

II. Macroeconomic and Financial Environment

2.1 Macroeconomic Environment and its Sustainability Factors

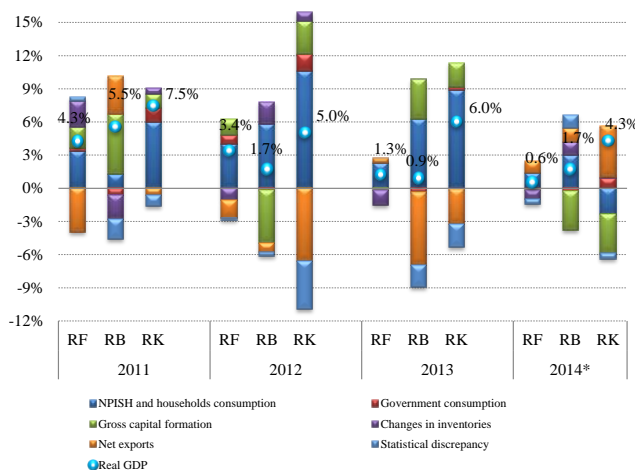
The growth of the Kazakh economy in 2014 was slowing, to a large extent, due to significant reduction of internal consumption against depreciation of the domestic currency. In this regard, notwithstanding the deterioration of external environment, adjustment of the Tenge exchange rate supported the economic growth due to increase in net exports (similarly to other EAEU member countries)

The services sector continues to be a sectoral trigger of GDP growth both in Kazakhstan and other EAEU member countries, irrespective of certain slowdown in the growth rate of their volumes in Kazakhstan and Russia.

Kazakhstan's economic growth of 4.3% at the end of 2014 (2013 – 6%) developed under the unfavorable external environment demonstrates a high degree of dependence of the economy on external shocks. According to the NBRK's estimates, slowdown of the GDP growth rate in Russia by 1 pp results in slowdown of business activity in Kazakhstan by 0.3 pp (Box 1). In terms of the GDP expense structure, net exports became a key source of Kazakhstan's economic growth in 2014 (4.6% contribution to the GDP growth). Such contribution was due to a significant reduction in imports with a slight decrease in exports (Figure 2.1.1). Amidst deceleration of energy prices at the end of 2014, exports decreased by 4.6% as compared to 2013, while reduction of imports of investment and intermediate goods resulted in an decrease in imports by 15.7%.

Household consumption, in its turn, which made the largest positive contribution to the GDP growth over the last four years, showed the negative dynamics at the end of 2014. Depreciation of the domestic currency and introduction of regulatory measures to limit the risks of consumer lending resulted in significant decrease in the physical volumes of household consumption expenses – by 2.3% (2013 – the 10.1% increase).

Figure 2.1.1
Contribution of components to the GDP growth of the EAEU countries



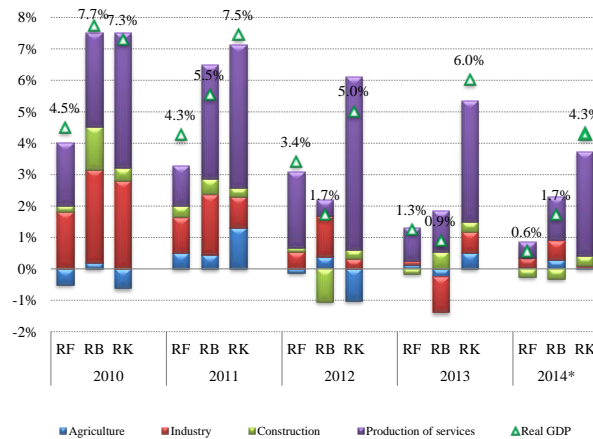
Note: *preliminary data

Source: CS MNE RK, FSSS, NSC RB, calculation by NBRK

Similar trend in dynamics of the GDP growth factors has been observed in other EAEU member countries: decrease of the household consumption contribution in Russia (1.4% versus 2.3% in 2013), Belarus (3.0% versus 6.3%) and positive contribution of net exports in Russia (1.1% versus 0.4%), Belarus (1.2% versus – 6.6%). Reduction in imports in Russia and Belarus developed amidst depreciation of the domestic currencies of both countries, and economic sanctions against Russia.

In terms of the industry-based breakdown, according to the 2014 performance, the real GDP growth rate was negatively affected by the mining industry (-0.3%) (Figure 2.1.3). Lower growth of

Figure 2.1.2
Contribution of industries to the GDP growth of the EAEU countries



the mining industry was due to a decrease in production of crude oil and natural gas (-1.1%), as a result of downturn in production of the largest oil company “Tengizchevroil” LLP, and that of coal and lignite (-2%).

Slight increase in the manufacturing industry (1%) was mainly supported by the growth in food production (2.9%) and weak growth of the metallurgical industry (0.2%) caused by a decrease in demand on the part of Kazakhstan’s major trade partners (Russia, China) for Kazakhstan’s metals and metal products.

The services sector continues playing a key role in Kazakhstan’s economic growth; however, its rate begins declining. According to the 2014 performance, growth of the production of services has been provided by the trade, the growth rate of which keeps slowing down (Figure 2.1.4).

Figure 2.1.3
Contribution of the production of commodities sectors to Kazakhstan's real GDP growth

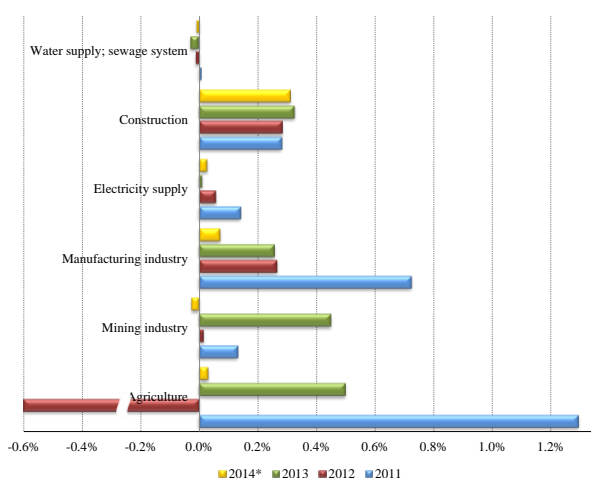
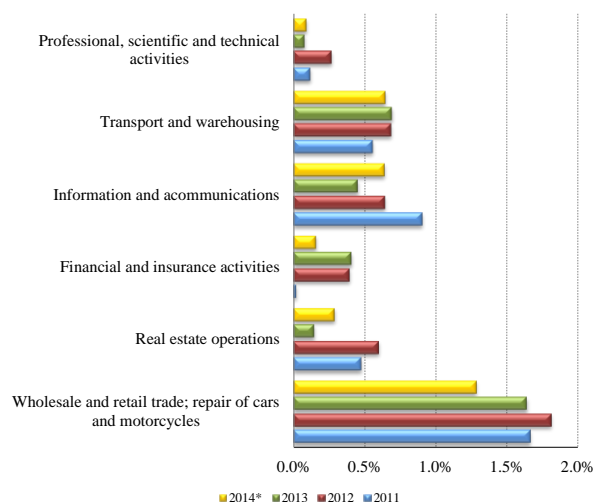


Figure 2.1.4
Contribution of the service sectors to Kazakhstan's real GDP growth



Note: *preliminary data

Source: CS MNE RK, calculation by NBRK

In contrast to Kazakhstan, the GDP growth in other EAEU member countries has been supported not only by the services sector, but also by rehabilitation of industrial production, mainly due to growth in the manufacturing industry (in Russia and Belarus – due to the production of coke and oil products, and in Belarus also due to chemical production) and agriculture.

Box 1

GVAR Model for assessment of impact by macro variables of the trading partner countries on Kazakhstan's economy

Individual economies in the global economy are interlinked through many different channels. Thus, as a result of the 1997 South-East Asia financial crisis and crisis in the USA in 2007, which developed into a global crisis, one can clearly see how realization of systemic risks of large-scale economies can result in the effect of “contagion” for countries which are smaller in scale and more sensitive to such effects. The Global Vector Autoregressive (GVAR) Model¹, in its turn, helps to establish interrelations of the economies. This model is an empirical model, which covers economic and financial inter-relationships in the global economy.

GVAR toolbox² is used to quantify assessment of the mutual influence of macro variables of the trading partners' economies on the Kazakh economy and the economies of other countries. To assess the model³, 28 countries have been selected, including Russia, China, Belarus, the USA, European countries⁴ and others. The model defines three types of shocks⁵ in the short-term (for one and two years)⁶:

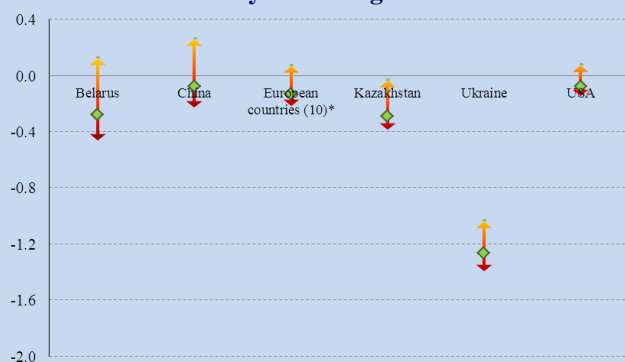
- country-specific shock: impact of slowdown in the GDP growth rate in one country on

GDPs of other countries;

- specific regional shock: impact of slowdown in the GDP growth rate in the European countries, on average, on GDPs of other countries;
- global shock: impact of the decline in the oil price on the GDP growth rate, actual exchange rate⁷.

a) The first shock is the negative *shock of the Russia's GDP*, in which case one standard deviation of shock is equivalent to a decrease in Russia's real GDP growth on average by 1 pp for two years. Reactions of real GDPs of other countries as a consequence of the effect of shock from

Figure 1
Russia's shock (if Russia's GDP goes down by 1 pp), two-year average



Source: EEC, calculation by NBRK

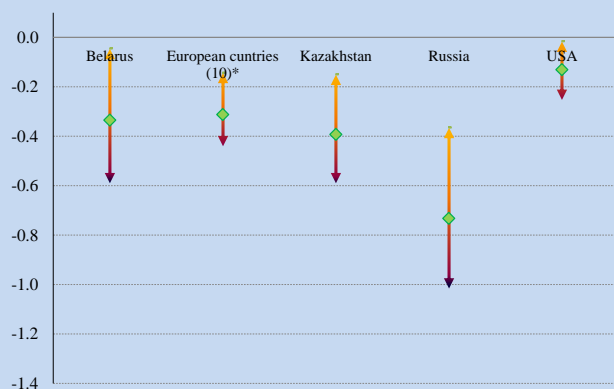
the decrease in Russia's GDP for two years on average are presented on a diagram (Figure 1). The findings show that this shock has a significant impact on the neighboring countries as the reaction of the decrease in the growth of Russia by 1 pp is characterized by decrease in the economic growth rate of Ukraine by 1.3 pp, that of Kazakhstan – by 0.3 pp, and of Belarus – by 0.3 pp. Reaction of GDPs of these countries is explained by a high level of synchronization of business cycles of the EAEU member countries and Ukraine.

The next shock is *China's shock*. The

assessment shows that if China's GDP decreases by 1 pp on average during two years, Kazakhstan's GDP will decline by 0.4 pp (Figure 2).

The dependence of Kazakhstan on China is due to the fact that China is a major trading partner of Kazakhstan and the impact is assessed mainly through the trade channel. The reaction of Belarus and Russia is no less significant.

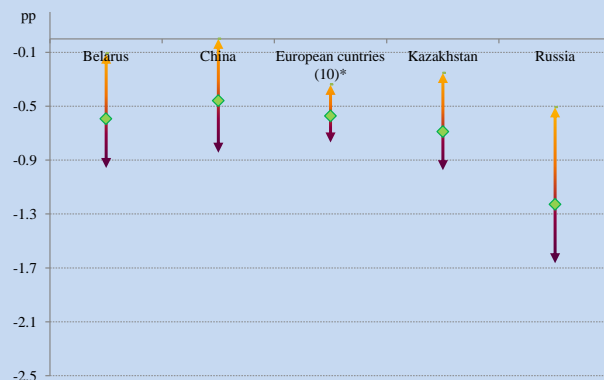
Figure 2
China's shock (if China's GDP goes down by 1 pp), two-year average



Source: EEC, calculation by NBRK

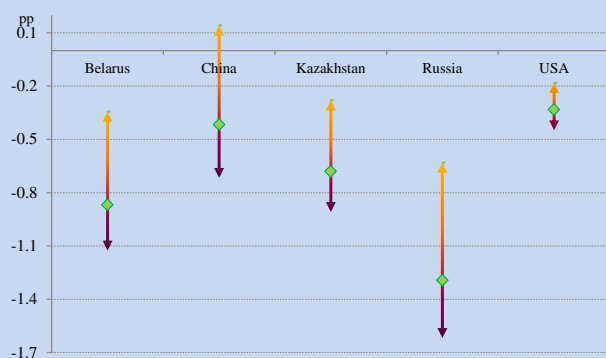
If the US GDP growth slows down, the reaction of Russia's GDP (1.2 pp) and that of Kazakhstan (0.7 pp) will be the strongest; however, as distinct from China's shock, the US shock is more significant (Figure 3).

Figure 3
USA's shock (if USA's GDP goes down by 1 pp), two-year average



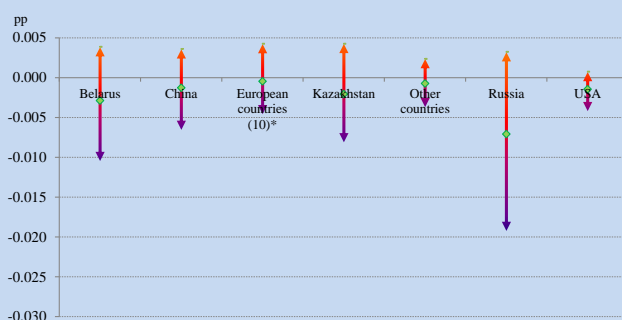
b) *The European countries' shock* has been considered as a specific regional shock, which comprises the impact of the weighted average values of variables of these countries (Figure 4). Similar to the US shock, this shock has significant impact on Kazakhstan (0.7 pp). The impact on Kazakhstan, similar to impact from China, is made mostly through the trade channel; impact through the financial channel is also possible.

Figure 4
Shock of 10 European countries (if their weighted average GDP goes down by 1 pp), two-year average



Source: EEC, calculation by NBRK

Figure 5
The effect of oil price shock on GDP, two-year average



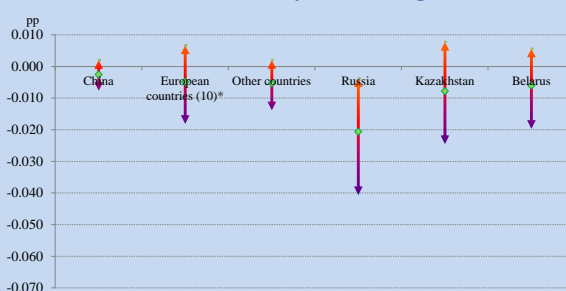
Source: EEC, calculation by NBRK

c) Given the impact of global shocks, there are shocks that can be common for the global economy as a whole. *Oil price* is considered as such *global shock*.

The results of the designed model of impact of an oil price shock on the country's economic growth show that the EAEU countries are more vulnerable to the oil price change as compared to other countries (Figure 5).

The model results also demonstrate that the oil price shock has less effect on Kazakhstan's real GDP and the Tenge

Figure 6
The effect of oil price shock on the real exchange rate**, one-year average



exchange rate, as compared to Russia, where the situation is the opposite. This circumstance may be due to Kazakhstan's more active policy in maintaining the economic growth and different approaches to the foreign exchange policy in these countries (Figure 6).

¹ Chudik A. and M. Hashem Pesaran «Theory and Practice of GVAR Modelling», May 2014.

The GVAR approach comprises two main steps. In the first step, small scale country-specific models are estimated versus the rest of the world. These models include domestic, foreign and global variables, which are presented in the form of a vector error correction model (VECM).

In the second step, individual country VAR models are stacked and solved simultaneously as one large global VAR model (GVAR).

² Based on ready GVAR toolbox developed by L. Vanessa Smith and Alessandro Galesi «GVAR Toolbox 2.0. User Guide», August 2014, and with the help of the engaged EEC employee.

³ Data applied on quarterly basis from 2000 to 2014.

⁴ Austria, Belgium, Finland, France, Germany, Italy, the Netherlands, Spain, Sweden and Great Britain, which account for more than 34% share in Kazakhstan's goods turnover.

⁵ Shocks are set as -1 standard deviation.

⁶ One year means the result of influence of variables at the end of the first year, i.e. for four quarters on average; two years - for eight quarters on average.

⁷ The real exchange rate here means the domestic currencies of countries in relation to US dollar, with adjustment for inflation rate in these countries.

⁸ Green diamonds on the figures represent the mean values of the Generalized Impulse Response Function (GIRF), while 90% Bootstrap Confidence Intervals are shown as arrows specifying the minimum and maximum values.

The overall increase in fixed capital investments is built up as a result of a significant contribution of own funds and funds from the state budget, while the contribution of borrowed funds has almost lost its importance (except for 2013.).

According to the 2014 performance, the tendency of investment growth mainly at the expense of own funds and public funds had been preserved. Their total contribution to the 8.3% growth in aggregate investments accounted for 16.0% at the end of 2014. Significant contribution of borrowed funds to the growth in fixed capital investments in 2013 due to investment in the sector of "transport and warehousing" turned out to be a one-time contribution and had no continuation in 2014 (Figure 2.1.5).

Figure 2.1.5
Contribution of funding sources to the growth in fixed capital investments

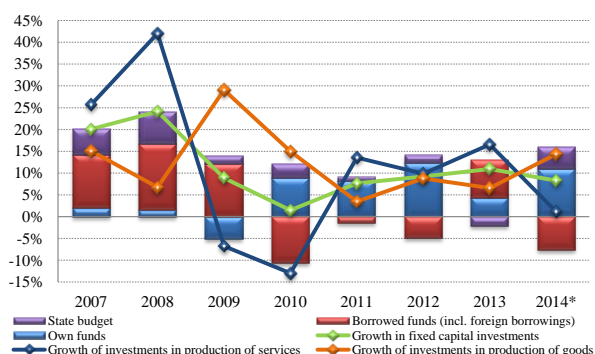


Figure 2.1.6
The volume of accumulated fixed capital investments during 2011-2014

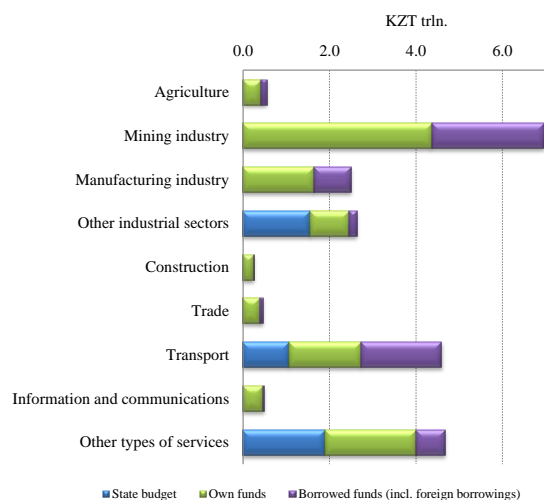
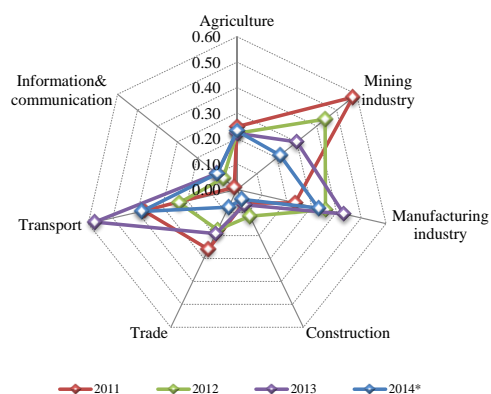


Figure 2.1.6
Share of borrowed funds (incl. foreign borrowings) in the fixed capital investments



A negative contribution of borrowed funds to the growth in aggregate volume of fixed capital investments had been due to the negative dynamics of borrowings in certain sectors of economy, which account for a major part of the investment volume (*“transport and warehousing”, the mining and manufacturing industries*). In this case, a low concentration of borrowed funds in the fixed capital investments in most sectors of the economy evidences their low investment attractiveness⁵.

The mining industry in the area of production of goods and *“transport and warehousing”* in the area of services production are considered to be Kazakhstan’s most attractive sectors of the economy for investments. Thus, for the period of 2011-2014, the amount of investments accumulated therein at the expense of the borrowed funds is the largest and equals KZT 2.6 trln. and KZT 1.9 trln., respectively (Figure 2.1.6).

Notwithstanding the maximum amount of accumulated investments in the *mining industry* of Kazakhstan, as a result of a gradual completion of the investment phase of the largest fields in Kazakhstan, a continuous decline is observed in the share of borrowed funds in the investments in this sector, which was 22% at the end of 2014. (2011 - 58%) (Figure 2.1.7). However, according to the study of Ernst & Young international group⁶, in spite of a drop in profits in the global oil and gas industry in the period of 2008-2012, capital expenditures were growing as a whole. Therefore, a downward trend in capital investments in the mining industry of Kazakhstan is consistent with the factor of its low investment attractiveness.

Meanwhile, the share of borrowed funds in fixed capital investments in the sectors that have the highest value of this indicator – *“transport and warehousing”* and the *“manufacturing industry”* - also decreased at the end of 2014: from 57% to 38% and from 43% to 33%, respectively.

In general, in spite of the decreased share of borrowed funds in fixed capital investments in the majority of economic sectors, overall investment activity in the economy still demonstrates the positive growth dynamics, where own funds remain the main source.

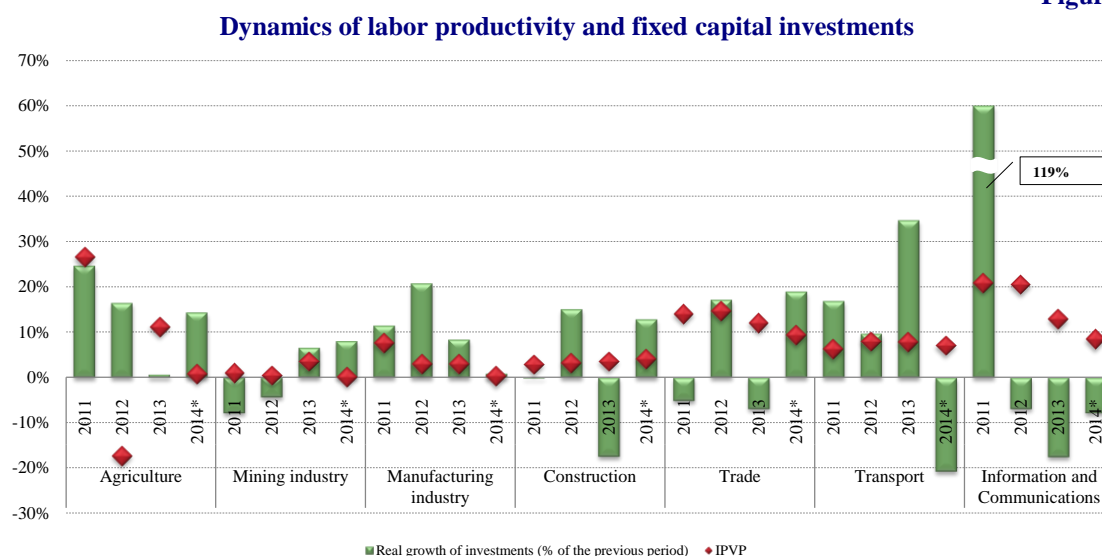
⁵ An assumption is used that borrowed funds, including foreign borrowings, were channelled to more attractive economic sectors; tis
⁶ Ernst&Young (2013). “Global oil and gas reserves study”.

An increase in capital investments of the economic sectors is not reflected in the growth of physical volumes of production output of these industries, which may be an evidence of low investment performance in the economy, or insufficiency of investments.

Performance indicators of the economic sectors and the amount of borrowed funds in the fixed capital investments, as a parameter to assess the investment attractiveness, do not demonstrate positive relationship.

The period of 2011-2014 has demonstrated that an increase in the physical volume of fixed capital investments does not necessarily result in a real increase of overall production in the economic sectors. For example, the sector of “construction”, regardless of the volume of investments experienced a moderate increase in production within the range of 2.8-4.1%. A similar trend is observed in the sector of “transport and warehousing” (6.2-7.9%) (Figure 2.1.8).

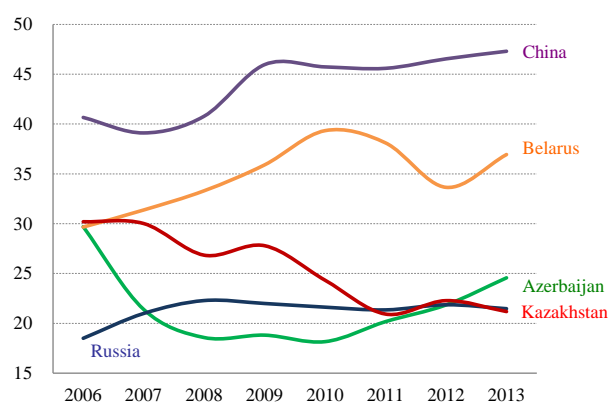
Figure 2.1.8



Note: *preliminary data

Source: CS MNE RK, calculation by NBRK

Figure 2.1.9
Gross fixed capital volume (% of GDP)



Source: WB

Overall, despite the stable growth of nominal volumes of fixed capital investments, the rate of accumulation (fixed capital investments to GDP ratio) remains low (Figure 2.1.9). In this regard, during the period of slow economic growth the role of the public funds and own funds in the fixed capital investments increases, and ability to attract investments through borrowings depends on the level of competitiveness of Kazakhstan's economic sectors relative to the others.

Analysis of the factors, which potentially determine the competitiveness of economic sectors, involves assessment of the relationship between the level of fixed capital investments and performance and profitability indicators of the industries. Based on the performance indicators, a high investment potential of economic sectors is demonstrated by sectors of “trade” and “information and communications”, which have the maximum average value of the workforce productivity and physical output for the period of 2011-2014 (Table 2.1.1). However, high performance indicators of these sectors do not contribute to a significant increase in funding from the external sources, and the share of borrowed funds in the investments therein remains low.

Table 2.1.1

Key performance and profitability indicators of economic sectors (as % of the corresponding period of the previous year)

	2011	2012	2013	2014*	aver. value for 2011-
Key economic sectors					
Physical production volume					
1. Information& communications	20.9%	20.5%	12.8%	8.5%	15.7%
2. Trade	14.0%	14.6%	12.1%	9.0%	12.4%
3. Transport& warehousing	6.2%	7.9%	7.7%	7.0%	7.2%
4. Agriculture, forestry & fishery	26.5%	-17.4%	11.2%	0.8%	5.3%
5. Manufacturing industry	7.5%	3.0%	2.9%	1.0%	3.6%
6. Construction	2.8%	3.1%	3.5%	4.1%	3.4%
7. Mining industry	1.0%	0.4%	3.5%	-0.3%	1.2%
Labor productivity					
1. Information& communications	5.1%	2.7%	13.9%	11.0%	8.2%
2. Trade	13.1%	17.8%	7.1%	8.5%	11.6%
3. Transport& warehousing	-0.5%	2.7%	8.0%	-0.7%	2.4%
4. Agriculture, forestry & fishery	32.2%	-16.6%	16.6%	9.3%	10.4%
5. Manufacturing industry	12.1%	3.0%	2.1%	3.0%	5.1%
6. Construction	-4.6%	-2.0%	1.1%	1.2%	-1.1%
7. Mining industry	-5.4%	-8.1%	-6.6%	-0.8%	-5.2%
Employment					
1. Information& communications	15.0%	6.8%	-1.0%	-1.1%	4.9%
2. Trade	0.8%	-2.7%	4.7%	0.9%	0.9%
3. Transport& warehousing	6.7%	4.5%	-0.3%	7.1%	4.5%
4. Agriculture, forestry & fishery	-4.3%	-1.1%	-4.6%	-12.0%	-5.5%
5. Manufacturing industry	-4.1%	0.2%	0.8%	-2.6%	-1.4%
6. Construction	7.8%	5.0%	2.4%	5.7%	5.2%
7. Mining industry	6.8%	8.8%	10.8%	0.3%	6.7%
ROA					
1. Information& communications	17.1%	10.9%	13.6%	11.5%	13.3%
2. Trade	7.5%	9.4%	6.7%	6.8%	7.6%
3. Transport& warehousing	6.8%	6.6%	5.9%	3.4%	5.7%
4. Agriculture, forestry & fishery	5.3%	2.5%	-1.5%	2.3%	2.2%
5. Manufacturing industry	11.8%	5.9%	5.4%	4.9%	7.0%
6. Construction	9.0%	6.9%	6.4%	7.1%	7.3%
7. Mining industry	50.9%	46.2%	35.0%	36.7%	42.2%

Note: Key sectors of the economy are ranked in descending order based on the average value of physical production volume for the period of 2011-2014

*preliminary data (data on the physical production volume from 17.02.2015)

Source: CS MNE RK, calculation by NBRK

Meanwhile, a significant increase in own funds in the fixed capital investment in the mining industry (against a significant decrease in the level of borrowings) is an evidence of insufficient fixed capital investments of this industry, which fact is reflected in its poor performance.

In addition, the increase in employment rate in the sectors, which have the highest decrease in the share of borrowed funds in the fixed capital investments (the “*mining industry*” and “*transport and warehousing*”), is accompanied by a decline in workforce productivity and possibly is an evidence of insufficient capital base to ensure additional workforce.

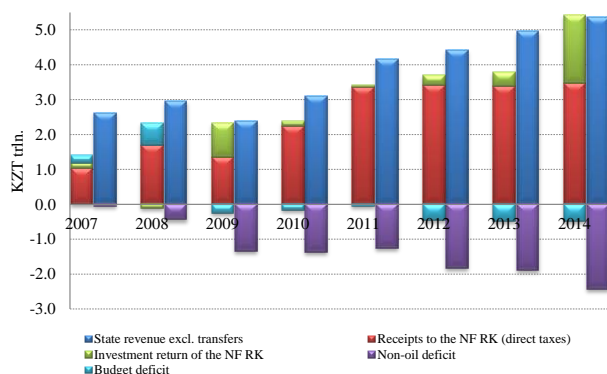
The level of profitability of economic sectors also does not demonstrate a clear relationship with the volume of borrowed funds in the fixed capital investments. For example, a proportion of borrowed funds in the investments in the *mining industry*, which significantly exceeds other sectors of the economy in terms of this indicator, at the end of 2014 was at the same level with agriculture, which has, on average, a lower profitability level for the period of 2011-2014.

In general, insufficient fixed capital investments in the economy explains the lack of modernization and actual change in the structure of the economy, and low growth of real output of individual industries.

As a result of accelerated growth of the government expenditures relative to the state revenues, the amount of non-oil budget deficit keeps growing. During the period of unfavorable oil prices, the need to restrain the growth of non-oil deficit increases, as its financing, amidst the lower receipts of petrodollars, involves the use of the NFRK reserves.

Overall, the moderate use of the NFRK funds in times of crisis as the measures of counter-cyclical nature has ensured the stable growth of its accumulations relative to the scale of the economy.

Figure 2.1.10
Dynamics of non-oil deficit and receipts to the NF RK

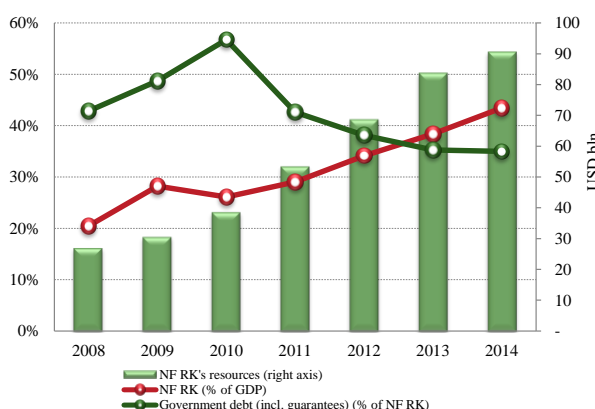


Source: MoF RK

trln. (20.5% of GDP) (Figure 2.1.10).

In terms of government revenues at the end of 2014, the growth of tax revenues dropped from 16.7% in 2013 to 7.0%. In this regard, it is necessary to emphasize two main trends in the tax revenues from the non-oil sector. Firstly, a significant recovery of increase in corporate income tax has been observed (13.3%) as well as increase of its contribution to the growth of tax revenues up to 2.9% versus -0.2% during 2012-2013. Secondly, there was a decrease in the VAT contribution to the tax revenues to 2.7% (in 2013 -10.1%) due to the increase of refund of VAT on foreign trade transactions from the budget.

Figure 2.1.11
Dynamics of the NF RK's resources



Source: CS MNE RK, calculation by NBRK

(2014 – 9.1% of GDP, 2013 - 10.1%, 2012 - 11.2%). However, the expansion of oil production may not become a factor compensating the lower fiscal revenues provided that the current level of global oil prices is preserved in the long term.

According to the 2014 performance, the state budget deficit had been at a rather low level (1.2% of GDP), similar to the trend observed over the last 5-6 years.

Meanwhile, a lower growth in government revenues, exclusive of transfers from NFRK, relative to government expenditures, observed during 2008-2014 continues contributing to an increase in the non-oil deficit. Thereby, at the end of 2014, government revenues (less transfers from the NFRK) increased by 7.8% to KZT 5.4 trln. (14.1% of GDP), while the government expenditures increased by 13.7% to KZT 7.8

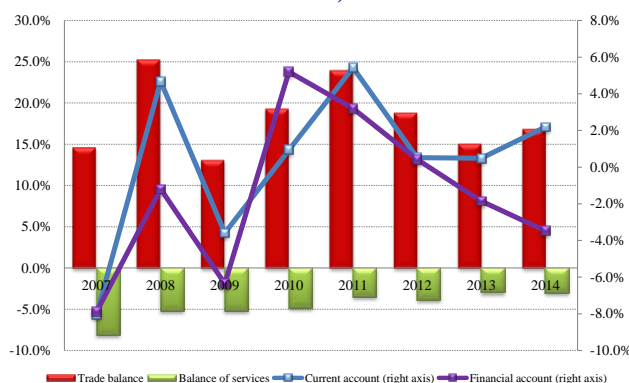
The annual increase of transfers from the NFRK to the state budget amounted to 39.1% at the end of 2014. At the same time, the structural problems of the economy and current trend of slowing growth in the mining industry amidst the falling oil prices cause a possible shortfall of petrodollars inflow to the NFRK, which, given the minimum annual volume of transfers from the NFRK, carries the risks of deceleration of the NFRK's accumulations. From this perspective, the issue of resuming oil production in the Kashagan oilfield and expansion of the Tengiz deposit acquires special importance as the amount of tax revenues from the oil sector reduces relative to the scale of the economy

Notwithstanding the annual growth of the amount of transfers from the NFRK to the state budget in absolute terms, their share in total reserves of the NFRK reduced in the mid-term and at the end of 2014 it amounted to 10.6%. At the same time, due to maintaining the moderate expenditure of the NFRK resources, especially during the period of crisis, the NFRK reserves were increasing continuously (Figure 2.1.11).

In general, the current level of the NFRK accumulations of 43.4% of GDP at the end of 2014 is estimated as a sufficient “safety cushion” to provide funding for government expenditures and for Kazakhstan public debt service, including that on the guarantees issued, not resulting in significant reduction in accumulations.

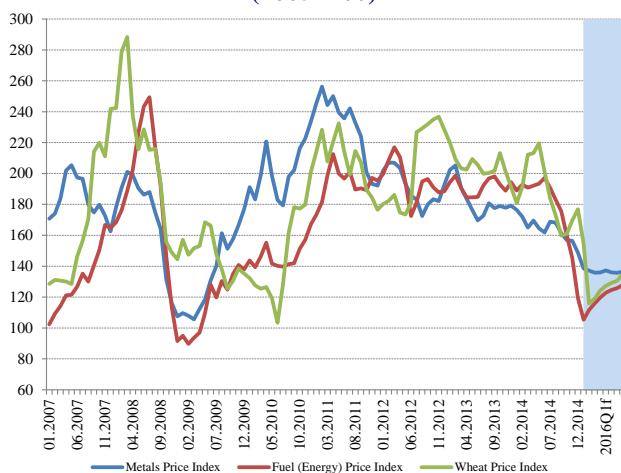
The exchange rate adjustments in February 2014 and high commodity prices in the first half of the year were among the key factors that contributed to preservation of the positive current balance of payments account for the year.

Figure 2.1.12
Dynamics of key balance of payments items, (% of GDP)



Source: NBRK

Figure 2.1.13
Dynamics of major export commodity groups⁷
(2005=100)



Source: IMF

According to the 2014 performance, the growth of the current account balance (2.2% of GDP) is due to a significant increase in the balance of trade surplus (Figure 2.1.12). This trend is largely a consequence of not fully realized effect of falling oil prices on the country's exports, the average level of which was relatively high than in the period of their maximum fall in 2009⁸. Meanwhile, in spite of increase in the physical volume of imports, a significant reduction in imports is the effect of low price parameters existed due to the adjustment of the Russian ruble exchange rate.

The financial account⁹ of the balance of payments at the end of 2014 was characterized by a net capital inflow into the country. This trend has developed largely because of increasing liabilities on the portfolio investment as a result of issue of sovereign bonds and new issues of securities of the non-banking sector of the economy, as well as reduction in the NFRK's assets and account balances of Kazakh banks with foreign banks.

If the unfavorable situation with prices in the global commodity markets (Figure 2.1.13) and the uncertainty of economies of Kazakhstan's major trade partners continue in the medium term, the risks associated with stability of the balance of payments will remain (Box 2).

⁷ Metals Price Index includes the price indices for copper, aluminum, iron ore, tin, nickel, zinc, lead and uranium; Energy Price Index includes the price indices for crude oil, natural gas and coal. Crude oil price - an average value of the spot price for Brent, Dubai and WTI.

f - forecast data. According to forecast data, in 2015 the average price for crude oil was USD 58.1 per barrel, in 2016 - USD 65.7.

⁸ In 2014, the average price of crude oil (Brent) was USD 99.3 /barrel; while in 2009 it was USD 61.6 USD/ barrel.

⁹ Net capital inflow in 2014 increased by USD 7.4 billion, similarly to 2009 (by USD 7.3 billion.)

A Scenario-Based Forecast of the Balance of Payments for 2015-2017 (as of April 2015)

If the average annual oil price remains at the level of USD 50 per barrel in the mid-term, the significant (almost double) decrease of the export of goods is expected due to reduction in both the contractual prices and physical volumes of exports (in 2015-2016), which will be compensated in future by increase in the number of oil deliveries due to the Kashagan oilfield commissioning (presumably from 2017).

Reduced revenues from oil exports will result in reduction of dividend payments to foreign direct investors and, accordingly, the narrowing of deficit of the investment income balance. As a result, the current account deficit in 2015 will be at 3.3% of GDP, and in 2016-2017 it will fall to 3.1-3.3% of GDP (with an average annual oil price of USD 55-60 per barrel, in 2015 the deficit will be at the level of about 2% of GDP).

Net inflow of foreign direct investment is expected to decrease during the forecast period due to completion of the existing projects and possible delay in the implementation of new projects with involvement of foreign direct investors, as a result of changes of prices in the commodity markets and substantial payments on previously received loans (including bond loans). At the same time, amidst the decline in net receipts of the NFRK in 2016, with the level of guaranteed and target transfers to the national budget being preserved, net capital inflow on portfolio investments will be observed.

If the average annual world oil price decreases to USD 40 per barrel during 2016-2017, the current account deficit will be about 3.8%-4.1% of GDP.

Under the pessimistic scenario as compared to the baseline scenario, net receipts of the NFRK are expected to decrease and the inflow of new financing for other investments will be reduced.

During 2016-2017, with the average annual world oil price of USD 60 per barrel, the forecast provides for the current account deficit within the range of 1.2-1.3% of GDP.

Decrease of the private sector's net borrowings will be observed in the financial account, which may be partially offset by new government loans from the international financial organizations. The decrease of new receipts and the growth of transfers from the NFRK will result in a decrease of external assets on portfolio investments (Table 1).

Table 1

Balance of payments forecast for 2015-2017, USD mln. (as of April 2015)

Item	2015	2016		2017			
	50 USD/barrel	60 USD/barrel	50 USD/barrel	40 USD/barrel	60 USD/barrel	50 USD/barrel	40 USD/barrel
Current account	-7 358.8	-2 937.6	-8 023.4	-9 662.4	-3 704.1	-8 532.6	-9 920.8
<i>Current account balance, of GDP</i>	-3.3%	-1.2%	-3.3%	-4.1%	-1.3%	-3.1%	-3.8%
Trade balance	9 869.0	16 354.1	9 751.0	6 123.2	16 520.4	10 091.2	6 869.2
Exports of goods	42 942.0	51 569.1	43 709.0	37 861.9	53 651.9	45 761.4	40 402.3
Imports of goods	33 073.0	35 215.0	33 958.0	31 738.7	37 131.5	35 670.1	33 533.2
Exports of services	4 346.9	5 041.3	4 713.0	4 380.5	5 513.4	5 164.3	4 782.8
Imports of services	9 024.7	10 205.6	9 780.7	9 119.4	11 423.6	10 920.6	10 289.3
Financial account	-7 641.5	-7 709.1	-9 109.0	-10 383.9	-6 578.9	-8 150.0	-9 797.0
Net direct investments	-6 285.7	-6 452.5	-6 152.5	-6 050.5	-6 356.4	-6 177.6	-6 482.6
Overall balance	4 633.5	-690.2	2 600.9	2 187.0	895.5	3 795.2	2 794.1
<i>Overall net balance, % of GDP</i>	2.1%	-0.3%	1.1%	0.9%	0.3%	1.4%	1.1%

Source: NBRK

High reliance of Kazakhstan's sales turnover on the oil prices persists. In this regard, low competitiveness of Kazakhstani goods from the non-oil sector determines their weak external demand, including that on the part of the EAEU member countries.

Changes in Kazakhstan's trade turnover are observed at the end of 2014 in relation to the main types of goods due to realization of negative external factors. Reduction in exports at the end of 2014 has been caused, first of all, by the decrease in physical volumes of oil (-3.5%) and metals (-9.7%) as compared to 2013. The value of imports, in its turn, had declined in 2014 due to reduction in the value of imports of machinery and equipment (-7.8%) and metals and products made of metal (-33.3%).

At the same time, the dynamics of exports and imports of metal products at the end of 2014 show the deterioration of competitiveness of Kazakhstani products. Thus, in 2014 the value of exports of these products dropped by 17.1% on a year-over-year basis (from 2011 it has decreased by 33.1%). The value of imports of metals, in its turn, dropped by 33.3% at the end of 2014 (from 2011 it has increased by 14.3%).

The structure of Kazakhstan's exports to EAEU member countries shows that the main export commodities are metals and mineral products (except for oil and gas condensate), while the main commodities exported to the rest of the world are oil and gas condensate – about 70% (Figure 2.1.14).

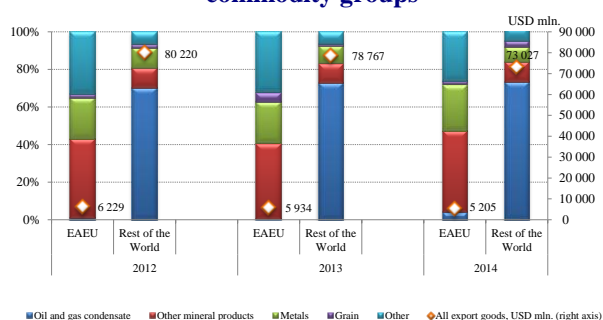
Table 2.1.2
Foreign trade of Kazakhstan broken down by large partners (% in the total export/import volume)

	2011	2012	2013	2014
Total exports, USD mln.:	84 336	86 449	84 700	78 238
Russia	8,3%	7,1%	6,9%	6,6%
China	17,5%	16,5%	17,0%	12,5%
EU countries	49,9%	52,4%	53,9%	56,8%
Rest of the world	24,2%	24,0%	22,2%	24,0%
Total imports, USD mln.:	36 906	46358	48 806	41 213
Russia	41,5%	36,6%	36,8%	33,3%
China	13,4%	16,1%	17,1%	17,9%
EU countries	19,8%	20,1%	18,6%	20,9%
Rest of the world	25,3%	27,2%	27,5%	27,9%

Source: CS MNE RK

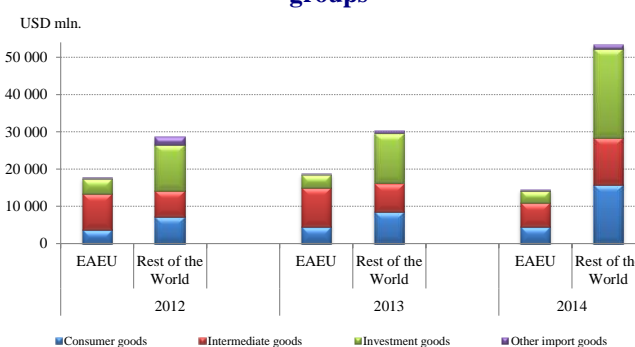
Figure 2.1.14

Exports from Kazakhstan, broken down by commodity groups



Source: SRC MoF RK, CS MNE RK, calculation by NBRK

Figure 2.1.15
Imports from Kazakhstan, broken down by commodity groups



Source: SRC MoF RK, CS MNE RK, calculation by NBRK

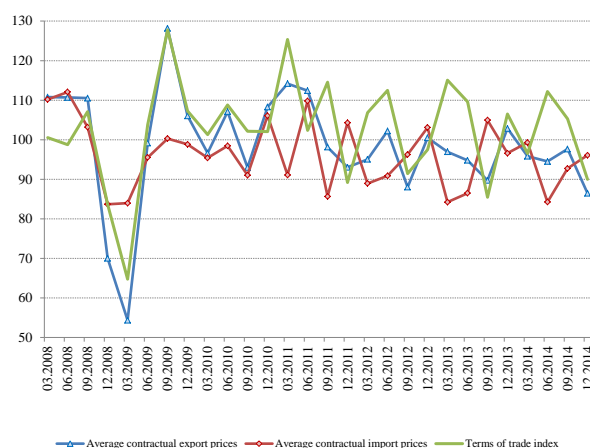
With the growth of total imports in the mid-term, Kazakhstan, in its turn, is prone to the increase in imports from the countries outside the EAEU (China, the European Union) (Table 2.1.2). Significant deterioration in the terms of trade outlined at the end of 2014 was due to lower average contract prices for mineral products and metals amidst the rising import prices for consumer goods (Figure 2.1.16). At the same time, the deterioration of the terms of trade with Kazakhstan's trade partners – Russia and Euro zone was noted.

Kazakhstan's REER which is an indicator of the country's price competitiveness demonstrated a multi-directional dynamics during 2104. In the first half of the year, due to the adjustment of the domestic currency exchange rate, the Tenge depreciated in the real terms, thus strengthening the competitive position of the country relative to its trading partners. Amidst the Financial Stability Report of Kazakhstan, December 2014

unfavorable situation with oil prices, a significant nominal depreciation of currencies of major trading partners, mostly the Russian ruble, and a slowdown of the inflation rate in Kazakhstan in the

Figure 2.1.16

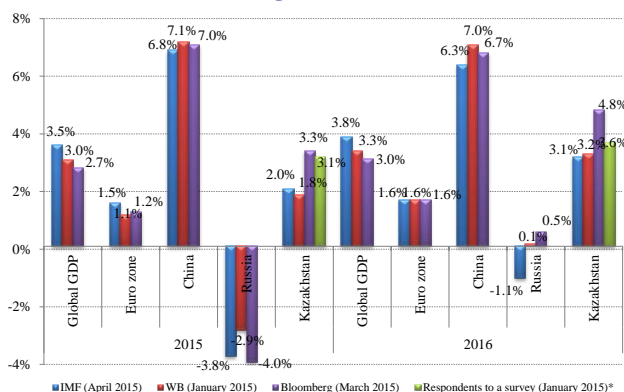
Terms of trade (2000=100)



Source: NBRK

Figure 2.1.17

Forecasts for growth of economies

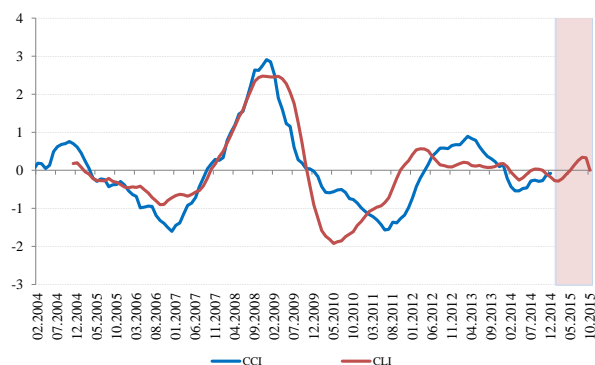


Note: *The average of answers of respondents to the survey "Risk assessment of the Kazakhstan's financial system" conducted by the NBRK. 127 representatives from financial organizations participated in the survey.

Source: IMF, WB, Bloomberg, NBRK

Figure 2.1.18

Leading and coincident indicators of Kazakhstan's economy

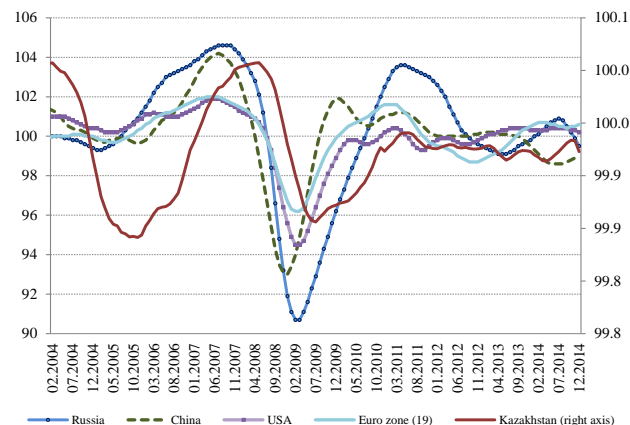


Note: CLI is shifted to the right for 10 months to reflect its leading characteristic.

Source: NBRK

Figure 2.1.19

Leading indicators of Kazakhstan's large trading partners



Source: OECD, NBRK

second half of the year, the Tenge had appreciated in real terms. On average during 2014, in real terms the Tenge remained at a level corresponding to or close to its equilibrium value.

Persistence of an unfavorable situation in the economy of Kazakhstan's partners in the short term may adversely affect the business activity of Kazakhstan.

Expectations about the future growth of Kazakhstan's economy for 2015-2016 are multi-directional. In the short term, the forecast of the real GDP in Kazakhstan assumes a slowdown of its growth rate at the level below the level prevailing at the end of 2014, mainly due to pessimistic expectations about the growth of the country's main trade partners (Figure 2.1.17). The forecasts for the mid-term, in their turn, are assessed rather positively against the positive expectations about continuing recovery in the global economy growth.

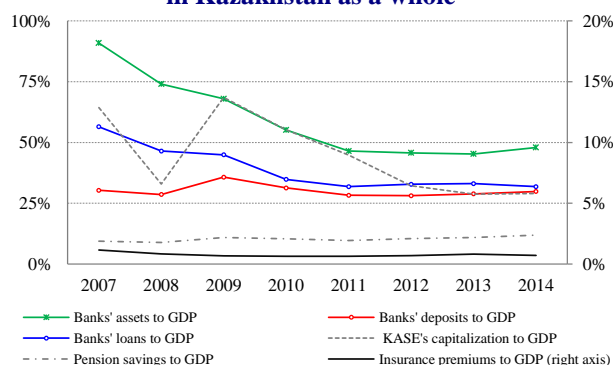
The dynamics in the composite leading indicator for the real sector, which has a short-term forecasting nature, assume maintaining the upward trend of economic growth. However, possible realization of substantial external risks increases the probability of slowing the economic activity of the country. At the same time, leading indicators of the economies of Kazakhstan's trade partners signal about the increased range of changes in their rates of economic growth (Figs. 2.1.18-2.1.19).

2.2 Role and Concentration of Financial Sector

2.2.1 Trends in Development of Financial Relations

Extensive development of the financial sector continues to be one of those factors that restricts the growth rate of the country's economy. Moreover, the continuing regional and sectoral differentiation in the development of financial relations affects the dynamics of entrepreneurship development, access to the financial services for business and population.

Figure 2.2.1.1
Dynamics of key financial intermediation indicators in Kazakhstan as a whole

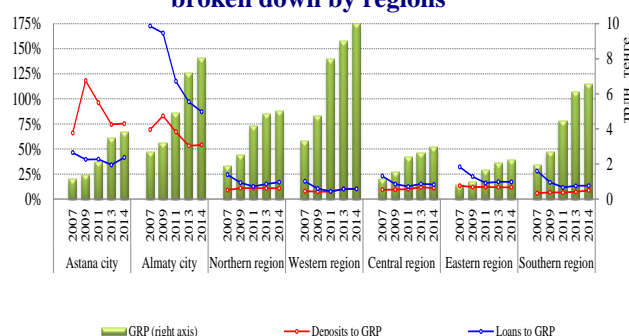


Source: CS MNE RK, NBRK, calculation by NBRK

From the beginning of 2014, a moderate growth is noted in the key indicators of financial intermediation relative to GDP. However, they have been practically at the minimum level over the last few years (Figure 2.2.1.1). A positive thing is that the stock market capitalization to GDP ratio has stopped decreasing. However, its long-term decline (over 4 years) has resulted in the situation when the amount of bank deposits exceeded the amount of the KASE capitalization (in terms of securities of corporate issuers); this indicates that cash depositing is preferable as compared to investments in the stock market instruments.

The share of assets of the banking sector in Kazakhstan's GDP has reached 50%; however, it remains not only below the pre-crisis level of 2007 but it is also below the countries with similar levels of economic development. The average value of this indicator for 2013 in respect of emerging economies is 110% of GDP, including the regions of Europe - 62%, Latin America - 65%, and Asia - 164%. In the USA, the similar indicator is 95%; in other developed countries it is usually much higher than 100% of GDP¹⁰.

Figure 2.2.1.2
Dynamics of key financial intermediation indicators broken down by regions¹¹



Source: CS MNE RK, NBRK, calculation by NBRK

The outrunning growth of deposits (15%) over loans (7%) contributed to reduction in the loan to deposit ratio of up to 110% (which level corresponds to that of the Euro zone)¹². Lower values of this indicator will correspond to the improved level of liquidity, but at the same time it will make signal of the insufficient use of resources by banks to generate profit given the decreasing lending activity. The deposit growth rate exceeds the GDP growth rate, resulting in an increase in the share of deposits in the GDP, which is also observed in the regional breakdown (Figure 2.2.1.2).

A positive thing is that the downward trend of this (deposits/GRP) ratio in Astana and Almaty has stopped, just as the loans to GRP ratio in Astana. The regional differentiation in terms of these ratios still exists, especially between the regions of the country and cities of Astana and Almaty. In this connection, further efforts are required on the part of the government, which are aimed at the

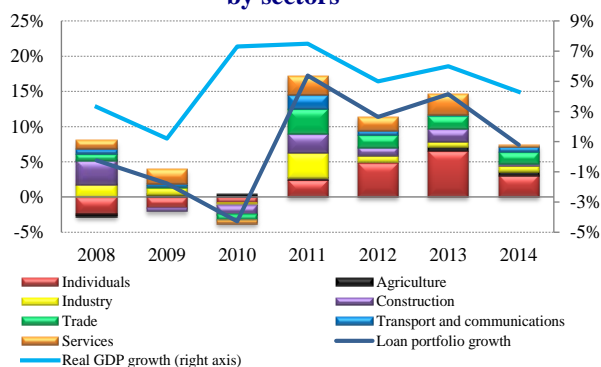
¹⁰ Source: IMF, NBRK calculations.

¹¹ Oblasts have been grouped into relevant regions as follows: Akmola, Kostanai, Pavlodar and North-Kazakhstan oblasts - Northern Region, Aktope, Atyrau, West-Kazakhstan and Mangistau oblasts - Western Region, Karaganda oblast - Central Region; East-Kazakhstan oblast - Eastern Region; Almaty, Zhambyl, Kzylorda and South-Kazakhstan oblasts - Southern Region.

¹² According to the IMF data, the values of a corresponding indicator for the emerging markets are as follows: China - 57%, India - 78%, Indonesia - 96%, Malaysia - 80%, Brazil - 99%, Argentina - 68%, Chile - 115%, Mexico - 113%, Poland - 115%, Russia - 148%, Turkey - 119%, Republic of South Africa - 106%.

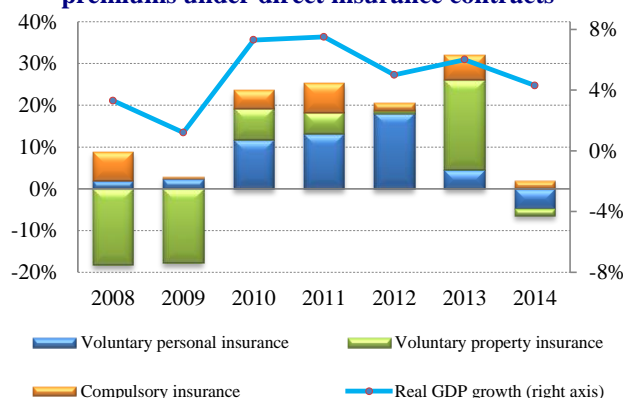
equal development of regions, support for regional small and medium-sized businesses, and raising the level of financial literacy of the population.

Figure 2.2.1.3
Dynamics of the change in total loans broken down by sectors



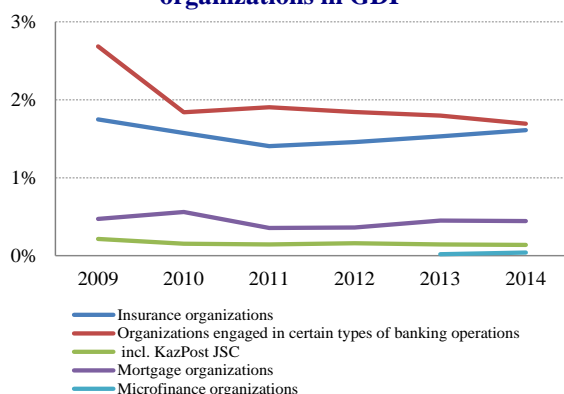
Source: CS MNE RK, NBRK, calculation by NBRK

Figure 2.2.1.4
Dynamics of the change in the volume of insurance premiums under direct insurance contracts



Source: NBRK

Figure 2.2.1.5
Dynamics of the share of assets of non-bank financial organizations in GDP



Source: NBRK

According to the 2014 performance, changes in the structure of the loan portfolio growth are visible (Figure 2.2.1.3). A proportion of loans to the construction and services sectors in the growth structure had decreased, at the same time retail loans continue making a major contribution to the growth of lending volumes. It should be noted that the net borrowing costs of the STBs (book value less provisions) increased by 19% during 2014, thus reflecting those measures which have been taken to reduce a share of non-performing loans, and respectively, the amount of provisions.

During 2014, an increase in insurance premiums collected was recorded in all classes of compulsory insurance, while the amount of insurance premiums collected in the categories of voluntary insurance decreased (Figure 2.2.1.4).

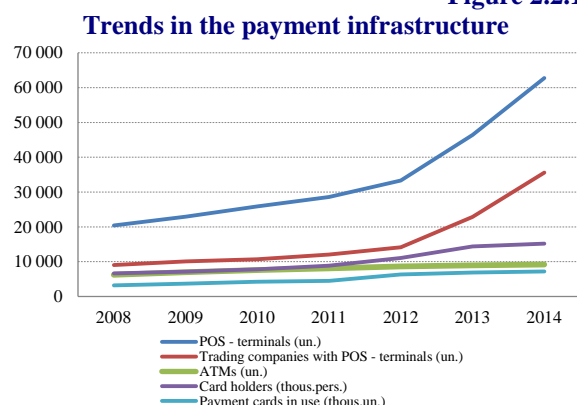
Insurance premiums in the voluntary personal insurance decreased as a result of decreased premiums under the annuity insurance as transfers of pension savings to insurance organizations were suspended during the period from July 2013 to May 2014, and amendments were made to the Law “On Retirement Security” (increase of adequacy of pension savings to conclude the annuity contract, changes in terms and conditions of the lump sum payment, etc.). Decrease of insurance premiums in voluntary property insurance had been caused by decreased premiums in the class of “insurance against other financial losses” as a result of closure of some banking products.

Assets of microfinance organizations remains small - 0.04% of GDP (Figure 2.2.1.5), in spite of their 2.3 times growth at the end of 2014. At the same time, the total amount of microcredits increased by 2.6 times and amounted to KZT 13.7 bln. as at January 1, 2015.

Enforcement of requirements for mandatory installation of POS-terminals when carrying out certain activities has resulted in an increase of their number and the number of trading enterprises with such equipment (Figure 2.2.1.6). Due to the increase in the number of trading companies with one POS-terminal from 2013, the average number of POS-terminals per enterprise decreased to 1.8 in 2014. The number of the bank cardholders at the end of 2014 exceeded 15 million; however less than half of the outstanding cards have been actively used. ATM penetration rate is one ATM per 1900 individuals. This indicator in the Euro zone is about 1000 individuals; so, the ATM penetration rate in Portugal,

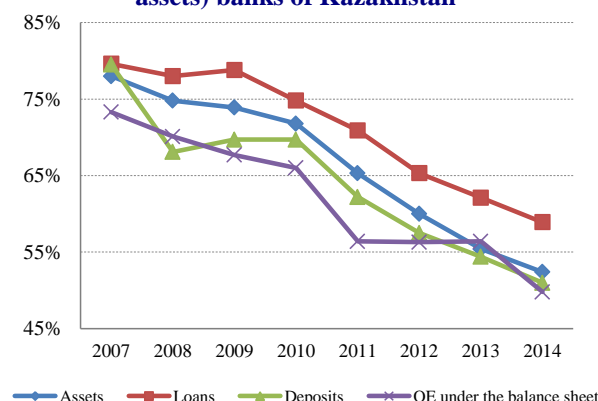
Spain and Germany is less than 1000 people per one ATM; in Austria, France and Italy – 1,000-1,200 people per one ATM; in Slovakia and Finland – more than 2,100 people per one ATM¹³.

Figure 2.2.1.6



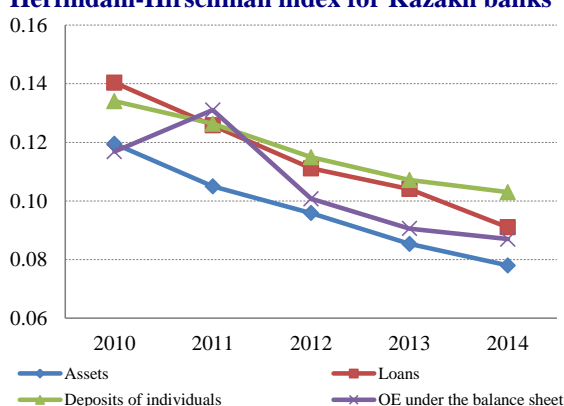
Source: NBRK

Figure 2.2.2.1
Concentration indicators of five largest (in terms of assets) banks of Kazakhstan



Source: NBRK

Figure 2.2.2.2
Herfindahl-Hirschman index for Kazakh banks



Source: NBRK

of the HHI downward trend observed since 2010. In the EAEU member countries, the HHI minimum value (0.08 for assets) and, consequently, low concentration levels are observed in Kazakhstan (in Russia - 0.11, and in Belarus - 0.22). In the EU, the HHI for assets is 0.07, and the lowest level of concentration of credit institutions has been registered in Germany (0.03), Austria and Italy (0.04), France (0.06), Spain (0.08); the medium level - in Portugal and Slovakia (0.12), in

2.2.2 Concentration in the Banking and Insurance Sectors

During 2014, the level of concentration both in the banking sector and insurance market remained negligible. However, in connection with the conducted bank mergers, this trend is expected to change towards increasing banking concentration.

In 2014, a share of the country's five top banks in terms of assets (loans) exceeded the share of these banks in terms of owners' equity (OE), i.e. capitalization of the top banks is lower than the average capitalization of the banking system (Figure 2.2.2.1).

During 2013, in the EU, five top banks held a 47% market share in terms of assets, in Central Europe – 64% of the market, 57% - in South-East Europe and 58% - in the CIS. In different countries, including those located within the same region, the indicators of concentration of assets vary in a wide range, for example, in Germany, Italy, Austria, Poland and Ukraine this indicator is less than 50%; in the USA and Denmark - 60-65%, in the UK, Slovakia, Croatia and Albania - 70-75%; in Finland, Belarus, Lithuania and the Netherlands - more than 75%; in Canada, Australia, Greece and Estonia - above 85%¹⁴.

Another significant indicator of concentration is the Herfindahl-Hirschman Index (HHI)¹⁵. The HHI in Kazakhstan in terms of assets, loans and equity of the STBs reflects a low level of concentration; the HHI for deposits of individuals is at a minimum level of the medium concentration (Figure 2.2.2.2). The HHI for equity is expected to increase, given that the HHI for other indicators remains relatively unchanged due to acquisitions in the banking sector during 2014, which would entail a change

¹³ Source: ECB

¹⁴ Sources: IMF, ECB, Raiffeisen RESEARCH.

¹⁵ Herfindahl-Hirschman Index, is used to assess monopolization of an economy sector. It is defined as the sum of the squares of the market shares of all banks operating in the market. The commonly used gradation for HHI is as follows: from 0 to 0.10 – a low concentration level; from 0.10 to 0.18 – a medium concentration level and from 0.18 to 1 – a high concentration level.

Cyprus and Malta (0.15); a high concentration is typical for the Netherlands and Greece (0.21), Estonia (0.25) and Finland (0.31)¹⁶.

A high level of concentration in Kazakhstan is observed among the interbank loans, loans to legal entities and non-performing loans with payments overdue for more than 90 days, where five banks having the maximum share of the corresponding indicator account for more than 75% of the total value (Fig. 2.2.2.3).

In the industry-based breakdown, beginning from 2014 the maximum increase in the

Figure 2.2.2.3
Concentration of five largest (by each indicator)
banks of Kazakhstan

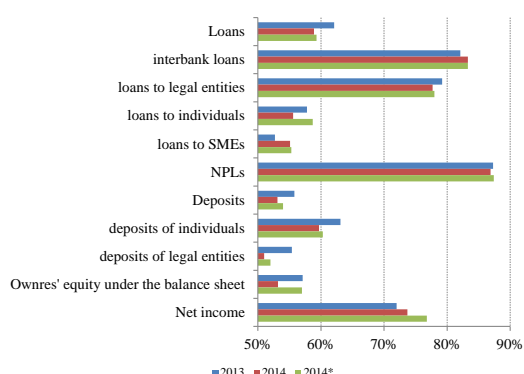
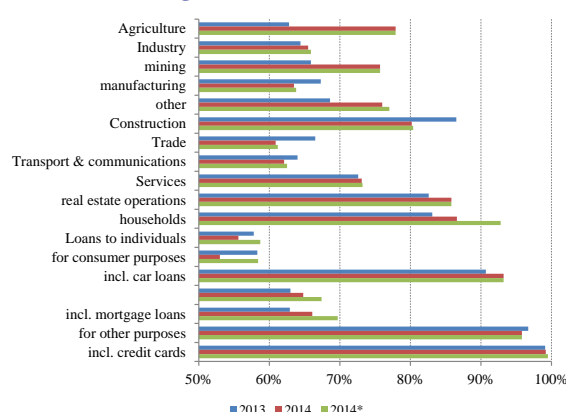


Figure 2.2.2.4
Concentration indicators of five largest (by each
sector/segment) banks of Kazakhstan



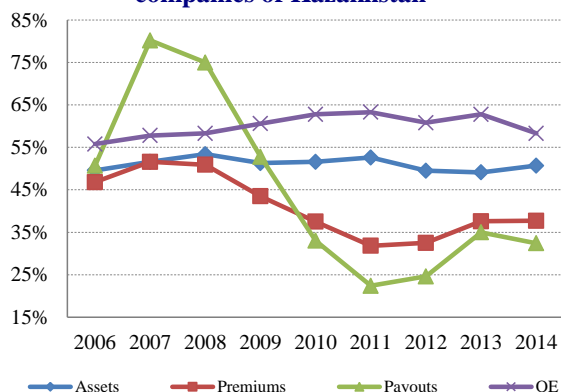
Note: *incl. transactions on acquisitions in 2014, except transaction with the BTA Bank JSC

Source: NBRK

Note: *incl. transactions on acquisitions in 2014, except transaction with the BTA Bank JSC

Source: NBRK

Figure 2.2.2.5
Concentration indicators of five largest insurance
companies of Kazakhstan



Source: NBRK

concentration of the loan portfolio (Fig. 2.2.2.4) has been recorded in agriculture, the mining industry and other industries (electricity, gas and water supply, etc.).

High levels of concentration (five banks with the largest share) can be seen in the following segments: loans to individuals for other purposes, most of which are represented by credit cards; loans to individuals for the purchase of motor vehicles; loans to the construction industry and loans to the service sector. Acquisition transactions concluded in the banking sector in 2014 have the greatest impact on the concentration growth (shares of five dominant banks) in the segment of retail loans, in

particular, consumer loans to individuals.

In the insurance sector, the concentration ratios of five top companies had changed insignificantly from the beginning of 2014 (Fig. 2.2.2.5). Data for the entire period under review shows a consistently low level of concentration of assets of the insurance companies. Concentration ratios of five top insurance companies in terms of insurance premiums received and insurance payments made are at the low level over the recent years. The persistently significant gap between the shares of five top companies in terms of equity and insurance premiums/payments indicates the existence of high risks in the sector, when the bulk of insurance benefit payments is in the companies with low capitalization.

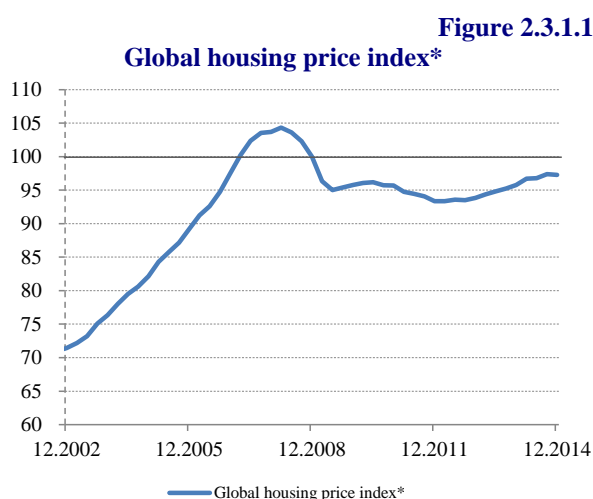
¹⁶ Source: ECB

2.3. Markets of Real and Financial Assets

2.3.1. Real Estate Market

The growth in real estate prices in Kazakhstan shows investment attractiveness of this market. However, given the current price level determined by the growth in the cost of construction, low payment capacity and existing conditions in the mortgage lending sector, home purchase remains unaffordable for the public at large, despite the increased supply in the new housing market. Virtually all global real estate markets including the real estate market of Kazakhstan continue to go through the post-crisis recovery stage.

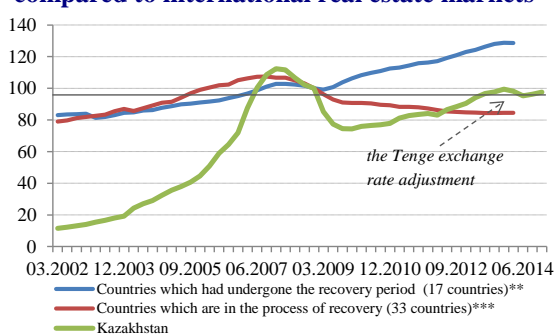
The dynamics of the aggregated world housing price index, beginning from the second half of 2012, is indicative of a gradual revival of real estate markets (Figure 2.3.1.1). According to the



Note: *4 quarter 2008 = 100

Source: IMF, calculation by NBRK

Figure 2.3.1.2
Price index in the real estate market of Kazakhstan as compared to international real estate markets *



Note: *4 quarter 2008 = 100

Source: IMF, CS MNE RK, calculation by NBRK

IMF¹⁷, two groups of countries are clearly singled out, in terms of intensity of recovery of various real estate markets: countries which are characterized by full recovery of real estate markets and countries which are only in the course of recovery (Figure 2.3.1.2).

The first group (a sample of 17 countries¹⁸) is characterized by a full recovery and the growth in housing prices. These countries did not face a drop in prices in 2008 and this became a prerequisite for a faster recovery: in the 1st quarter of 2014, prices exceeded the level of the 4th quarter of 2008 by 28.6% on average.

The second group (a sample of 33 countries¹⁹) demonstrates an apparent trend of falling real estate prices which were 15.5% lower in the 1st quarter of 2014 than in the 4th quarter of 2008.

Housing prices in Kazakhstan grew by virtually 10 times during the 2002-2007 boom. At the same time, as opposed to countries both in the first and in the second group, Kazakhstan has been demonstrating the trend of growing prices over 5 years; however, the peak of 2007-2008 has not been exceeded yet.

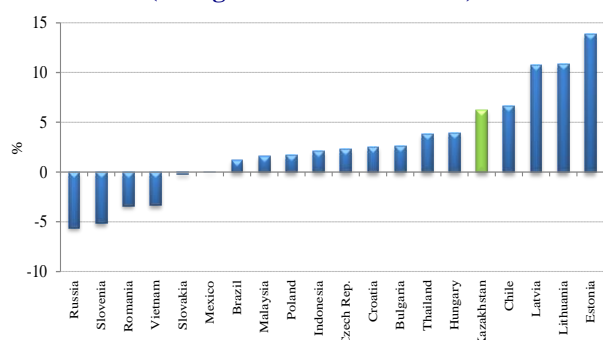
The price in the housing market of Kazakhstan is overestimated; however, the Kazakh real estate market is still attractive from the investment standpoint.

¹⁷ IMF's publication "Global housing watch: quarterly update (October 2014)".

¹⁸ Australia, Austria, Brazil, Canada, China, Columbia, Germany, Hong Kong, Israel, Luxembourg, Malaysia, New Zealand, Norway, Philippines, Singapore, Sweden, Switzerland.

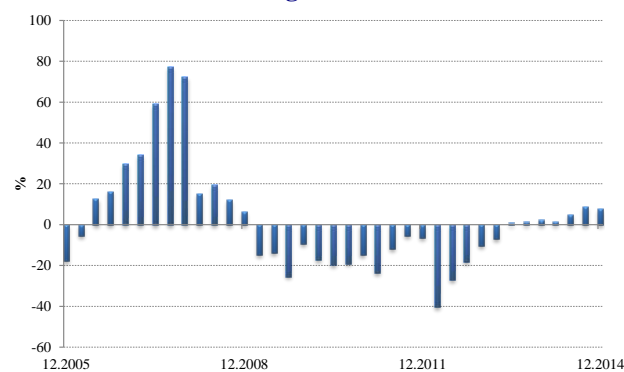
¹⁹ Belgium, Bulgaria, Croatia, Cyprus, the Czech Republic, Denmark, Estonia, Finland, France, Greece, Hungary, Iceland, India, Indonesia, Ireland, Italy, Japan, Korea, Latvia, Lithuania, Malta, Mexico, Netherlands, Poland, Portugal, Russia, Slovakia, Slovenia, the South Africa, Spain, Thailand, the UK, the USA.

Figure 2.3.1.3
Real estate prices* in the countries comparable in terms of their level of development (change in 2014 versus 2013)



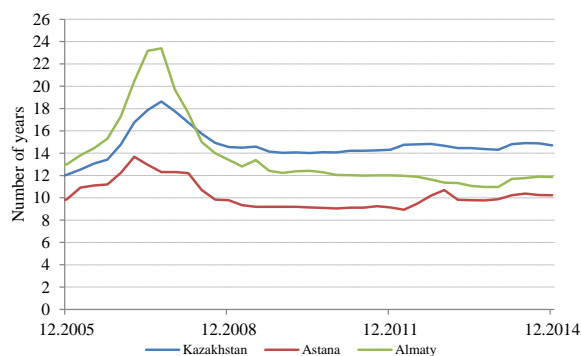
Note: *real change in prices in the local currencies
Source: IMF, calculation by NBRK

Figure 2.3.1.4
Housing price versus the construction cost: deviation from the average historical value²¹



Source: CS MNE RK, calculation by NBRK

Figure 2.3.1.5
Pay-back period for housing



Source: CS MNE RK, calculation by NBRK

Based on the 2014 performance, despite some slowdown in prices as a result of the adjustment of the Tenge exchange rate, a real growth in housing prices was fairly high (6.2%), especially against the countries which are comparable in terms of their development level²⁰: the average change in prices in this group accounts for 2.4% (Figure 2.3.1.3).

The price growth in Kazakhstan is primarily caused by the growth in the cost of construction: a minor deviation in the housing price/cost of construction ratio from its historical value indicates that during the last two years the cost of construction was growing in proportion to the housing prices (Figure 2.3.1.4).

At the same time, there is overestimation of the current level of housing prices. So, the payback period for housing²² in Kazakhstan is about 15 years (Figure 2.3.1.5), whereas the payback period for housing according to existing international standards does not exceed 10 years. Despite some overestimation of housing prices, the Kazakh real estate market is still attractive from the investment standpoint.

Firstly, according to the studies by the Global Property Guide²³, the highest investment benefit may be received if the pay-back period of housing does not exceed 12.5 years; in case of a pay-back period not exceeding 20 years investment still brings economic benefit but to a smaller extent than at the initial period of the price growth.

Secondly, housing prices are at the growing phase and there are no prerequisites for their dramatic decline. A positive value of the deviation in the housing price to rental price ratio points to that fact (Figure 2.3.1.6).

At the same time, a significant deviation, as it had been the case in 2007-2008, would indicate a considerable reappraisal of the cost of housing in the short-term.

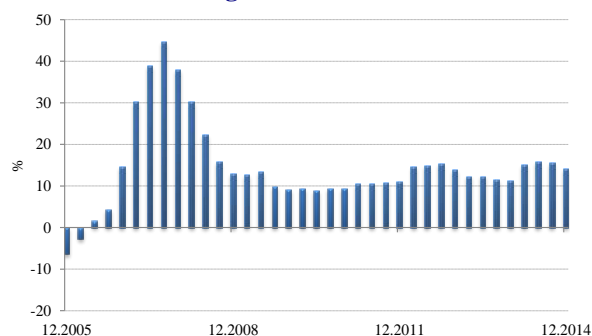
²⁰ Countries comparable with Kazakhstan in terms of their GDP per capita, per capital income and comparable level of attractiveness of their capital markets for investors (grouping of countries on the basis of the MSCI Frontier Emerging Markets Index, S&P Frontier Broad Market Index and Dow Jones Frontier Market Index) were selected for comparison.

²¹ Deviation from the historical mean: ([current value] minus [the mean for 2001-2014]) / [the mean for 2001-2014]).

²² Pay-back period for housing: an annual ratio of the housing price and rental price.

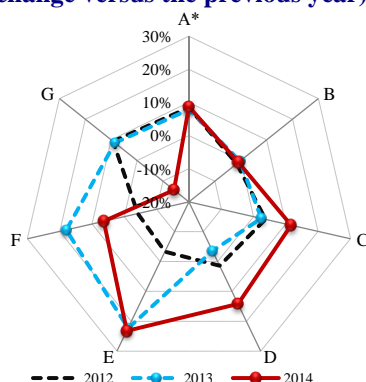
²³ According to the Global Property Guide, the pay-back period not exceeding 12.5 years speaks for an underestimated cost of housing, from 12.6 to 20 – for fair prices in the real estate market, and over 20 years – for an overestimated cost of housing.

Figure 2.3.1.6
Housing price versus rental price: deviation from the average historical value²⁴



Source: CS MNE RK, calculation by NBRK

Figure 2.3.1.7
Activity in the real estate market
(change versus the previous year)



Note: *A - Volume of construction works (services), KZT thous.; B - Number of houses commissioned, units; C - Total area of commissioned residential buildings, sq.m; D - Total area of commissioned non-residential buildings, sq.m; E - Investments in residential construction, KZT thous.; F - Investments at the population's expense in total investments, KZT thous.; G - Number of home purchases/sales

Source: CS MNE RK, calculation by NBRK

Thirdly, real estate investments in Kazakhstan remain a more attractive alternative to bank deposits, where weighted average interest rates accounted for 8.8% in 2014, whereas the annual growth in nominal prices of housing accounted for 15.3%. During 3 years, the return on deposit accounted for 30.5% and the return on real estate investments – 41.9%.

In 2014, the active behavior of the population in the real estate market was reducing, while the construction sector was still characterized by moderate activity, with differentiation by regions.

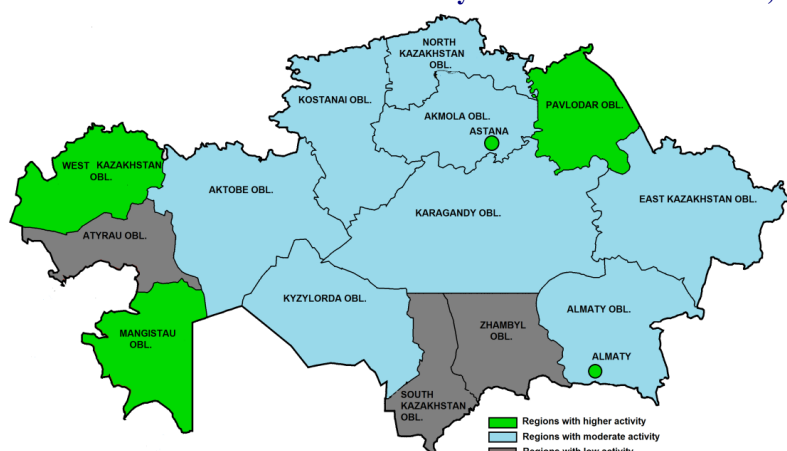
First, in 2014, the number of purchase/sale transactions decreased by 14.2% as there have been disproportions in the wage growth rates and the growth rates of housing prices since 2013 (Figure 2.3.1.7). So, average rates of the wage growth during 2013-2014 account for 9.7%, whereas average rates of growth in housing prices account for 16.9%.

Second, if in 2013, the growth of investments in housing construction was by 35.0% explained by the growth in own funds of the population, in 2014 such increase accounted for 11.6% only.

During 2014 as a whole, there was still a regional diversification of activity in the real estate market of Kazakhstan. In three regions of Kazakhstan, activity in the real estate market was low (Figure 2.3.1.8). These regions demonstrate the 5.8% decrease in volumes of construction works as compared to 2013. The relative share of

Figure 2.3.1.8

Activity* in the real estate market, by regions



Source: CS MNE RK, calculation by NBRK

*Activity indicators:

- growth in the volume of construction works
- growth in the volume of construction works
- growth in the total area of commissioned residential buildings
- growth in home purchases/sales

Method for the breakdown by regions:

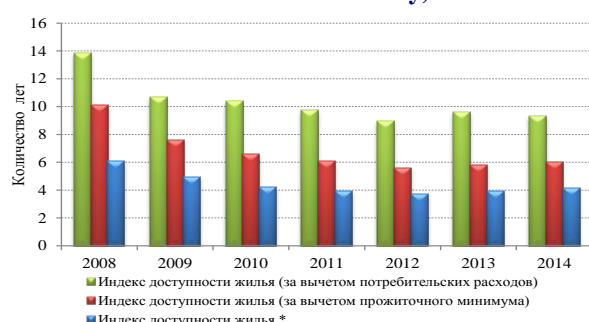
- **Low activity group:** at least 2 indicators are < 33 percentile
- **Moderate activity group:** at least 1 indicator is < 33 percentile
- **Higher activity group:** at least 2 indicators are > 67 percentile

²⁴ Deviation from the average historical value: ([current value] minus [average value for 2001-2014]) / [average value for 2001-2014]

this group in the overall volume of operations accounts for 17.9%. The largest relative share (50.3%) in the total volume of operations in the real estate market belongs to 8 regions which demonstrate a moderate level of activity in the real estate market. The volume of construction works in the group increased by 3.6%, thus ensuring the 5.8% growth in the total area of commissioned residential buildings.

In the group of regions with a higher degree of activity, the overall volume of construction works increased by 24.6%, and the total area of commissioned residential buildings increased by 28.3% versus 2013. The relative share of this group in the total volume of operations accounted for 31.8%.

Figure 2.3.1.9
Housing affordability index, at the expense of own funds (the increase in the index is an indicator of reduced affordability)



Note: *Housing affordability index = (Price of 1 sq.m of housing*54)/(Average monthly wage*12*1,5)

Modified formula:

A) (Price of 1 sq.m of housing*54)/(Average monthly wage*12*1,5 – Subsistence wage*3)

B) (Price of 1 sq.m of housing*54)/(Average monthly wage*12*1,5 – Subsistence wage*3)

Source: CS MNE RK, calculation by NBRK

households throughout Kazakhstan), whereas in 2013 it reached 4.2% (211 400 households out of 5 million households).

Thus, based on the statutory established standards for provision of housing space per one person²⁸, housing in Kazakhstan is moderately unaffordable, and according to the UN standards the housing becomes even more unaffordable (Table 2.3.1.1).

Table 2.3.1.1
Housing affordability index in Kazakhstan under Kazakhstan's standards and international standards of housing per capita

A part of total income used for savings	Total area of an apartment for a family consisting of 3 persons	
	54 sq.m in the RK	90 sq. m according to the UN standards ²⁹
All of total income	4 years ³⁰	about 7 years
Total income less the subsistence wage ³¹	6 years	about 10 years
Total income less consumer expenditures	9 years	15 years

Source: CS MNE RK, calculation by NBRK

²⁵ Hereinafter: a household/a family consists of 2 adults and 1 child.

²⁶ International practice: an affordable housing (the time for savings does not exceed 3 years), moderately unaffordable housing (3.1-4 years), seriously unaffordable housing (4.1-5 years), significantly unaffordable housing (above 5.1 years).

²⁷ According to the CS MNE RK, the average housing per capita in 2013 was equal to 20.9 sq. m per a person.

²⁸ Under the Law on Housing Relations in Kazakhstan, the standard for provision of residential accommodation shall be not more than 18 square meters of the usable floor area per 1 person.

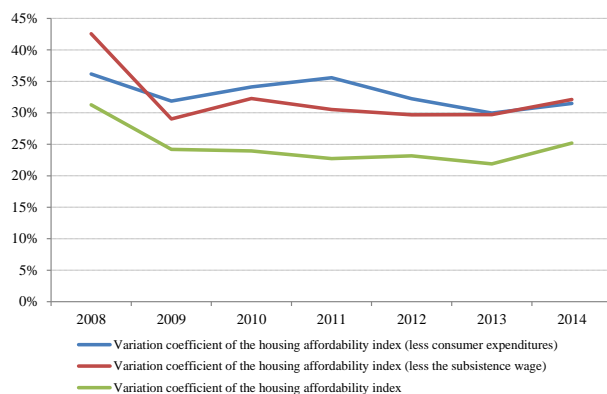
²⁹ According to the UN international standard, the minimum acceptable standard is 30 square meters of the usable floor area per 1 person.

³⁰ International practice: an affordable housing (less than 3 years), moderately unaffordable housing (3.1-4), seriously unaffordable housing (4.1-5), and significantly unaffordable housing (above 5.1).

³¹ In 2014, the minimum subsistence level in Kazakhstan was KZT 19 966.

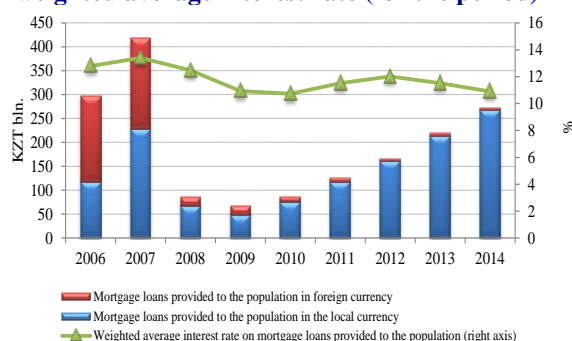
Starting from 2013, differentiation in the housing affordability in a regional breakdown increases.

Figure 2.3.1.10
Variation coefficient of the housing affordability index³² (reduced coefficient is an indicator of reduced differentiation)



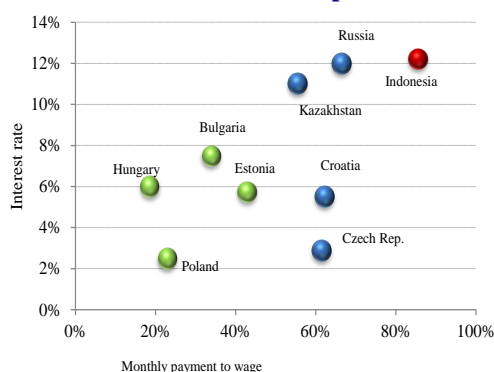
Source: CS MNE RK, calculation by NBRK

Figure 2.3.1.12
Mortgage loans provided to the population and their weighted average interest rate (for the period)



Source: NBRK

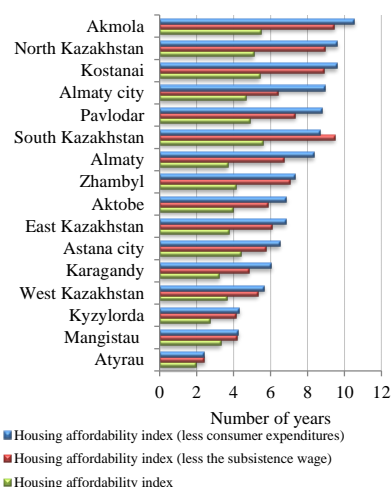
Figure 2.3.1.13
Housing affordability at the expense of borrowed funds, versus the countries comparable by the level of their development



Source: WB, IMF, Thomson Reuters Eikon, calculation by NBRK

governmental housing programs as one of preferred instruments of home purchase.

Figure 2.3.1.11
Housing affordability at the expense of own funds, broken down by regions



Source: CS MNE RK, calculation by NBRK

In general, as compared to historical values, decreasing differentiation and, respectively, gradual aligning of the housing affordability by regions may indicate that living conditions of the population in the regions with lowest wages are improving (Figure 2.3.1.10). However, in 2013-2014, differentiation of the housing affordability among regions of Kazakhstan slightly increased; this was caused by slowing rates of wage growth in general across all regions as compared to the growth in real estate prices.

Based on the 2014 performance, only in 8 regions of Kazakhstan the purchase of housing may be considered relatively affordable, where the housing affordability ratio does not exceed 3-4 years; and it was in two regions only that a three-member family would need less than 3 years to buy a home with the total area of 54 sq. m (Figure 2.3.1.11).

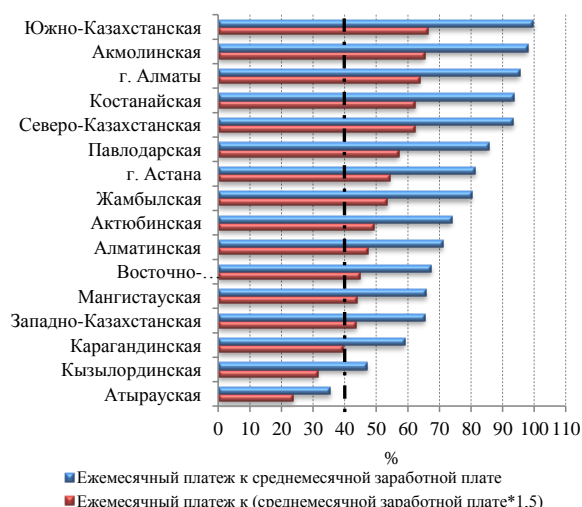
A low affordability of housing at the expense of own funds requires the development of alternative instruments to finance home purchases. However, high housing prices and the existing terms and conditions of mortgage lending do not foster the increase in affordability of housing at the expense of borrowed funds, thus leaving

³² Variation coefficient is calculated under the formula: [standard deviation] / [the mean].

In 2014, only 5.7% of all households in Kazakhstan had an adequate wage level³³ to be able to pay monthly interest on a mortgage loan (Figure 2.3.1.12) to buy a 54 sq. m housing; in 2013 this indicator was higher – 8.2%.

Figure 2.3.1.14

Housing affordability at the expense of borrowed funds*



Примечание: *Ежемесячный платеж был рассчитан, исходя из следующих условий:

- площадь приобретаемого жилья 54 кв.м.
- срок займа: 15 лет
- размер первоначального взноса: 20%

Source: calculation by NBRK

A low affordability of housing at the expense of borrowed funds is observed in many regions of Kazakhstan. So, inhabitants of only one region of Kazakhstan can buy home with borrowed funds (Figure 2.3.1.13, Figure 2.3.1.14). The ratio of a monthly payment and aggregate family income (1.5 wages) does not exceed the permissible limit in 2 regions of Kazakhstan only.

In Almaty, a monthly payment will account for 95% of a wage and 64% of aggregate family income. In Astana, corresponding indicators account for 81% and 54%, respectively.

In the environment of a low paying capacity of the population and unaffordability of mortgage lending for the public at large, one of the solutions in increasing the housing affordability in Kazakhstan is the governmental support programs for construction of affordable housing as well as the mechanism of housing construction savings.

2.3.2. Foreign Exchange Market and Money Market

Throughout 2014, the foreign exchange market demonstrated periods of overaction expressed in the increased market demand for foreign exchange which occurred against the backdrop of deteriorating foreign economic conditions of Kazakhstan. Increased dollarization of the economy as well as outlining negative expectations about the situation in the domestic foreign exchange market resulted in that the problems with the Tenge liquidity became critical by the end of the year.

Based on the 2014 performance, the average daily turnover in the foreign exchange spot market increased by 46% versus 2013 and in certain periods reached the volumes exceeding USD 1 bln. The first significant spike in the trading activity occurred after the adjustment of the Tenge exchange rate in February 2014 and is characterized by the increased demand of the market for foreign exchange that was not determined by operating needs of the real sector of the economy (Box 3). Despite the subsequent relief of pressure on the domestic currency exchange rate, a periodic increase in the intra-day stock exchange turnovers against the deteriorating environment of external mineral commodity and financial markets started to be observed by the second half of 2014.

Throughout the year, periods of volatility in the foreign exchange market were marked with significant interest rate spikes on NDFs³⁴. Moreover, by the end of the year the market of non-deliverable forward contracts started to demonstrate a significant increase in the spread between the demand and supply rates, which reflected market expectations about the adjustment of the Tenge exchange rate in the nearest term.

³³ The amount of a monthly payment on a mortgage loan should not exceed 40% of a borrower's wage.

³⁴ NDF - Non-deliverable forward contract. NDF operations are the segment of the OTC market; therefore rates on such operations are more sensitive to changes in the financial market.

Analysis of the short-term market response to the adjustment of the Tenge exchange rate in February 2014

Due to the need to restore external competitiveness of the Tenge exchange rate, to maintain a positive balance of payments of Kazakhstan as well as to ensure competitiveness of domestic producers, a one-time adjustment of the Tenge exchange rate was conducted on February 11, 2014. Immediately after the adjustment, activity in the foreign exchange spot market slowed. The average daily trading volume on USDKZT_TOD¹ decreased by 15% during a week.

However, by the third decade of February 2014, the pressure on the Tenge increased. One of the factors that caused such increase was the fact that after the exchange rate adjustment the stock exchange repo rates remained unchanged and the existing spreads between those rates and rates on NDFs indicated a potential for arbitrage for the market participants.

Soon after that the increase in repo rates because of the tax assessment period supported the Tenge although the spread between rates was still big. Moreover, the spread between rates of demand and supply on NDFs somewhat widened, thus indicating uncertainty in the foreign exchange market.

Later, during April-May 2014, the situation in the foreign exchange and money market generally stabilized.

¹ Delivery on the payment day.

During the year, the volume of OTC trades in the US Dollars was lower than the stock exchange turnovers; this is evidence that the demand for the US Dollar was to a larger extent satisfied at the KASE. At the same time, starting from September 2014, the volume of OTC purchases of the US Dollars from non-resident banks increased, due to the increased demand for foreign currency in general.

The trend of 2014, determined by a periodically increasing activity of participants in the foreign exchange market had an impact on structural parameters of the market: on average, there was a prevailing trend of foreign exchange purchases among the market participants and by the end of the year an average number of transactions conducted by one participant reduced along with an overall increase in the volume of one transaction (Box 4).

Structural parameters of the KASE foreign exchange spot market in 2014

In 2014, the trends in the KASE foreign exchange spot market were changing: during the year, periods of increased activity were noted, which were generally characterized by the increased intra-day transaction turnover as well as the increased demand for the US Dollar on the part of market participants. The existence of periods of increased activity resulted in the overall change in the structural market parameters. Moreover, there were differences between the structural market parameters in different periods of increased activity during 2014.

In order to perform a more detailed analysis of structural parameters of the KASE foreign exchange spot market, (1) periods of increased activity in 2014 were identified; and (2) indicators of key foreign exchange market parameters were calculated on a daily basis for 2014.

With a view to determine periods of increased activity of the stock exchange foreign currency market, the following approaches were used based on the analysis of the exchange rate behavior as one of parameters of trades¹:

1) Comparing the behavior of market participants with their own behavior as well as with the historical market behavior. *The number of market participants* with identified “outliers”² serves as an indicator of increased activity.

2) Identifying transactions where exchange rates were deviating from the market intra-day behavior of the exchange rate. In this case, *the number of transactions* with identified “outliers” serves as an indicator of increased activity.

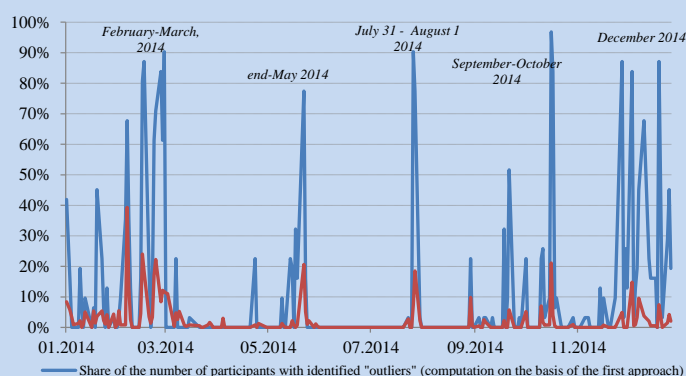
According to these approaches, a number of clear periods of increased activity of the foreign exchange market participants in 2014 was identified (Figure 1).

Further, with a view to analyze structural parameters of the foreign exchange market,

calculations of the following parameters were made³:

- A group of indicators computed on the basis of general market data (without calculating indicators for each individual market participant):
 - AVE_VOL – average volume of one transaction conducted during a trading day.
 - BUYER_NUM – the number of buyers of foreign exchange in the market during a trading day.
 - SELLER_NUM – the number of sellers of foreign exchange in the market during a trading day.
- A group of indicators computed on the basis of data averaging as calculated for each individual market participant which participated in trades during that trading day (the averaging was performed excluding the data of the NBRK which acted as one of participants of the KASE's foreign exchange market):
 - HET – an indicator of heterogeneity of the participant's operations is calculated as the ratio of difference between the participant's volumes of foreign exchange purchases and sales/the total transaction volume of that participant in the foreign exchange market during the trading day. An indicator of heterogeneity varies within the range of [-1; 1] and indicates the prevailing demand for foreign exchange (at a value tending to 1) of supply of foreign exchange (at a value tending to -1) on the part of the market participants.

Figure 1
Results of analysis of activity of participants in the KASE's spot foreign exchange market



Source: data by KASE, calculation by NBRK

- CHG – an indicator of the change in the participant's position is calculated as the ratio between changes in the position in transactions (when a participant changed its position from foreign exchange “purchase” to foreign exchange “sale”, and vice versa) during a trading day and the number of transactions conducted by that participant during the trading day. The indicator of the change in position varies within the range of [0; 1] and its increase is an evidence of the increased intra-day speculative trend in the market.
- DEAL_NUM – the number of transactions conducted by a participant during a trading day. When this indicator decreases, it is an evidence of decreasing activity in the foreign exchange market in general.

The difference between indicators calculated on the basis of the sample of “quiet” days and days of increased activity was significant for all presented market parameters (except the mean of heterogeneity of operations) (Table 1), which is generally an evidence of a statistically *significant change in behavior of the market participants during the periods of increased activity*.

On the whole, a positive mean of the heterogeneity of operations (HET) spoke for *a prevailing trend for purchasing foreign exchange on the part of the market participants*. Despite the fact that the difference of this indicator in the “quiet” days and days of increased activity was statistically insignificant, by the end of the year the mean of the indicator approximated its maximum limit equal to 1, which indicates that the *magnitude of the pressure on the domestic currency increased*.

A gradual increase in the indicator was also observed in relation to the average volume of

one transaction (AVE_VOL), whereas the average number of transactions per one counterparty (DEAL_NUM) decreased. Presumably, this fact indicated that the *US Dollar purchases not motivated by the operating needs of economic agents* were conducted.

Despite a significant difference in the values of the indicator of the change in position (CHG) in the “quiet” days and days of increased activity, in general a homogeneous trend was observed throughout the year. However, small values of this indicator coupled with prevailing foreign exchange purchases by the market participants could be indicative of *longer-term positions of the market to keep resources in foreign currency*.

Table 1

Structural indicators of the KASE's spot foreign exchange market

Период	AVE_VOL Average volume of one transaction, in USD thous.	BUYER_NUM Average number of FX buyers	SELLER_NUM Average number of FX sellers	HET Mean heterogeneity indicator of operations	CHG Average indicator of the change in position	DEAL_NUM Average number of deals of one counterparty
"Quiet" days*	1 437	21	11	0,4159	0,0496	10
Days of increased activity	1 694	24	14	0,4381	0,0759	16
t-statistics**	2,3456	2,9575	4,5886	0,4684	5,5856	4,5380
p-value	2,16%	0,55%	0,00%	64,14%	0,00%	0,01%
Details of values in certain periods of increased activity:						
06.01 - 10.02.2014	1 300	22	13	0,3607	0,0655	18
11.02 - 14.02.2014 г.	1 491	16	18	-0,2561	0,0750	15
21.02 - 05.03.2014 г.	1 329	24	15	0,3874	0,0775	25
19.05 - 28.05.2014 г.	1 181	21	15	0,2127	0,0648	18
31.07 - 01.08.2014 г.	1 921	31	9	0,8511	0,0442	23
26.09.2014 г.	2 087	25	10	0,8122	0,0846	14
21.10 - 22.10.2014 г.	1 997	29	10	0,7451	0,0546	13
02.12 - 31.12.2014 г.	2 663	25	13	0,5305	0,0698	13

Notes:

* Classification of days into "quiet" days and days with increased activity was done by using the results of analysis on activity of players on the KASE's spot foreign exchange market (see Figure 1 to Box 4). Days where the values of numerical results (shares of the number of market participants or a share of the number of transactions with identified "outliers") were equal to or exceeded the 80th percentile in a respective sample of values for 2014 were referred to the period of increased activity.

** t-statistics – t is critical based on the results of the two-tailed t-test with different dispersions.

Source: data by KASE, calculation by NBRK

¹ The analysis was performed on the basis of data for 2014 on all transactions in the KASE's foreign exchange spot market for KZT/USD pair with the foreign exchange delivery on the day of transaction (KASE's codification: USDKZT_TOD).

² The use of the term “outlier” in determining the number of participants (under the first approach) means a case when the exchange rate of the participant's transactions exceeds the 90th percentile of the exchange rate computed on the basis of its historical behavior. The use of the term “outlier” in determining the number of transactions (under the second approach) means a case when the exchange rate of the transaction differs from the exchange rate behavior that was observed during the trading day by a calibrated value.

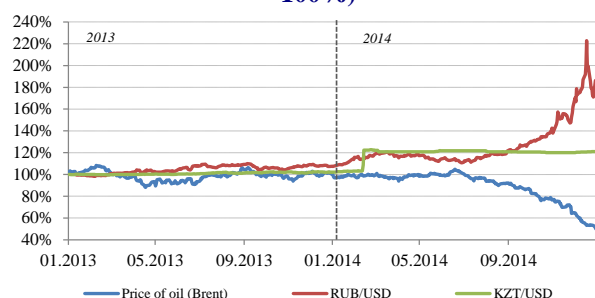
³ Methods used in the publications shown below are used as the basis for the calculation (methods used to calculate a number of indicators were modified):

- Schreiber, B.Z. (2014). Identifying Speculators in the FX Market: A microstructure approach. Journal of Economics and Business, 73(2014)97-119.
- Gabrieli, S. (2011). The Microstructure of the Money Market Before and After the Financial Crisis: A Network Perspective. Centre for Economic Research and Studies for Vergata, Research Paper Series, Vol. 9, Issue 1, No. 181.

The decline in oil prices which started in mid-2014, depreciation of the Russian ruble as well as the overall tension in the Russian market against the backdrop of the changing geopolitical situation were putting pressure on the Tenge.

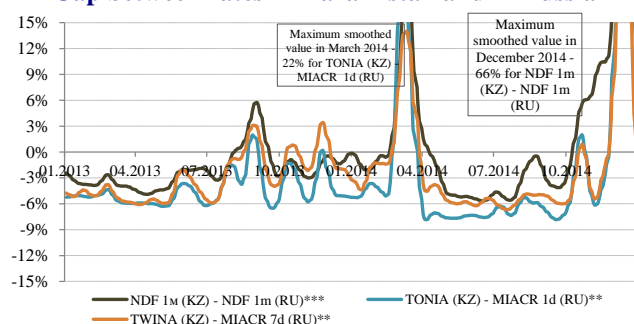
After some stabilization of the situation in the Kazakh foreign exchange market, a gradual deterioration in foreign economic conditions of Kazakhstan became visible from the second half of 2014. At year-end, the overall decline in the oil price (Brent) accounted for about 50% (Figure 2.3.2.1); this had an impact on the volume of foreign exchange coming to the country. Depreciation of the Ruble versus the US Dollar resulted in tightening of the monetary policy in Russia: the CBRF's key rate was going up 7 times during 2014 and increased from 5.5% to 17%. The increased difference between rates in Kazakhstan and in Russia during June-October 2014 created

Figure 2.3.2.1
Trends in foreign economic factors (01.01.2013 = 100%)



Source: NBRK, CBR, Thomson Reuters Eikon

Figure 2.3.2.2
Gap between rates in Kazakhstan and in Russia*



Notes: * 1) Time series are smoothed by using the Hodrick-Prescott filter ($\lambda=100$).

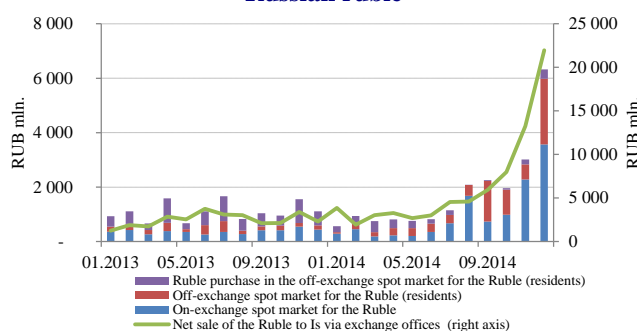
2) Vertical axis of the chart is limited by the value of 15%.

** MIACR – Moscow interbank actual weighted average credit rate.

*** Non-deliverable forward between the pair of relevant currencies and the US Dollar.

Source: data by KASE, Bloomberg, Thomson Reuters Eikon, calculation by NBRK

Figure 2.3.2.3
Transaction volume in the on-exchange and off-exchange spot foreign exchange markets for the Russian ruble *



Note: *Include transactions made solely against the local currency, i.e. for the KZT/RUB pair. The chart reflects interbank transactions, except for exchange transactions of Is.

Source: KASE, NBRK

prerequisites for the arbitrage (the “carry trade” strategy)³⁵, which put an additional pressure on the Tenge (Figure 2.3.2.2). However, as the year-end approached, the difference between rates of the two countries reversed due to the building up expectations regarding the situation in the domestic foreign exchange market.

Due to increased attractiveness of Russian goods because of the Russian ruble depreciation, the number of foreign exchange transactions in rubles increased dramatically from the fall of 2014 (Figure 2.3.2.3). In December 2014, the volume of transactions with the ruble, including the sales of rubles to individuals via exchange offices, hit record high.

It should be noted here that settlements for exports with Kazakhstani enterprises were mainly effected in the US Dollars whereas settlements for imports were made in rubles and euro, among other currencies. Accordingly, the increased demand for the ruble, presumably, was also satisfied by the market participants by purchasing this currency against the US Dollar from non-residents in the OTC market.

The tense situation in the foreign exchange market was manifesting itself in the common intention of economic agents to convert resources into foreign currency. During 2014, active dollarization of resources of the corporate sector and the population was discernible, which caused the increase in the on-balance sheet FX exposure of banks.

Despite measures taken to increase the differentiation of interest rates on deposits in the domestic and foreign currency³⁶, at the end of the year it became obvious that the share of retail deposits in foreign currency is dominating (Figure 2.3.2.4).

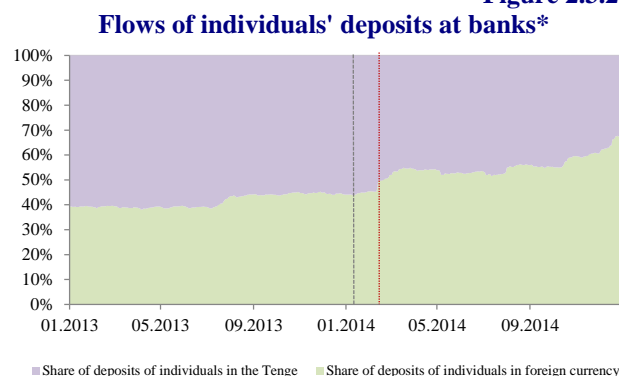
The sale of the US Dollars by exchange offices also reflected periodic spikes in the demand for the US Dollar that correlated with periods of activity in the stock exchange foreign currency market, whereas the reverse conversion of the US Dollars into the Tenge on

³⁵ The “carry trade” strategy involves borrowing resources in the domestic currency of the country which set low interest rates, and their converting and investment in the domestic currency of countries which set high interest rates. In the event if the purchase of Russian rubles in the OTC market is made against the US Dollars (by-passing the Tenge), such transaction may put pressure on the KZT/USD exchange rate.

³⁶ From March 1, 2014, the interest rate on newly attracted Tenge deposits recommended by the KDIF was increased to 10% per annum (before it was 9%). From April 1, 2014, the interest rate on newly attracted foreign currency deposits recommended by the KDIF was decreased to 4% per annum (before it was 4.5%).

the part of the population had an even pattern throughout the year. Thus, newly received resources of the population were either converted into foreign currency or saved in the Tenge.

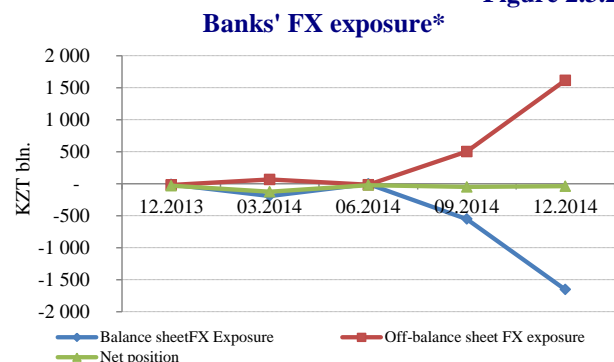
Figure 2.3.2.4



*Note: * With a view to provide data excl. the impact of the Tenge exchange rate adjustment on the deposit volumes, calculations used to construct a chart were made on the basis of the Tenge volumes translated into the US Dollar based on the KZT/USD exchange rate.*

Source: NBRK

Figure 2.3.2.5



*Note: *Based on the data about currency positions of banks in all foreign currencies.*

Source: NBRK

The growth of dollarization of banks' liabilities by the end of 2014 caused the increase in the on-balance FX exposure of banks (Figure 2.3.2.5). In July 2014, the NBRK, with a view to implement its monetary policy as well as to maintain the Tenge liquidity, began to provide banks with long-term liquidity in the Tenge against the USD pledge through cross-currency interest rate swaps.

In doing so, given that the NBRK's cross-currency interest rate swaps, for the most part, were of a long-term nature, there was a risk of a temporary mismatch between foreign currency assets and liabilities of banks that could be realized in case of a large volume of claims on early foreign currency deposit withdrawals on the part of bank clients.

During 2014, there were periods of shortage in the Tenge liquidity, including due to simultaneous occurrence of two events: (1) increase in the demand for the Tenge on the part of the corporate sector because of the beginning of tax assessment periods and periods of closing of major financial settlements; and (2) escalation of negative expectations among the market participants about the Tenge exchange rate. In certain periods of stress, the market participants were showing preference to borrowing rather than

the reverse conversion of foreign exchange. In general, during 2014, and especially during the periods of liquidity shortage, the NBRK was actively providing immediate Tenge liquidity to the market.

In 2014, against the backdrop of continuing dollarization, the average daily volume of operations in the stock exchange repo market decreased by 7%³⁷ versus the indicator in the previous year, whereas a corresponding increase in the average daily turnover in the stock exchange market of foreign currency swaps accounted for 67% (or 31% during January-November 2014 as compared to the corresponding period of the previous year)³⁸; this is an evidence of a greater availability / attractiveness of the US Dollars as a security for banks' operations on borrowing liquidity in the domestic currency.

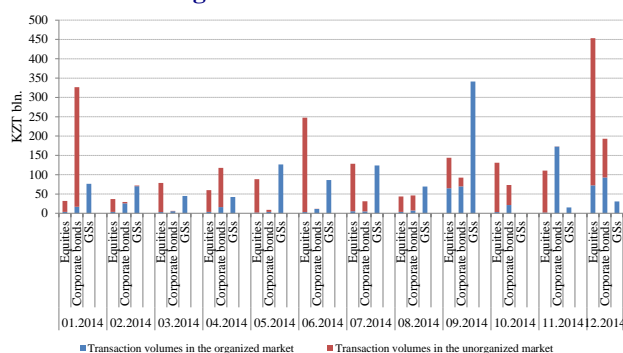
In general, there were two dramatic periods of significant spikes in the stock exchange rates during the year – in February-March and in November-December 2014. A significant growth in rates was associated with the increased demand for the *immediate* Tenge liquidity along with persisting negative expectations about the Tenge exchange rate among the market participants.

In December 2014, as volumes of cross-currency interest rate swaps were decreasing, the NBRK started to participate in the market of stock exchange foreign currency swaps as well as

³⁷ During January-November 2014, the decrease in the average daily turnover in the repo market accounted for 18% as compared to the corresponding period of the previous year.

³⁸ A significant difference in the growth rates of foreign exchange swaps occurred as a result of the NBRK's participation in this segment of the market, beginning from December 2014.

Figure 2.3.3.2
Transaction volumes in the domestic organized and unorganized securities markets*



Note: * Include/ new placements and subsequent circulations of securities.

Source: KASE, USR, CSD

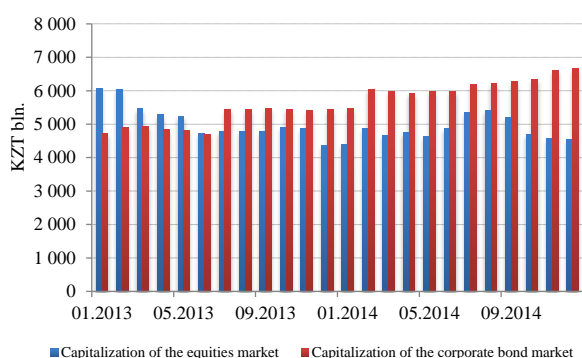
participants, which resulted in the decreased operations of banks on provision of the Tenge credits to the economy.

2.3.3 State of the Securities Market

In 2014, the securities market was characterized by a low liquidity caused by a shortage of good quality financial instruments as well as by a general steady trend for reduction in volumes of the domestic organized securities market. Issuers increasingly use bank loans as the funding sources and the population uses bank deposits as an investment instrument.

The domestic market of government securities was characterized by a large number of outstanding securities issues, and in the environment of low trading activity could not serve as a reliable basis for building a yield curve required to determine a “risk-free” benchmark in the securities market.

Figure 2.3.3.1
Market capitalization of the on-exchange market of NGSS



Source: KASE

and 130-135% (for the bond market), which are typical for countries with developed capital markets such as the USA, the UK, Canada, Australia, Turkey, the UAE, Malaysia, etc.

In 2014, over 99.8% of the overall volume of transactions with government securities were conducted in the *organized* government securities market, whereas volume of transactions in the *organized* markets of equities and corporate debt securities accounted for 11.1% and 40.4%, respectively (Figure 2.3.3.2).

A significant volume of transactions with government securities in the organized market was to a larger extent explained by the fact that all issues of government securities were presented in the KASE listing; therefore, the stock exchange was the main platform for investors where government securities transactions were entered into.

significantly increased lending in the repo market, thus providing the short-term Tenge liquidity to the market. During the period, the market demand for the Tenge was reaching its maximum which to a larger extent was caused by current needs of the real sector of the economy because of the beginning of tax assessment periods and periods of closing of major financial settlements of enterprises.

Thus, negative exchange rate expectations which increased in December 2014 and the possibility of getting the immediate Tenge liquidity from the NBRK limited a full-scale transformation of maturity of financial resources by the market

In 2014, annual capitalization in the organized securities market was at a relatively stable level – KZT 4 830 bln. on average. During 2014, capitalization of the corporate bond market demonstrated a steady growth and amounted to KZT 6 668 bln. at the end of 2014 (Figure 2.3.3.1).

At the same time, average annual ratios of capitalization of the equities and corporate bond markets to GDP accounted for 11.9% and 17.5%, respectively, at the end of 2014 (at the end of 2013 – 12.3% and 15.4%, respectively). Such indicators are well below the average indicators – 40-45% (for the equities market)

At the same time, it was noted that the major volume of effected transactions in the equities market falls on the unorganized market given that only 100 out of 1 575³⁹ registered issues of equities were included in the KASE listing. Moreover, only 8 equities out of 100 were actively traded on the KASE (Box 5).

Box 5

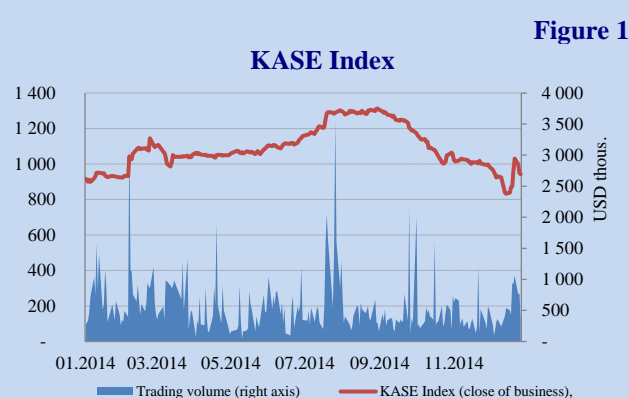
Analysis of trades in the stock exchange equities market in 2014

During 2014, the most active trading in corporate securities was in equities of issuers included in the KASE Index⁴⁰.

The adjustment of the Tenge exchange rate had significantly affected the behavior of the KASE Index and caused its 23.0% increase by end-February 2014 versus its value at February 10, 2014 (Figure 1). Later, by mid-March 2014, the KASE Index went down by 13.9% versus its value as of February 28, 2014.

In August-September 2014, trading in securities became more active; to a larger extent, this was due to the increase in volumes of trades in equities issued by KAZ Minerals PLC that occurred in connection with the increase in price of these equities in the context of reorganization announced by the Kazakhmys Group. Also, in July-August 2014, the KASE Index was growing because of increased prices for equities of “Kazkommertsbank” JSC due to repurchase of these equities by their issuer.

From September 2014, the KASE Index was gradually going down and its value reached the min



Source: KASE

imum annual value of about 830 points in December 2014. During this period, prices of equities of all issuers included in the KASE Index representative list were declining; the largest decline in prices was for equities of “KazMunaiGas Exploration-Production” JSC and “Kaztransoil” JSC and was caused by a significant excess of supply over demand.

In its turn, the imbalance between demand and supply was caused by negative expectations of investors about the adjustment of the Tenge exchange rate and the drop in oil prices. In this connection, investors while

increasing the volume of supply in the market looked to close long positions in Kazakstani equities and convert the resources which became available into foreign currency.

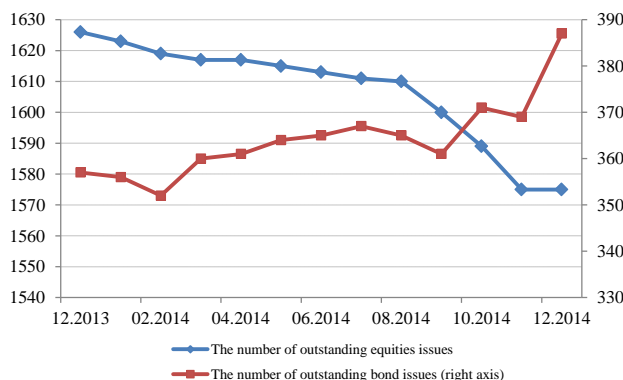
At the same time, at the end of 2014, the KASE Index slightly increased, mainly due to increased prices for equities of the banking sector’s issuers.

Out of 387 registered bond issues, 275 issues were included in the KASE listing. However, due to the fact that bonds were offered among a limited number of entities, the main volume of transactions for their offering was in the unorganized market. In 2014, the number of outstanding equities issues in the organized and unorganized markets was decreasing while the number of outstanding bond issues was growing (Figure 2.3.3.3). The decrease in the number of outstanding equities’ issues was caused by the fact that the NBRK continued its effort to identify those joint-stock companies which had not brought their operations in conformity with the provisions of Article 90 of the “Joint-Stock Company Law” of the Republic of Kazakhstan, which require that in case of their non-compliance with requirements of the Law joint-stock companies had to either

³⁹ Information about the number of equities and bond issues is presented as of January 1, 2015.

⁴⁰ As of January 31, 2014, equities of the following companies were included in the KASE Index representative list: “Bank CenterCredit” JSC, KAZ Minerals PLC, “Halyk Savings Bank of Kazakhstan” JSC, “KCell” JSC, “Kazkommertsbank” JSC, “Kazakhtelecom” JSC, “KazTransOli” JSC, “KazMunaiGas” Exploration-Production” JSC.

Figure 2.3.3.3
The number of outstanding issues of NGSs

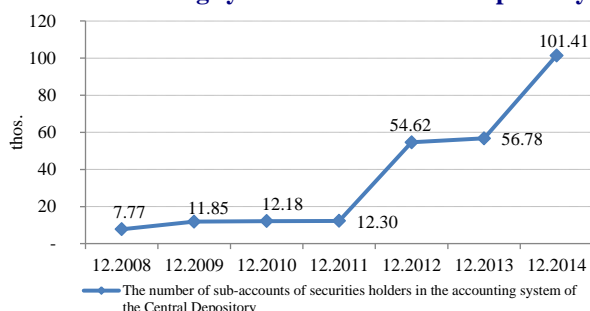


Source: NBRK

– 40 bond issues totaling about KZT 737 bln.), of which 37 were issued by STBs. In general, an average volume of bond issue amounted to KZT 25 bln., with interest accounting for 7.47%⁴¹ on average.

With a view to develop the securities market of Kazakhstan and provide an opportunity to hold shares of largest domestic companies for the general public of Kazakhstan, in 2014 the Government of the Republic of Kazakhstan, jointly with the NBRK and the “SWF “Samruk-Kazyna” JSC, implemented the second stage of the “People’s IPO” Program – offering of shares of “KEGOC” JSC.

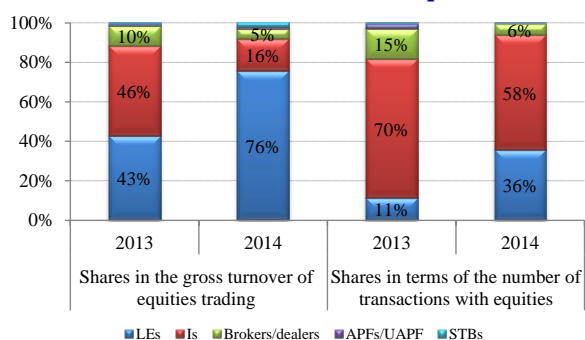
Figure 2.3.3.4
The number of sub-accounts of securities holders in the accounting system of the Central Depository



Source: CSD

The volume of accepted bids for shares of “KEGOC” JSC was KZT 13 bln., where individuals comprised the largest share in the investor structure (72%).

Figure 2.3.3.5
Investors structure in the KASE's equities market



wind up or reorganize into business partnerships, as well as in connection with liquidation of joint-stock companies and their reorganization into limited liability partnerships.

At the same time, the increase in the number of registered issues of equities in 2014 was to a larger extent caused by increased volumes of placements of their bonds by banks in the securities market, due to the change in the prudential regulation of STBs. So, in 2014 the NBRK registered 63 issues of non-government debt securities of Kazakhstani issuers totaling about KZT 1 598 bln. (in 2013

– 40 bond issues totaling about KZT 737 bln.), of which 37 were issued by STBs. In general, an average volume of bond issue amounted to KZT 25 bln., with interest accounting for 7.47%⁴¹ on average.

In the course of offering of shares of “KEGOC” JSC, private investors had demonstrated a lot of interest in good quality instruments in the securities market, which resulted in the growth of the number of personal accounts and sub-accounts opened in the Central Depository’s accounting system (Figure 2.3.3.4).

Also, according to the KASE, the demand for shares of “KEGOC” JSC exceeded their supply by 1.3 times reaching about 42 thousand bids in the amount over KZT 16 bln.

The change in the structure of institutional investors, due to termination of operations of private APFs after consolidation of pension assets at the UAPF, caused slackening of trades in the secondary market of corporate securities issued by Kazakh companies.

Acc-ording to the KASE, in 2014 *the organized equities market* demonstrated a dramatic increase in the gross market turnover, which was represented by legal entities – non-institutional investors (Figure 2.3.3.5). In

⁴¹ The issue volume varied from KZT 50 mln. to KZT 170 bln., and the amount of interest was within the range of 0.15% - 16% per annum.

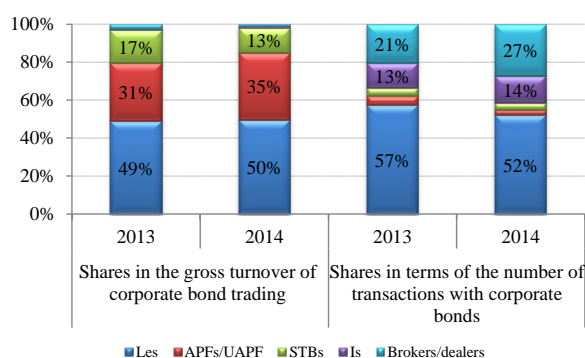
general, while remaining as active players in terms of the number of effected transactions, in 2014 individuals significantly reduced their share in the trading turnover; this was especially visible beginning from the second half of 2014.

The volumes of transactions of individuals in the equities market could decrease because of the change in priorities among retail investors, who at that time tried to convert the Tenge investments into financial instruments denominated in foreign currency, including deposits with STBs. However, as mentioned above, in the course of offering of shares of “KEGOC” JSC in December 2014, individuals demonstrated increased activity and interest in participating in the IPO. This fact is yet another proof of the need to conduct new IPOs, including by continuing implementation of the “People’s IPO” Program, with a view to attract individual investors in the securities market and make them more active.

In 2013-2014, the largest share in the gross trading volumes in the *organized corporate securities market* was represented by institutional investors which provided the demand (APFs/UAPF and banks) and by legal entities – corporate bond issuers (including banks) which provided the supply (Figure 2.3.3.6)⁴². At the same time, despite a small share in the gross trading volume, in 2014 the number of broker and dealer transactions effected not with the funds of institutional investors increased dramatically.

The demand for *securities of the Ministry of Finance* in the primary market was secured by institutional investors (Figure 2.3.3.7). In the secondary organized market of government securities the banking sector’s share in the gross volume of trading reduced and the share of the NBRK and the UAPF increased.

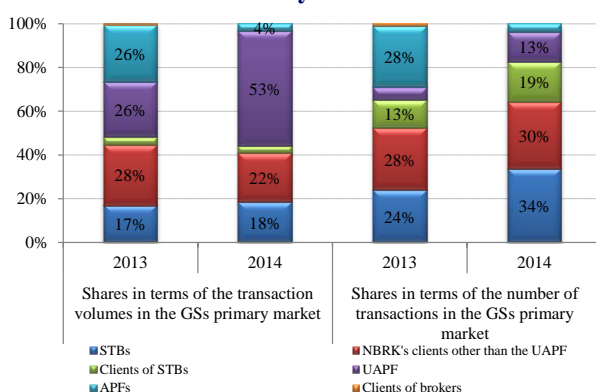
Figure 2.3.3.6
Investors structure in the KASE's corporate bond market



Source: KASE

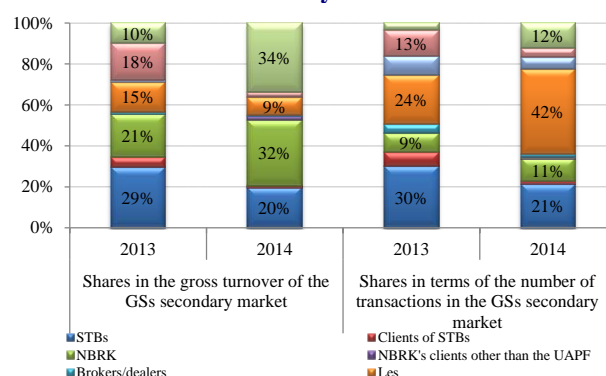
Figure 2.3.3.7

Investors structure in the KASE 's GSs primary and secondary markets
Primary market



Source: KASE

Secondary market



In 2014, the NBRK granted 6 approvals for issuance and placement of issue-grade securities of an organization-resident of the Republic of Kazakhstan within a foreign jurisdiction⁴³. The

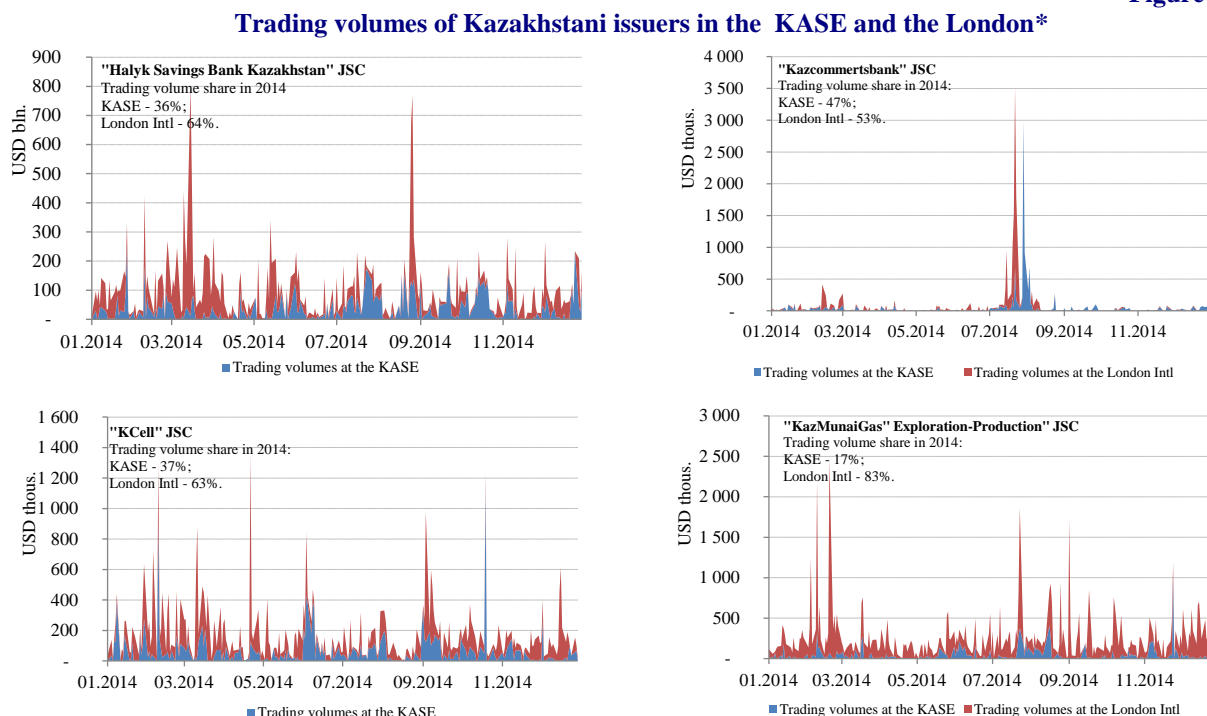
⁴² The second quarter of 2014 was an exception, when the structure of investors in the gross volume significantly changed, since the UAPF did not take part in the trading during that period. It should be noted that during the period the NBRK was investing the UAPF's pension assets in banks' deposits through deposit auctions.

⁴³ Among them, 5 approvals for the issuance and placement of Eurobonds (issuers: “National Management Holding Company “KazAgro” JSC with the volume of issue worth €600 mln., “Kazakhstan Temir Zholy” National Company” JSC – CHF 455 mln., “KazMunaiGaz” National Company” JSC – USD 1.5 bln., KazStroyService Global B.V. – USD 300 mln., “Eurasian Bank” JSC – USD 500 mln.) and 1 approval for the issuance and placement of equities (Caspian Services Inc – USD 447 bln.). Also, in 2014 the NBRK acknowledged the notice of issuance of depositary receipts by “Astana-Finance” JSC.

geography of such placements was represented mainly by such countries as the UK, the USA, the Kingdom of the Netherlands and Switzerland.

The volumes of trades in depositary receipts of Kazakhstani issuers on the London Stock Exchange significantly exceed the volumes of trades in equities of such issuers on the KASE; therefore, circulation of depositary receipts of Kazakhstani issuers on the London Stock Exchange significantly erodes liquidity on shares of such issuers on the KASE (Figure 2.3.3.8).

Figure 2.3.3.8



Notes: *Trading volumes are presented on a cumulative basis.

The averaged exchange rate of the Tenge versus the US Dollar is used to present the KASE's trading volume.

Source: KASE, Bloomberg

In addition, it should be noted that in October-December 2014 negative price movements for the above equities in foreign stock markets were recorded. If the decline in the price of equities of Kazakhstani companies in the domestic market was caused, to a larger extent, by negative expectations of investors about the exchange rate, the decline in the price in foreign markets, on the contrary, was associated with long-term expectations of investors based on macro-economic factors developing in Kazakhstan, such as slowing rates of GDP growth, falling prices for energy products which represent the key export items, lowered sovereign and credit ratings, etc.