that caused such slowdown was the negative growth in agriculture (-6.6% in the 3<sup>rd</sup> quarter on the YoY basis) as a result of drop in the grain crop due drought in the main grain-growing regions of Kazakhstan. Slowdown of economic growth was also caused by decline in the growth rates of the mining sector from the peak values of 14% in

to 12.7% in the 3<sup>rd</sup> quarter of 2010. As a result, in the 3<sup>rd</sup> quarter the contribution of the tradable sector to the economic growth has dropped significantly (Figure 2.1.20).

**Figure 2.1.21**  
**Contribution by expenditure components to GDP growth**



Source: SARK, NBRK calculations

According to the GDP expenditure structure, a positive growth in 2009 was preserved due to net export positive contribution. In this case it should be noted that the net export contribution during that period was not due to the increase in exports but due to the fact that decrease in imports was stronger than the increase in exports. In 2010 the net export contribution has become even more tangible, now due to increasing export revenues. As it has been already mentioned above, the consumer demand (3.1%) and net export (6.6%) accounted for the main contribution to the economic growth during 6 months of 2010 (Figure 2.1.21).

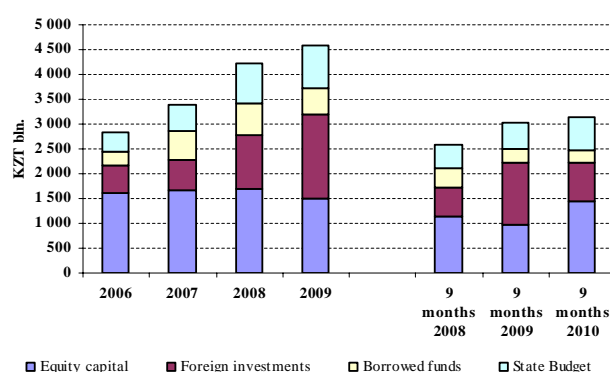
Real export growth for 6 months of 2010 on the YoY basis is 10.7% due to the

favorable energy resources prices, while import in real terms has reduced 7% as a result from decrease in imports of the investment goods.

Gross fixed capital formation as a GDP component, in fact, has played marginal role in the economic recovery, and this fact will adversely affect the future rates of economic growth taking in account the high capital consumption in non-oil sector. It should be mentioned that while the increase in the consumer and investment expenditures have become the key factors promoting the world economy growth, including the developing countries during the recovery period, investment expenditures in Kazakhstan accounted for rather small contribution to the economic growth – 0.1% (for 6 months of 2010).

**Reduction in the rates of investments to the capital formation has been slowed down; however,**

**Figure 2.1.22**  
**Sources of investments in fixed capital**



Source: ASRK, NBRK calculations

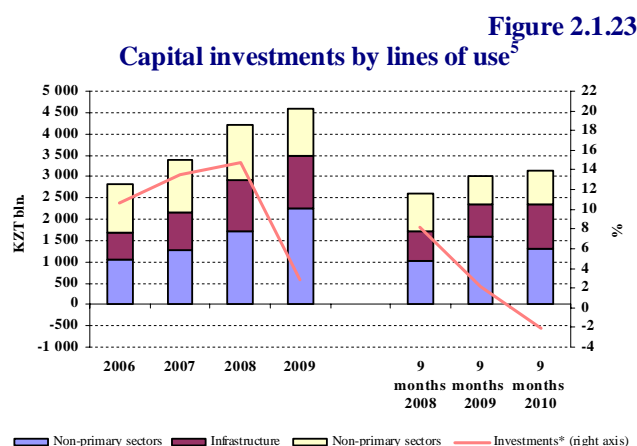
funds (Figure 2.1.22).

Foreign investments, which significant inflow supported the growth in investments in 2009, have dropped during analyzed year. Decrease in the foreign investment in 2010 has been compensated by the investments of the construction industry enterprises' own funds (+46.5% for 9 months on an annualized basis) and manufacture (+10.1%).

**no significant contribution to the economic growth has occurred. Low level of capital formation combined with insufficient investments in the non-oil sector of economy retard the renewal of the technological base, which limits the economic growth both in the mid- and long term.**

In general, reduction in the rates of investments to capital formation have slowed down (-2.1% for 9 months of 2010) as compared to the data for the 1<sup>st</sup> quarter and 6 months (-7.3 and -4.8%, respectively). In the 3<sup>rd</sup> quarter of 2010 certain recovery has been observed (2.3%) thanks to owned and budget

However, the structure of investments by lines of use (Figure 2.1.23) demonstrates that the



Note: \* real growth, YoY

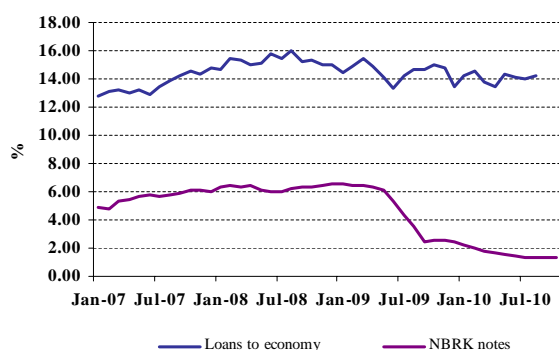
Source: ASRK, NBRK calculations

investment activity in the non-primary sectors is still low. The nominal volume of investments in the non-primary industries, which has remained practically unchanged for a few last years, reflects the gradual process of obsolescence of the production technologies in these industries and limitation in the development, first of all, of the processing industry in the long term.

In the short run the further growth of the processing industry is limited by the tough current conditions of access to the credit resources, which have appeared to be one of the key sources of the investments for the enterprises in this industry. In the nearest future this source will remain limited due the fact that the banks, despite the increased liquidity in the market, still assess corporate risks as high (Figure 2.1.24).

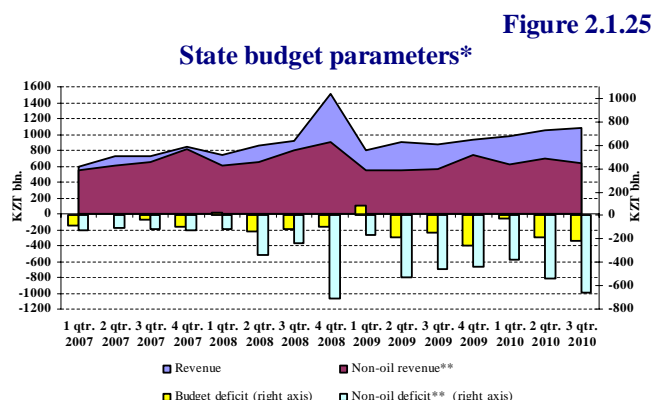
Increase of investments in infrastructure, where the budget capital expenditures still are the important source, can be treated as a positive trend.

**Figure 2.1.24**  
**Interest rates on banks' loans and NBRK notes**



Source: NBRK

*To stimulate the consumer demand and growth recovering the “soft” fiscal policy continues to be pursued in 2010. In this regard the structure of public expenditures, in a greater extent, reflects the social orientation of the budget due to the Government’s obligations to increase the social expenditures. The increasing budget deficit, which is financed at the expense of increase in the domestic government debt and transfers from the NFRK, puts pressure on public finance and increase dependence on the oil prices.*



Note: \* for the period

\*\* less transfers from NFRK

Source: MoF, NBRK calculations

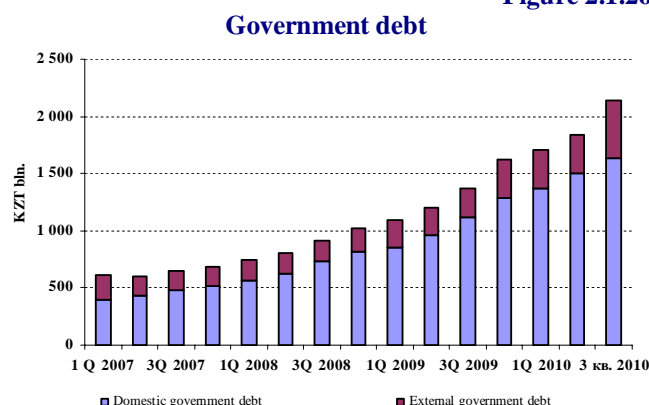
The expansive fiscal policy has continued in 2010, which is manifested in the increase of the social payments and growth in capital expenditures to the infrastructure facilities. At the same time a high level of expenditures maintained this year with no

<sup>5</sup> Investments in the non-primary sectors are approximated by the amount of investments in the primary industry, foreign investments in transport and communications and real estate transactions.

Investments in the infrastructure included gross investments in the state administration sector, education, public health service and provision of the social services, utilities, social and personal services; production and distribution of electric energy, gas and water, as well as investments funded at the expense of the state budget funds, borrowings and owned funds in transport and communication. Investments in the non-primary sectors include those in agricultures, processing industry, construction, trade, hotels and restaurants, financial operations, as well as investment funded at the expenses of the state budget funds, borrowings and own funds invested in the real estate operations, rent and provision of services to the consumers.

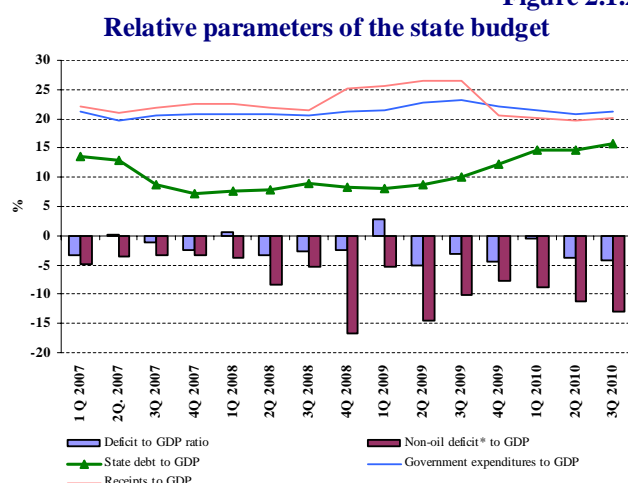
growth in the non-oil budget revenues has resulted in the increase of the non-oil deficit (Figure 2.1.25), which is financed at the account of transfers from NFRK and increase of the domestic government debt (Figure 2.1.26).

**Figure 2.1.26**



Source: MoF

**Figure 2.1.27**

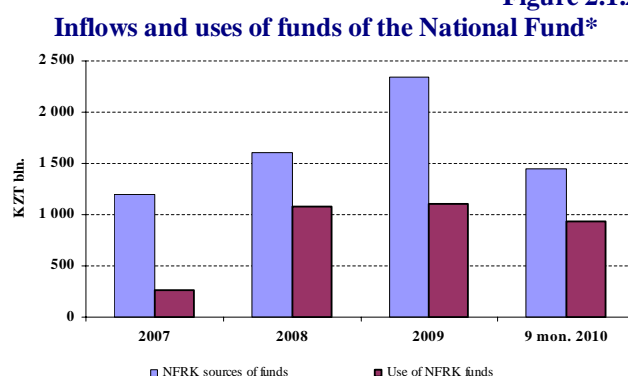


Note: \* less transfers from NFRK

Source: MoF, ASRK, NBRK calculations

sector development. Due to the same reasons the budget consolidation, as a means for the fiscal stability recovery within next few years, is highly remote.

**Figure 2.1.28**



Note: \* for the period

Source: MoF

The domestic debt has increased almost by 4 times as compared to the pre-crisis period. On the one hand, its increase make possible to cover the budget deficit avoiding applying to the external borrowings and seniorage, while on the other hand, the massive state borrowings which absorb liquidity and savings in the domestic market during the period of credit squeeze and stock market underdevelopment further increases deficit and cost of private investment.

The relative budget parameters (Figure 2.1.27) also speak for the increasing risks of the budget deficit and growing dependence of the budget on the oil revenues. Due to limited growth rates of the oil industry in the mid term, the oil proceeds to the NFRK will be increasingly dependent on the world oil price fluctuations, which may deteriorate the country fiscal sustainability for the next few years. The need to support the budget has determined a high ratio of the NFRK funds use to its proceeds during the crisis period (Figure 2.1.28).

The policy of the oil revenues active utilization continues during the recovery period and most probably will continue in the nearest future due to the Government's undertakings with regard to the social obligations and programs for the non-oil

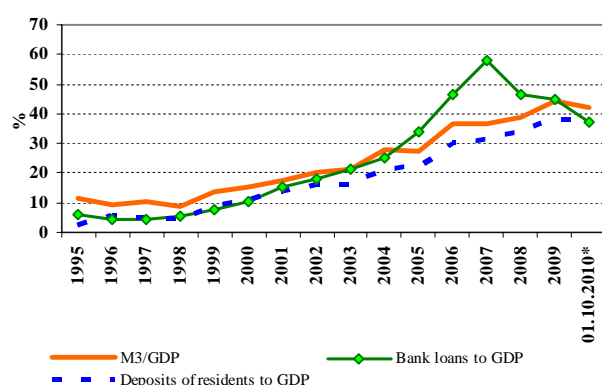
Under such conditions the relevant direction will be the gradual substitution of the policy of expenditure expansion with the policy concentrated on budget funds efficiency, in particular with regard to the current expenditures. In this case, to achieve the sustainable inflow of revenues from the non-oil sector in future, the released funds should be redistributed in favor of investments in the factors of sustainable economic growth (education, infrastructure, industrial programs).

## 2.2 Key Structural Parameters of the Financial Sector Development

*During three quarters of 2010, just like in 2009, the role of financial institutions in the operation of the real sector of the economy diminished to a certain extent, which is evidenced by the downturn of the so-called “depth of financial relations”. It is also worth mentioning that one of the effects of the crisis was some decrease in the level of institutional concentration in the banking sector.*

**“Depth of financial relations”.** The absence of serious external shocks and a favorable foreign economic environment were conducive to the revival of activity in the financial sector and banks in particular. If in the dramatic phase of the crisis lending activity of banks was supported by

**Figure 2.2.1**  
**The “depth” of relations financial development in Kazakhstan**



Note: \* GDP data is given to annual terms

Source: ASRK, NBRK calculations

the funding on the part of the government which covered foreign liabilities, in the first-third quarters of 2010 a slow process of substitution of financing as part of the anti-crisis package by the funding from deposit-taking in the domestic market had started. It is also should be noted that a successful completion of the foreign debt restructuring in three banks (BTA Bank, Alliance Bank and Temir Bank) became a signal for foreign investors and the Kazakh financial institutions about downsizing risks in the financial system of Kazakhstan. Thus, a moderate increase in the activity of financial institutions in the foreseeable future can be expected.

Nonetheless, in January-September 2010 the indicator of the “depth” in the development of financial relations in Kazakhstan has been somewhat decreasing. Thus, the ratio of deposits to GDP was 36.5% as of the end of the third quarter of 2010 versus 38% at end-2009. This occurred as a result of the GDP growth in the real sector of the economy on the one hand and the reduction of the total volume of the credit portfolio on the other hand due to low lending activity of banks and the charging off a significant volume of bad debts by the banks which completed their foreign debt restructuring (Figure 2.2.1).

**Structural parameters of the financial sector.** The increase in the number of banks and insurance market participants (insurance actuaries and insurance organizations) during the three quarters of 2010 is an evidence of a relative stability of those segments of the financial market. An opposite trend has been observed in the segment of professional participants in the securities market whose number has reduced from 172 to 159 due to unstable price and non-price parameters of the Kazakh securities market coupled with immaturity of the stock market as well as the effect of tightening of regulatory measures in 2009. The number of mortgage companies had reduced dramatically at end-2009 and to some extent – during three quarters of 2010 in view of remaining uncertainty in the real estate market (Table 2.2.1).



Table 2.2.1

## The structure of the financial sector

(units)

Number of financial institutions	01.01.2007	01.01.2008	01.01.2009	01.01.2010	01.10.2010
Banks	33	35	37	38	38
Insurance organizations	40	41	44	41	40
Insurance actuaries	33	44	56	63	65
Professional participants of the SM, including:	147	208	213	172	159
Brokers-Dealers	70	106	104	83	78
Registrars	16	17	15	12	10
Pension asset management companies (PAMC)	13	11	13	14	15
Investment portfolio managers (IPM)	37	61	66	49	43
Custodians	9	10	11	11	10
Transfer agents	2	3	4	3	3
Trade organizers	1	1	1	1	1
Accumulation pension funds	14	14	14	14	13
Mortgage companies	10	12	12	7	6
Institutions performing certain types of banking operations	16	23	21	8	8
including investment companies	1	4	4	2	2

<sup>1</sup>-number of issued licenses

Source: FSA

**Institutional concentration.** Based on the performance for 3 quarters of 2010 the concentration in the banking sector decreased to a certain extent: in the period the share of assets of five largest banks decreased from 73.88% (74.03% as of end-2009) to 73.19%. In doing so, the reduced share of assets of BTA Bank which occurred primarily because of the charging off of its bad loans to off-balance sheet was offset by the growth in the share of assets of Kazkommertsbank, Halyk Bank and Bank CenterCredit. Significant decrease in the institutional concentration is observed in the portfolio of loans to individuals: the percentage of loans to individuals provided by five largest banks decreased from 66.46% to 58.16%. The decrease in concentration in this segment of the credit market happens mainly because of the consumer lending segment where the share of five largest banks decreased from 73.05% to 45.94%. Such situation is explained by short maturities of consumer loans coupled with low activity of banks in this market segment (Table 2.2.2).

Table 2.2.2

## Share of 5 top financial institutions (by assets) of each segment

Item	at 1.01.2009	at 1.01.2010	at 1.10.2010
<b>Banks engaged in lending in the following sectors:</b>			
legal entities	84.40	85.78	83.14
individuals	66.46	60.21	58.16
consumer loans to individuals	73.05	54.74	45.94
for construction and home purchase by individuals	63.14	61.28	66.16
residential mortgage loans to individuals	63.96	60.47	64.71
construction	87.85	91.45	88.01
trade	79.18	80.15	76.73
Share of 5 top banks by assets	74.03	73.88	73.19
<b>Insurance (reinsurance) organizations in the following sectors:</b>			
general insurance	57.16	55.59	58.95
life insurance	83.04	85.97	88.18
<b>Accumulation pension funds</b>			
on attracted pension assets	78.12	76.00	76.69

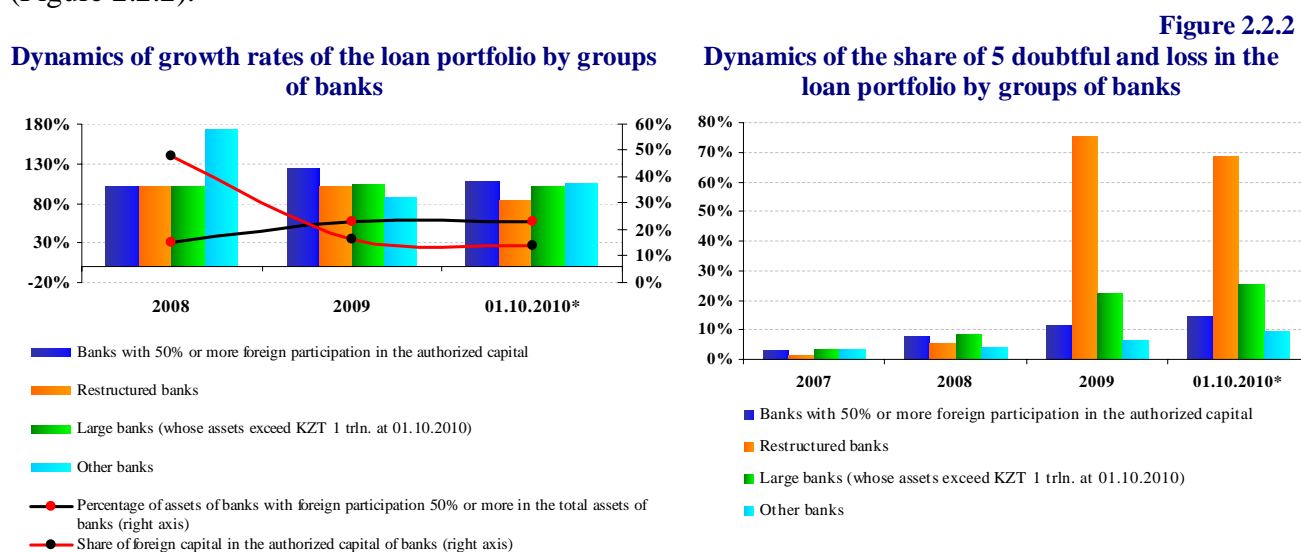
Source: FSA

Since the beginning of 2010 there has been a growth in concentration in the insurance sector. Thus, the share of assets owned by five largest insurance (reinsurance) organizations operating in the non-life segment has increased from 55.59% to 58.95% over nine months of this year, and a similar indicator for the life insurance segment increased from 85.97% to 88.18%.

During 2009 – 2010 there was an insignificant decrease in the asset concentrations in the APF (accumulation pension funds) segment: if at end-2008 the share of five largest APFs accounted for 78.12%, so based on the results of the third quarter of 2010 it accounted for 76.69%. In

particular, a problem in one of the parent banks (BTA Bank) caused the decrease in the asset share of one of the large APFs. An effect of insignificant decrease in the concentration of two other APFs within the five largest APFs is also worth mentioning.

**Lending activity by various groups.** Based on 2009 and the first three quarters of 2010 the highest growth rates in the loan portfolio – 7.62% based on the results of three quarters of 2010 – were demonstrated by banks with dominating foreign participation (over 50% of equity participation). High lending activity of foreign banks was primarily associated with the fact that these banks have the access to funding from their parent companies. At the same time, the share of foreign participation in the total authorized capital of the banking system decreased significantly in 2009, this fact being related to significant volumes of additional capitalization of a number of banks at the expense of the state. Thus, the share of foreign participation in the total authorized capital of banks decreased from 47.82% as of end-2008 to 14.02% at the end of the third quarter of 2010 (Figure 2.2.2).



Generally, foreign banks in Kazakhstan prefer to deal with better quality borrowers. However, during 2008 – 2010, quite a fast growth in the share of problem loans was observed within this group of banks: as of the third quarter of 2010 the percentage of doubtful loans of category 5 and loss loans in the loan portfolio accounted for 14.54% (at end-2007 – 2.89%). The deterioration in the loan portfolio quality of a group of foreign banks was mainly related to the fact that in 2008 ATF Bank joined the group of foreign banks. Its portfolio contained significant volumes of relatively high-risky loans – consumer loans, mortgage loans and loans to construction companies.

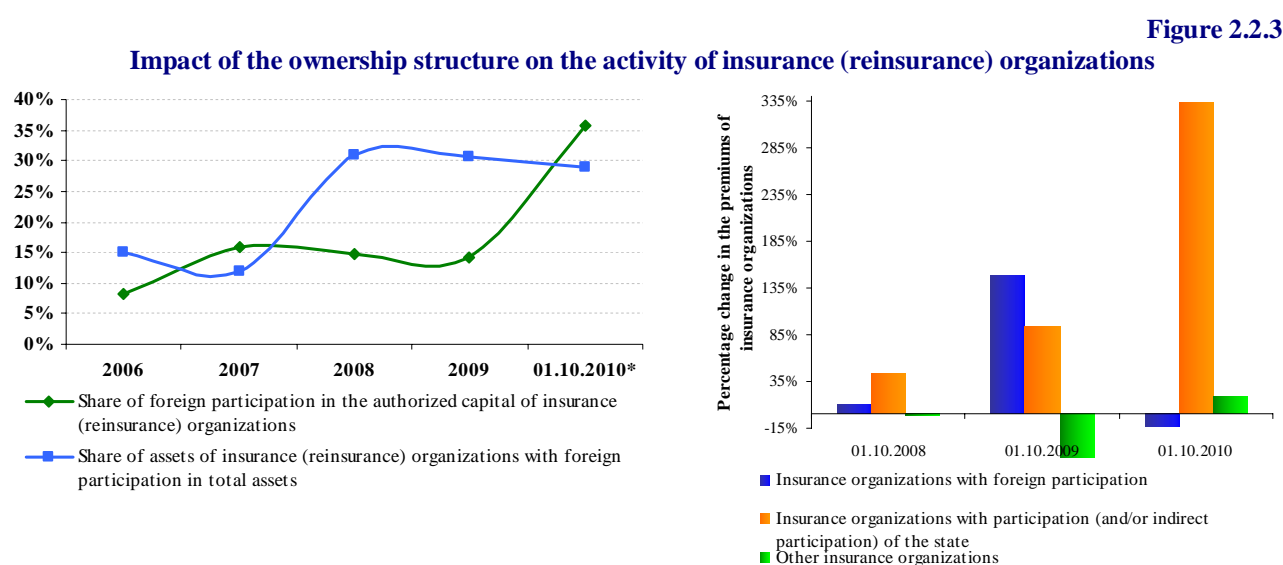
On the whole, in 2009 – the first three quarters of 2010 Kazakh banks – both large and small ones – demonstrated very low growth rates of their loan portfolios. At the same time, if in the “dramatic” period of the crisis low credit activity of banks was mainly explained by the shortage of funding and liquidity problems, in 2010 such problems were no longer urgent for the banks. Currently low volumes of new loans are explained, in the first instance, by low “risk appetite” among the majority of banks and, in some instances, by overestimation of borrower risks.

At the same time, it is worth mentioning that the portfolio quality of five largest banks has deteriorated significantly based on the results of 2009: the share of doubtful loans of category 5 and loss loans in the loan portfolio increased from 8.48% to 22.47%. Alongside with that, if before the dramatic phase of the crisis in 2009 banks had been managing their loan portfolio quality via restructuring, in the first half of 2009 the resource for restructuring of problem and potentially problem loans was exhausted to a large extent. This resulted in a dramatic deterioration in the loan portfolio quality of large banks, and the rates of such deterioration slowed down in 2010 only.

However, deterioration in the loan portfolio quality of other (small-and medium-sized) banks was much less explicit: as of the end of the third quarter of 2010 the share of doubtful loans of category 5 and loss loans in the total loan portfolio of this group of banks was less than 10%. The rates of deterioration in the loan portfolio quality within this group of banks were much lower due to the fact that large banks implementing intensive credit expansion before the crisis assumed much greater volumes of latent risks as compared to small banks.

As for the three banks that have completed their restructuring process, total volume of their credit portfolio decreased because the loss loan charge offs became more intensive in 2010. Thus, if at end-2009 the share of loans of category 5 and loss loans in the total portfolio of this group of banks accounted for 75.3%, by the end of the third quarter of 2010 it decreased to 68.6%. It is worth mentioning that the major portion of problem loans in the system as a whole is concentrated in the credit portfolio of this group of banks.

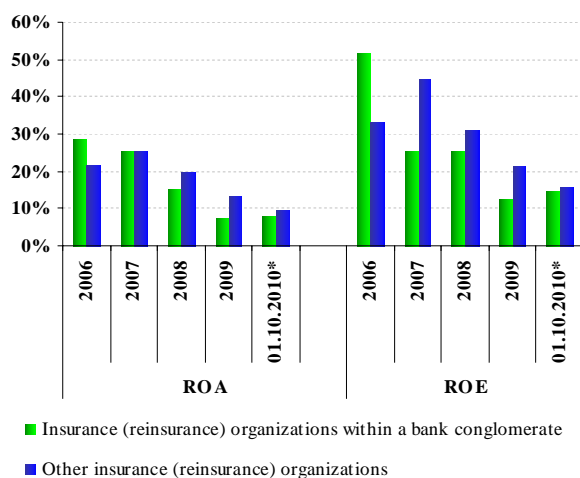
***Efficiency of operation of insurance companies depending on the ownership structure.***  
The growth in the share of foreign capital in the insurance sector was determined by the appearance of new participants and additional capitalization in a number of insurance companies with foreign participation. Thus, during three quarters of 2010, foreign participation in the authorized capital of insurance organizations increased from 14.28% to 35.89%. In the same period the percentage of assets in the insurance companies with foreign participation goes down from 30.7% to 29% because of a significant decrease in premiums in a number of insurance companies with foreign participation. It should be also noted that during three quarters of 2010 there was a spike in the volumes of received insurance premiums of insurance organization with the state participation where parent companies were represented by banks which were passed into the state ownership (Figure 2.2.3).



Source: FSA, NBRK calculations

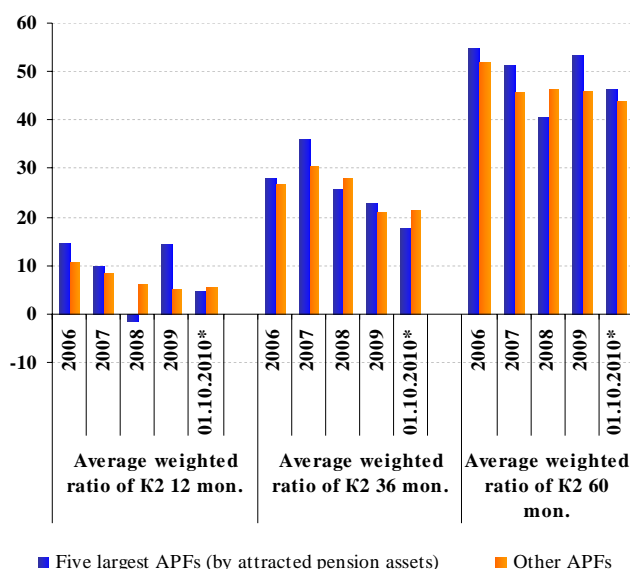


**Figure 2.2.4**  
**Dynamics of profitability ratios of insurance (reinsurance) organizations depending on their affiliation with a bank conglomerate**



Source: FSA, NBRK calculations

**Figure 2.2.5**  
**Distribution of profitability ratios of APFs by groups (quartiles) depending on the APF's size, in dynamics**



Source: FSA, NBRK calculations

It is also remarkable that returns on assets and returns on equity in insurance organizations which are not a part of conglomerates appear to be better than in those within bank holding companies. In a number of instances this fact could be explained by inefficiency of management decisions made in the parent banks (Figure 2.2.4).

**Efficiency of operation of pension funds.** The financial market instability in the crisis period was the reason for the decline in returns of APFs. Thus, if the average weighted profitability ratio for 5 years in the system as a whole at end-2008 was 46.15%, it decreased to 43.29% at October 1, 2010.

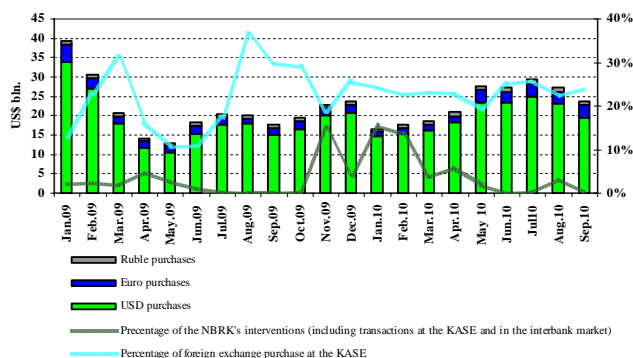
It should be noted that the efficiency of operation of large APFs is higher than in case of small ones, which is evidenced by the average weighted nominal return ratio (K2) of five largest pension funds for 1 year, 3 and 5 years. One of the reasons for a relatively higher efficiency in the operation of pension funds is the so-called “returns to scale” effect. A relatively higher efficiency in the operation of large APFs is one of the reasons for institutional concentration of assets in the accumulation pension system (Figure 2.2.5).

## 2.3 State of Financial Markets

### 2.3.1 State of the Foreign Exchange Market

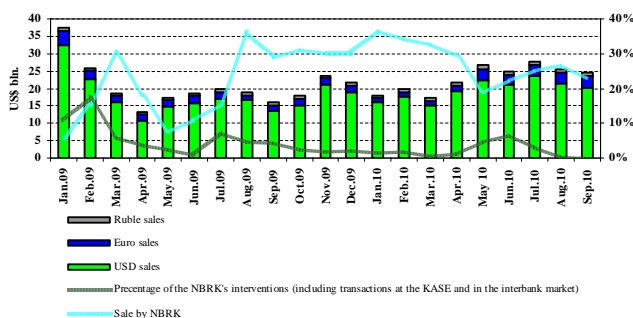
*In January-September 2010 the domestic foreign exchange market demonstrated revival which was stipulated by a favorable foreign economic environment, moderate economic growth and absence of serious shocks.*

**Figure 2.3.1.1**  
Volumes of foreign exchange purchase by banks



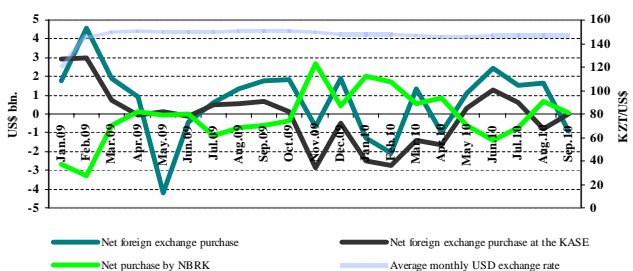
Source: NBRK

**Figure 2.3.1.2**  
Volumes of foreign exchange sales by banks



Source: NBRK

**Figure 2.3.1.3**  
Volumes of net foreign exchange purchase by banks



Source: NBRK

Since the beginning of 2010 there has been a gradual growth in the total volumes of foreign exchange (mainly US Dollars) purchases and sales by banks in the domestic foreign exchange market. Thus, volumes of US Dollar purchases increased from USD 14.6 bln. in January to USD 24.9 bln. in July, and volumes of sales – from USD 16 bln. in January to USD 23.6 bln. in July. The growth in the total turnover of the foreign exchange market was primarily stipulated by the growth in foreign economic activity of large Kazakhstani enterprises amidst gradual revival of the Kazakh economy and a relatively favorable environment in the global commodity markets (Figures 2.3.1.1 – 2.3.1.2).

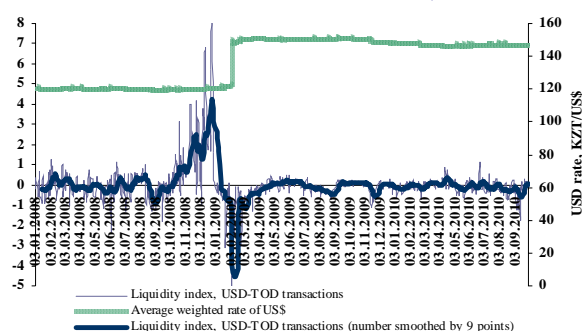
As a whole, during 3 quarters of 2010 the supply of foreign exchange (mainly US Dollars) exceeded its demand on the part of financial institutions and entities of the real sector of the economy. At the same time, there was growth in demand for the US Dollars in the summer months on the part of banks, which was caused by uncertainty of expectations about the state of financial markets in Europe and the USA and the volatility of the Euro exchange rate versus the US Dollar. A pressure on the Tenge exchange rate in the stock market on the part of demand (June – July) and supply (January – April, August) was absorbed by the National Bank via transactions in the exchange currency market (Figure 2.3.1.3).

As a whole, during 3 quarters of 2010 there were no shocks that would be followed by the change in liquidity of the exchange currency market which is evidenced by the liquidity index<sup>6</sup>. Asymmetry indices<sup>7</sup> of the exchange currency market indicate a moderate level of

<sup>6</sup> Liquidity index in the USD exchange market was computed by using series of normalized values of spread between the average weighted demand and supply prices, number of transactions, amount of an average transaction and the ratio of price differential between the first and the last transaction to the amount of the average transaction modulo. The following formula was used in the computation: Liquidity index = - Spread + (Number of transactions - Average transaction)/2 - Ratio of the of price differential between the first and the last transaction to the amount of the average transaction modulo". It is assumed that the market is liquid to maximum when the spread is minimal, number of transactions is maximal, and the ratio of the price differential between the first and the last transaction to the amount of the average transaction is minimal. As part of this Report when building up an index a data series

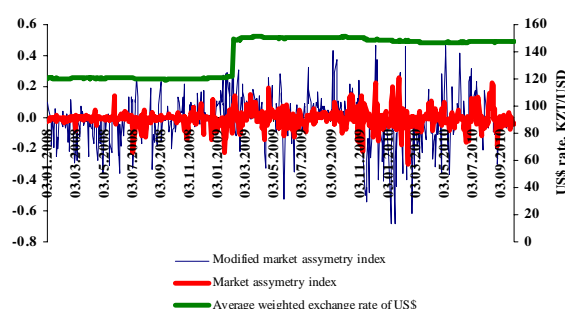
speculative pressure on the market by its players, where pressure on the part of sellers interchanges with pressure on the part of buyers (Figures 2.3.1.4 – 2.3.1.5).

**Figure 2.3.1.4**  
**Liquidity index of the USD stock exchange market (on USD\_TOD transactions)**



Source: KASE, NBRK calculations

**Figure 2.3.1.5**  
**Skewness of the USD stock exchange market**



Source: KASE, NBRK calculations

## 2.3.2 State of the Money Market

*Policy of banks aimed at maintaining a high level of liquidity with low level of their lending activity happened to be the reason for stabilization of the cost of liquidity attraction at an extremely low level. In these circumstances the National Bank from November 2009 stopped conducting reverse REPO operations at the KASE, and from September 2010 (after the restructuring of BTA Bank was finalized) has completely given up to engage in providing liquidity to banks.*

The result of policy for maintaining a high liquidity level implemented by the majority of banks became the stabilization of the price of liquidity attraction at extremely low levels after its gradual decline in 2009. Thus, from February 2009 to March 2010 the value of the KazPrime index decreased from 15% до 1.8%, and from May 2010 this indicator was at 2% (Figure 2.3.2.1). Until March there was a restitution of the total volume of REPO transactions to the level of January-February 2009 mainly in the segment of automatic REPO, at the same time the total number of transactions decreased.

Thus, while the average volume of REPO transactions at the KASE in January 2010 amounted to KZT 1.53 trln., it reached KZT 2.48 trln. and didn't go below KZT 2 trln. until September. The downward trend in the activity in all segments of the REPO market except for the automatic REPO with government securities should be also noted (Figure 2.3.2.2).

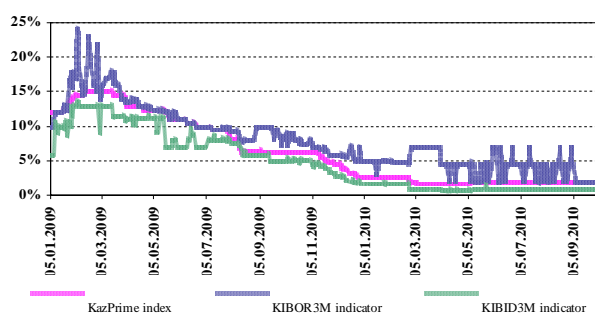
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are used on the KASE trading (instrument USD\_TOD) for the period from 3.01.2008 to 30.09.2009. Series were normalized by dividing the difference between the actual value of the indicator and its average for the period by a standard deviation in a sample. It should be noted that the technique for computation of the index had undergone some changes as compared to the technique used in the Financial Stability Report for 2008. For instance, in the present Report the market resistance determined as the ratio of the price differential between the first and the last transaction to the amount of the average transaction was included in the structure of liquidity index.

<sup>7</sup> Asymmetry index is computed as the difference between aggregate volumes of bids for USD purchase and sale divided by the aggregate volume of transactions in the market. This index is used to estimate the pressure on the price by the market players and allows assessing possible changes in the trend. Positive values indicate the pressure on price by the demand and negative values – by the supply.

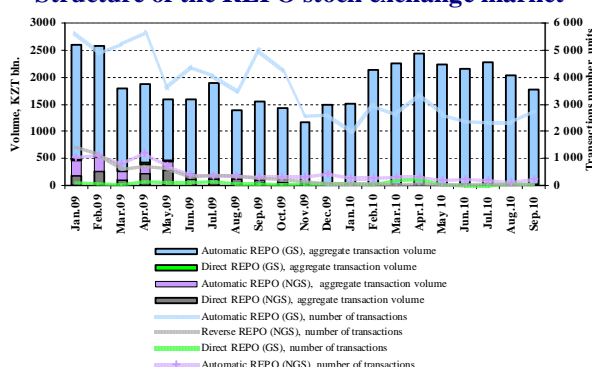
Modified asymmetry index is computed similar to asymmetry index but transactions and bids of the NBRK are not taken into account. The use of two indices allows assessing the role of the NBRK's interventions as the factor of shock absorptions.

**Figure 2.3.2.1**  
**Indicators of the interbank money market**



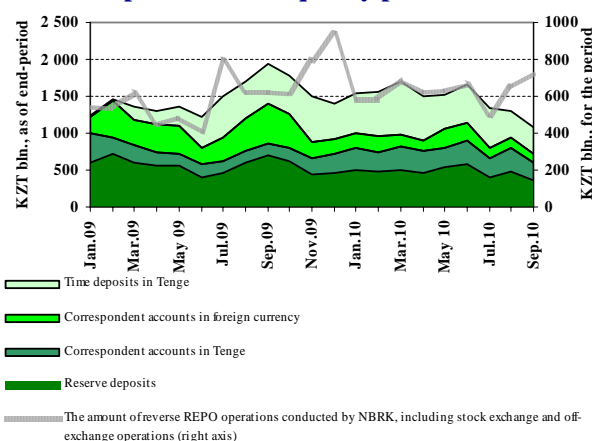
Source: KASE

**Figure 2.3.2.2**  
**Structure of the REPO stock exchange market**



Source: KASE, NBRK calculations

**Figure 2.3.2.3**  
**Liabilities of banks to the NBRK's and volumes of operations for liquidity provision**

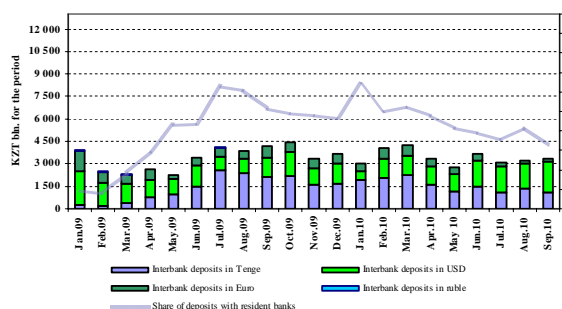


Source: NBRK

The policy for maintaining a high liquidity level implemented by banks was also a reason for the fact that banks were willing to place their assets on accounts with the National Bank until September 2010. This trend changed only in September 2010 when the lending activity of banks somewhat stabilized. A signal for the change in the lending policy and the policy for liquidity maintenance was a successful restructuring of BTA Bank (Figure 2.3.2.3).

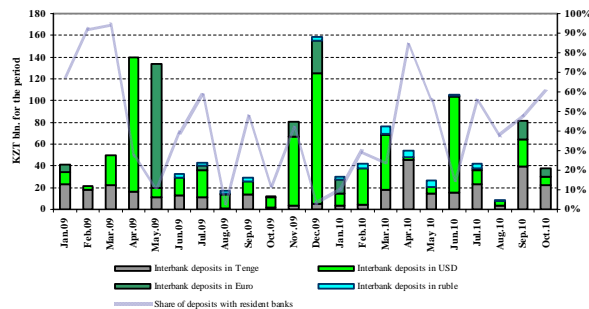
During 3 quarters of 2010 there was a clear trend of decrease in the share of interbank deposits with resident banks mainly caused by the decreased rates in the domestic money market. Thus, the share of interbank deposits with maturity less than 30 days while amounting to 63.7% in January decreased to 32.7% in September. It is also worth mentioning that in the 2<sup>nd</sup> and 3<sup>rd</sup> quarters of 2010 there was a decrease in the volumes of interbank deposits in Euro and increase in the USD deposits, which was caused by uncertainty of expectations about the Euro exchange rate. As before, the role of interbank loans and deposits with maturity over 30 days and their share remain insignificant. Thus, during 9 months of 2010 placement of deposits with maturity over 30 days accounted for less than 1.5% of the total interbank deposit placements (Figures 2.3.2.4 and 2.3.2.5).

**Figure 2.3.2.4**  
**Interbank deposits with maturity less than 30 days**



Note: The amount excl. banks' deposits in the NBRK  
Source: NBRK

**Figure 2.3.2.5**  
**Interbank deposits with maturity over 30 days**

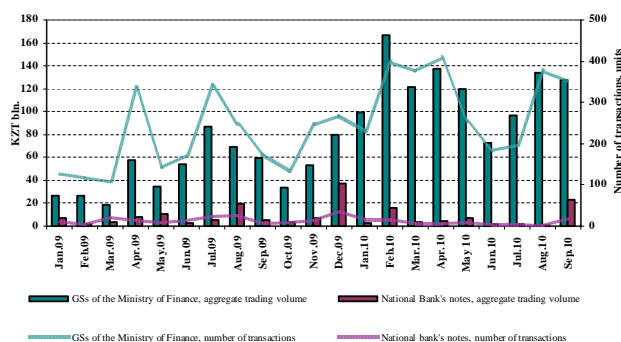


Note: The amount excl. banks' deposits in the NBRK  
Source: NBRK

## 2.3.3 State of the Securities Market

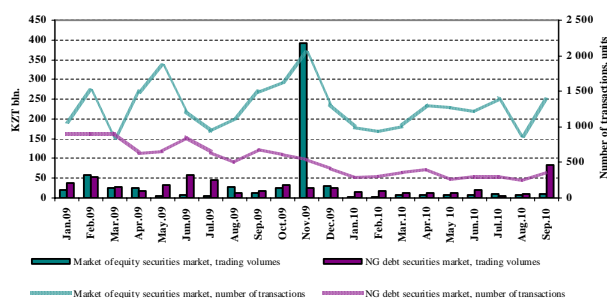
Despite some revival in the securities market, investors still prefer to invest in less risky assets: government securities (GSs) and debt securities of a higher quality.

**Figure 2.3.3.1**  
**Dynamics of total turnover of the government securities market**



Source: KASE

**Figure 2.3.3.2**  
**Dynamics of total turnover of the non-government securities market**



Source: KASE

in capitalization in the segment of equity securities amounting to KZT 9.4 trln. Unstable situation in a number of developed economies and expectations of a new wave of crisis quite common for that time on the part of the market players caused the drop in capitalization in that market in April – June to KZT 7.3 trln., with no swings in the indicator afterwards (Figure 2.3.3.3).

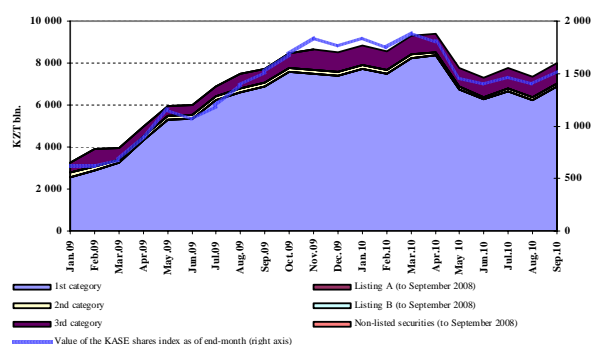
As a whole, during three quarters of 2010 as compared to the previous year there was significant revival in government securities sector of the stock exchange market, which was caused by the investors' intention to invest in most liquid and less risky assets. Thus, while in January – September 2009 the total trading volume in the segment of government securities amounted to KZT 495.9 bln, it totaled KZT 1136.2 bln. in the respective period of 2010.

At the same time, due to the similar reasons, the volumes of number of transactions in the non-government securities market decreased significantly from January 2010.

Extremely high volumes of transactions in the equity securities market in November 2009 and debt securities in September 2010 were related to specialized trading for the sale of common stock of JSC “Mangystaumunaigas” on November 25, 2009 in the first case and on bond offering of the NWF “Samruk-Kazyna” on September 27, 2010 in the second case (Figures 2.3.3.1 and 2.3.3.2).

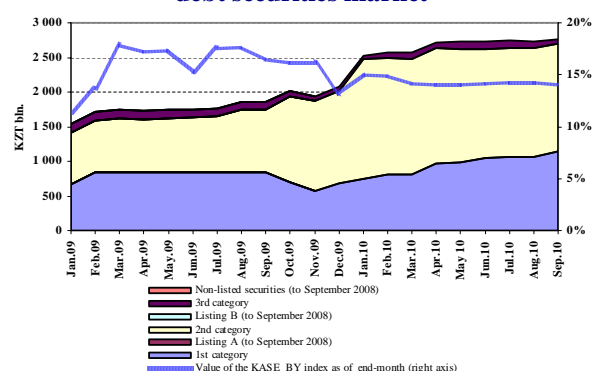
Until April 2010 there was an increase

**Figure 2.3.3.3**  
**Capitalization and yield of equity securities market**



Source: KASE

**Figure 2.3.3.4**  
**Capitalization and yield of the non-government debt securities market**



Note: Classification of securities traded at the KASE changed in September 2008

Source: KASE

From December 2009 to April 2010, the equity securities segment demonstrated an increase in capitalization stabilizing at the level of about KZT 2.7 trln., which remained unchanged until the end of the third quarter. It is worth mentioning that the increase in capitalization occurred mainly due to the increase in capitalization of the 1<sup>st</sup> category bonds, i.e. securities with the lowest risk level (Figure 2.3.3.4).



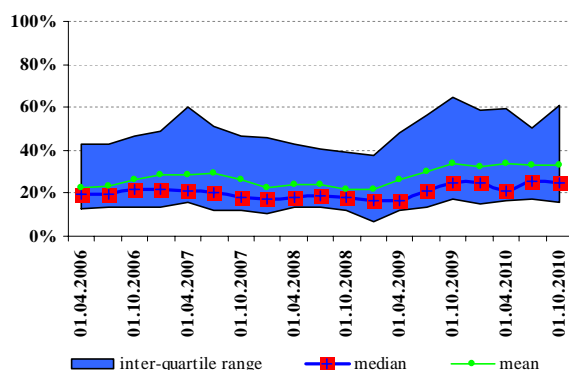
### III. Risks of the Financial Intermediation Institutions

#### 3. Risks of the Banking Sector

##### 3.1 Liquidity Risk and Efficiency of Banks

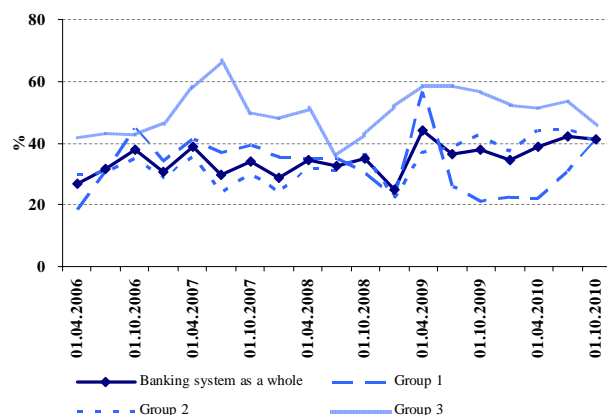
*At present liquidity risk is not critical for the banking sector since an active growth in the deposit base of banks and low credit activity resulted in accumulation of free liquidity. In its turn, the lack of investable assets as an alternative to lending has a negative impact on the bank profitability and doesn't allow creating the prerequisites for sustainable growth of banks in the long term.*

**Figure 3.1.1**  
Share of highly-liquid assets in total assets



Source: FSA, NBRK calculations

**Figure 3.1.2**  
Coverage by highly-liquid assets of short-term liabilities of banks with a remaining maturity of 1 year or less and demand liabilities, %



Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank, and Temir Bank), group 2 - banks with the market share of up to 2% incl. (excluding 3 restructured banks), group 3 - banks with the market share less than 2% and over 0.1% as of 01.10.2010

Source: FSA, NBRK calculations

liabilities in the banks of Group 1 where their level decreased by over 50% as a result of restructuring, and by a steady increased level of liquid assets of banks with a low market share.

On the other hand, as of 01.10.2010 there was a negative maturity mismatch in relation to financial assets with remaining maturity less than 1 month, and from 6 months to 1 year. This assumes that banks have liabilities with shorter maturities (Figure 3.1.3). The trend where short-term liabilities prevail is a result of the lack of supply of long-term funding sources in the markets,

The problem of accumulation of liquid assets by banks amid the inevitable conservative lending policy was still relevant this year. As a result of a steady trend for increasing liquid assets by banks which had commenced last year, the growth in liquid assets has reached 16% since the beginning of this year.

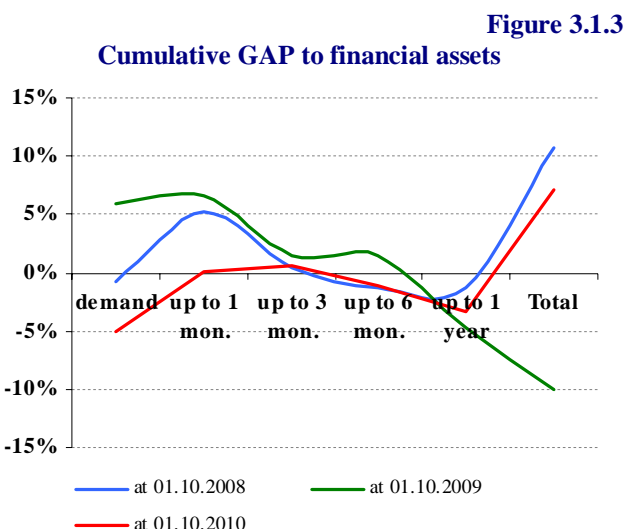
A high liquidity level in banks largely caused by the growth in the deposit base of banks and the absence of the proportional loan portfolio growth has exceeded by now the numbers existed in the pre-crisis period (Figure 3.1.1). Thus, the average share of highly liquid assets in the banking system as a whole during 9 months of 2010 accounted for 23% versus 16% for the respective period of 2006 (just like during 9 months of 2007).

It should be noted, however, that growth rates in liquid assets are gradually lowered by banks in the fear to lose interest income, since there was the growth in liquid assets during 9 months of 2010 in slightly over 50% of banks versus 73% for the respective period of the last year.

In the reviewed period highly liquid assets in the banking system on average cover 40% of short-term liabilities with a remaining maturity of 1 year or less and demand liabilities (Figure 3.1.2). This level is relatively higher than its prior historical values (yearly average value during 2006-2008 was 32%, in 2009 – 38%). Meanwhile, inhomogeneous situation in the first and third group of banks was caused by a high level of short-term

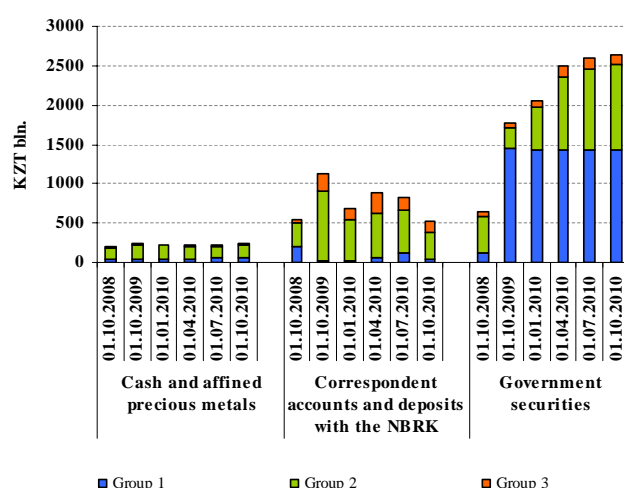
both domestic and foreign, and if this trend persists it would create prerequisites for the increase in liquidity risk.

Liquidity in the banking system was significantly supported by the government funds allocated to banks to ensure their adequate liquidity level and encouragement of the real sector of



Source: FSA, NBRK calculations

**Figure 3.1.4**  
**Structure of highly liquid assets by groups of banks, KZT bln.**



Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank, and Temir Bank), group 2 - banks with the market share of up to 2% incl. (excluding 3 restructured banks), group 3 - banks with the market share less than 2% and over 0.1% as of 01.10.2010

Source: FSA, NBRK calculations

(Figure 3.1.5). Repayment of foreign liabilities was directly insured by the inflow of cash to bank deposits.

The finalization of the foreign debt restructuring process in three banks allowed reducing the foreign debt of banks from USD 39.2 bln. as of the end of Q4 2008 to USD 25 bln. at the end of Q2 2010.

via extensive programs for top-priority sectors of the economy. However, the efficiency of the disbursement of funds is low since it didn't allow encourage crediting to the economy by banks. Given the bank policies for non-assumption of additional credit risks with a view to seek for reliable investment instruments and replacement of the interest income generation sources, there were some structural changes in highly liquid assets. Active assets of banks deposited with the NBRK, despite their reliability, by no means could provide the banks with acceptable profitability level because of low interest rates on such assets. Concerns about the pressure on the interest margin led to the expansion of the government securities portfolio and the decrease in correspondent account and bank deposit balances with the NBRK (Figure 3.1.4).

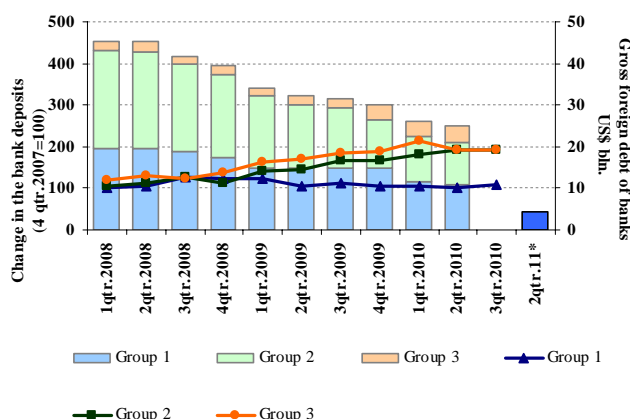
Thus, since the beginning of the year, in the structure of highly liquid assets cash and refined precious metals increased by 6.2%, government securities - by 42.7%, and correspondent account and bank deposit balances with the NBRK decreased by 24.6%.

In doing so, if in the group of restructured banks a significant expansion of the securities portfolio was achieved owing to securities of the JSC "NWF "Samruk-Kazyna", large and medium-size banks built up their portfolio by decreasing account balances with the NBRK.

The key factors that had effect on the improvement in liquidity of the banking sector are the decrease in the foreign debt of banks and increase in the deposit inflows



**Figure 3.1.5**  
**Factors determining banks' liquidity (foreign debt of banks, USD bln. and the change in deposits, 4qtr. 2007=100)**



Note: 1) Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank, and Temir Bank), group 2 - banks with the market share of up to 2% incl. (excluding 3 restructured banks), group 3 - banks with the market share less than 2% and over 0.1% as of 01.10.2010;

2) \*- forthcoming payments for 1 year for servicing of gross foreign debt of banks existing as of 30.06.2010.

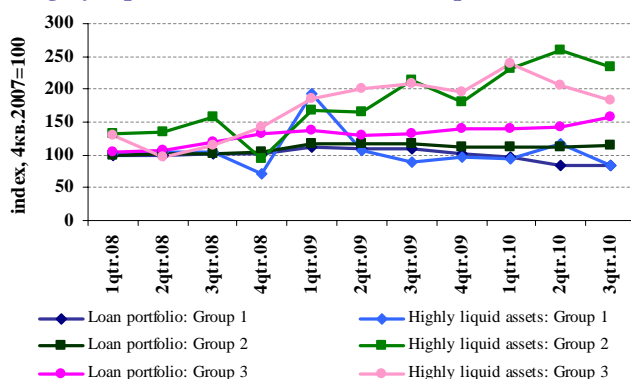
Source: FSA, NBRK, NBRK calculations

Based on the data for Q2 2010, the amount of servicing of foreign liabilities in the coming year appears to be less onerous for banks and should not create an extra burden on the existing liquidity level in the short run.

In its turn, the growth in the deposit base of the banking system (excluding SPV) during 9 months of this year accounted for 12% (including 10.3% - in deposits of individuals, and 13% - of deposits of legal entities). At the same time, the increase in the deposit base is observed not in all banks. So, the deposit level of banks which finalized their restructuring process remained virtually unchanged and, despite the fact that the government anti-crisis measures helped avoiding a massive outflow of deposits, the market's confidence in reliability and low risk of depositing with these banks remains low. In its turn, during 9 months of this year in the second group of banks the growth in the deposit base for the year was over 20% in the range between 9% -54%.

While recognizing a conservative bank policy as a factor negatively affecting the recovery of economic growth and diminishing the probability of non-performing loans recovery in the long run, deposits should be considered as the main resource for crediting the economy. Thus, if low lending activity of banks which finalized the restructuring process (group 1) was caused by a low growth in liquidity, large/medium-size banks and other banks demonstrate high liquidity growth rates which could be used for credits to the real sector. An average rate of growth in liquid assets in annual terms during 9 months of 2010

**Figure 3.1.6**  
**Factors determining bank liquidity (loan portfolio and highly liquid assets of banks, index, 4qtr. 2007=100)**

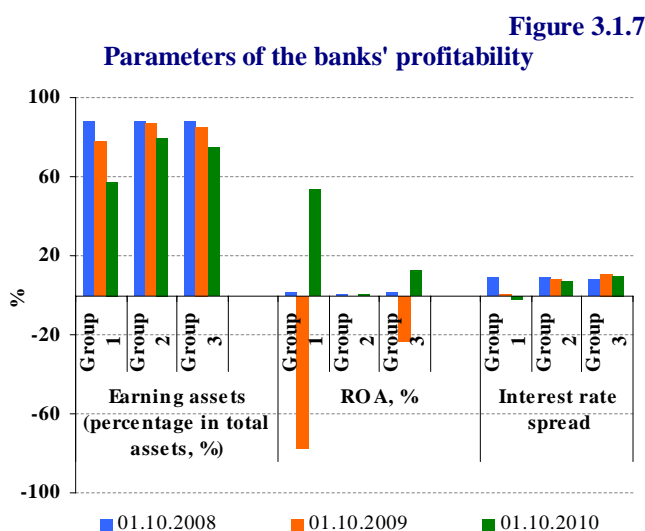


Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank, and Temir Bank), group 2 - banks with the market share of up to 2% incl. (excluding 3 restructured banks), group 3 - banks with the market share less than 2% and over 0.1% as of 01.10.2010

Source: FSA, NBRK, NBRK calculations

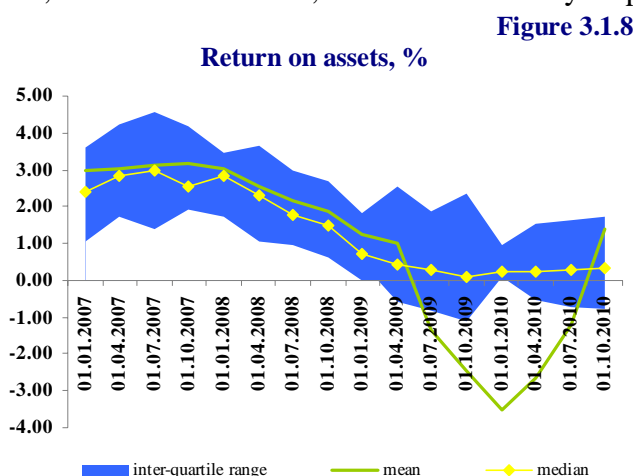
accounted for 15% in the banking system as a whole, 35% - in relation to large and medium-size banks and 6.5% - in other banks (Figure 3.1.6).

Persisting conservative policy of banks and a high level of non-performing loans in the banking system resulted in shrinkage in the credits portfolio and, hence, in the decrease of assets that produce a major profit for sound operation of banks (Figure 3.1.7).



*Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010.*  
*Source: FSA, NBRK calculations*

the banks of Group 1 in annual terms amounted to 53.4% versus -78% at the respective period of the last year, in the group of large and medium-size banks it amounted to 0.26% versus -0.56%, and in other banks – 0.48% versus 0.60% (Figure 3.1.8). However, despite some positive trends, the existing sources for increasing the bank earnings do not provided a basis for sustainable growth of the banking sector since the key revenue items are generated in the area of non-interest income and, in the first instance, due to the recovery of provisions, which, in its turn, doesn't assume cash



*Note: The sample includes the banks that comprise 99.5% of the banking system. ROA is calculated on the basis of quarterly data of net earnings before tax in annual terms*  
*Source: FSA, NBRK calculations*

resources for the service consumers. Thus, based on 9 months of 2010, a percentage of operating expenses in the total earnings of banks was on average 11% (within the range of 36%-0.7%) versus 20% (within the range of 63%-0.6%) in the respective period of the last year with the average interest rate spread of banks of 7.2<sup>8</sup> in 2010 and 8.2% in 2009 (Figure 3.1.9).

Such situation generally reduces the possibilities of banks to generate operating earnings in the form of interest income. Expensive servicing of borrowed funds with low levels of interest income in their turn cause the decrease in the interest rate spread of banks and have a negative effect on the bank profitability as a whole.

Based on 9 months of 2010, some improvement in the profitability ratios of banks may be noted. Net income of banks after tax was positive at KZT 1474.3 bln. versus losses - KZT 2834.2 bln. as of the beginning of this year. The major growth in earnings occurred due to the restructuring of foreign liabilities by three banks. At the same time, net income of banks excluding the group of restructured banks amounts to KZT 3 bln. only.

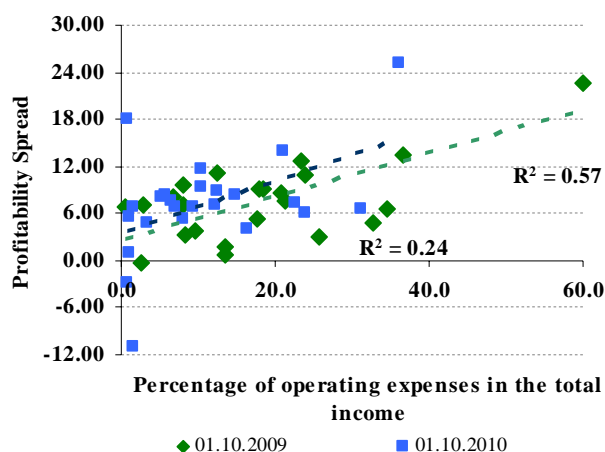
Accordingly, the return on assets in the banks of Group 1 in annual terms amounted to 53.4% versus -78% at the respective period of the last year, in the group of large and medium-size banks it amounted to 0.26% versus -0.56%, and in other banks – 0.48% versus 0.60% (Figure 3.1.8). However, despite some positive trends, the existing sources for increasing the bank earnings do not provided a basis for sustainable growth of the banking sector since the key revenue items are generated in the area of non-interest income and, in the first instance, due to the recovery of provisions, which, in its turn, doesn't assume cash inflow to the bank's balance sheet.

At the same time, capabilities of increasing profitability of banks and bringing it up to the prior levels via replacing the earnings from lending operations by the buildup of the securities portfolio are limited in view of a relatively low yield on securities as well as persistent conservative approach to funding, which is mainly reflected in the form of investments in government securities.

Again, despite the fact that in 2010 banks continued implementing the policy of optimization of the expense structure, specifically cutting operating expenses from servicing of the banks' operation, this policy was not conducive to the increase in the profitability level and reduction cost of credit

<sup>8</sup> A spread is calculated as a difference between loan and deposit interest rates. Interest rates on loans are calculated by dividing the interest income on loans for a period by an average lending position for the same period. The interest rates on deposits are calculated by dividing the accrued interest costs on deposits for a period by an average position on deposits for the same period. Credits and deposits between banks are excluded.

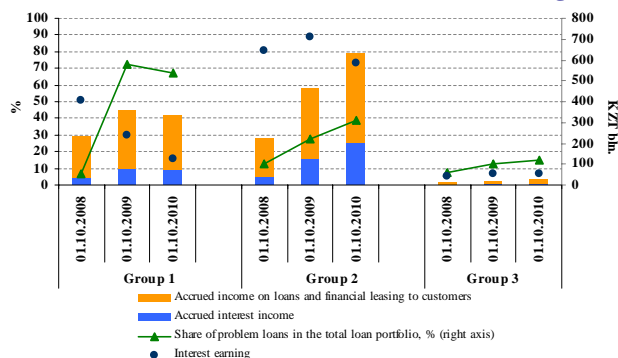
**Figure 3.1.9**  
**Profitability and performance of banks**  
**(at qtr.3 2010 in annual terms)**



*Note: The sample was provided by Banks which are not limited by some particular kinds of services*  
*Source: FSA, NBRK calculations*

Amidst the growth in delinquencies on loans banks fail to receive a major portion of their earnings (Figure 3.1.10). With decreasing volumes of earning assets and a relative stability of the cost of credit resources there is an increase in accrued income on loans of the banks' balance sheet which, in case of scrupulous servicing of loans, must generate a real cash flow. However, the growth in the volume of non-performing loans increases the volume of "missed interest income" of a bank and currently the only solution to improve profitability of banks is to make efforts in relation to improving the loan quality.

**Figure 3.1.10**  
**Accrued interest income and interest earnings**



*Note: The sum of doubtful loans of categories 2, 4 and 5 and loss loans is used as the problem loans*  
*Source: FSA, NBRK calculations*

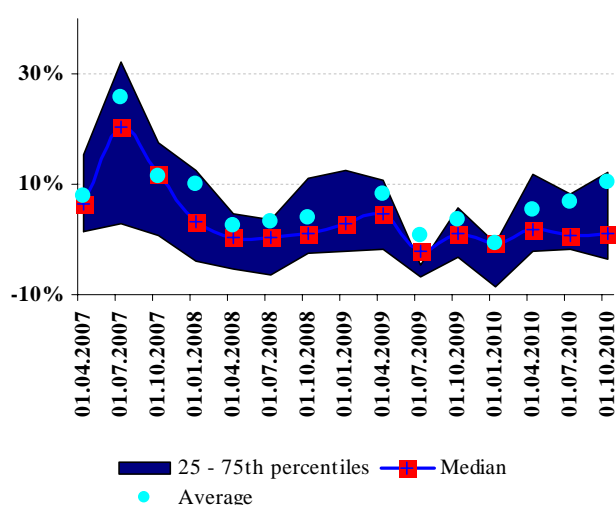
### 3.2 Credit Risks of the Banking Sector

*One of the most significant negative implications of the crisis is still low quality of the credit portfolio caused by materialization of risks mostly in 2009 – beginning of 2010. Low quality of the loan portfolio and a relatively high level of risks are still the factors which constrain lending activity of banks. At the same time, based on the third quarter 2010, there was some revival in lending activity of banks. One of the reasons for such revival was a successful restructuring of BTA Bank.*

**Factors determining lending activity of the banking sector.** During three quarters of 2010 there was a “shrinkage” in the banks’ loan portfolio occurring mainly because the banks undergoing restructuring wrote off their loss loans. Thus, based on the first half of 2010 a total volume of loan portfolio of the banking system decreased by 5.3%. At the same time, based on the third quarter,

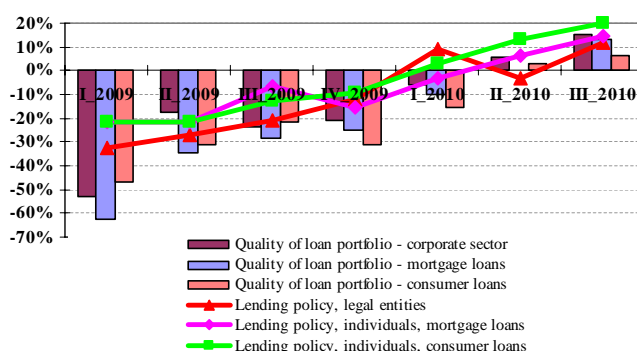
there was some change in the trend as a result of growth in lending activity of banks: in July-September 2010 a total loan portfolio increased by 1.5% (Figure 3.2.1).

**Figure 3.2.1**  
Change in the loan portfolio, % for the period



Source: FSA, NBRK calculations

**Figure 3.2.2**  
Change in the lending policy and the quality of loan portfolio



Note: The results are presented as net percentage change which is calculated as a difference in the % of respondents who noted the increase /easing of parameters, and the % of the respondents who noted the decrease /tightening of parameters

Source: Banks, NBRK calculations

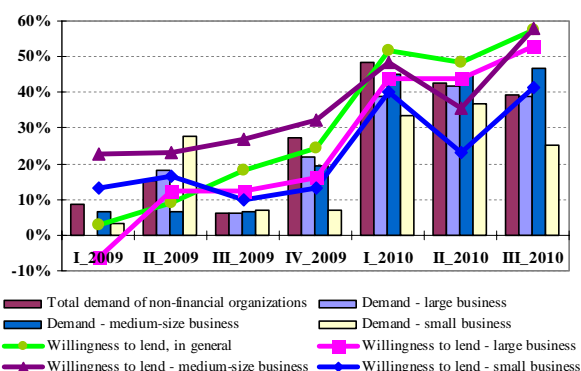
According to the quarterly surveys of the state of the credit market done by the NBRK, one of the reasons for a credit policy mitigation implemented by banks was just the shortage of good quality borrowers. On the other hand, restructuring of one of the largest Kazakh banks – BTA Bank – was a signal about the end of the period of uncertain future of the Kazakh banking system and thereby encouraged the increase in risk appetite of banks (Figure 3.2.2).

According to the information received from banks, in 2010 there was a growth in demand for credit resources both on the part of the corporate sector and individuals. At the same time, if there was a decrease in demand for credit resources on the part of the large and small-size business, there was an increase in the demand by the medium-size business. The decreased demand by the large businesses is explained by tight credit policy of banks as well as the fact that banks mainly provide short-term loans for working capital financing and restructuring of existing debts, therefore the majority of businesses prefer to use their own resources. Reluctance of banks to provide long-term financing is explained by two key factors – lack of good quality borrowers and long-term resources for project lending (Figure 3.2.3).

The retail lending market revives largely owing to the growth in activity of some banks in the consumer lending segment and to the increased demand of the population for consumer loans. The growth in the consumer lending volumes is explained by the realization of deferred demand for certain types of goods on the part of the population, that became possible owing to stabilization of the economic situation in the country.

In addition to that, banks tend to ease their credit policy in this type of lending due to the existing competition of banks in this segment as the only source for the growth in business volumes in the banking sector (Figure 3.2.4).

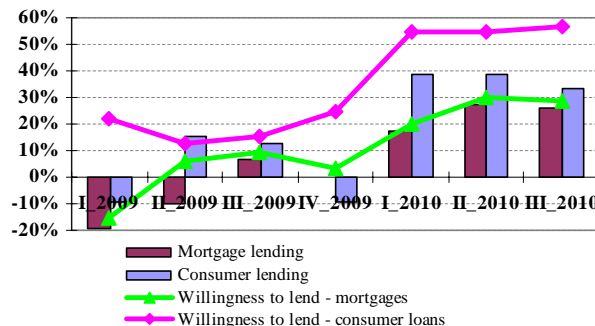
**Figure 3.2.3**  
Change in the demand for and supply of credit resources, % of respondents (corporate sector)



*Note: The results are presented as net percentage change which is calculated as a difference in the % of respondents who noted the increase /easing of parameters, and the % of the respondents who noted the decrease / tightening of parameters. In this case the diagram shows changes in the actual demand and willingness to lend.*

*Source: Banks, NBRK calculations*

**Figure 3.2.4**  
Change in the demand for and supply of credit resources (market of loans to individuals), % of respondents



*Note: The results are presented as net percentage change which is calculated as a difference in the % of respondents who noted the increase /easing of parameters, and the % of the respondents who noted the decrease / tightening of parameters.*

*Source: Banks, NBRK calculations*

**Dynamics of the credit portfolio quality.** The change in the quartile distribution of banks by the percentage of loans past due over 90 days during the period from the end of the third quarter of

**Table 3.2.1**  
Transfer Matrix on the Share of Loans in the Loan Portfolio with Delinquency over 90 days

		as of 01.10.2010			
as of 01.10.2009		Quartile 1	Quartile 2	Quartile 3	Quartile 4
		2,12%	7,58%	19,54%	69,54%
Quartile 1	1,14%	7	1	1	0
Quartile 2	6,68%	2	5	1	0
Quartile 3	14,24%	0	1	3	4
Quartile 4	56,72%	0	1	3	4

*Note: Numeric values in the matrix reflect the number of banks*

*Source: FSA, NBRK calculations*

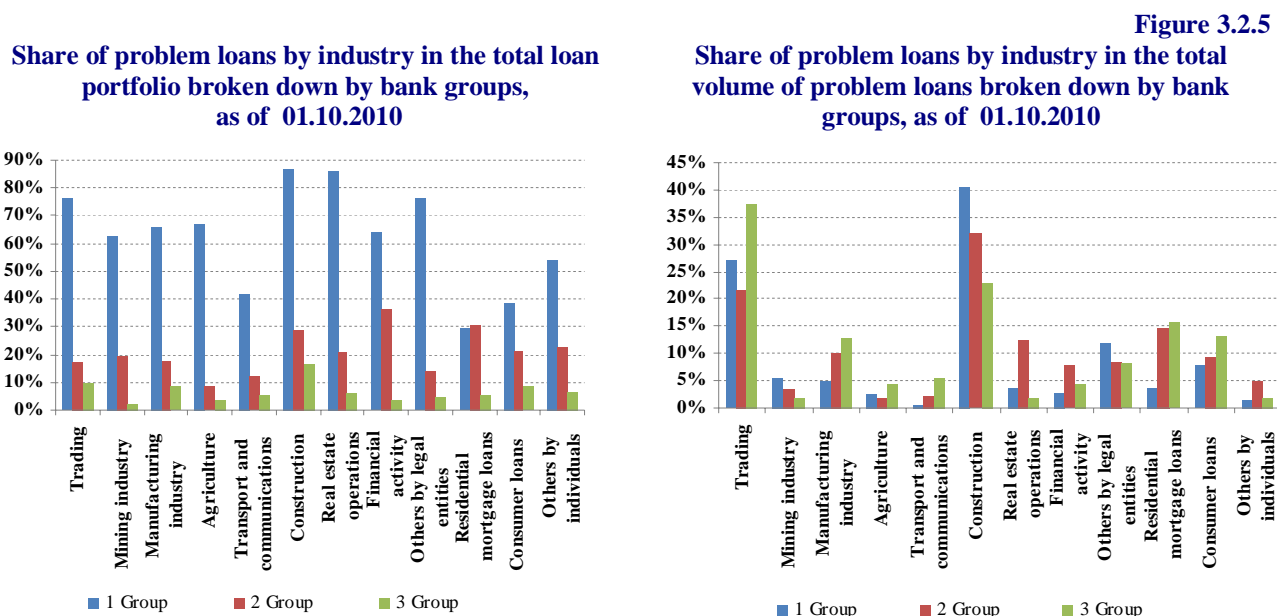
2009 to the end of the third quarter of 2010 shows that the deterioration of the credit portfolio quality affected the majority of banks. Thus, out of 17 banks in the first and second quartiles only 4 banks improved their credit portfolio quality. The share of loans past due over 90 days is lower than the median only in one large bank<sup>9</sup> (7.6% at the end of the third quarter 2010). The majority of large banks during this period moved from the 3<sup>rd</sup> quartile to the 4<sup>th</sup> quartile which also includes restructured banks. It should be also mentioned the growth in values in all

quartiles, i.e. the deterioration of the credit portfolio quality is observed not only in certain large banks but it has an explicit systemic nature (Table 3.2.1). It is worth mentioning that aggregated indicators of the credit portfolio quality in the banking system are significantly distorted when including the three banks which undergone restructuring this year into the computation. Thus, the share of problem loans (doubtful loans of the 5<sup>th</sup> category and loss loans) in the portfolio of these banks by different lending lines accounts for 41.7% - 87.1% of the loan portfolio of legal entities depending on the credited sector and 29.5% - 54.2% in different segments of crediting of individuals. If the group of problem banks and relatively small banks is excluded from the review, then the average percentage of loans classified as doubtful of the 5<sup>th</sup> category and loss loans accounts for 25.8% in the loan portfolio of these banks. The largest concentration of problem loans falls on the following economic sectors: financial activity

<sup>9</sup> Large banks hereinafter mean those banks whose assets in total assets of the banking system account for 10% or more



(36.2% of loans), construction (28.8%), real estate operations (20.7%), and also mortgage lending (31%) (Figure 3.2.5).

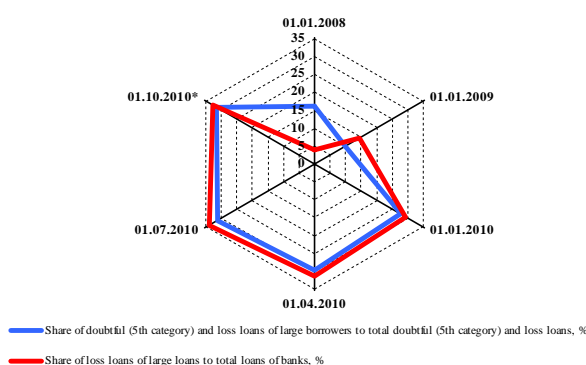


Note: 1) Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank, and Temir Bank), group 2 - banks with the market share of up to 2% incl. (excluding 3 restructured banks), group 3 - banks with the market share less than 2% and over 0.10% as of 01.10.2010;

2) Problem loans consist of doubtful loans of category 5 and loss loans.

Source: FSA, NBRK calculations

**Figure 3.2.6**  
**Share of problem loans of 25 large borrowers in the problem loans of banks**



Note: \* Information about loans to large borrowers is presented excl. "HSBC Bank Kazakhstan", problem loans consist of doubtful loans of Category 5 and loss loans

Source: FSA, NBRK calculations

The degree of concentration of the credit portfolio has quite a ponderable influence on the credit portfolio quality of banks. In this respect it is worth mentioning that the extent of such influence somewhat decreased in 2010. Loss loans of 25 largest borrowers within loss loans of banks at the end of the 3<sup>rd</sup> quarter 2010 accounted for 32.5% (33.8% at the end of the first half of 2010) (Figure 3.2.6).

On the whole, the dynamics in the ratio of provisions to total loan portfolio by virtue of the requirements set to the accrual of provisions and applied in Kazakhstan correlate with the loan portfolio quality; at the end of the 3<sup>rd</sup> quarter 2010 this ratio was 32.8%. The decrease in ratio of the value of

collateral and the amount of created provisions to loan portfolio that have occurred in the 2<sup>nd</sup> quarter 2010 because of collateral revaluations and recognition of losses by the banks which had undergone through their foreign debt restructuring, is also worth mentioning (Figure 3.2.7).

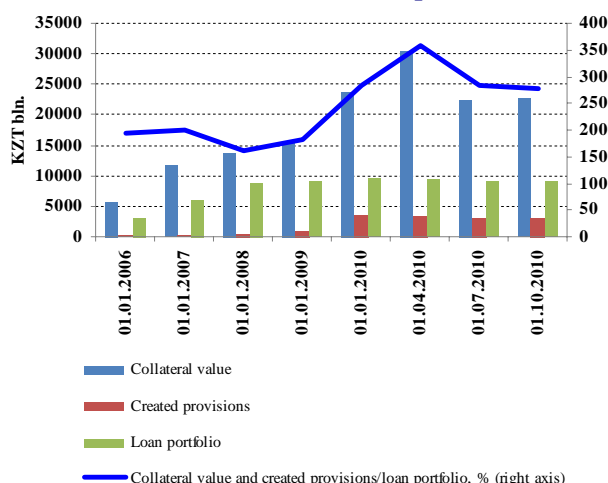
However, when analyzing the distribution of residential mortgage loans by the loan to value ratio, one may point out a significant prevalence of loans with a high LTV, which represents a significant risk of losses in case of the need to realize collateral given low pricing environment in the real estate market (Figure 3.2.8).

Starting from the 3<sup>rd</sup> quarter of 2009 there is a relative stabilization of prices for the real estate which is used as a security for a significant part of loans. At the same time, a significant decrease in the real estate prices until mid-2009 (in Almaty – until the 3<sup>rd</sup> quarter of 2010) appeared

to be one of the factors causing the decrease in the quality of loan portfolio of banks in 2008 – 2010 (Figure 3.2.9). It should be noted that in the majority of banks the policy for appraisal and reappraisal of the real estate which is in pledge determines a certain time lag between the change in the real estate prices and the change in the LTV.

Figure 3.2.7

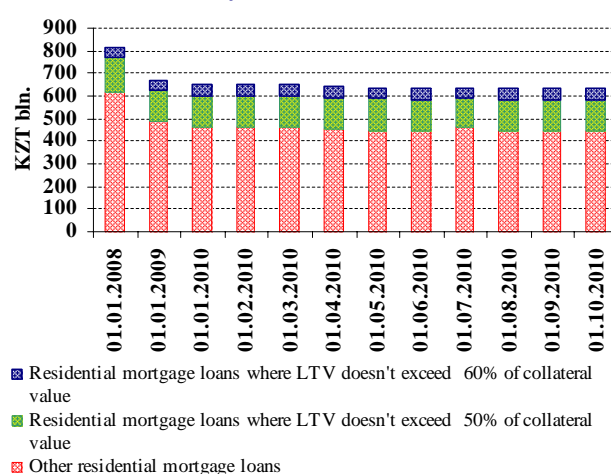
The extent of coverage of the loan portfolio by the collateral value and created provisions



Source: FSA, NBRK calculations

Figure 3.2.8

Information about residential mortgage loans provided by Kazakh banks



Source: FSA

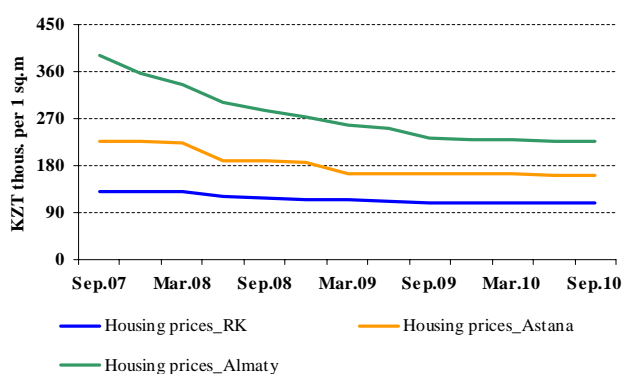
With a view to manage their loan portfolio quality, banks actively turn to the loan portfolio restructuring. According to the information provided by banks<sup>10</sup> at the NBRK's request, at the end of the 3<sup>rd</sup> quarter of 2010 the percentage of restructured loans in the portfolio of legal entities

accounted for 28%, of individuals – 16%. Within the portfolio of loans to individuals restructuring is used in the most intensive manner in relation to mortgage loans. Mortgage loans in the restructured portfolio of individuals amount to 51% at the end of the 3<sup>rd</sup> quarter of 2010. As for restructuring of consumer loans, it is carried out at slower rates (at the end of 9 months of 2010 – 39%) (Figure 3.2.10). The main types of restructuring are<sup>11</sup>: providing a delay of the past-due debt repayment (46%) and prolongation of the overall loan tenor and the change in the maturities (31%) (Figure 3.2.11).

One of the reasons for the growth in the volumes of loss loans is low volumes of loans written off the balance sheet.

Figure 3.2.9

Average housing prices



Note: An average price hereinafter means the average of 4 prices: sale of new standard housing and resale of tenement, housing with all modern amenities and elite housing

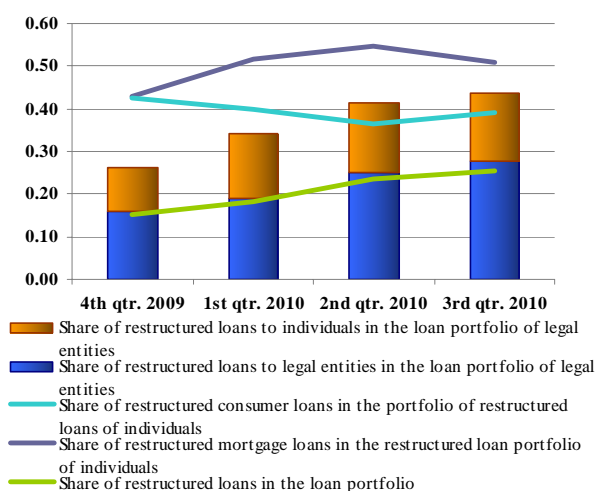
Source: FSA, NBRK calculations

<sup>10</sup> The information was provided by 12 large and medium-size banks in response to the special request from the National Bank in November 2010. Banks are responsible for the accuracy of provided information.

<sup>11</sup> According to the data at the end of Q3 2010.

Figure 3.2.10

## Portfolio of restructured loans

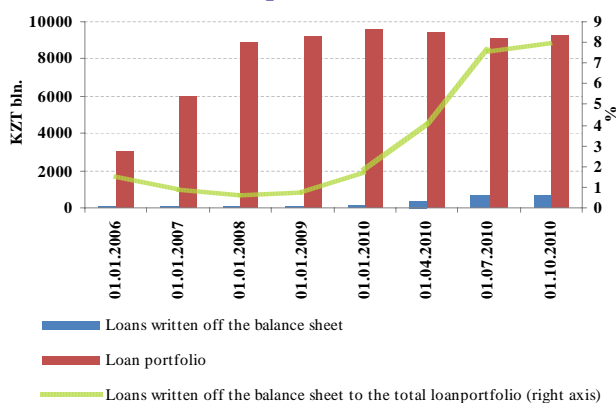


Note: Data for the survey of 12 banks

Source: Banks, NBRK calculations

Figure 3.2.12

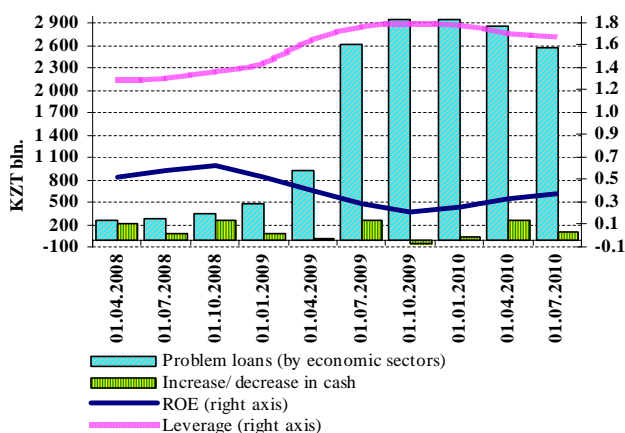
## Loans written off the balance sheet to the total loan portfolio



Source: FSA, NBRK calculations

Figure 3.2.13

## Solvency factors of the corporate sector



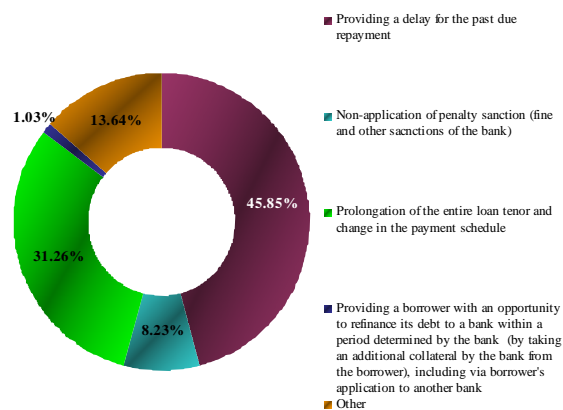
Note: 1) Data do not include households;

2) Problem loans by economic sectors – doubtful of category 5 + loss loans by economic sectors

Source: ASRK, FSA, NBRK calculations

Figure 3.2.11

## Structure of parameters in respect of which restructuring was provided



The increase in the volume of loans written off the balance sheet in the first half of the year occurred primarily because of intensification of written offs of such loans and recognition of losses in the balance sheet by banks undergoing their foreign debt restructuring. However, at the systemic level as a whole banks adhere to the policy of keeping their problem loans on the balance sheet; this fact can be explained by the absence of mechanisms for the management of collateral which is passed over to banks after defaults by problem borrowers and by the fact the issues pertinent to taxation of income from recovery of provisions are still unresolved (Figure 3.2.12).

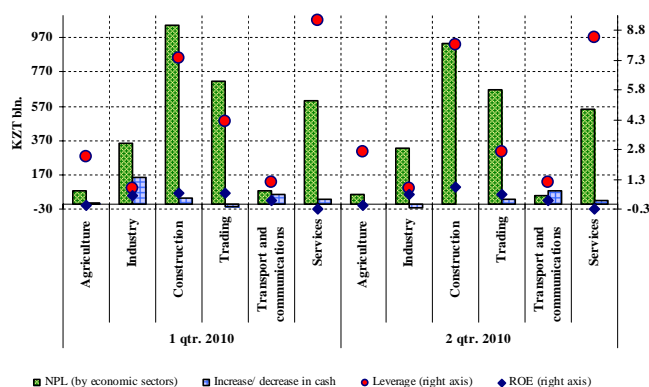
*Credit risk of the corporate sector*

In terms of the key financial indicators of the corporate sector as a factor causing credit risk, some decrease in the debt to equity ratio (financial leverage) and the increase in the performance of businesses (ROE) should be mentioned (Figure 3.2.13). Also, at the end of the 2<sup>nd</sup> quarter of 2010 there was an increase in cash balances on the bank checking accounts of large and medium-size enterprises of over KZT 105 bln., which enables to say about a partial coverage of the existing debt of the corporate sector to banks. Basing on the prior experience, one may admit that the increase in

ROE, increased cash balances and decrease in financial leverage leads to a reduced number of problem loans in the economic sectors. At the same time, there are still problem



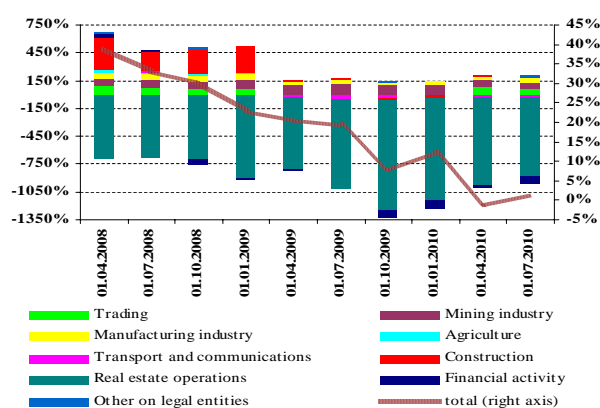
**Figure 3.2.14**  
**Solvency factors of the corporate sector by economic sectors**



Note: 1) Data do not include households;  
2) Problem loans by economic sectors – doubtful of category 5 + loss loans by economic sectors  
Source: ASRK, FSA, NBRK calculations

**Figure 3.2.15**

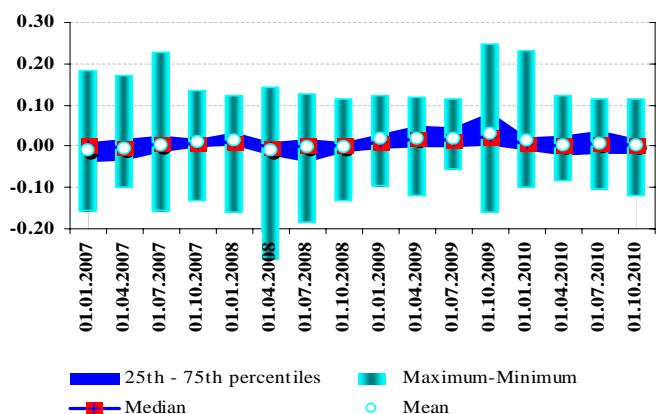
**FX position of the corporate sector to its equity**



Note: FX position is a difference between financial assets and liabilities in foreign currency on large and medium-size enterprises adjusted for cash receipts from the operating activity in foreign currency (in annual terms).  
Equity – owners equity of large and medium-size enterprises  
Source: ASRK, NBRK calculations

**Figure 3.2.16**

**Net FX position of banks in US\$ to their equity**



Note: BTA Bank, Alliance Bank and Temirbank were excluded from the sample due to their negative equity value.  
Source: FSA, NBRK calculations

sectors in the corporate sector such as agriculture and services. These sectors have very high credit risks since the return on equity is still negative and, according to the data for Q2 2010 the liabilities to equity ratio in the agricultural sector is over 2 and over 8 in the sector of services (Figure 3.2.14). Generally, a small decrease in problem loans in Q2 2010 as compared to Q1 2010 may be mentioned as a positive trend in the sectors.

In addition to the financial position of the corporate sector another factor that affects the soundness of businesses is foreign exchange position of a business. The businesses in such sectors as real estate operations and financial activity may be referred to businesses with the highest risk in Q2 2010 since the businesses in this sector have a highest short exposure. The ratio of foreign currency position to equity in these sectors is -848.5% and -78.3%, respectively (Figure 3.2.15).

Nonetheless, this indicator compared in the dynamics shows that there was a decrease in short exposure in these sectors. Enterprises operating in such sectors as mining industry and trade have the highest foreign currency exposure. The ratio of foreign currency position to equity in these sectors has the highest positive value (70.3% and 61.9%, respectively), which reflects a high foreign exchange risk in these sectors that may arise in the event of appreciation of the exchange rate of the Tenge versus the US Dollar.

If we consider the corporate sector as a whole, there was an increase in the ratio of foreign currency position to equity in Q2 2010 as compared to Q1 2010. In Q2 2010 this indicator was 1.3%, which shows an insignificant level of foreign exchange risk in the corporate sector as a whole.

Some decrease in the probability of default of enterprises (Box 2) also is an evidence of improved situation in the corporate sector.

Foreign currency position of the banking sector was within regulatory values although restructured banks were excluded from the sample again since they used to have negative capital in the past (Figure 3.2.16). Moreover, the ratio of short and long

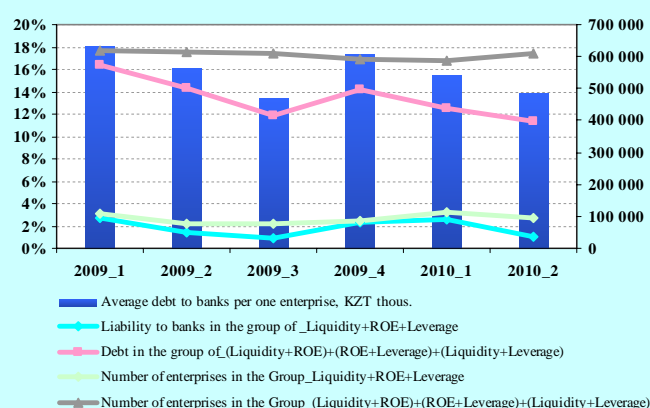
foreign currency exposures in banks was approximately the same, with a minor prevalence of short exposures.

## Box 2

### Financial Soundness Risks of the Corporate Sector (large and medium-size business)\*

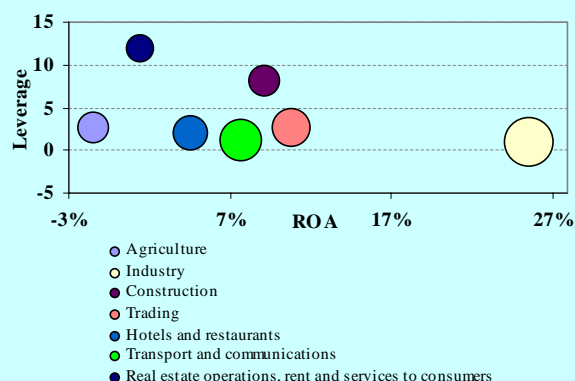
Despite a gradual decrease in the average debt to banks per 1 enterprise a high level of debt and leverage still represents a significant risk factor for the corporate sector, where profitability and liquidity are somewhat growing, at the same time reflecting a positive trend in the corporate sector.

**Figure 1**  
Financial soundness risks of the corporate sector (large and medium-size enterprises)\*\*



Source: ASRK, NBRK calculations

**Figure 2**  
Risk distribution by sectors (2Q 2010)



Note: The size of a point corresponds to the current liquidity level

Source: ASRK, NBRK calculations

The share of enterprises and share of their debt in the group with increased risk of default (the worst indicators on all three parameters: liquidity, leverage and profitability) as compared to the previous period decreased insignificantly and amounted to 2.75% and 1.02%, respectively. Despite the fact that a number of enterprises with both risk factors (group of enterprises where at least two risk factors exist) somewhat increased, the debt in this group is going down. (Figure 1). The debt burden on the corporate sector is still high. The percentage of loans in the banking sector that were provided to enterprises from the group with at least two “worst” debt indicators \*\*\* in Q2 2010 was about 19.2% of all loans, of which the highest percentage falls on the agricultural enterprises – 3.4%, enterprises in the manufacturing industry – 4% and construction – 5.3%.

The remaining trend in the sectoral risk distribution showed that the highest risk of default exists in industries such as: (1) real estate operations, rent and services to consumers, (2) agriculture, and (3) construction (Figure 2); alongside with that the banking sector goes on with its active efforts on restructuring of non-performing loans with a view of further rehabilitation of the corporate sector.

\* A more detailed review of the methodology was presented in the financial Stability report in 2007 in the Special Research Section.

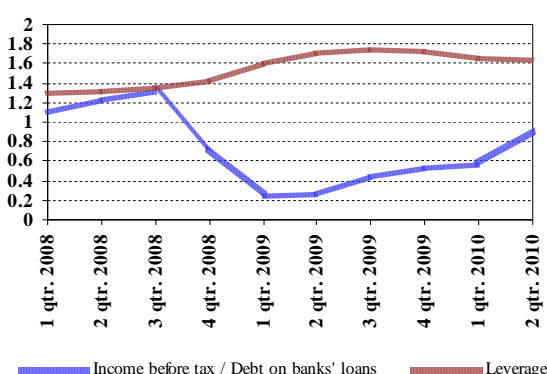
\*\* Indicators of the risk of default of enterprises:

Liquidity+ROE+Leverage – an area of maximum risk of default combining enterprises with low liquidity\*\*\*, low return on equity\*\*\* and a high level of debt;

A combination of two indicators with worst performance, for instance - Liquidity+ROE, is an indicator of the two-factor risk, i.e. an enterprise combines a low liquidity ratio and at the same time a low return on equity;

\*\*\* «The worst» performance of indicators – low indicators of liquidity and ROE, comprising the group of up to 25 percentile and high leverage comprising the group of over 75 percentile.

**Figure 3.2.17**  
**Incomes and debt of the corporate sector**



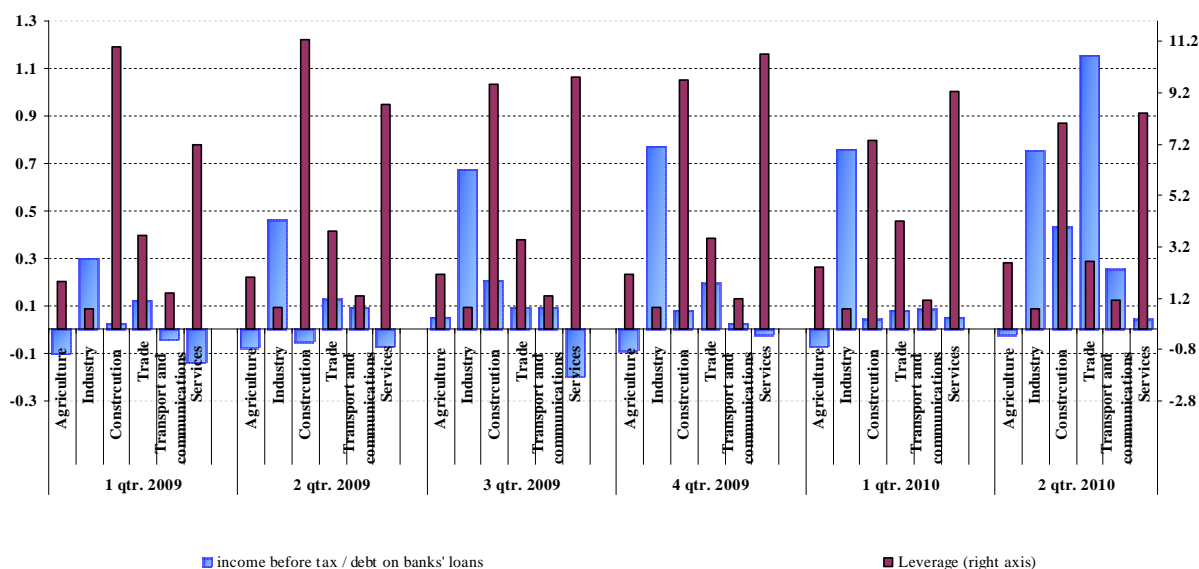
Source: ASRK, NBRK calculations

The enhanced capability of enterprises to repay their obligations is also proved by the fact that income before tax in relation to debt to banks is increasing and is approaching a pre-crisis number (Figure 3.2.17).

Therefore, performance of the corporate sector is gradually improving although this happens not in all sectors. Agriculture and services are still the most troubled sectors in respect of this indicator (Figure 3.2.18). In the construction sector during the first two quarters of 2010 there is an increase in the ratio of income before tax in relation to debt to banks; hence a gradual mitigation of credit risk in this sector in

**Figure 3.2.18**

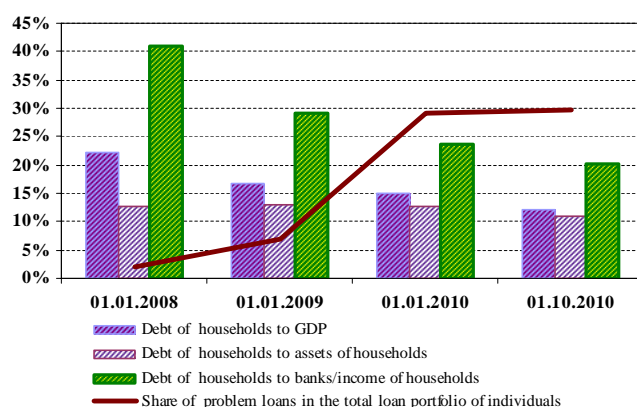
**Sectoral distribution of the ratio of income before tax to debt to the banking sector**



Source: ASRK, NBRK calculations

**Figure 3.2.19**

**Solvency factors of households**



Source: ASRK, FSA, NBRK calculations

future should be expected. Thus, stabilization of the situation in the country leads to a gradual improvement in the performance of the corporate sector in the majority of industries, which will have a favorable effect on the ability of enterprises to repay their obligations to banks in future.

### Credit risk of households

Financial position of households also improves. The debt to GDP ratio is gradually decreasing (at 01.10.2010 – slightly over 12%) as well as the ratio of debt to assets of the households (at the end of Q3 2010 – less than 11%) (Figure 3.2.19).

The increased income and decreased debt to banks resulted in the decreased ratio between the two from 41% at the beginning of 2008 to slightly over 20 % at the end of 9 months of 2010. The changes of these indicators to the

better resulted in the slowdown of the growth rates in problem loans among individuals and allow expecting the credit risk mitigation in this line of lending in future (Box 3).

### Box 3

#### Assessing the uniformity in the distribution of income and expenses of the population

Gradual decrease in the uneven distribution of income reflects a positive trend in the living standards of the population. Besides that, the groups with the income above the average show the parsimonious trend.

The number of individuals in the surveyed households grows by all groups; about 15% of the population is concentrated in the groups with the income above the average. As compared to the prior period, a disposable income of households increased by 5%, whereas as the result of insignificant growth of the debt burden on households the majority of groups demonstrate the decrease in consumer spending and decrease in the bank financing. Consumer spending accounts for a largest portion of disposable income for groups of the population with a higher level of income whereby reducing the disparity of household income. This is reflected in the decreased Gini coefficient\* which was 0.267 at end-2009 whereas in the respective period of the preceding year it was at 0.288.

Table 1

#### Debt burden on per capita monthly income used for consumption in 2009

KZT	less than 5000	5001 - 10000	10001 - 15000	15001 - 20000	20001 - 25000	25001 - 30000	30001 - 35000	35001 - 40000	40001 - 45000	40001 - 45000	over 50000
Share of population in the surveyed households, as % of the total population participating in the survey	0.11	8.02	26.94	23.70	16.23	9.80	5.63	3.64	2.01	1.38	2.56
Debt servicing/disposable income, %	2.14	1.44	1.98	2.85	3.73	4.07	4.63	4.55	5.96	6.95	8.08
Consumer spending/disposable income, %	70.1	77.4	79.3	78.8	81.5	83.7	87.4	90.8	92.1	92.7	98.8

Source: ASRK, NBRK calculations

\*Gini coefficient – index of inequality in income. Its magnitude may vary from 0 to 1, and the higher the magnitude of the coefficient, the more dispersed is the distribution of income among the public (is calculated by the Agency of Statistics of the Republic of Kazakhstan).

#### Stress-testing of banks

With a view to assess the effect of the change in macroeconomic indicators on the credit risk and pressure on the bank capital, the NBRK conducted stress-testing of the banking sector<sup>12</sup>. The baseline scenario is the change in the price of oil (Brent) from USD 76.91 per barrel (the price is given for Q3 2010) to USD 25 per barrel. In the stress scenario, the price is falling gradually until the third quarter of 2011, in the shock scenario the price in Q4 2010 would go down to US\$ 25 per barrel and would remain at this level until Q3 2011.

Stress-tests were conducted by using two models: macroeconomic model and panel model. In the macroeconomic the shock was applied to the value of real GDP in individual sectors (industry, construction, trade), and in the panel model to the overall real GDP smoothed seasonally, and real estate prices in Kazakhstan.

The macroeconomic model is three-staged:

- 1) the assessment of impact of the change in the price for oil, the GDP of Russia and the nominal exchange rate of the Tenge versus the US Dollar on the real GDP of Kazakhstan by economic sectors;
- 2) carry-over of the resulting risk factor to normal distribution;

<sup>12</sup> With participation of Deutsche Bundesbank, based on the IFO Working papers No.85 «Methodology of stress test for the Kazakh banking system», April 2010

- 3) carry-over of the normalized risk factor to other sectors of the economy via correlation between the sectors, and assessment of the change in the loan portfolio of banks influenced by the resulting risk.

In the panel model an equation was obtained, which directly estimates the effect of the change in GDP, ratio of credits in the economy to GDP, real estate prices and oil prices on the change in the loan portfolio of banks

The following assumptions were made in the models:

*for the macroeconomic model:*

- the share of credits in the sectoral breakdown remains unchanged throughout the forecasted period and will be equal to the share at 01.10.2010.
- assets, capital and the loan portfolio are considered as equal to the data at 01.10.2010 and remain unchanged till the end of the forecasted period;

*for the panel model:*

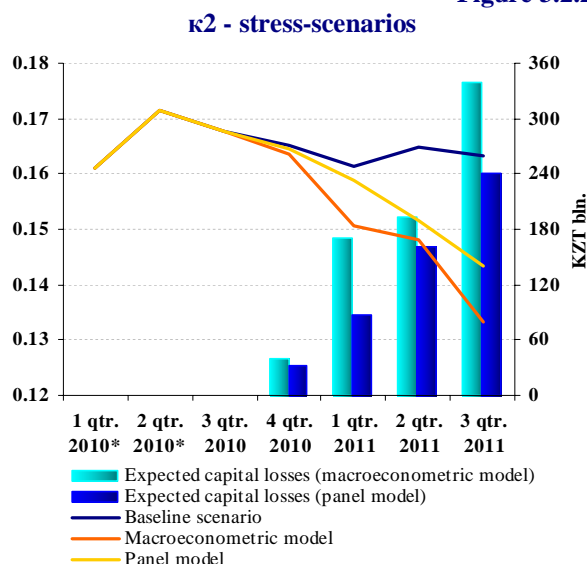
- the share of assets in the total share of assets in the banking system will remain at the level of 01.10.2010.
- expenditures to income will be at the level of Q3 2010.
- The ratio of credits to the economy to GDP will coincide with the trend planned for 01.10 2010.

The assessment was made on the sample of banks which included banks providing credits to those sectors of the economy that were exposed to shocks (industry, construction and trade) and have a share of assets in the total volume of assets of at least 0.1% at 01.10.2010. 19 banks including the restructured banks meet this requirement.

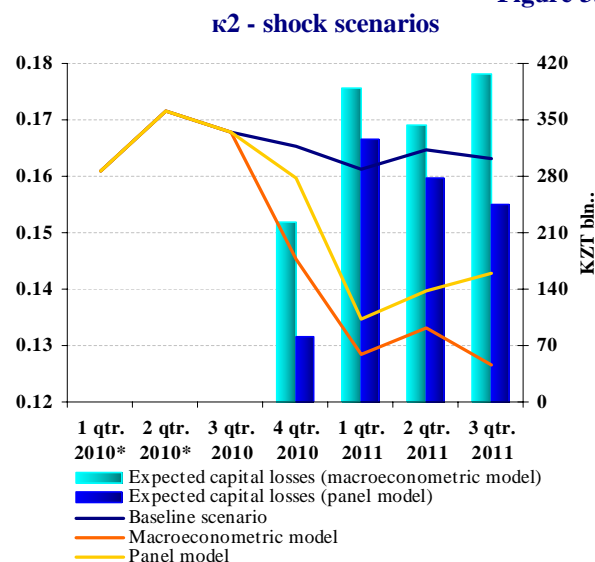
As a result of stress-testing, 4 banks out of selected 19 violate capital adequacy ratio and one of the banks is at the marginal level between 0.12 and 0.10, but there is no violation of the capital adequacy ratio  $k_2$  given the bank's status. However, it should be taken into account that those banks whose financial condition is not stable yet were included in the sample.

As for the general picture in respect of the sample, the expected capital losses range between

**Figure 3.2.20**



**Figure 3.2.21**



*Note: Computed for 19 banks*

*1 and 2 qtr. 2010 are computed excl. BTA because of its negative capital*

*Source: FSA, NBRK calculations*

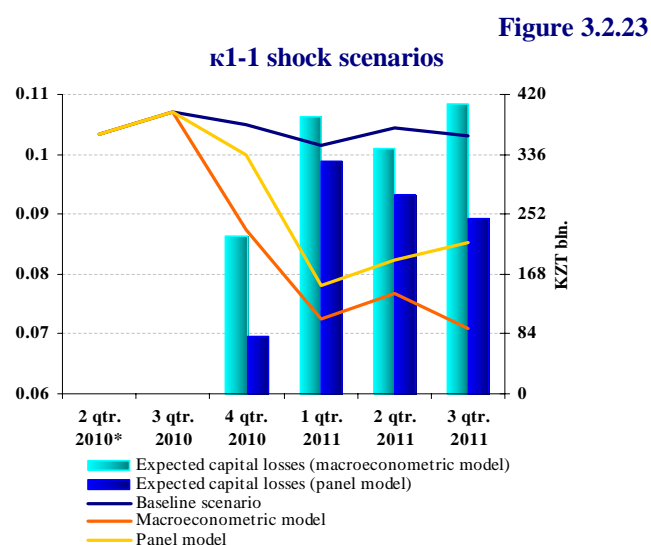
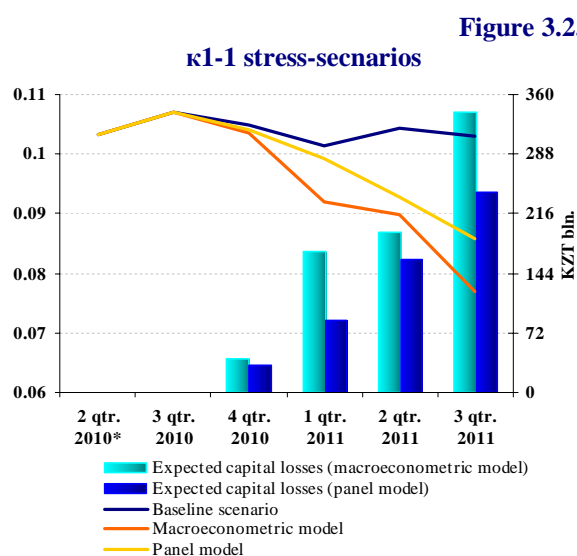
KZT 40.5 bln. and KZT 339.1 bln. in case of the stress-scenario and between KZT 80.3 bln. and 407.4 bln. under the shock scenario. In doing so, under the stress-scenario there is a gradual buildup of losses (Figure 3.2.20) and the maximum capital losses fall on the 3<sup>rd</sup> quarter of 2011, and the largest value corresponds to the macroeconomic model and amounts to KZT 339.1 bln. In this case  $k_2$  is equal to 0.1334. Under the shock scenario capital losses change spasmodically (Figure 3.2.21). the highest capital losses, as before, fall on the 3<sup>rd</sup> quarter of 2011, but in Q1 2011 the



losses are significant. The maximum capital losses were obtained under the macroeconomic model and they amount to KZT 389.4 bln. at Q1 2011, and KZT 407.4 bln. – at Q3 2011. As to the capital adequacy ratio  $k_2$ , at the maximum capital loss under the shock scenario it equals to 0.1266 in Q3 2011. Estimates were also made in respect of the change in  $k_1$  ratio to see the effect on the tier-one capital of the reviewed banks. Under the stress-scenario (Figure 3.2.22) a minimal value of  $k_1$  also fell on Q3 2011 and made up 0.077. Under the shock scenario (Figure 3.2.23) a minimal value of  $k_1$  also falls on Q3 2011 and is equal to 0.071 (data from the macroeconomic model).

As a result of stress-testing, generally no violation of the regulatory values of  $k_1$  and  $k_2$  was found in the sample of banks since virtually all the banks in the sample, except for a few, after the crisis maintain their  $k_1$  and  $k_2$  ratios at a level considerably higher than the regulatory requirements. *At the same time it should be noted that the obtained results assess the effect of only one shock parameter; if such shocks are more than one, results would be essentially different.*

In addition, the FSA conducts the analysis of the banking sector's sensitivity to various indicators (Box 4).



Note: Computed for 19 banks

1 and 2 qtr.2010 are computed excl. BTA because of its negative capital

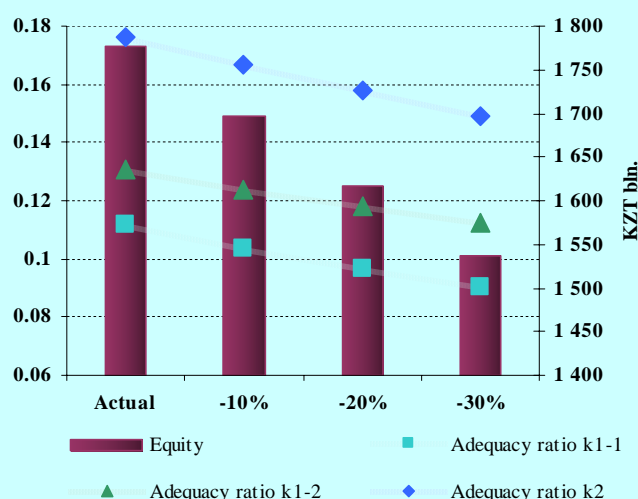
Source: FSA, NBRK calculations



### Stress-Testing of the Banking System of the Republic of Kazakhstan as of 01.10.10

With a view to test the banking system for sustainability, the FSA conducts the sensitivity analysis as necessary, where a maximum impact of adverse factors on the banking sector is estimated. In doing so, such factors as foreign exchange rates, real estate prices and deterioration in the loan portfolio quality are taken into consideration.

**Figure 1**  
Stress-testing as of October 1, 2010 (appreciation of the exchange rate on the USD)



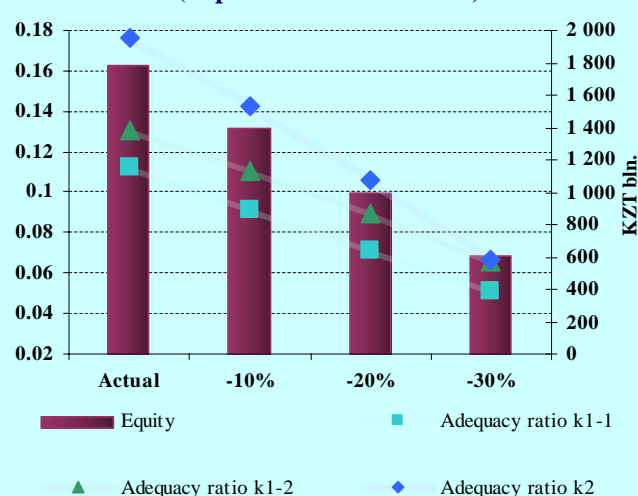
Source: FSA

Based on the results of stress-testing, one may note that when the exchange rate to the US Dollar increases by 10%, capital adequacy ratios  $\kappa 1-1$  and  $\kappa 1-2$  would be violated – by 1 bank. If the rate appreciates by 20% and 30%, capital adequacy ratio  $\kappa 2$  in addition will be violated by 2 banks.

#### Scenario of the change in the real estate prices

When assessing financial condition of the banking sector, a scenario was analyzed under which the real estate impairment would make up 10-30%.

**Figure 2**  
Stress-testing as of October 1, 2010 (impairment of real estate)



Source: FSA

#### Scenario of changes in foreign exchange rates

In the structure of foreign currency assets and liabilities of banks, assets and liabilities in the USD constitute the highest percentage. As of 01.10.2010, this percentage was 88.2% and 88.6%, respectively. In this connection, stress-testing was conducted on the basis of foreign currency exposure on the US Dollar.

Scenarios under which the exchange rate of the Tenge to USD appreciated by 10%, 20% and 30%, if at 01.10.2010 the exchange rate of the tenge versus USD was 148.46, scenarios assume that it would increase to 163.3; 178.2; 193.0. In doing so, due to the change in the credit risk provisions were increased by 20% of the difference between the actual amount of assets and that obtained as a result of computations.

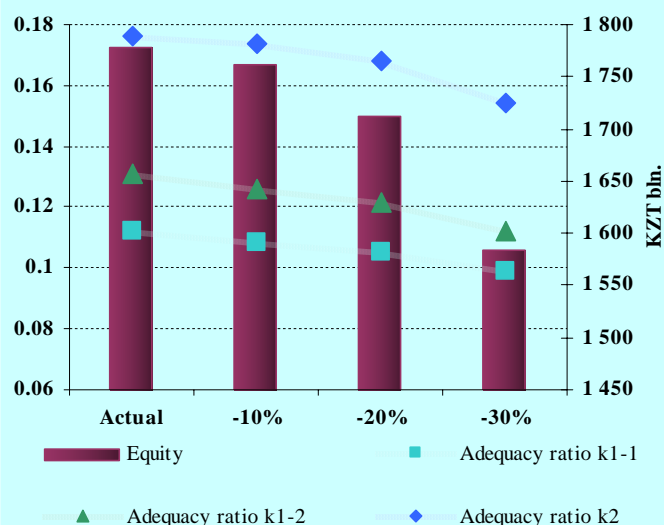
In the computation mortgage loans (secured by real estate) which account for 36.8% of the total loan portfolio of banks as of 01.10.2010, were taken into consideration. So, when the value of real estate under mortgage loans impairs by a certain percentage, the banks would be expected to create additional provisions for the amount of impairment.

As a result, the impairment of real estate by 10-30% under mortgage loans secured by real estate will have a significant impact on financial condition of the entire banking sector. In case of the real estate impairment by 10% 4 banks would violate capital adequacy ratios, by 20% - 7 banks, and in case of 30% impairment – by 11 banks.

## Scenario of deteriorated loan portfolio quality by economic sectors

Figure 3

Stress-testing as of October 1, 2010 (deterioration of loan quality in the construction sector, trade and industry)



Source: FSA

noted in 1 bank, when it's a 20% increase - 2 banks violate the ratio, and in case of 30% - 5 banks.

At the same time, when a scenario was analyzed where the percentage of provisions was increased in the construction sector, trade and industry simultaneously to 10 percentage points, capital adequacy ratio was violated by 1 bank, if it was increased to 20 percentage points – 2 banks violated capital adequacy ratio, and in case of 30 – 5 banks.

Generally, when conducting stress-testing one may note that the situation in the banking system has improved significantly as compared to the respective period of the last year. Positive changes are largely associated with restructuring of liabilities of 3 large banks. This event had a considerable impact on the banking system's performance and the results presented above are close to and comparable with the results of stress-testing in the pre-crisis period.

Based on the structure of credits to the economy, as well as the percentage of loss loans in each economic sector, stress-testing was conducted in relation to the construction sector, trade and industry. When conducting such stress-testing, the percentage of provisions for loans in a certain economic sector was increased to 10 – 30%. The most significant impact on the change in equity of the banking sector is made by the deterioration of loan quality in the trade sector.

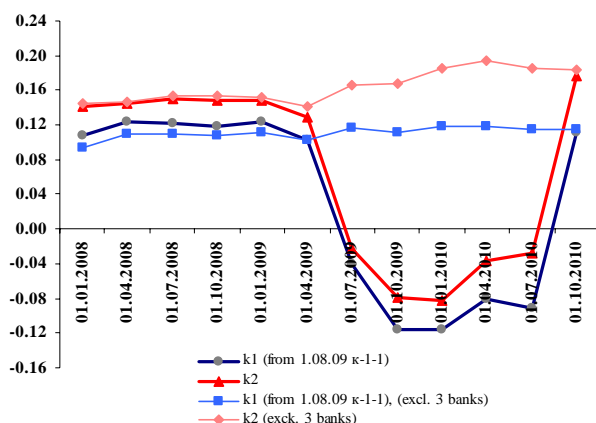
It should be noted that deterioration of the loan portfolio in the industry and construction individually would not greatly affect financial condition of banks; and capital adequacy ratio would not be violated by banks. In the sector of trade, when the percentage of provisions is increased by 10% - violation of capital adequacy ratios was

### 3.3 Capital Adequacy and the Funding Structure of Banks

*The volume of equity of the banking system returned to its prior positive level as a result of finalized restructuring of foreign liabilities of Kazakh banks. However, deteriorating loan portfolio quality, in its turn, continues to increase the burden on the banks' equity, which requires additional capitalization of the banking system.*

Figure 3.3.1

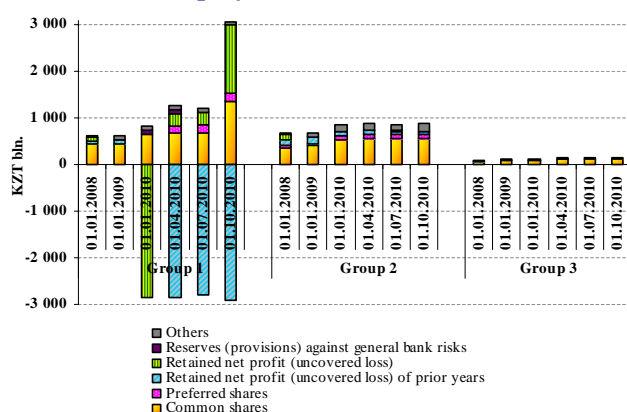
Capital adequacy ratios



Source: FSA

Figure 3.3.2

Equity structure of banks



Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010

Source: NBRK

years, the extent of pressure made on equity by the provisions for potential loan losses remains high and continues to increase as the asset quality deteriorates (Figure 3.3.3).

However, in the three banks that had undergone restructuring the pressure on equity decreased during this year as a result of the recognition of loan losses and their write off.

On the other hand, when analyzing the level of created provisions and their distribution within the banking system, the highest level of provisions is observed in banks with a low level of capital adequacy (Figure 3.3.4). However, as compared to the last year, there was some easing of

Based on 9 months of 2010, equity of the banking system reached a positive value of about KZT 1229.6 bln. versus KZT -979.5 bln. as of 01.01.2010 as a result of finalized foreign debt restructuring of BTA Bank, Temir Bank and Alliance Bank. As a result, prudential ratios of capital adequacy set by the regulator have increased (Figure 3.3.1).

The growth in equity was achieved due to the debt write-offs of the banks, the increase in the authorized capital when converting a part of the debt into common and preferred shares of banks as well as due to the growth in retained net profit of the current period (Figure 3.3.2). Thus, the total amount of the debt write-offs in the restructured banks was KZT 1613 bln.

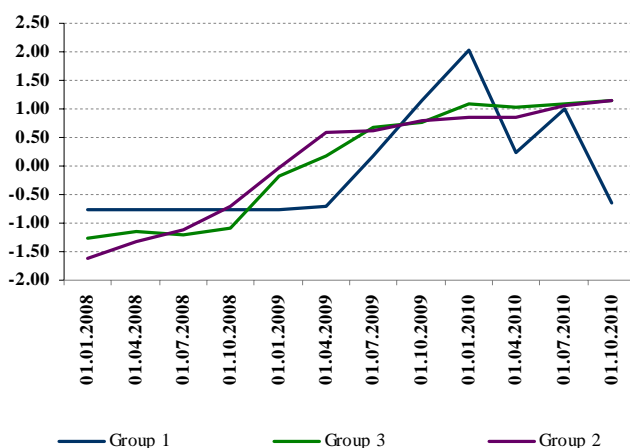
At the same time, during the period from 01.01.2007 to 01.10.2010, authorized capital of the banking sector increased by KZT 1735.0 bln. and this was a result of additional capital injection on the part of the government<sup>13</sup> of KZT 1140 bln., including on behalf of the JSC "NWF "Samruk-Kazyna" as well as on the part of banks' shareholders of KZT 595.0 bln.

However, the current level of equity of the banking system is less than those positive values that were observed before and is comparable with the second half of 2007.

Despite the fact that the level of equity hasn't increased significantly over the recent

<sup>13</sup> Halyk Bank Kazakhstan – KZT 60 bln., Kazkommertsbank – KZT 36 bln., BTA Bank – KZT 883 bln. including the bond conversion of the NWF "Samruk-Kazyna" into the bank's shares, Alliance Bank – KZT 129 bln including the bond conversion of the NWF "Samruk-Kazyna" into the bank's shares, Temir Bank – KZT 23.5 bln., as well as "Housing Construction and Savings Bank of Kazakhstan" – KZT 8.5 bln.

**Figure 3.3.3**  
**Assessment of pressure on the bank's capital by the provisions**



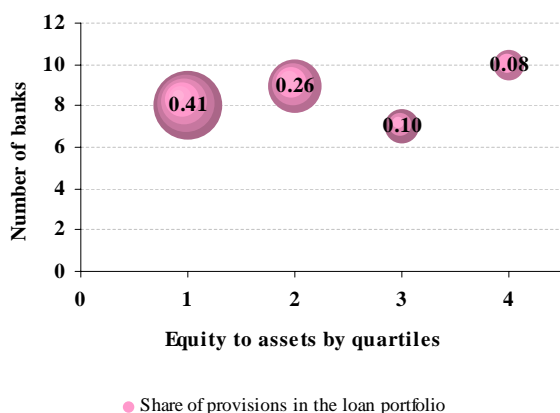
Note: 1) assessment was made through the normalized values of the ratio of provisions to the sum of provisions and regulatory capital.

2) Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010.

Source: FSA, NBRK calculations

**Figure 3.3.4**

**Distribution of provisioning burden and its impact on banks' capitalization, as of 01.10.2010**



Note: In terms of capitalization banks are distributed by quartiles as follows: Group 1 – to 0.9, Group 2 - from 0.09 to 0.17, Group 3 - from 0.17 to 0.52, Group 4 - from 0.52 to 0.91

Source: FSA, NBRK calculations

to non-residents in the banks that have accomplished the restructuring process (Group 1) decreased from 67% to 33%, large and medium-size banks (Group 2) – from 48% to 22%. At present the maximum value of this indicator by banks amounts to 38% actually enabling the banks to increase their liabilities to non-residents while complying with regulatory requirements to the volume of foreign funding within total liabilities of a financial institution.

In the structure of liabilities to non-residents the major changes that have occurred were in the form of decreased volumes of loans, reduced deposits of SPVs and increased volume of securities issued into circulation (Figure 3.3.6). The latter two changes are mainly associated with reclassification of instruments and players without performing actual cash operations as a

the burden of the provisions on the capitalization of banks. As compared to the respective period of the last year, some banks have moved from the first quartile bank group to the second quartile and from the third quartile to the fourth. So, the number of banks with the equity to assets ratio of 0.09-0.10 and the level of provisions in the loan portfolio between 41% and 58%, decreased from 9 to 8 banks. And the number of banks with the equity to assets ratio of 0.17-0.19 and the percentage of provisions in the loan portfolio between 20% and 26% increased to 9 from 7.

*In the term of limited access to external financing significance of deposits as the main source of funding of the banking system increased. However, the current level of deposits is not sufficient to restore the previous rates of lending of the economy. In this regard, the banks are required mitigation of credit policy as well as continuation of further attraction of domestic funding sources.*

*In its turn public funds directed to maintaining the banks' financial sustainability have contributed to maintaining their optimal level of liquidity and enabled banks to lend to the real economy through government programs, and also helped to increase confidence in the banking system.*

A limited access to the foreign market resources, lack of opportunity and acceptable conditions for foreign borrowing as well as finalization of the foreign debt restructuring of BTA bank, Alliance bank and Temirbank led to a gradual decrease of the bank liabilities to non-residents (Figure 3.3.5).

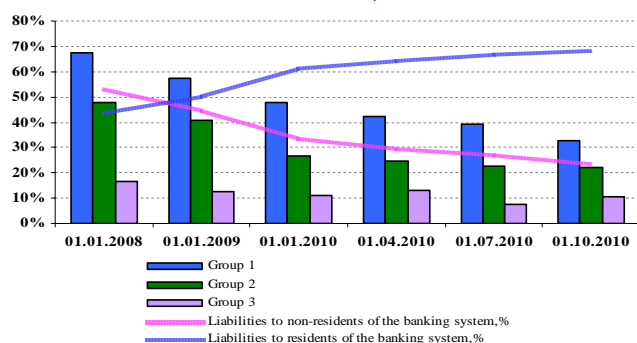
Thus, during the period from 01.01.2008 to 01.10.2010 the percentage of liabilities of the banking system to non-residents decreased by half from 53% to 24%.

At the same time, the percentage of liabilities

cancellation of a part of debt via by Eurobonds (Group 1) and replacement of the issuer of Eurobonds of SPVs (Group 2).

**Figure 3.3.5**

**Liabilities of banks to non-residents (share in total liabilities)**

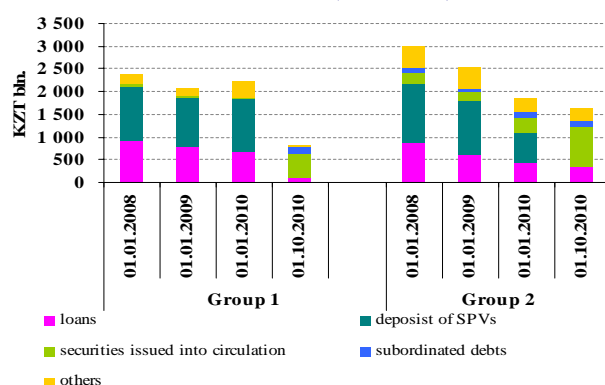


Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010

Source: FSA, NBRK calculations

**Figure 3.3.6**

**Structure of liabilities to non-residents of the Republic of Kazakhstan (KZT bln.)**



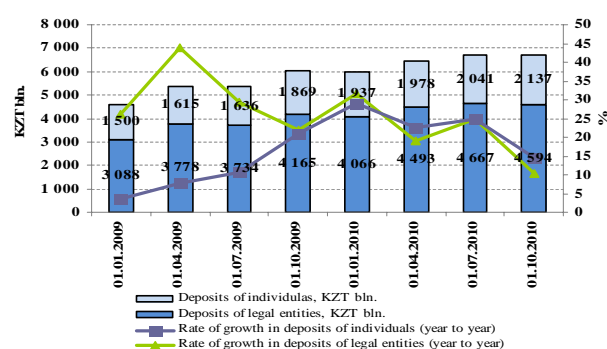
Note: 1) Item "Others" includes interbank deposits, customer deposits, REPOs, non-financial liabilities and other financial liabilities

2) Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010

Source: FSA, NBRK calculations

**Figure 3.3.7**

**Structure of the deposits base of banks\***



Note: \* - excluding deposits of SPVs

Source: FSA, NBRK calculations

Amid the decrease in foreign liabilities of the banking system there is a steady growth in the domestic funding sources and replacement of foreign sources by the domestic ones (Figure 3.3.7).

A positive growth in deposits in the first instance helped the banks to service their foreign debt and maintain an adequate level of liquidity.

During 9 months of 2010, the growth in the deposit base of the banking system (excluding SPVs) accounted for 12%. Alongside with that, the increase in deposits in the group of large and medium-size banks (Group 2) was 15%, ranging between 8% and 62% from bank to bank. The growth in deposits in restructured banks (Group 1) accounted for 6% during the same period.

The increase in deposits of individuals has happened due to improved financial position of the population, the increased amount the minimum amount of the deposit payoffs and guaranteed increases in wages, retirement benefits and social benefit payments from the state budget (Figure 3.3.8).

Remarkably, anti-crisis measures for the increase of the guaranteed deposit amount from KZT 1 mln. at end-2008 to KZT 5 mln. by 2012 ensured the growth in the deposit base of banks directly due to the increase in the deposit amount against the decreased number of bank customers (Figure 3.3.9).

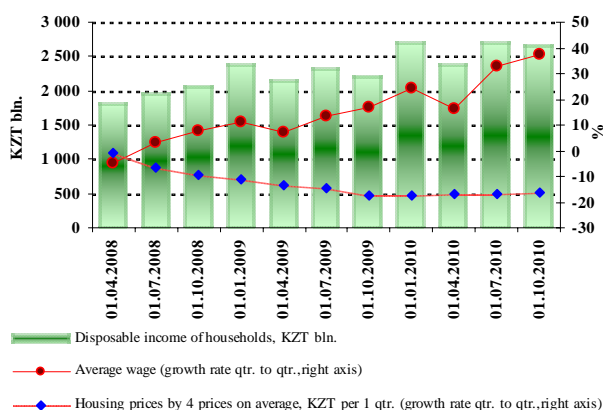
However, despite a sustainable growth in bank deposits in absolute terms, the volume of newly attracted deposits is gradually decreasing. Thus, from the beginning of 2010 there is a decrease in the growth rates both on retail and corporate deposits.

The decrease in the returns on deposits and renewed interest to the real estate market as a long-term investment reduces attractiveness of deposits as a means of saving, for individuals in particular. On the other hand, a conservative lending policy of banks that limited the access of the real sector to the sources of funding, working capital in the first instance, forces corporate customers to seek for additional resources to ensure their operation, including by reducing investments in deposits.



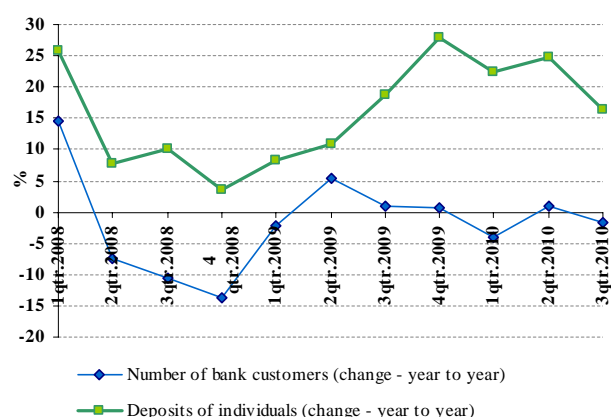
In the structure of the deposit base deposits of legal entities are prevailing which make up 68% of all customer deposits as of Q3 2010. Specific position is occupied by the public funds and resources of entities related to the government that were allocated to banks to ensure their sustainable operation.

**Figure 3.3.8**  
**Income of individuals and real estate prices**



Source: ASRK, NBRK calculations

**Figure 3.3.9**  
**Deposits of individuals and the number of bank customers**

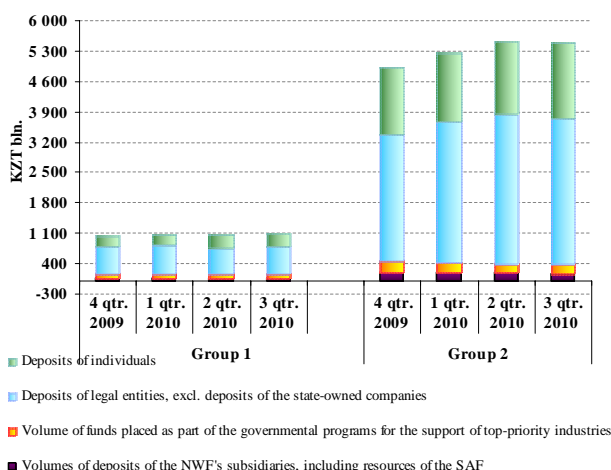


Source: KDIF, NBRK calculations

Such resources include deposits of subsidiaries of the NWF and funds provided as part of the governmental programs for the support of top-priority industries in the real sector. The share of public funds in the funding sources is stable and on average accounts for about 16% in the deposits of legal entities in the period from Q4 2009 – Q3 2010, and in the group of restructured banks (Group 1) this indicator on average makes up 21%, and in large and medium-size banks (Group 2) – 11.5% (Figure 3.3.10).

Despite the fact that the main purpose of the public funds allocation was to maintain an optimal level of liquidity and encourage the banks to credit the real sector of the economy, only the first goal was mainly reached. Nonetheless, such governmental programs represent that very small channel through which the banks can lend under moderate credit risk of borrowers from the corporate sector and support the growth of their loan portfolio.

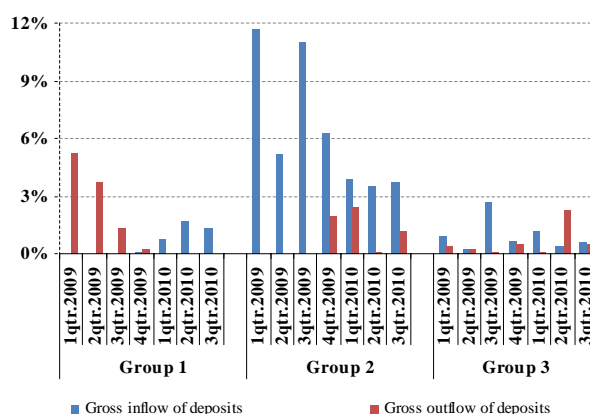
**Figure 3.3.10**  
**Deposit base structure of banks, KZT bln.**



Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010

Source: FSA, NBRK calculations

**Figure 3.3.11**  
**Change in deposits of individuals by group of banks**



Note: Group 1 includes 3 restructured banks (BTA Bank, Alliance Bank and Temir Bank), group 2 - banks with a market share of up to 2% incl. (excl. 3 restructured banks), group 3 - banks with a market share less than 2% and over 0.10% as of 01.10.2010

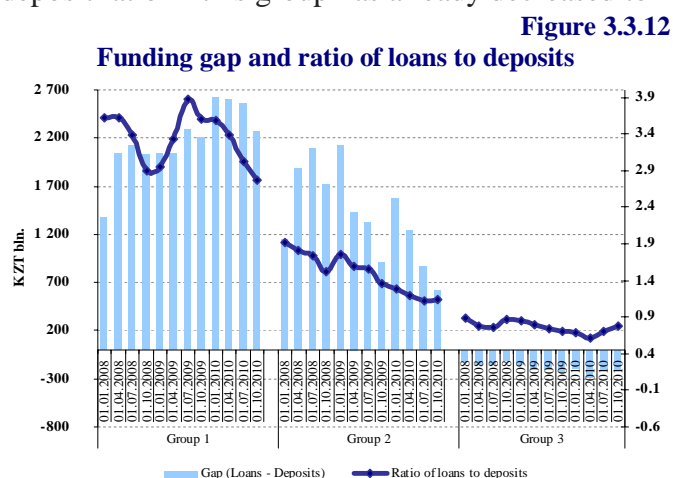
Source: KDIF, NBRK calculations



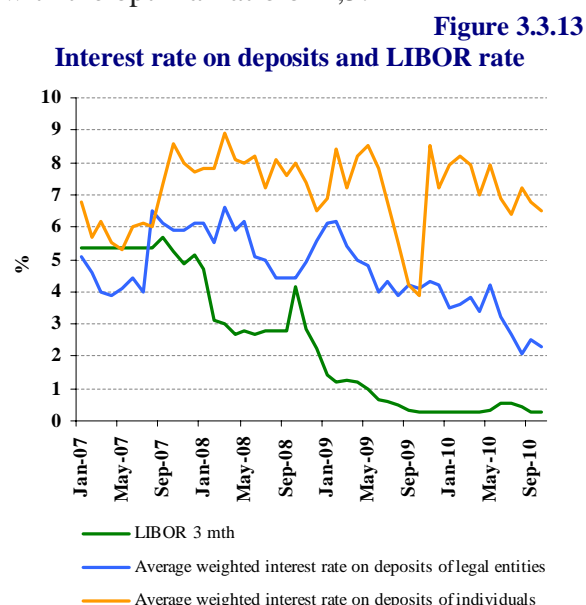
It should be noted that one of the positive effects of governmental anti-crisis measures is the recovery of confidence of the population in the three banks that have accomplished the restructuring process. Thus, a gross outflow of deposits of individuals that had been observed since the beginning of 2009, gave way to a gross increase from the beginning of this year<sup>14</sup> (Figure 3.3.11).

In the banking system as a whole, depositors less frequently redistribute their deposits among banks in search of acceptable profitability and reliability. Thus, the percentage of reallocation of deposits of the banking system among banks as of the end of Q3 2010 decreased to 3% as compared to 5% in the past year.

Generally, if to assess the role of deposits as a main source of credits to the economy, this potential is virtually not realized on the one hand, and on the other hand existing volumes of the domestic funding sources are not sufficient for recovering prior rates of economic growth (Figure 3.3.12). For instance, funding gap in Group 1 remains at the essential level while preserving high funding risk, which requires from banks within this group to implement an active policy on deposit-taking. In its turn, Group 2 is less exposed to funding risk as compared to Group 1 and the loan to deposit ratio in this group has already decreased to 1.1 with the optimal ratio of 1,5.



Source: FSA, NBRK calculations



Source: NBRK, Datastream

Expanded choice of investment instruments for potential depositors via the stock market, unit trusts or the real estate market pursuing high returns will create competition and struggle among banks in the market for funding resources. The cost of borrowed resources will be an important factor in this situation. The level of interest rates on deposits remains at a much higher level as compared to foreign interest rates and high costs of the servicing of funding without revitalization of the lending process keeps having pressure on interest income.

At the same time, limitation of maximum interest rates on newly taken deposits on the part of the deposit insurance fund, on the one hand, allows avoiding attraction of potential depositors in the market by way of offering a high return; on the other hand, it enables banks to reduce the cost of internal resources on the whole. In doing so, banks need to actively pursue the policy for managing the cost of funding in addition to the change in the lending policy in order to regain their former positions on profitability.

<sup>14</sup> Flows in period t for a bank i are determined as follows (I – bank deposits):

$$POS / NEG \text{ flows} = \sum_i^N |g_i| * \left( \frac{(I_{i,t-1} + I_{i,t}) / 2}{\sum_{i=1}^N I_{i,t-1}} \right)$$

where g – the rate of the change in deposits versus a prior period weighted by the bank's share in total deposits.

## 4. Risks of the Non-Banking Sector

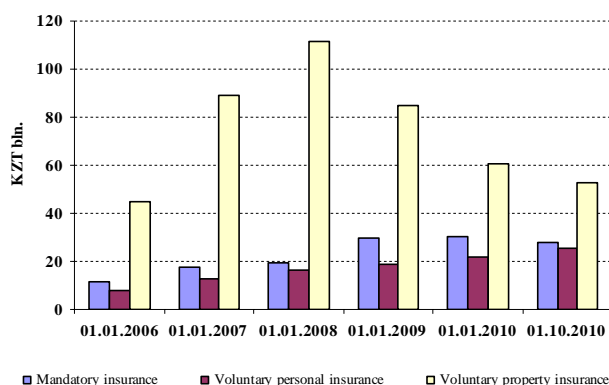
### 4.1 Insurance Sector

*Stabilization of the situation in the economy and growth recovery in its key sectors had a favorable effect on the state of the insurance sector where the key performance indicators have demonstrated a moderate growth over 9 months of this year.*

*A high capitalization level, reduced risks associated with foreign re-insurance as well as a low percentage of default securities in the insurance companies' investment portfolio are the evidence of a potential for the future economic development of the sector.*

*At the same time, such factors as liquidity risks associated with the growth in problem receivables and a remaining high percentage of insurance premiums of insurance (reinsurance) companies comprising a bank conglomerate within total insurance premiums may be referred to the vulnerability factors of the sector.*

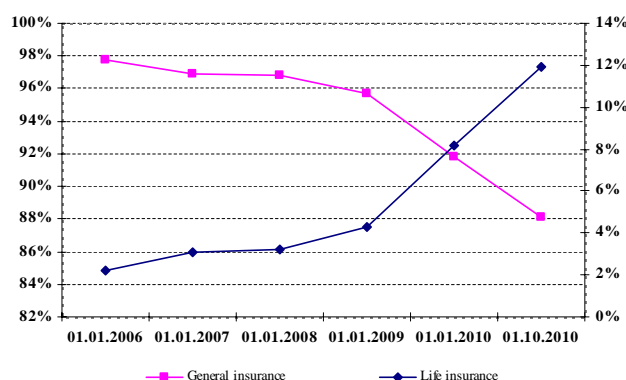
**Figure 4.1.1**  
**Structure of insurance premiums received \***



Note: \* insurance premiums written under direct insurance contracts

Source: FSA

**Figure 4.1.2**  
**Distribution of insurance premiums by types of insurance \***



Note: \* insurance premiums written under direct insurance contracts

Source: FSA

Amidst the revival of the business activity of a corporate sector as a whole and recovery in the key sectors of the economy from the consequences of financial instability in the insurance sector, there are also positive trends determining a moderate growth in its key performance indicators. Thus, total assets of insurance (reinsurance) organizations increased during 9 months of 2010 as compared to the respective period of the last year by 10.6% to KZT 339.7 bln., owners equity increased by 10.2% to KZT 201.0 bln. over the same period. The growth in owners' equity of insurance (reinsurance) organizations was achieved due to the tightening of regulatory requirements in respect of the increase in the guarantee fund's minimum amount. Accordingly, the increase in the own resources of insurance (reinsurance) organizations served as a basis for the asset growth in the insurance sector. In doing so, the amount of insurance reserves amounted to KZT 121.1 bln. as of 01.10.2010.

The improved overall economic situation also had a favorable effect on the amount of collected total insurance premiums, which have demonstrated a significant growth over 9 months of 2010 as compared to the respective period of the last year, having increased by 26.7% or KZT 22.3 bln. The largest contribution to the growth in total insurance premiums was made by the voluntary personal insurance segment, namely

lines of insurance referring to the life insurance industry. This is associated with the implementation of a retirement security scheme via life insurance organizations and annuity payments under the employer's civil liability insurance. Thus, premiums in this insurance line amounted to KZT 25.5 bln. at October 1, 2010 exceeding the level of the respective period of the last year by 60.1% (Figure 4.1.1). Annuity insurance appeared to be the most sought-after line of

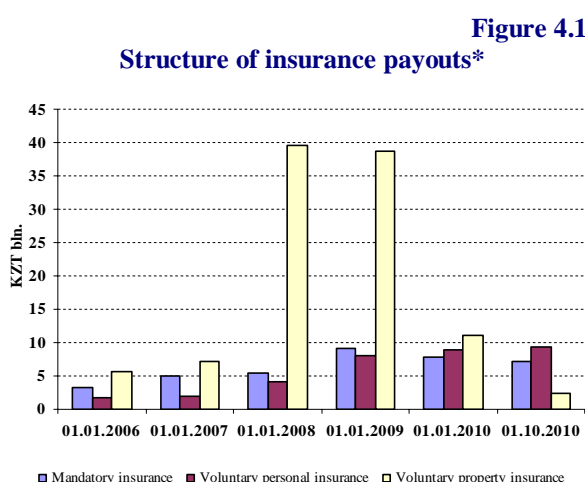
insurance in the segment. Premiums under the annuity insurance increased by more than twice during the period from 01.10.2009 to 01.10.2010 (to KZT 11.5 bln.), and accounted for 45.0% of total premiums collected under the voluntary personal insurance.

There was also some revival in the voluntary property insurance, which was mostly sensitive to the financial crisis as a result of stagnation in the bank lending. Such revival resulted in the increase in insurance premiums by 18.0% (to KZT 52.5 bln.) during 9 months of 2010 as compared to the respective period of the last year. The most significant growth in insurance premiums (by 6.8 bln. or 92.8%) from 01.10.2009 to 01.10.2010 was recorded in the civil liability insurance (except motor-vehicle liability insurance for automobile, air and water transport owners). It should be noted that the growth in insurance premiums under this insurance class was secured by major insurance contracts on civil liability for damages, concluded by the real sector enterprises.

In the mandatory insurance the volume of premiums collected during 9 months of 2010 was KZT 28.1 bln., having increased by 20.3% as compared to the respective period of the last year. The highest growth in the sector was demonstrated by the motor liability insurance.

Non-life insurance is still dominating in the structure of the insurance premium distribution by insurance classes. The percentage of premiums under non-life insurance at October 1, 2010 accounted for 88.1% of total premiums underwritten. Nonetheless, the upward trend in the percentage of premiums under life insurance class remains (Figure 4.1.2) and reached 11.9% of total insurance premiums in the market as a whole (as compared to 7.4% at the respective date of the last year).

At the same time, amidst a notable increase in insurance premiums, the total volume of insurance indemnities paid at October 1, 2010 as compared to October 1, 2009 increased insignificantly (by 1.3%, to KZT 18.7 bln.). Alongside with that, in the structure of insurance indemnity the growth was observed in the mandatory and voluntary personal insurance only (by



Note: \* insurance premiums written under direct insurance contracts

Source: FSA

21.1% and 57.3%, respectively), since there is a significant growth in the business volumes in these areas. However, insurance indemnity volumes in voluntary property insurance decreased by 65.4% during 9 months of 2010 as compared to the respective period of the last year and amounted to KZT 2.3 bln. (during 9 months of 2009 – KZT 6.7 bln.) (Figure 4.1.3.). This could be largely explained by the fact that insurance indemnity volume doesn't immediately respond to the change in the business volumes but with a certain lag, since the settlement of insurance indemnities, especially those under the civil liability contracts, takes quite a lot of time (up to a few months) till the time of actual insurance indemnity payment.

### Insuring Banking Risks

As of October 1, 2010 35 insurance organizations out of 40 have contracts in their portfolios for insurance of risks associated with bank lending and other banking risks. As of this date, 12 insurance organizations are participants in the bank conglomerates.

Coverage of risks related to bank operations is provided by insurance organizations via insurance against other financial losses, property insurance (except transport and cargo insurance), motor insurance, civil liability insurance (except liability of vehicle owners), insurance of loans, guarantees and sureties (Table 4.1.1).

The most risky class of insurance associated with the banking operations is insurance from other financial losses. If in other insurance classes shown in the Table the loss ratio doesn't exceed

50%, in the insurance from other financial losses at 01.01.2008 this ratio was 82.7%, and at 01.01.2009 – 205.9% (with the target of 100% maximum).

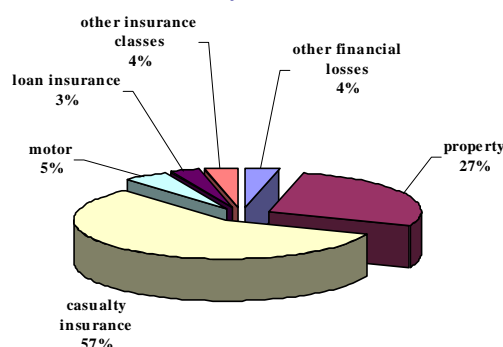
The total volume of insurance premiums accrued at 01.10.2010 under the bank insurance amounted to KZT 7.8 bln. or 7.0% of total insurance premiums collected in the insurance market as a whole. An insignificant growth in the total volume of insurance premiums under bank insurance was recorded as compared to the respective period of the last year (by KZT 3.6 bln).

<b>Table 4.1.1</b>								
<b>Receipt of premiums and payouts under insurance classes ancillary to banking operations ( KZT mln.)</b>								
Classes	Premiums/ Payouts	01.01.06	01.01.07	01.01.08	01.10.08	01.01.09	01.01.10	01.10.10
Motor insurance	Premiums/	3 228	4 970	6 589	4 134	4 906	3 549	2 409
	Payouts	1 110	1 151	1 818	1 735	2 252	1 493	906
Property insurance	Premiums/	14 824	21 809	32 925	22 039	26 760	32 856	23 255
	Payouts	2 204	1 038	1 144	734	1 008	7 602	519
Civil liability insurance	Premiums/	16 628	22 640	20 581	22 084	25 749	11 331	14 063
	Payouts	750	402	564	110	132	190	36
Loan insurance	Premiums/	-	616	208	126	382	320	242
	Payouts	-	1	1	182	344	59	7
Insurance of guarantees and sureties	Premiums/	-	8	9	16	16	2	3
	Payouts	-	0	0	6	6	20	0
Insurance against other financial losses	Premiums/	4 365	31 415	42 242	14 424	16 459	4 229	5 794
	Payouts	1 363	3 419	34 947	32 858	33 889	1 070	143

Source: FSA

The review of the structure of insurance premium distributions under bank risk insurance contracts shows that the following classes of insurance represent the most sought-after classes for the banking sector: casualty insurance as well as property insurance where the percentage of premiums at 01.10.2010 accounted for 57.5% and 27.4%, respectively, of the total amount of insurance premiums under the bank insurance (Figure 4.1.4).

**Figure 4.1.4**  
**Distribution of insurance premiums under bank risk insurance contracts by insurance classes**



Source: FSA

At the same time, during 9 months of 2010, as compared to the respective period of the last year, there was a steady trend for reduction of the percentage of insurance premiums under the class “insurance from other financial losses” (from 48.4% at 01.10.2009 to 3.6% at 01.10.2010). This is largely related to the reduced number of contracts for insuring risks of default by borrowers of an affiliated bank under unsecured consumer loans.

During 9 months of this year the percentage of assets of insurance (reinsurance) organizations comprising a bank conglomerate in the total assets of the insurance sector just as the percentage of

premiums of insurance (reinsurance) organizations comprising a bank conglomerate in the total insurance premiums demonstrated an increase from 31.5% at 01.10.2009 to 48.4% at 01.10.2010 and from 31.1% to 37.1%, respectively (Table 4.1.2). However, as a whole over the last five years

beginning from 2005, these indicators have decreased significantly from 70.3% to 47.0% and from 64.8% to 31.74%, respectively. Such dynamics of these indicators assumes the decrease in the extent of influence and dependence of the entire insurance sector of the country on the banking services market. Naturally, this allows the insurance sector to gain more stability and sustainability to stressful situations in the economy.

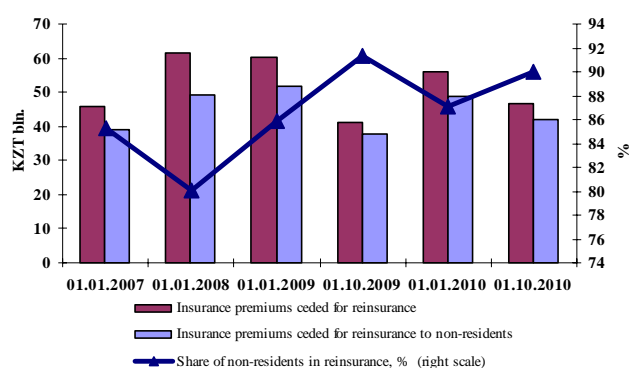
**Table 4.1.2**

**Concentration of insurance organizations comprising a bank conglomerate  
( KZT mln.)**

	Share of assets of insurance (reinsurance) organizations comprising a bank conglomerate in total assets of the insurance sector	Share of premiums of insurance (reinsurance) organizations comprising a bank conglomerate in total premiums of the insurance sector
01.01.2006	70.3	64.8
01.01.2007	67.5	58.3
01.01.2008	62.5	59.7
01.01.2009	35.7	43.9
01.01.2010	47.0	31.74
01.04.2010	49.7	42.48
01.07.2010	51.0	39.58
01.10.2010	48.4	37.10

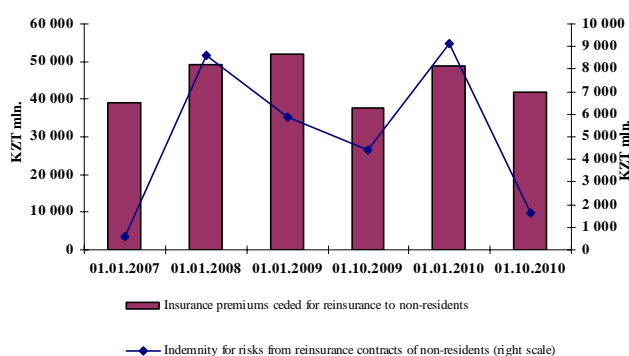
Source: FSA

**Figure 4.1.5**  
**Insurance premiums ceded for reinsurance including to non-residents**



Source: FSA

**Figure 4.1.6**  
**Efficiency of reinsuring risks abroad**



Source: FSA

Alongside with that, within the insurance sector three insurance organizations may be mentioned as those active in captive insurance. Their affiliated party transactions as of 01.10.2010 were in the range between 24% to 77% of the total amount of insurance premiums of these insurance organizations. However, one should take into account that the total percentage of captive premiums collected by these companies doesn't exceed 4% in the total volume of insurance premiums in the market. Therefore, potential problems associated with these companies would not have a significant impact on the insurance sector.

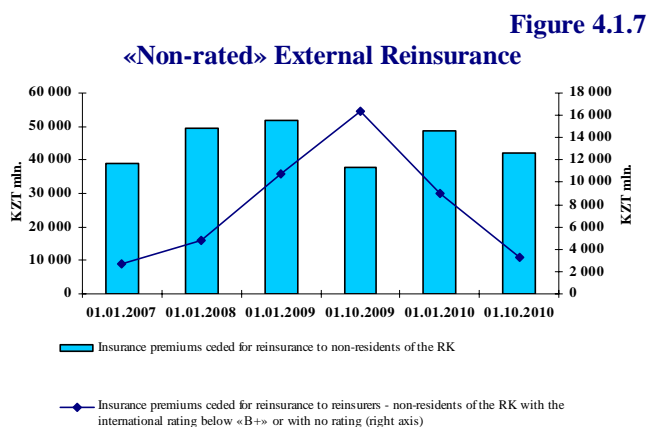
### Reinsurance

During 9 months of 2010, as compared to the respective period of 2009, the volume of insurance premiums ceded for reinsurance increased by 13.1%, amounting to KZT 46.7 bln. or 44.0% of the total volume of insurance premiums at October 1, 2010 (Figure 4.1.5).

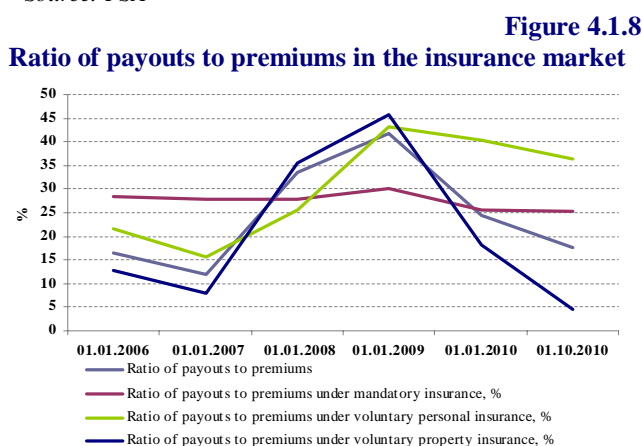
At the same time, in the structure of reinsurance alike in the past years foreign reinsurance continues to dominate. Thus, the percentage of insurance premiums ceded for reinsurance to non-residents at 01.10.2010 accounted for 90.0% in the total insurance

premiums ceded for reinsurance. The volume of premiums ceded abroad amounted to KZT 42.0

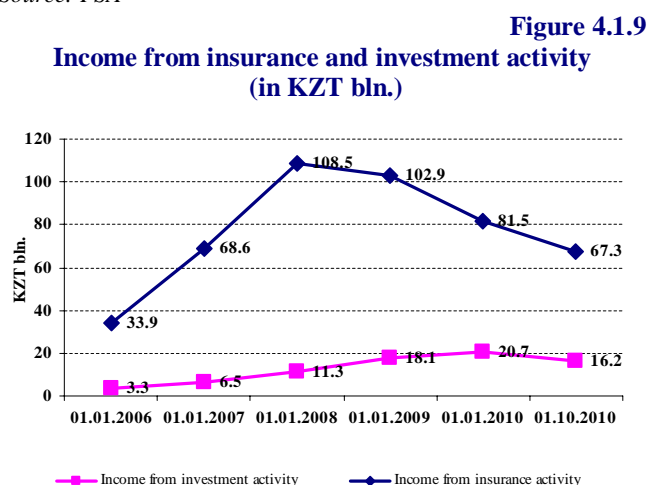




Source: FSA



Source: FSA



Source: FSA

the same time the use of more reliable reinsurance schemes could have resulted in the increase of rates on reinsurance premiums and decrease of operating earnings of insurance organizations.

### Sustainability and profitability of the insurance sector

The ratio of indemnity payments to premiums in the insurance market demonstrated a decrease from 24.5% at the beginning of the period to 17.6% as of 01.10.2010 (Figure 4.1.8).

In the break-down by insurance classes at 01.10.2010 the ratio of insurance indemnities to premiums is 4.4% voluntary property insurance, 25.3% and 36.4% in mandatory and voluntary personal insurance, respectively. Over the reviewed period the loss ratios both in the market as a whole and by insurance classes do not exceed 45%, which is an evidence of adequacy of insurance

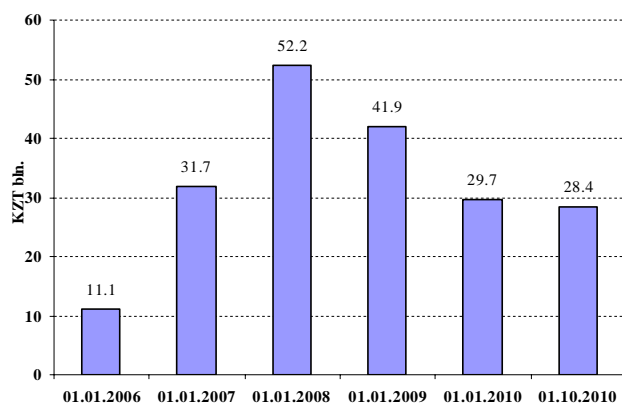
bln. in absolute terms at that date, thus exceeding the level of the respective period of the previous year by 11.5% (Figure 4.1.5), while not exceeding the amount of business in the property insurance line.

Lower level of insurance indemnity payments alongside with significant increase in the volumes of insurance premiums under voluntary property insurance had its effect on the efficiency of reinsurance of risks abroad. So, despite growth in insurance premiums ceded abroad indemnity against risks received under the reinsurance contracts from non-residents decreased by 62.9% during 9 months of 2010 as compared to the respective period of the last year, amounting to KZT 1 647.1 mln. at 01.10.2010 (Figure 4.1.6). As mentioned earlier, the total volume of insurance indemnity under property insurance decreased by 65.4%. Such decrease in the total level of insurance indemnity and consideration amounts from non-resident reinsurers is explained by the implications of the global financial and economic crisis as well as insofar ineffective use of the foreign reinsurance tool in the insurance sector of Kazakhstan. The efficiency indicator of such reinsurance for the period from 2006 to 2009 increased from 1.5% to 18.8%.

A positive trend in reinsurance is a significant decrease in the percentage of “rating-free” foreign reinsurance, which went down from 43.5% at 01.10.2009 to 7.7% at 01.10.2010. (Figure 4.1.7). From the beginning of this year, the volume of insurance premiums ceded for reinsurance to non-residents with the international rating below «B+» or without any rating assigned has decreased by more than 2.5 times. Thus, this year credit risks associated with reinsurance decreased significantly, at the



**Figure 4.1.10**  
**Dynamics of net profit of insurance organizations**



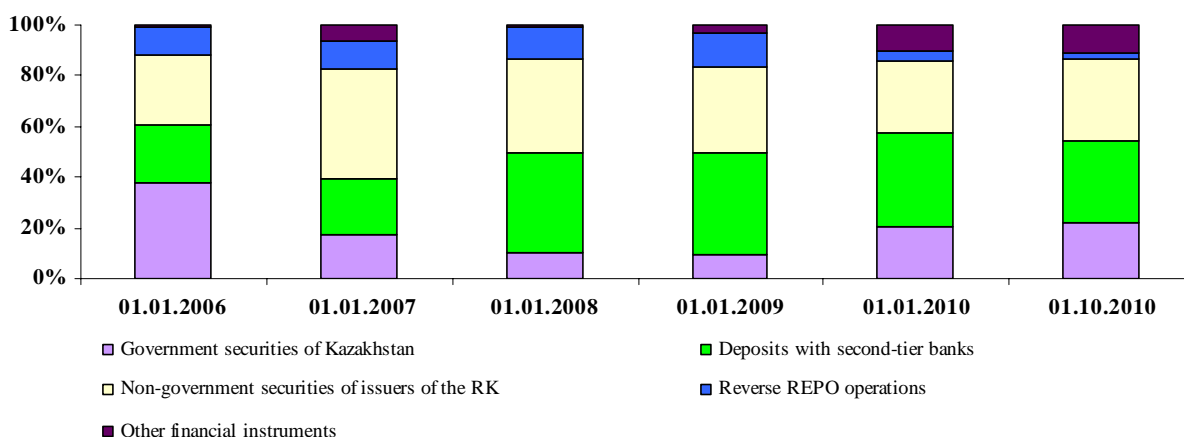
Source: FSA

tariffs and an acceptable level of insurance risk allowing insurance organizations to show positive financial performance from insurance (reinsurance) operations.

Investment income in the insurance sector at 01.10.2010 amounted to KZT 16.2 bln., which is somewhat lower than the indicator for the respective period of the last year of KZT 18.6 bln. (Figure 4.1.9). On the whole, the decrease in the investment income in absolute terms is explained by the decrease in the total level of return from different financial instruments as well as the lack of sufficient offer of attractive highly-liquid instruments in the stock market.

**Figure 4.1.11**

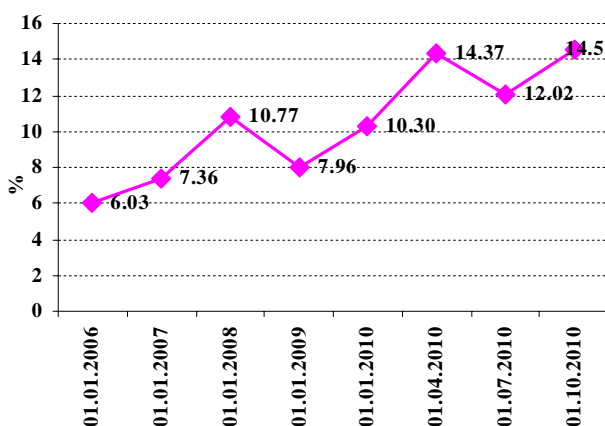
**Investment portfolio structure of insurance (reinsurance) organizations**



Source: FSA

It is worth mentioning that both earnings from insurance activities and from investments during 9 months of this year decreased significantly in relation to assets of insurance organizations. This fact will not be conducive to the increased attractiveness of the domestic insurance sector for foreign investors.

**Figure 4.1.12**  
**Share of problem receivables in the total receivables from insurance activity**



Source: FSA

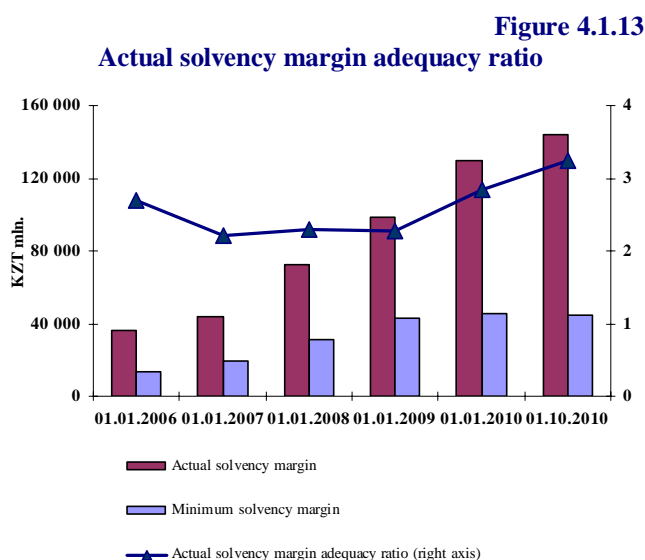
The net profit indicator for 9 months of 2010 decreased as compared to the respective period of the last year by 5.7%, amounting to KZT 28.4 bln. at 01.10.2010. (Figure 4.1.10).

The structure of the investment portfolio of insurance organizations is presently characterized by quite a high share of risk-free financial instruments in the form of government securities.

Their share accounts for about 22% of the total investment portfolio of insurance organizations. In particular, at 01.10.2010 the percentage of non-government securities of issuers in the RK accounted for 32.3%, and of bank deposits and government securities – 32.1% and 21.9%, respectively (Figure 4.1.11).

The increase in the percentage of risk-free financial instruments in the portfolio of insurance organizations is an evidence of downsized

investment risks associated with creditworthiness of securities issuers. However, such downsizing of investment risks against a significant decrease in the interest earning of assets of insurance organizations especially those that operate in the life-insurance segment, increase the risk of mismatch between such returns with the return on liabilities under concluded insurance (reinsurance) contracts in future. Yet another risk factor for the insurance sector may be represented by the increase in the share of problem receivable (receivable past due 90 days and over) in the total amount of receivables from the insurance activity (Figure 4.1.12), which accounted for 14.5% at 01.10.2010.



Source: FSA

(Box 5).

Alongside with that a further growth in past due receivables under insurance and reinsurance contracts may result in deterioration of financial soundness indicators of insurance organizations.

As for financial soundness of the insurance sector, the actual solvency margin adequacy ratio defined as the ratio of actual solvency margin to minimum solvency margin, in the dynamics significantly exceeds the level required by the regulator (at least 1), amounting to 2.8 and 3.2 at 01.01.2010 and at 01.10.2010, respectively. Thus, at present capitalization of the insurance sector is at a high level (Figure 4.1.13).

In order to determine financial soundness and solvency of the insurance sector, the FSA conducted its stress-testing

## Box 5

### Stress-testing of the Insurance Sector

With a view to determine whether the insurance sector can sustain unfavorable developments associated with possible deterioration in financial condition of shareholders of the insurance organizations, stress-testing was conducted with a breakdown by insurance organizations to see whether the actual solvency margin adequacy ratio is complied with in the event of the shareholders' default.

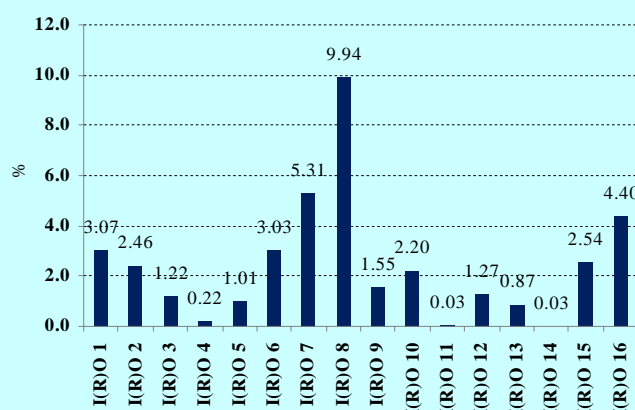
In the course of stress-testing the existing requirements to asset diversification were taken into account, under which insurance organizations are allowed to invest no more than 10% of their assets in one legal entity and its affiliates including banks.

As part of stress-testing, actual solvency margin adequacy ratio was reduced by the respective percentage of assets less reinsurance assets (by 4.22<sup>15</sup> %, 7.99% and 10%).

It should be noted that a default by one of the shareholders in whose assets the insurance organization is investing may have significant impact on its financial soundness. Thus, there was a violation of the actual solvency margin adequacy ratio with the reduction of actual solvency margin by 4.22% of assets in 15 insurance organizations, by 7.99% - in 18 insurance organizations, by 10% - in 21 insurance organizations. In the event of default in several legal entities (groups) the number of insurance organizations violating the actual solvency margin ratio would be increasing accordingly.

<sup>15</sup> at 01.10.2010 the average assets in the insurance sector invested in securities (including reverse REPOs) and cash in one legal entity which is not a second-tier bank and affiliates of such legal entity accounted for 4.22%, average assets in the insurance sector invested in securities (including reverse REPOs) and deposits and cash in one second-tier bank and its affiliated persons accounted for 7.99%.

**Figure 1**  
**Share of financial instruments whose issuers defaulted on**  
**financial instruments from assets of insurance**  
**(reinsurance) organizations net of reinsurance assets**



Source: FSA

difficulties, the performance in 2009 and in 9 months of 2010 shows stable operation of insurance organizations where shareholders faced predicaments in the time of instability. For instance, such insurance organizations during the indicated period maintained a required capital level and complied with the legal requirements to solvency without seeking for the governmental financial support. Thus, soundness of the insurance organizations whose main business is not focused solely on the interest of financial groups is less exposed to risks associated with deterioration in financial conditions of the latter. In addition, the problem of a failure by the domestic issuers to discharge their obligations under the bonds is still urgent. So, as of 01.10.2010, over 30 companies officially listed in the stock exchange defaulted on their securities. In this context, in order to identify the extent of vulnerability of the investment portfolio of insurance (reinsurance) organizations to risks associated with the default of securities issuers, a sensitivity analysis was performed.

When performing a sensitivity analysis a percentage of financial instruments of defaulted issuers was determined in relation to assets of insurance (reinsurance) organizations less reinsurance assets.

Based on the analysis performed the percentage of financial instruments of defaulted issuers in the total assets less reinsurance assets in the insurance sector amounted to 1.65%. At the same time, the same indicator computed only in relation to those insurance (reinsurance) organizations which have defaulted securities in their investment portfolio was 2.67%.

Thus, an insignificant portion of defaulted financial instruments in the investment portfolio of insurance (reinsurance) organizations shows a low dependence of the insurance sector on unfavorable developments associated with insolvency of securities issuers.

At the same time, it should be noted that problems of deteriorated financial soundness in some financial groups observed in the time of crisis exposed their members, including insurance organizations, not only to direct risk of losing their financial soundness but also to the risk for their business reputation in the market. Thus, a negative assessment by the insurance market players of the activity of both the insurance organizations and their shareholders could have impact on reducing a number of customers in the organizations, number of insurance contracts written, decreased receipts of insurance premiums and finally lower liquidity and solvency ratios of insurance organizations- members of financial groups.

At the same time, despite those

## 4.2 Accumulation Pension System

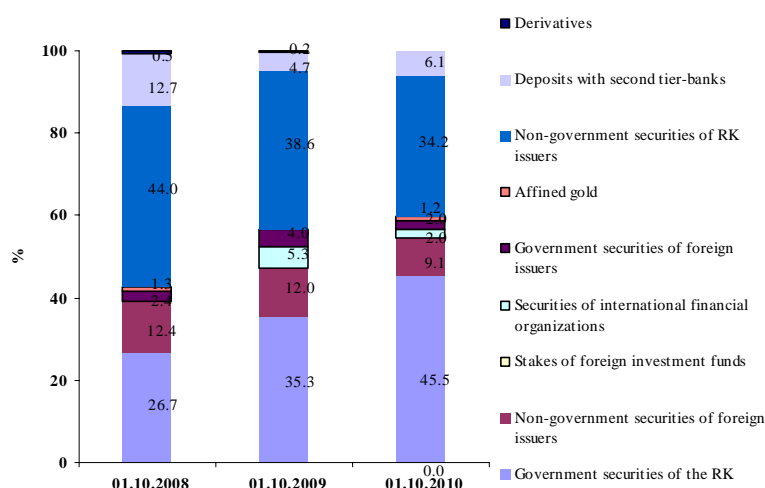
*In the environment of instability in the financial markets accumulation pension funds continue to adhere to a conservative investment policy by maintaining a high level of reliable financial instruments in their investment portfolios. Measures by the financial regulator aimed at ensuring the safety of pension accumulations were also conducive to that.*

*Credit risk remains to be the major risk for accumulation pension funds due to a high percentage of credit risk weighted pensions assets as well as continuing technical defaults of corporate issuers.*

As of 01.10.2010 13 accumulation pension funds (APFs) were operating in Kazakhstan.

The total volume of pension assets while having increased by 21.4% since October of the last year amounted to KZT 2 129.8 bln. in absolute terms at 01.10.2010. Alongside with that, average monthly increase in pension assets during the period from 01.10.2009 to 01.10.2010 amounted to KZT 31.3 bln. As a whole, the increase in the volume of pension assets from regular contributions transferred by subscribers to the system requires good quality investment facilities. However, there is still a shortage of liquid and reliable financial instruments in the stock market.

**Figure 4.2.1**  
**Structure of total investment portfolio of APFs**



Source: FSA

international financial institutions and government securities of foreign issuers (Figure 4.2.1).

Generally, as of 01.10.2010, based on the reports presented by APFs, by the economic sectors the major portion of pension assets was invested (excluding government securities) in the financial activity: banks – 23.47% and other financial organizations – 4.77% (Table 4.2.1).

Resulting from the increase of reliable and hence low-income financial instruments in the investment portfolios of APFs there was a decrease of average weighted ratios of nominal return on pension assets of APFs during 9 months of 2010. In addition, return on pension assets of APFs doesn't cover inflation. So, as of 01.10.2010 accumulated inflation rates for 12, 36 and 60 months exceeded average weighted ratios of nominal return on pension assets of APFs for the same periods by 1.5, 2 and 1.4 times, respectively (Figure 4.2.2).

During 9 months of 2010 there was absolute growth in pension accumulations in each subsequent month as compared to the preceding month. Similar situation was observed in respect of the investment return, other than in May and June 2010 (Figure 4.2.3).

Due to this fact structural changes in the total investment portfolio of APFs at 01.10.2010 were still oriented at the increase in low-risk financial instruments.

So, at 01.10.2010, as compared to the respective period of the last year investments of pension assets in government securities of Kazakhstan (from 35.3% to 45.5%) and in bank deposits (from 4.7% to 6.1%) increased. At the same time, there is a decrease in the percentage of investments in non-government securities of Kazakhstan's issuers, non-government securities of foreign issuers, securities of

Table 4.2.1

## Share of pension assets in the economic sectors\*

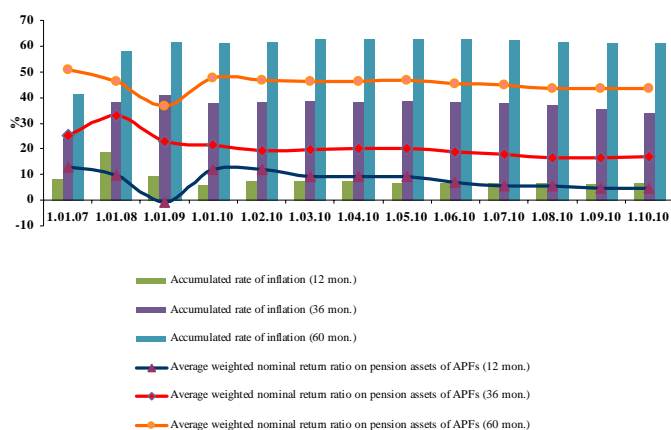
	(%)	(%)
	01.01.2010	01.10.2010
Agriculture, forestry and fishery	0.97	1.31
Mining industry and quarry operation	2.09	1.33
Manufacturing industry	1.47	1.11
Power supply, gas and vapor supply and air conditioning	1.71	1.85
Water supply, sewage system, control over waste collection and distribution	0.00	0.00
Construction	1.12	0.85
Wholesale and retail trade, repair of cars and motorcycles	1.70	1.38
Transport and warehousing	0.56	0.41
Accommodation and catering services	0.01	0.00
Information and communications	0.56	0.39
Financial and insurance activity	30.20	28.24
<i>Banks</i>	24.19	23.47
<i>Other financial organizations</i>	6.01	4.77
Real estate operations	0.24	0.16
Professional, scientific and technical activity	0.01	0.00
Activity in the area of administrative and ancillary service	0.00	0.08
Public administration and defence, mandatory social security	0.00	0.24
Education	0.00	0.00
Healthcare and social services	0.00	0.00
Arts, recreational facilities	0.00	0.00
Providing other types of services	0.77	2.22
Activity of extra-territorial organizations and bodies	0.00	0.00

\* Value of financial instruments of residents of the RK, excl. government securities

Source: FSA

Figure 4.2.2

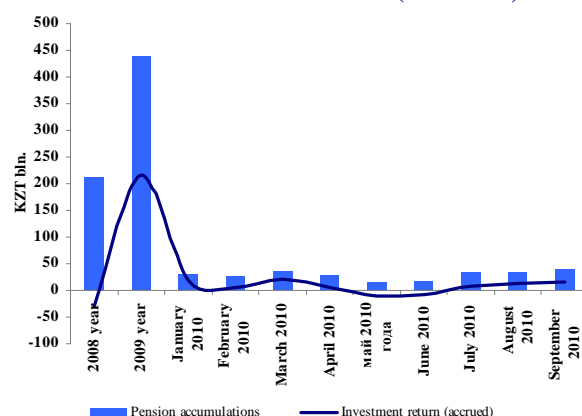
## Average weighted nominal return ratio and accumulated rate of inflation



Source: FSA

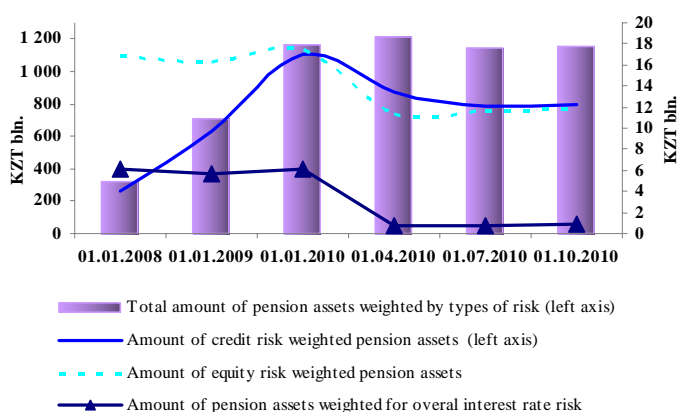
Figure 4.2.3

## Dynamics of changes in pension accumulations and investment return of APFs (KZT bln.)



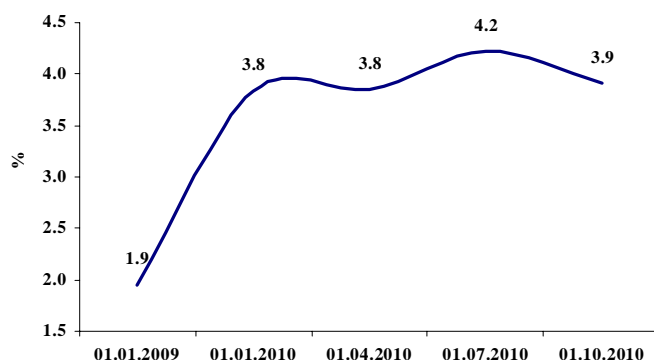
Source: FSA

**Figure 4.2.4**  
**Volumes of pension assets of APFs weighted by risk types**



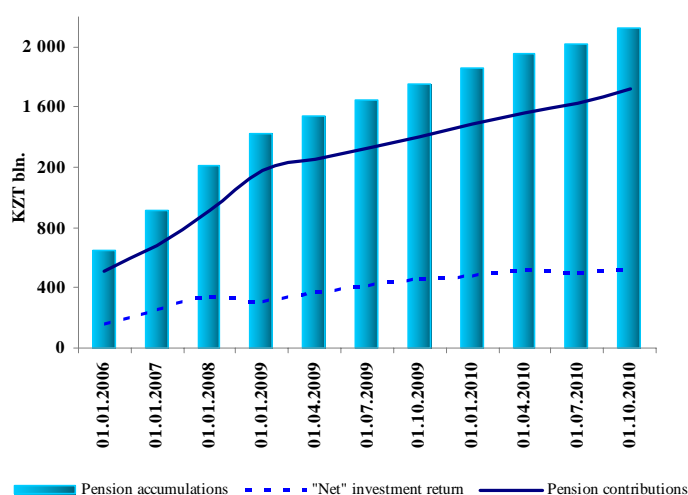
Source: FSA

**Figure 4.2.5**  
**Share of financial instruments of defaulted issuers in the present value of pension assets**



Source: FSA

**Figure 4.2.6**  
**Dynamics of growth in pension accumulations**



Source: FSA

value of pension assets by 2.0% (or to KZT 2 129.8 bln.).

During 9 months of 2010 as broken down by quarters there were positive trends in the dynamics of pension accumulations of subscribers (beneficiaries) and dynamics of pension contributions. Thus, pension accumulations of subscribers (beneficiaries) as of 01.10.2010

As part of the counter-cycling approach, from 01.01.2010 a decrease in credit risk weighting of certain financial instruments is envisaged. Therefore, based on 9 months of 2010, the amount of credit risk weighted pension assets decreased by 27.8%. And yet, as of 01.10.2010 credit risk weighted pension assets were dominating in the total amount of pensions assets weighted by risk types (69.2%).

Amidst uncertainty in the financial markets APFs made their investment preference in favor of the government securities of Kazakhstan. As a result, during 9 months of 2010 the amount of pension assets weighted by total interest rate risk decreased by 84.7%, the amount of equity risk weighted pension assets also decreased 32.4%. (Figure 4.2.4).

At present the securities market in Kazakhstan continues to face the implications of the global financial crisis. Specifically, as of 01.10.2010 investment portfolios of all APFs contained financial instruments of issuers that had technical defaults. Thus, the percentage of debt securities whose issuers defaulted under bond issues accounted for 3.9% (including securities of BTA Bank, Alliance Bank and Temir Bank which have undergone the restructuring process) of the total volume of pension assets or KZT 83.4 bln. in absolute terms (Figure 4.2.5).

At the same time, the loss incurred under defaulted financial instruments (during the period of possession) increased from KZT 31.4 bln. at 01.01.2010 (or 1.7% of the present value of pension assets) to KZT 53.4 bln. at 01.10.2010 (or 2.5% of the present value of pension assets).

As of 01.10.2010 the amount of provisions created to cover losses from impairment of pension assets amounted to KZT 43.6 bln. reducing the present

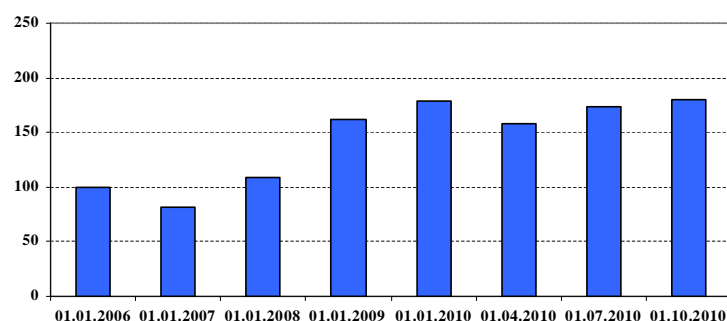


amounted to KZT 2 129.6 bln., increasing by 14.5% over 9 months of 2010. Based on 9 months of 2010, pension assets grew up by 15.6 % amounting to KZT 1 720.4 bln. at 01.10.2010. The amount of “net” investment income (less fees) from pension asset investments credited to the accounts of subscribers (beneficiaries) amounted to KZT 532.5 bln. as of 01.10.2010. During 9 months of 2010 “net” investment income increased by KZT 50.9 bln. or by 10.6% (Figure 4.2.6).

### 4.3 Risks of Other Financial Organizations

*In spite of some improvement in the overall economic situation in the country non-banking organizations continue facing negative implications of the crisis (loss-making, deterioration of the loan portfolio quality and solvency, etc.), which is caused by the presence of high credit risks. At the same time, an active recovery is observed in the sector of mortgage companies.*

**Figure 4.3.1**  
Loans to legal entities and individuals provided by organizations engaged in certain types of banking operations (KZT bln.)



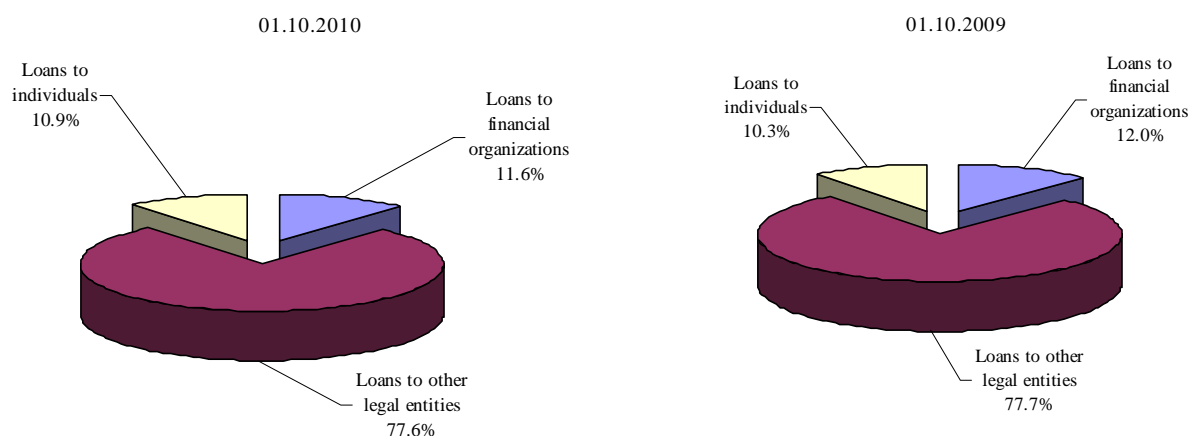
Source: FSA

### Organizations engaged in certain types of banking operations

From the beginning of this year, loans provided by organizations engaged in certain types of banking operations increased by 0.6% only or by KZT 1.1 bln. amounting to KZT 179.9 bln. as of October 1 of this year (Figure 4.3.1).

The lending structure of non-banking organizations has virtually remained unchanged (Figure 4.3.2).

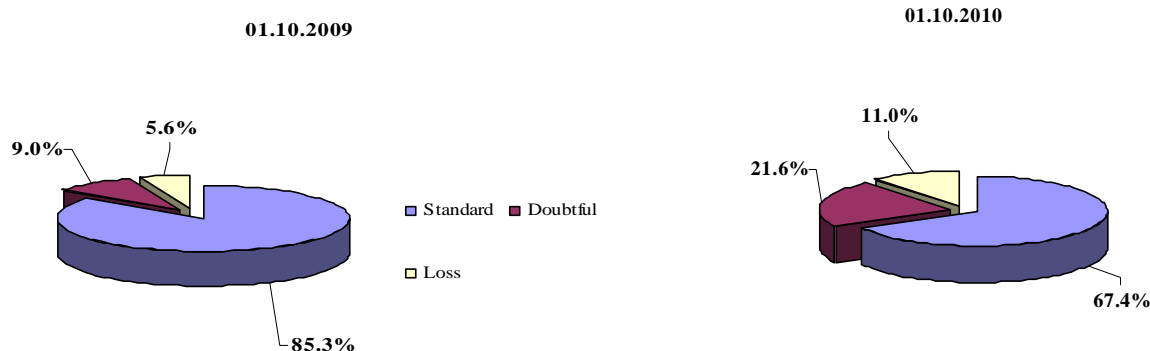
**Figure 4.3.2**  
Lending structure of non-banking organizations (as% of total)



Source: FSA

Figure 4.3.3

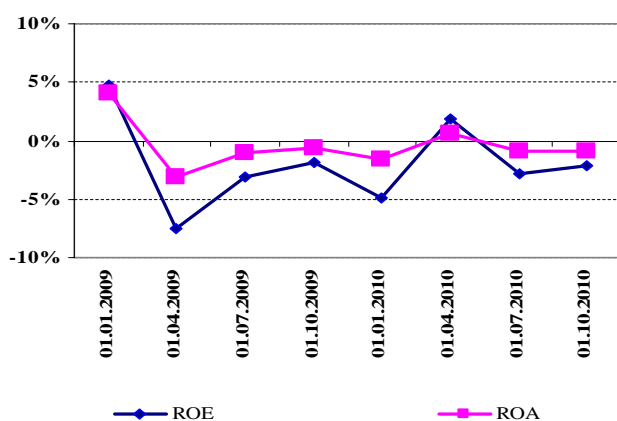
## Loan portfolio quality of non-banking organizations



Source: FSA

Figure 4.3.4

## Profitability ratios of organizations engaged in certain types of banking operations



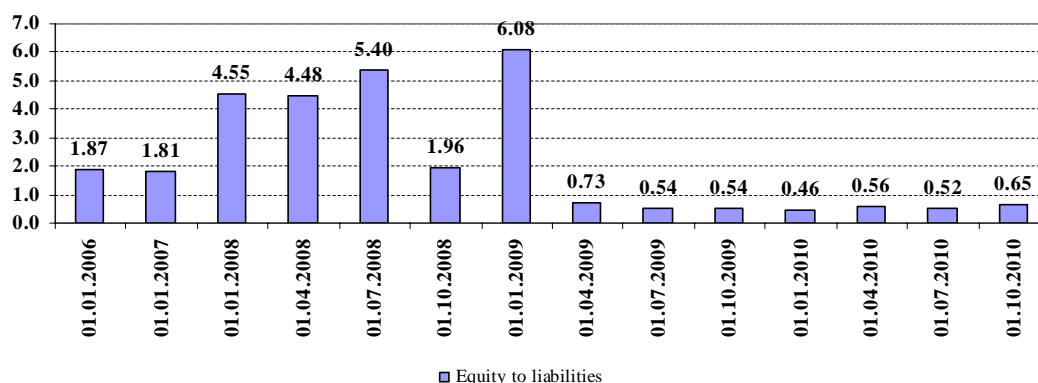
Source: FSA

During the reviewed period from 01.10.2009 to 01.10.2010 there are still some negative trends in the activity of organizations engaged in certain types of banking operations associated with the deteriorated loan portfolio quality. So, the percentage of standard loans in the credit portfolio structure of non-banking organizations reduced from 85.3% to 67.4%, whereas the percentage of doubtful and loss loans increased from 9.0% to 21.6% and from 5.6% to 11.0%, respectively (Figure 4.3.3).

Amidst low lending activity profitability ratios of non-banking organizations also continue to demonstrate a negative performance (Figure 4.3.4).

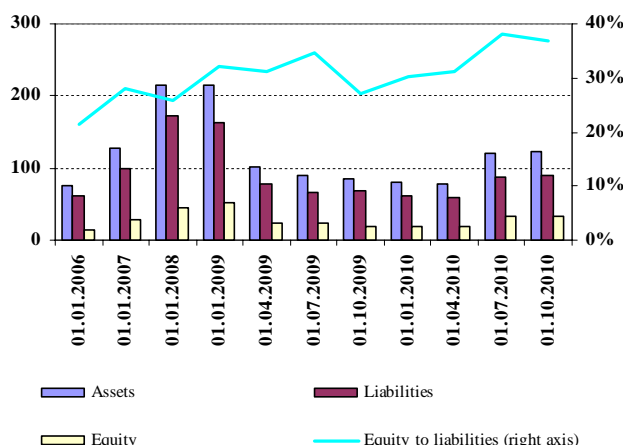
Figure 4.3.5

## Solvency risks of non-banking organizations



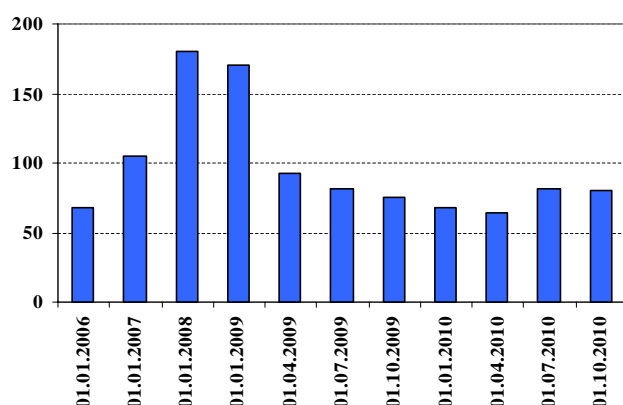
Source: FSA

**Figure 4.3.6**  
Information about assets, liabilities and equity of mortgage companies (KZT bln.)



Source: FSA

**Figure 4.3.7**  
Loan portfolio dynamics of mortgage companies (KZT bln.)

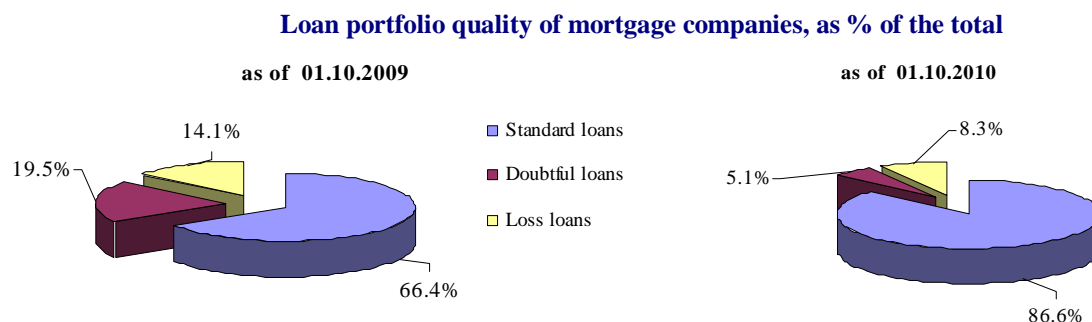


Source: FSA

beginning of the year (Figure 4.3.7).

There were positive trends in the structure of credit portfolio of mortgage companies. Thus, from last October the share of standard loans increased from 66.4% to 86.6%, and shares of doubtful and loss loans decreased from 19.5% to 5.1% and 14.1% to 8.3%, respectively (Figure 4.3.8).

**Figure 4.3.8**



Source: FSA

Despite the fact that the extent of coverage of liabilities by equity increased from 0.54 to 0.65 at October 1 of this year as compared to the respective period of the last year, domination of commitments in the structure of liabilities of non-banking organizations indicates an increased insolvency risk (Figure 4.3.5).

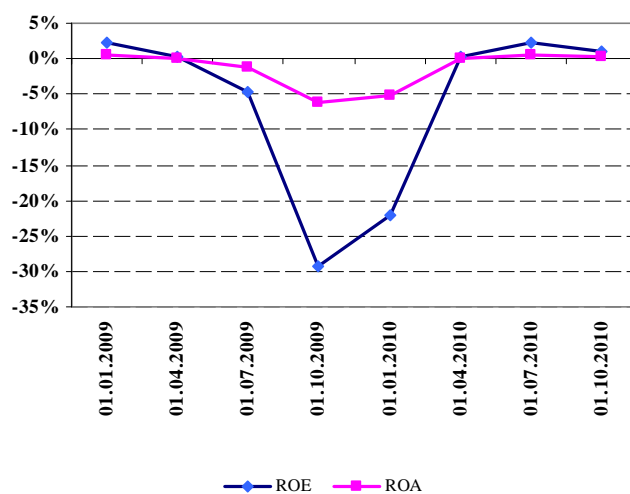
### Mortgage Companies

There are positive trends in the mortgage company segment in the environment of post-crisis development of the financial market. From the beginning of this year assets and liabilities of mortgage companies increased by 52.2% (KZT 41.9 bln.) and by 44.8% (KZT 27.6 bln.), respectively. The increase in assets and liabilities of insurance organizations was largely caused by the growth in the investment of funds in highly-liquid assets (securities, correspondent accounts and deposits with banks) and issue of securities into circulation.

During the reviewed period capital of mortgage companies also increased by 76.8%. The capital coverage level of liabilities of mortgage companies in the 3<sup>rd</sup> quarter 2010 as compared to the respective period of the last year increased from 27.2% to 36.9% (Figure 4.3.6).

The loan portfolio of mortgage companies has increased from KZT 68.4 bln. to KZT 80.3 bln. or by 17.4% since the

**Figure 4.3.9**  
**Profitability ratios of mortgage companies**



Source: FSA

Despite remaining high credit risks, improved quality of credit portfolio was conducive to the positive performance of mortgage companies in terms of their profitability (Figure 4.3.9).

## 5. Payment Systems

*During 2010, in order to increase the operational reliability and production efficiency of Kazakhstan payment systems, the works have been carried out to update the technical infrastructure thereof, converge with the international standards and further improve the legal framework and supervision mechanisms (oversight) over the payment systems. In this regard stabilization of the financial situation in the country; measures undertaken by the government and control of liquidity on the part of the payment system users have contributed to the growth in volumes of payments through Kazakhstan payment systems.*

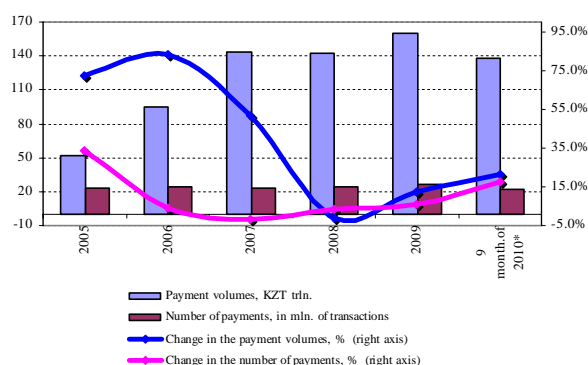
### 5.1 Development of the Payments Systems in Kazakhstan

Based on the update of the technical infrastructure of the national payment systems, which are operated by the “Kazakhstan Interbank Settlement Center” State Enterprise, on 7 June 2010 the payment system migrated to the new versions that are characterized by higher level of safety and larger throughput capacity.

Also as a part of development of the integration processes and ensuring convergence with the European Union's standards on 7 June 2010 Kazakhstan banking and payments systems transferred to the use of new numbers of bank accounts (IIC) and bank identification codes (BIC) based on the international standards ISO 13616: IBAN and ISO 9362: BIC, respectively.

To secure the legal status of the “electronic money” statutorily and regulate the legal relations arising from the issue and use thereof for making payments, the works has been carried out during 2010 to refine the Draft Law of the Republic of Kazakhstan “On Making Certain Additions to Some Legislative Acts of the Republic of Kazakhstan Concerning Electronic Money”.

**Figure 5.1.1**  
**Payment flows in the payment systems of Kazakhstan**



Note: \* 9 mon. of 2010 as compared to the respective period of 2009

Source: NBRK

and 1.7% of total number thereof (13.4 mln. of documents for KZT 2.3 trln.), which also demonstrates that the system has performed its mission which is to make a large number of retail payments for small amounts.

In general as compared on YoY basis with 2009 a number of payments through the payments systems has increased by 17.3% (by 3,212.0 ths. transactions), while the amount of payments has grown by 21.5% (by KZT 24.5 trln.). Increase in the amount of payments was mostly due to increase by 32% in the amounts of payments related to transactions with securities and bills of exchange issued by the residents of the Republic of Kazakhstan, as well as with the interbank deposits and transfers of the banks' own finds and funds of their clients – by 15.8% (Table 5.1.1).

In this regard the year 2010 is characterized by the gradual increase in the number and volume of payments in Kazakhstan payments systems (Figure 5.1.1). During 9 months of 2010, 218 mln. of transactions for the amount of KZT 138.5 trln. were made through Kazakhstan payment systems. 98.3% of the total volume of non-cash payments in Kazakhstan and 38.6% of the total number thereof (84 mln. of transactions for KZT 136.1 trln.) were made through the Interbank System of Money Transfer (ISMT), which is oriented at the large priority payments in the country related to the financial sector transactions). The Interbank Clearing System (ICS) processed 614% of the total number of all non-cash payments in Kazakhstan

Table 5.1.1

## Amounts of Payments Broken Down for Types of Payment Purposes

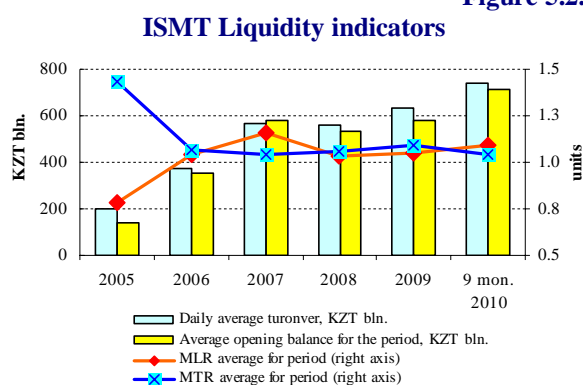
Indicator	9 months of 2009		9 months of 2010		Change	
	In KZT bln	% to total volume	In KZT bln	% to total volume	In KZT bln	in %
Foreign exchange and precious metals transactions	13 542.2	11.9%	14 548.4	10.5%	1 006.3	7.4%
Deposits	32 307.1	28.3%	37 422.7	27.0%	5 115.6	15.8%
Loans	1 145.1	1.0%	1 077.7	0.8%	-67.3	-5.9%
Securities, bills and deposit certificates issued by the RK non-residents	1 187.7	1.0%	64.0	0.05%	-1 123.7	-94.6%
Securities and bills issued by the RK residents	48 586.3	42.6%	64 144.1	46.3%	15 557.9	32.0%
Goods and intangible assets	4 252.3	3.7%	5 705.6	4.1%	1 453.3	34.2%
Services	4 292.2	3.8%	4 966.0	3.6%	673.8	15.7%
Other payments <sup>16</sup>	8 654.6	7.6%	10 546.3	7.6%	1 891.7	21.9%
<b>Total</b>	<b>113 967.3</b>	<b>100.0%</b>	<b>138 474.8</b>	<b>100.0%</b>	<b>24 507.5</b>	<b>21.5%</b>

Source: NBRK

## 5.2 Liquidity Risk and System Risk

Growth in volume of payments through Kazakhstan payment systems has been accompanied by increase in the users' liquidity, which reduced considerably the liquidity risk<sup>17</sup> and system risk<sup>18</sup>.

Figure 5.2.1



Source: NBRK

money turnover ratio (MTR)<sup>20</sup> and ISTM money liquidity ratio (MLR)<sup>21</sup>, as well as analysis of its compliance with the specified values<sup>22</sup>. In average for 9 months of 2010 the ISTM MLR was equal to 1.09 and MTR – to 1.04, that complies with the values, at which the liquidity risk and systemic risk are considered to be minimum.

Increase in the liquidity of the payments systems users promoted reduction in the number and volume of payments that were rejected (recalled) by the users in ISTM due to lack of liquidity. Thus, for 9 months of 2010, 5 payments for the amount of KZT 7.1 bln. were rejected in the ISTM (Figure 5.2.2), while in 2009 not executed due to lack of liquidity were 30 payments for the amount of KZT 7.9 bln.. All rejected or recalled payment documents were executed again by ISMT users at the same day or next following business days. In this regard a share of rejected payments amounted

<sup>16</sup> Include pension payments and allowances, special-purpose transfers, payments to and out of budget.

<sup>17</sup> Liquidity risk is a payer's risk caused by its inability to fulfill the money transfer liabilities.

<sup>18</sup> System risk is a risk that a failure of one user of a payment system to meet its money transfer liabilities would entail failures of other user (users) of a payment system to fulfill their money transfer liabilities.

<sup>19</sup> User's opening balance is a cash amount that a user transfers from its correspondent account to the position in the system

<sup>20</sup> Money Turnover Ratio (MTR) is a ratio of debit turnover in ISMT to the system liquidity.

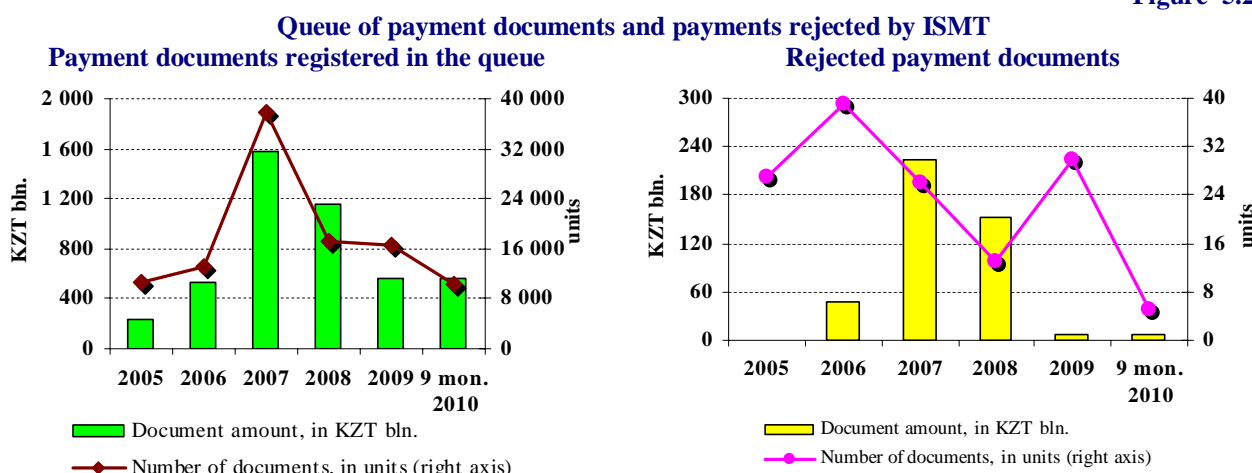
<sup>21</sup> Money Liquidity Ratio (MLR) is a ratio of the systems liquidity (opening balances of all users) to the sum of debit turnover in ISMT and rejected (recalled) payments in ISMT.

<sup>22</sup> To regulate the liquidity risk the following corridors of the liquidity ratio limits and money turnover have been set in the system: MLR upper limit  $\geq 1.5$  at MTR  $< 0.5$ ; MLR lower limit  $\leq 0.5$  at MTR  $> 1.5$ .



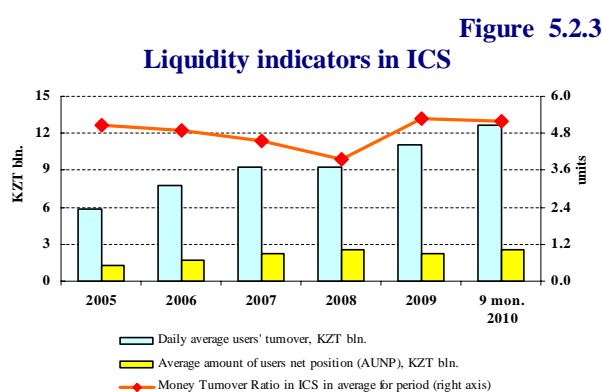
to only 0.05% of the total number of payment documents registered in queue and just 1.3% in terms of money

Figure 5.2.2



Source: NBRK

Source: NBRK



Source: NBRK

No facts of rejection or annulment of the payments documents due to insufficient liquidity have been identified in the ICS during 9 months of 2010. In this case the average daily money turnover ratio in the ICS amounted to 5.18, which is characteristic of the system's high turnover (Figure 5.2.3). Based on the clearing results, the average daily net position of the users equaled to KZT 2.56 bln. (0.4% of the amount of average daily turnover of the users in ISMT), which contributes to reduction of the liquidity risk when calculating the net position through ISMT.

### 5.3 Operating and Technical Risks

To manage the operating risk<sup>23</sup> the payment system operator carries out activities aimed at raising the personnel qualification and uses mechanism for separation of the personnel operations (access) in accordance with their functions.

To manage the technical risk<sup>24</sup> there were applied such methods as using of the backup center, user inspection and continuous monitoring of the hardware and software complex of payments system. As it has been mentioned before, in June 2010 Kazakhstan payment systems were transferred to the new hardware and software platform, the components of which have been developed with due account of the requirements of economy and maximum use of resources; ensuring the necessary level of protection and accessibility as well as compatibility with the standards applied in the financial sector. To maintain the backup center of the payment systems in constant readiness KISC NBRK State Enterprise at least twice a year carries out arrangements to transfer the system operations to the backup center's software.

During 2010 the National Bank also continued works related to construction of a new backup center in Astana, which will ensure the ongoing functioning of the payments systems in the event of contingent and emergency situation in the location of the main center. To monitor the safety of the payment system users' workplaces (approval of payments and software reliability) the NBRK has performed 11 inspections of the banks of the Republic of Kazakhstan during 9 months of 2010.

<sup>23</sup> Operating risk is the risk of errors that can be made by the user's personnel while performing their duties.

<sup>24</sup> Technical risk is the risk of defects and errors in the hardware and software and telecommunication

One of the indicators of effective development of the payments systems is the maintenance of high coefficient of uninterrupted operation (operability)<sup>25</sup> of the payment systems. For 9 months of 2010 the average monthly operability coefficient of ISMT was 99.55% and that of ICS – 99.86%. High operability coefficients of Kazakhstan payment systems demonstrate high effectiveness of their operations.

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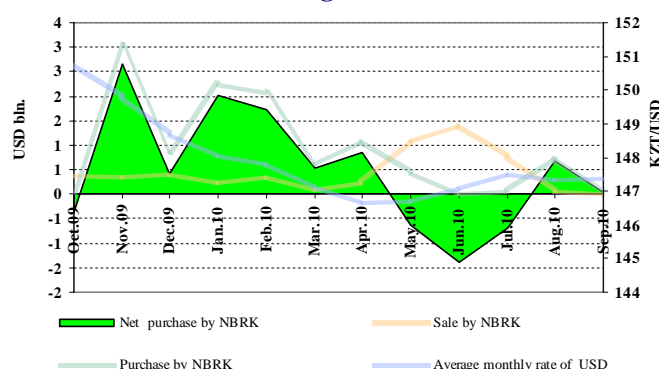
<sup>25</sup> Payment system's operability coefficient for year is calculated as the ratio of real time of operations (period of time from opening of a business day till closing of a payment system's business day, less the time when a payment system was suspended) to the total time of operation of a payment system (period of time from opening of the payment system business day till closing of its business day).

## 6. Financial System Regulation and Risk Management

### 6.1 Measures taken by the National Bank to maintain stability of the financial system

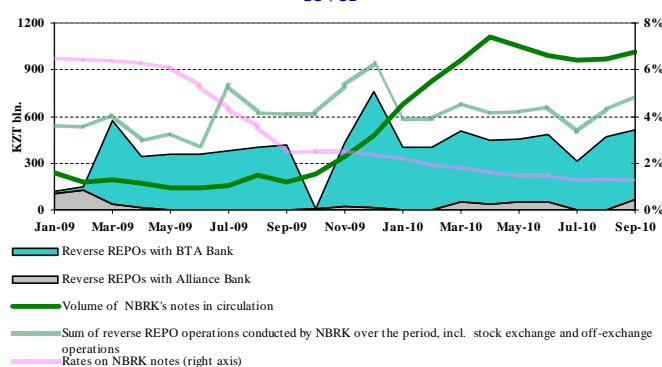
In the situation when the economy started to recover and no serious external shocks exist while banks pursue the policy of maintaining a higher level of liquidity, the National bank's role in ensuring the financial system stability came down to maintaining the stability of the Tenge exchange rate.

**Figure 6.1.1**  
Volumes of the NBRK's interventions in the foreign exchange market



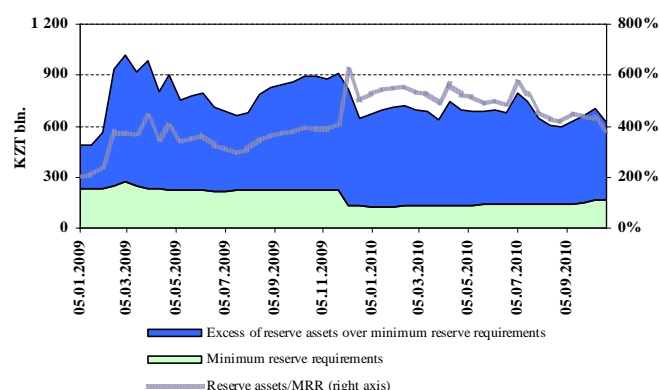
Source: NBRK

**Figure 6.1.2**  
NBRK's operations related to the regulation of liquidity level



Source: NBRK

**Figure 6.1.3**  
Reserve assets and minimum reserve requirements



Source: NBRK

In November 2009 – April 2010 there was an excess of foreign exchange supply over its demand in the domestic foreign exchange market. The reasons for such increase were the increased inflow of foreign exchange into the country as the result of favorable foreign economic environment and the growth in speculative pressure on the part of foreign exchange sellers brought about by the “weak dollar policy”. Under these circumstances the NBRK had to sterilize excessive supply of foreign exchange in the market: total volume of net USD purchases from November 2009 through April 2010 amounted to USD 8.2 bln. The situation changed in May: volatility of the Euro – USD foreign currency couple and uncertain expectations in respect of stability of the European economies resulted in increased demand for dollar in May-July 2010, when the NBRK was forced to intervene in the stock exchange market in order to overcome the pressure on the Tenge exchange rate. The volume of US Dollar sales by the NBRK in May-July 2010 amounted to USD 3.2 bln., exceeding the purchase volumes by USD 2.7 bln. (Figure 6.1.1).

The trend for increased liquidity in the banking sector that evolved in 2009 was the reason for the NBRK to give up engaging in reverse repo operations at the stock exchange from November 2009. Until September 2010 liquidity injections were made mostly with BTA Bank which finalized its restructuring on August 30, 2010. Thus, from January through August 2010 total volume of reverse repo operations conducted with BTA Bank amounted to about KZT 3.3 trln. In September 2010, BTA Bank completed its restructuring therefore there was no longer

a need to provide liquidity to the bank.

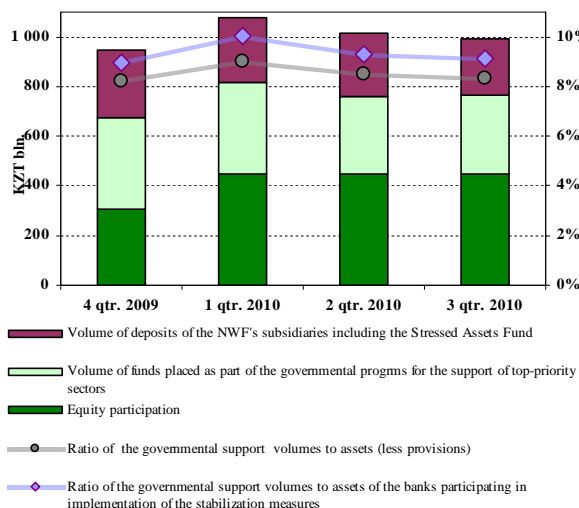
In order to immobilize liquidity in the banking sector the NBRK significantly increased the volume of notes in circulation in 2010: while in 2009 its average monthly amount was about KZT 223 bln., the indicator amounted to KZT 252 bln. in 2010. At the same time in the environment of excessive liquidity supply in the market the interest rates on notes further declined from 2.23% in January to 1.30% in September (Figure 6.1.2).

The policy of banks aimed at maintaining excessive liquidity resulted in significant increase of minimum reserve requirements by reserve assets. Thus, from December 2009 up to August 2010 reserve assets exceeded minimum reserve requirements by more than five times. Later, owing to the change in the asset and liability management policy of banks as well as the change and revitalization of their activity in the credit market this indicator decreased significantly – as of October 25, 2010 the ratio of minimum reserve requirements to reserve assets was 379% (Figure 6.1.3).

## 6.2 Funding provided to banks by the National Welfare Fund “Samruk-Kazyna”

In the 1<sup>st</sup> – 3<sup>rd</sup> quarters of 2010 credit activity of the banking sector was mainly maintained through the implementation of government programs for the support of top-priority sectors of the economy. In the first quarter 2010 total funding from the state<sup>26</sup> increased by KZT 131.6 bln. and amounted to about KZT 1.08 trln. or 9% of total assets of the banking system. The growth in government funding volumes was associated with the acquisition of shareholding in Alliance Bank of KZT 141.3 bln. by the NWF “Samruk-Kazyna”. Later on the total funding volume started to decrease due to repayment of funds placed with banks under the program for the support of top-priority sectors of the economy. As of the end of the third quarter 2010 the total volume of government funding amounted to KZT 992.6 bln. or 8.3% of total assets of the banking system (Figure 6.2.1)

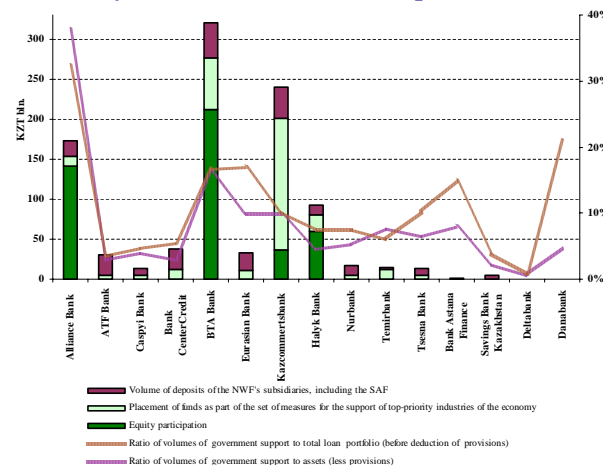
**Figure 6.2.1**  
Coverage by the government of the shortage of funding of the banking system



*Note: The volume of funding on the part of the government is estimated as the amount of liabilities to NWF from provision of funds as part of the anti-crisis program, as of end-period, and volumes of funds provided by NWF when stepping up in the banks' equity.*

*Source: NWF, FSA, NBRK calculations*

**Figure 6.2.2**  
Funding of the banking system with a broken down by banks as of the end of 3 qtr. 2010



*Note: The volume of funding on the part of the government is estimated as the amount of liabilities to NWF from provision of funds as part of the anti-crisis program, as of end-period, and volumes of funds provided by NWF when stepping up in the banks' equity.*

*Source: NWF, FSA, NBRK calculations*

The main volume of the government's participation in the banking system's capital – 79% of the total volume of government participation – falls on Alliance Bank (KZT 141.3 bln. as of the

<sup>26</sup> Government's participation in the capital of banks, funds allocated as part of the government program implementations and deposits of subsidiaries of the National Welfare Fund “Samruk-Kazyna”

end of Q3 2010) and BTA Bank (KZT 212.1 bln. as of the end of Q3 2010). About 73% of funds allocated as part of the support for top-priority sectors were distributed to BTA Bank (KZT 64.4 bln.) and Kazkommertsbank (KZT 164.5 bln.) in the third quarter 2010. The major portion of deposits of subsidiaries of the NWF “Samruk-Kazyna” was placed with these banks (over 36%). The volume of funds allocated as part of the support for top-priority sectors at the end of Q3 2010 amounted to 3.5% of the total credit portfolio<sup>27</sup> of banks participating in the implementation of the government programs for the support for top-priority sectors (Figure 6.2.2).

### **6.3 Results of restructuring of foreign liabilities of Alliance Bank, BTA Bank and Temir Bank<sup>28</sup>**

**One of the most important signs of normalization of situation in Kazakhstan for the financial market participants was the finalization of restructuring of three Kazakh banks – BTA Bank, Alliance bank and Temir Bank.** The uniqueness of the Kazakhstan’s experience in the bank foreign debt restructuring is that it was a combination of a “classical” restructuring and a set of the governmental support measures. A comprehensive approach allowed avoiding costs and risks that the government and the financial system as a whole would face in the event if one of the two “extreme” options were selected – bankruptcy or coverage of liabilities of these banks with the public funds. In the first case there would be a risk of undermining the public confidence in the banking system that would cause a serious damage to the banking system as a whole. In the second case the image of the financial system and the country would deteriorate seriously in the eyes of investors since full bank debt coverage would serve as a signal that the financial system is unable to solve its problems without the governmental support and becomes dependent on the government.

**I. Results of restructuring of JSC “Alliance Bank”.** The restructuring of Alliance bank has been successfully accomplished on March 30, 2010. As a result of restructuring the bank’s foreign debt was cut from USD 4.5 bln. to USD 1.1 bln., and the term of debt servicing was extended from 1-7 years to 7-20 years. The bank’s capital increased by KZT 547.9 bln., allowing the bank to comply with the FSA’s prudential requirements.

As a result of restructuring 33% of common and preferred stock were transferred to creditors of Alliance Bank and 67% of common and preferred stock changed over to the NWF “Samruk-Kazyna”, which allowed the latter to retain control over the bank. This helped retaining control over the bank and provided an optimal level of the debt conversion into the shareholders equity. In addition, creditors set a number of binding conditions, such as:

- In the event the major shareholder of the bank is changed, creditors should have the right to sell their shares at par, if a new shareholder is not a bank with a credit rating of at least A- in the first two years and at least BBB after 2 years from the date of completion of the restructuring process;
- The bank must not pay out dividends on its common stock in 2010-2011, i.e. until 50% of the restructured debt is extinguished. After 2011 dividends may be paid provided that the bank’s capital adequacy ratios are above the minimum regulatory requirement by 2%;
- As far as corporate governance is concerned, creditors were allowed to participate in the key aspects of corporate governance of the bank through their representatives in the management body of Alliance Bank.

**II. Results of restructuring of JSC “Temir Bank”.** On July 1, 2010 Temir Bank announced that its restructuring is finalized and became the second bank which has successfully completed its foreign debt restructuring. The bank’s foreign debt was cut from USD 770 mln. to USD 61 mln. and the maturity of debt servicing was extended from 1-4 years to 10-12 years. 20% of new common stock issued was transferred to foreign creditors and over 79% of shares changed over to the NWF “Samruk-Kazyna”. The remaining stock was distributed among the existing shareholders, including

<sup>27</sup> Before deduction of provisions

<sup>28</sup> According to the information from the NWF “Samruk-Kazyna”

BTA Bank. The main conditions set by the creditors, mainly to protect the rights of minority shareholders, were as follows:

- The right for a sale of debt securities by creditors in the event if the equity holding of the NWF “Samruk-Kazyna” in the bank falls below 51%, if a new shareholder is not a financial institution of the Organization for Economic Cooperation and Development or a sovereign wealth fund with a credit rating of at least BBB;
- Introduce at least three representatives of creditors into the bank’s board, one of which should be an independent director;
- One of financial preconditions is the capitalization of Temir Bank by the Fund in the amount of no more than KZT 23.5 bln.

**III. Results of restructuring of JSC “BTA Bank”.** Out of the three banks that have implemented their restructuring in 2010 BTA Bank was the most systemically important. It announced about successful completion of its foreign debt restructuring on August 31, 2010. As a result of restructuring, the bank’s foreign debt was cut down from US\$ 12 bln. to USD 4.4 bln., the maturity of its liabilities was changed from 1-5 years to 8-20 years while the average borrowing rate was reduced to 10%. Participation interests in shareholders equity were distributed as follows: 18.5% of common stock was transferred to foreign creditors of BTA Bank, the share of the NWF “Samruk-Kazyna” accounted for 81.4%.

It is worth mentioning that one of the key areas in the bank’s activity in the coming years will be foreign asset recovery. To this end, as part of the negotiations it was determined that the bank would issue securities against the assets to be recovered in the amount of USD 5 bln. Pursuant to the terms and conditions regarding the securities, 50% of return from recovery of those assets will be transferred to the creditors.

Creditors set the following binding requirements:

- Mandatory participation of creditors in the aspects of bank management related to the asset recovery and capital raising as well as coordination of key position in the bank’s management body, during the first three years after the restructuring.
- A requirement to the board of directors of BTA Bank: five board members should be the representatives of the NWF “Samruk-Kazyna”, two – representatives of creditors, and two other members should be independent directors. The board members should be elected on an annual basis.
- Requirements to potential investors: minimum credit rating assigned by international rating agencies should be at least BBB, no affiliation with the existing and former shareholders of the bank as well as that a future investor should be a financial regulated entity in an OECD member country.

#### **6.4 Regulatory actions taken by the Agency on Regulation and Supervision of the Financial Market and Financial Organizations to mitigate risks and strengthen stability of the banking sector**

**A prerequisite for many regulatory measures taken in 2010 was in effect an intention to mitigate risks similar to those that resulted in a critical condition in a number of the Kazakh banks, and BTA Bank in the first instance.** Measures of prudential regulation of the banking sector taken by the FSA in the fourth quarter 2009 – third quarter 2010 were primarily aimed at the mitigation of risks related to the capital quality of banks and transparency of their operations. The set of measures included the following components:

**1. Improving the quality of the bank capital.** This set of measures is aimed at strengthening the banks’ capability to absorb potential losses at the expense of capital and exclude the possibility of fictitious bank capitalizations, and includes:

- expanding investment components of the banks deducted from the bank’s owners equity;



- improving the leverage by adding contingent liabilities to the calculation of capital adequacy ratio (k1-1), by applying a stage-by-stage tightening of ratios: from July 1, 2012 – at least 0.08, and from July 1, 2013 – at least 0.09.

**2. *Assisting banks undergoing restructuring through the implementation of specific requirements to their capital structure*** comprised:

- providing an opportunity for banks subject to restructuring to include subordinated bonds issued in line with the laws of other countries into the equity;
- using the earnings received from the restructuring of liabilities in the current year into the tier-one capital as well as providing an opportunity for banks subject to restructuring to include 75% of the subordinated debt amount into the tier-two capital.

**3. *Mitigation of risks determined by the ownership structure of banks and bank holding companies as well as risks arising at the level of a bank conglomerate:***

- specifying the maximum exposure per one borrower of a bank conglomerate, similarly to the calculation of the ratio for the banks;
- a requirement was established for a long-term rating in foreign currency for a parent bank or a bank's holding company for the purposes of paragraph 13 Article 30 of the Law of the Republic of Kazakhstan of August 31, 1995 “Of Banks and Banking Activity in the Republic of Kazakhstan»;
- establishing a requirement for a minimum rating of a parent bank to be eligible for conducting operations of a bank such as deposit-taking, opening and maintenance of bank accounts of individuals to acquire a status of a parent bank;
- deducting investments from the actual equity amount of a bank conglomerate participant.

**4. *Measures intended for mitigation of risks related to transparency of borrowers and banking operations,*** including:

- determining the “borrower transparency” criteria when calculating maximum exposure per one borrower (k3);
- optimizing the calculation of maximum exposure per one borrower (k3) by excluding the bank's guarantees and securities guaranteed by the bank from the calculation of the ratio;
- providing an opportunity for credit default swap purchases and total return swap purchases only provided that the following conditions are met: (a) an underlying asset is not an own liability of a bank; (b) acquisition with a view of credit risk hedging on the underlying asset; (c) acquisition is effected in the organized securities market;
- refining the format for providing information about related party transactions of banks.

**5. *A set of measures related to the improving of the quality of newly provided loans and of the existing credit portfolio,*** including:

- encouraging banks to clean their balance sheets from “bad” loans by excluding the liabilities of a borrower to the bank written off the balance sheet and liabilities for which 100% of provisions (allowances) were created, from the calculation of the ratio;
- amending the concept of collateral value (value of collateral at the present moment determined based on the market value given the possibility of its realization (sale));
- the category of loans whose classification category is identified as “loss” was specified: the following items are referred to as loss loans (a) loans provided to a borrower (co-borrower) incorporated in off-shore zones, or when fifty or more percent of voting shares or participation interests in the borrower's (co-borrower's) authorized capital are directly owned by persons incorporated in off-shore zones; (b) loans provided to a borrower (co-borrower), whose decisions are determined by other person incorporated in off-shore zones, by virtue of an agreement or otherwise;
- establishing a stage-by-stage procedure for creating a minimum amount of provisions by banks for loans provided in foreign currency to borrowers with no appropriate foreign

currency proceeds, wages and/or whose foreign exchange risks are not covered by the proper hedging instruments on the part of the borrower<sup>29</sup>;

- establishing the deadlines within which the number of loan extensions is calculated, with reference to the frequency of loan repayments.

**6. Measures for improving the risk management procedures.** As part of this set of measures requirements were introduced for the bank to have an Emergency Action Plan in place that defines preventive arrangements containing a qualitative assessment of the amount of financial losses at which stage the bank should start implementing the arrangements intended for mitigating the impact of emergencies on the bank's financial soundness and on its operation as a whole, as well as a matrix determining responsibility of the bank's officials and employees for execution of the above Plan. In addition, the following requirements were established for the banks:

- they are obliged to present stress-scenarios, results of stress-testing as well as the Emergency Action Plan to the authorized body on a monthly basis.
- they are required to present matrices of credit risk and liquidity risk monitoring, credit risk assessment matrices and liquidity risk assessment matrices as well as credit and liquidity risk control matrices to the Agency of the Republic of Kazakhstan on Regulation and Supervision of the Financial Market and Financial Organizations;
- the Emergency Action Plan of a bank should contain procedures for how the backup centers should function, including the requirements providing for a remote location of backup centers from the main centers, and determine the frequency and the ways of creation of the data backups.

## **6.5 Establishing an institutional system of macro-prudential regulation in Kazakhstan and the activity of the Council for Financial Stability and Financial Market Development in the Republic of Kazakhstan**

**Experience gained by Kazakhstan during the times of crisis served as an impetus for developing the system of macro-prudential regulation. The key role in the system is to be played by the Council for Financial Stability and Financial Market Development in Republic of Kazakhstan.**

The concept for the financial sector development in the Republic of Kazakhstan in the post-crisis period approved by the Presidential Edict of the Republic of Kazakhstan as dated February 1, 2010 No. 923 suggests that the role of the National Bank as a central authority responsible for macro-prudential regulation should be enhanced. Under the Concept, macro-prudential regulation shall mean the following:

- 1) determining major sectoral principles and approaches for prudential regulation of systemic risks and application of appropriate ratios;
- 2) developing the measures of anti-crisis management and mechanisms for minimization of losses, should systemic risks materialize.

As part of the existing regulation system the FSA is responsible for micro-prudential regulation i.e. it performs supervision of the activity of financial institutions at the level of each individual financial entity as well as for information gathering about the status of the financial sector. The National Bank is an institution responsible for ensuring the stability of the overall financial system and for macro-prudential regulation i.e. regulation of the condition of the system as a whole.

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<sup>29</sup>For such loans provided from September 1, 2009 the classification category should be reduced by one category and should not be less than:

- 5 percent of provisions – from January 1, 2010;
- 10 percent of provisions – from July 1, 2010 года;
- 20 percent of provisions – from January 1, 2011 года.

From January 1, 2012 the classification category of such loans cannot be higher than “doubtful of the 3<sup>rd</sup> category” with the creation of at least 20% of provisions.

Elaboration of approaches to macro- and micro-prudential regulation is implemented within the Council for Financial Stability and Financial Market Development in the Republic of Kazakhstan, established by the Presidential Edict dated June 12, 2010 No. 994 «Concerning the Council for Financial Stability and Financial Market Development in the Republic of Kazakhstan». Mr. Grigory Marchenko, Governor of the National Bank, is the Chairman of the Council, the members of the Council include Aide to the President Mr. B.Sultanov, Minister of Finance Mr. B.Zhamishev, Chairperson of the FSA Ms. Ye.Bakhmutova, Chairman of the Competition Protection Agency Mr. M.Yessenbayev, Deputy Governor of the National Bank Mr. D.Akisev and Chairman of the Union of Legal Entities “Financial Institutions’ Association of Kazakhstan” Mr. S.Akhanov. The first session of the Council was held on June 30 this year, the total number of sessions conducted between June and December is 7. The topics included various aspects of functioning of the banking, insurance, pension sectors and different financial market segments. As a result of sessions a number of working groups were established to elaborate a consolidated stance of the government authorities and representatives of the financial sector.

In order to ensure communication between the National Bank and the FSA in respect of macro-prudential regulation there is an intention to establish a permanent taskforce on the aspects of macro-prudential regulation. The taskforce will be functioning under the leadership of the Deputy Governor of the National Bank who is in charge of ensuring financial stability. The taskforce will have the following objectives to pursue:

1) working out proposals and drafting regulations aimed at implementing the principles and instruments of macro-prudential regulation;

2) elaborating all aspects of micro-regulation that may have a direct effect on the fulfillment of objectives of macro-prudential regulation within the Agency’s scope, in particular:

- financial institutions’ solvency (capital adequacy and structure and funding sources),
- liquidity;
- credit risk;
- structure and concentration of the financial sector, issues pertinent to activities of bank conglomerates;
- early warning measures and mechanisms of bank rehabilitation including restructuring and other measures of governmental intermediation.

3) elaboration of other aspects based on the decision of the senior management of the National Bank and the FSA;

4) compilation of documents and drafting of regulations for implementation of proposals regarding the development of the financial services market.

The regulations that are to be discussed as part of the taskforce meetings will be submitted for consideration of the FSA’s Management Board only after relevant resolution of the taskforce.

## IV. Appendixes

### Appendix 1

#### Financial Stability Indicators of Kazakhstan <sup>1</sup>

(as per cent)

	2007	2008	2009	6 mon. 2010	9 mon.2010
<b>Banking Sector <sup>2</sup></b>					
<i>Capital adequacy ratios</i>					
Notional capital to risk-weighted assets	14.2	14.9	-8.1 (18.4)	-2.8 (18.5)	17.4 (18.1)
Tier-1 capital to risk-weighted assets	10.2	11.6	-9.3 (14.1)	-4.7 (14.2)	13.3 (13.7)
Owners equity to total assets	12.2	12.2	-8.5 (11.5)	-4.3 (11.3)	10.3 (11.5)
Past due loans over 90 days less their specific provisions to owners equity	n/a	10.2	-52.2 (39.3)	-116.2 (46.7)	61.5 (49.6)
Owners equity to total liabilities	13.9	13.9	-7.8 (13.0)	-4.1 (12.7)	11.5 (13.0)
<i>Asset quality</i>					
Past due loans over 90 days to loan portfolio	n/a	5.2	21.2 (14.4)	25.3 (16.7)	25.8 (17.4)
Created provisions to loan portfolio	5.9	11.1	31.5 (20.7)	35.3 (19.8)	32.7 (20.1)
Created provisions on past due loans over 90 days to past due loans over 90 days	n/a	68.9	74.9 (55.9)	74.0 (53.5)	68.4 (53.4)
Foreign currency loans to loan portfolio	50.4	52.2	57.2 (54.2)	66.0 (64.2)	51.7 (60.3)
<i>Profitability Ratios</i>					
Return on assets (ROA) <sup>3</sup>	2.6	0.2	-24.1 (0.2)	4.7 (0.4)	16.8 (0.2)
Return on equity (ROE) <sup>3</sup>	22.8	1.9	-1192.5 (1.9)	-73.9 (3.2)	11.2 (1.3)
Interest margin to total income*	48.4	68.7	92.9 (10.0)	93.3 (22.2)	95.9 (12.8)
Non-interest expense to total income *	76.9	98.7	145.4 (99.6)	83.6 (98.1)	67.5 (99.5)
Personnel expense to non-interest expense *	10.6	4.6	1.0 (1.4)	3.3 (4.3)	2.4 (2.7)
Spread between reference rates on deposits and loans * <sup>4</sup>	1 092.4	756.5	509.2 (745.9)	176.3 (340.7)	290.8 (517.9)
<i>Liquidity Ratios</i>					
Highly-liquid assets to total assets	13.9	13.6	19.2 (20.3)	23.3 (24.4)	22.5 (24.7)
Highly-liquid assets to short-term liabilities <sup>5</sup>	56.7	49.5	53.1 (64.9)	57.6 (67.9)	62.2 (65.6)
Customer deposits to total loans (excl. interbank loans)	45.3	53.4	67.2 (82.1)	71.3 (92.3)	74.9 (90.5)
<i>Market Risk Sensitivity</i>					
Net FX exposure to owners equity *	2.6	5.2	177.3 (1.3)	246.4 (2.1)	4.3 (-0.5)
<b>Other Financial Corporations <sup>6</sup></b>					
Assets to total assets of the financial system	21.4	38.1	19.9	20.5	17.9
Assets to GDP	24.8	45.5	16.9	33.9	18.2
<b>Corporate Sector</b> <b>(large- and medium-size enterprises)</b>					
Return on assets (ROA)	20.4	17.9	11.3	14.0	n/a
Return on equity (ROE)	48.0	43.2	29.8	37.9	n/a
Total debt to equity ratio (leverage)	1.3	1.5	1.7	1.6	n/a
Net FX exposure to owners equity	n/a	-40.8	-55.1	-52.8	n/a
Current liquidity ratio	1.5	1.4	1.3	1.4	n/a
<b>Households Sector</b>					
Debt of households to GDP	22.3	16.9	15.2	12.5	12.1
Debt of households to disposable income	45.2	32.9	27.5	24.2	23.3

Source: FSA. ASR. derivations by the NBRK

*\* - data differ from data of the Financial Stability Report in 2009 due to changes in methodology for generating data*

*<sup>1</sup> – financial soundness indicators were calculated under the methodology (FSI Compilation Guide, IMF, 2007) and explanations provided by the IMF. Therefore, values of indicators may be different from those calculated by the supervisor.*

*<sup>2</sup> – numbers provided in brackets represent the banking system of Kazakhstan excluding BTA Bank, Alliance Bank and Temir Bank.*

*<sup>3</sup> – net income before tax to average assets. Intra-annual numbers for income before tax were annualized by multiplying a current number for the indicator by a numeric value inverse to the respective period of the year. Average assets value was calculated as the average of positions at the beginning and end of the period. Average capital was calculated as the average of positions at the beginning and end of the period.*

*<sup>4</sup> – reference rate on loans is calculated as the ratio of the sum of interest income on loans (interest income on bank loans to customers) to the average position on loans. The reference rate on deposits represents the ratio of interest expense on deposits (interest expense on attracted deposits) to the average position on deposits. The average position on loans and deposits represents the average of positions at the beginning and end of the period on loans and deposits, respectively. The numbers are given as percentage points.*

*<sup>5</sup> – short-term liabilities are calculated based on the net position on transactions with financial derivatives.*

*<sup>6</sup> –when calculating indicators only data on the sector of non-banking financial institutions were used.*