

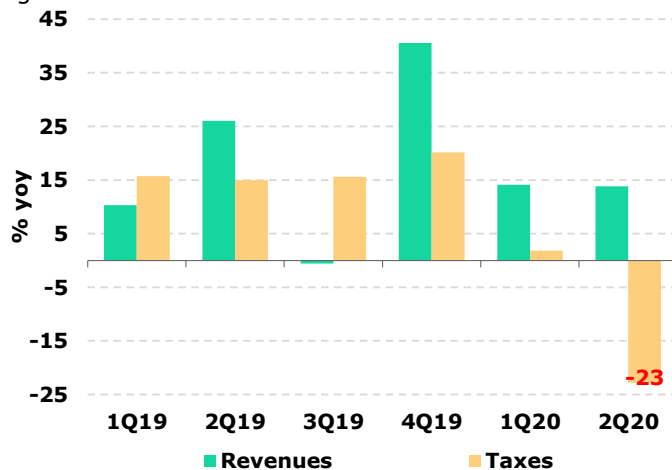
August 27, 2020

In the second quarter and in the first half of this year as a whole, the situation in the budgetary sphere was in stress: due to the expansion of anti-crisis measures, social expenditures and investments increased most noticeably, while total state budget expenditures in 1H2020 increased by 25% yoy. As a result of a decrease in tax revenues in 1H2020 by more than 11% yoy, transfers from the National Fund became the main source of filling the state budget, providing more than 40% of all revenues in 1H2020. At the same time, the state budget deficit sharply increased to 3% of GDP in 1H2020 (0.4% of GDP in 1H2019). To finance the increased budget deficit, the Ministry of Finance increased borrowing in the domestic market by 55% yoy. The persisting oil prices at a level above \$40 per barrel contribute to the fact that, given the favorable development of the epidemiological situation in the second half of the year, the situation in the economy and, accordingly, in state finances will begin to improve. At the same time, the deficit of the state budget in Kazakhstan, thanks to transfers from the National Fund, will be moderate by world standards, although it will reach a record value over the past 20 years.

### State budget tax incomes declined by 23% yoy (T0.5 tn) in the second quarter of 2020

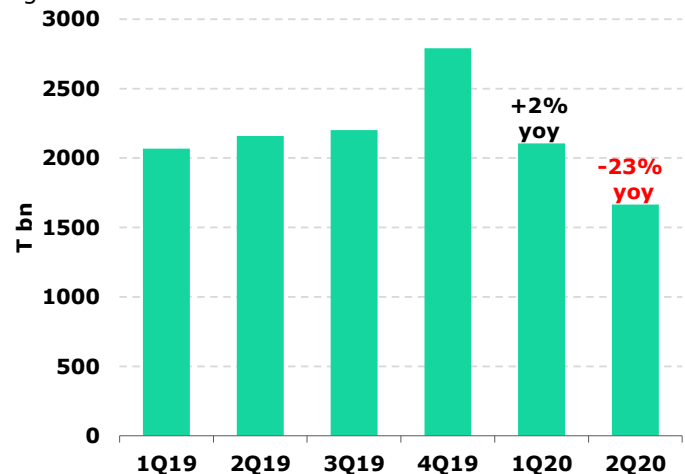
The downturn of the Kazakh economy in the second quarter was accompanied by a 23% decrease in tax revenues compared to the second quarter of 2019. Due to the transfer from the National Fund, the total revenues of the state budget turned out to be in positive territory by 14% yoy. For comparison, in the second quarter of last year, tax revenues increased by 15% yoy, revenues – by 26% yoy. Such data clearly demonstrate the negative impact of the spread of COVID-19 on the economy and the budgetary sphere. The decrease in state budget revenues reflects not only the crisis in the economy, but also, to a large extent, measures of fiscal stimulation of the economy – deferral of tax payments, reduction of VAT on certain medical supplies, lower prices for motor fuel and tariffs for housing and communal services, etc. In general, for the first half of 2020, the implementation of the annual plan for tax receipts was fulfilled by 42.4%, against 46.3% in 2019.

Figure 1. Revenues and taxes



Source: Minfin RK, CS MNE

Figure 2. Decline of taxes



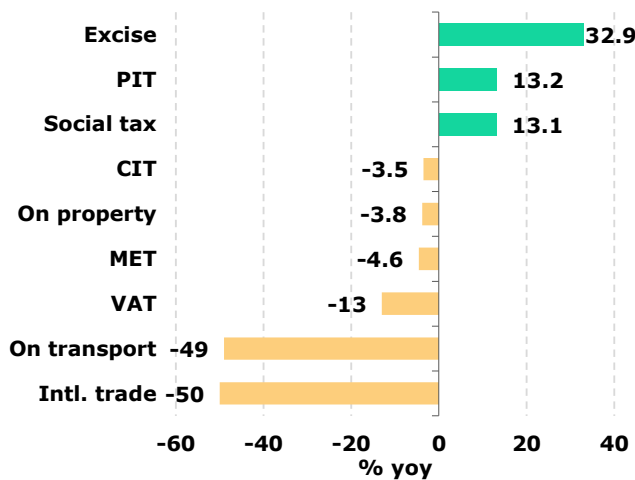
Source: Minfin RK, CS MNE

In the first half of 2020, total tax revenues fell by about 11% yoy. The deepest drop occurred in taxes on international trade -50% yoy, in taxes on transport -49% yoy, VAT receipts decreased by 13% yoy. Corporate income tax revenues decreased by 3.5% yoy, while in April the decline reached 94% yoy, but in May there was an increase of +75% yoy, and in June – a slight decrease to -5% yoy. Based on the monthly dynamics of tax receipts, it is not yet possible to talk about the stabilization of the situation with their collection – for some taxes the reduction is still ongoing, for others there is a moderation in the slump.

Against the generally volatile background of tax receipts, the income from the PIT and the social tax has shown good dynamics, the receipts from these taxes increased by more than 13% yoy. This is due to an increase in budget spending on salary payments by almost T330bn or 37% yoy in 1H2020, although small businesses were temporarily exempted from payroll taxes and other taxes. Due to the increase in excise taxes on tobacco products, receipts from excise taxes increased by almost 40% yoy.

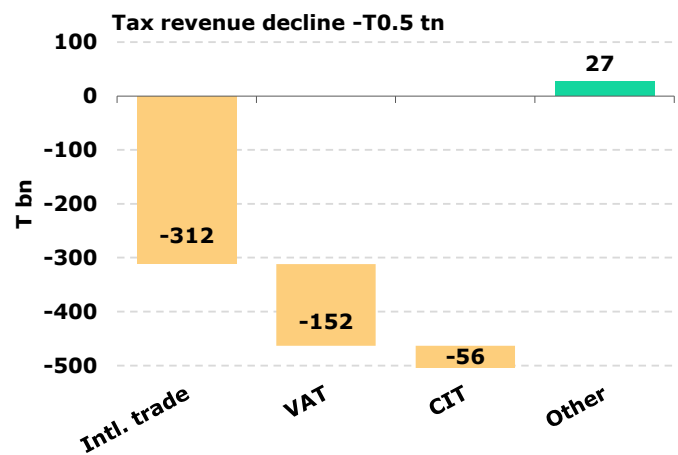
In the second quarter, which saw the peak of isolation measures, tax revenues fell by almost half a trillion tenge, or 23% yoy. The main decrease occurred in taxes on international trade by KZT312bn (-77% yoy), VAT receipts decreased by KZT152bn (-26% yoy), CIT decreased by T56bn (-12% yoy). The main decrease in taxes on international trade was due to a decrease in export customs duties on oil by approximately T330 billion, or 92% yoy. Recall that the decline in revenues this year due to the unfavorable economic situation was estimated by government agencies at -T1.7 trillion with an average annual oil price of \$20 per barrel, while in the first half of the year its price averaged about \$41 per barrel.

Figure 3. Taxes 1H2020



Source: Minfin RK, CS MNE

Figure 4. Decline of taxes 2Q2020

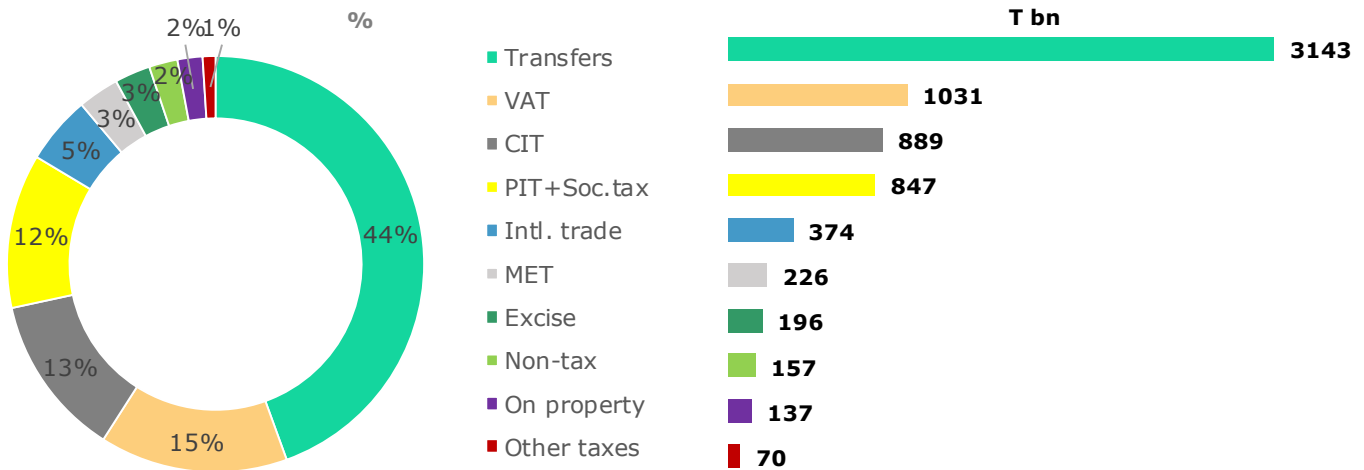


Source: Minfin RK, CS MNE

**Due to the crisis the National fund transfer became the main income of the state budget**

The total budget revenues in 1H2020 amounted to KZT7.1 trillion, which is almost KZT900 billion or 14% higher than the level for the same period in 2019. The main source of income for the state budget in the first half of the year was transfers from the National Fund – 44%. Among taxes, in the first place were receipts from VAT (15%), in second place – CIT (13%), in third place personal income tax and social tax (12%), together these taxes provided 40% of all income. Thus, the transfers in terms of amount exceeded the receipts from the three main taxes in the country.

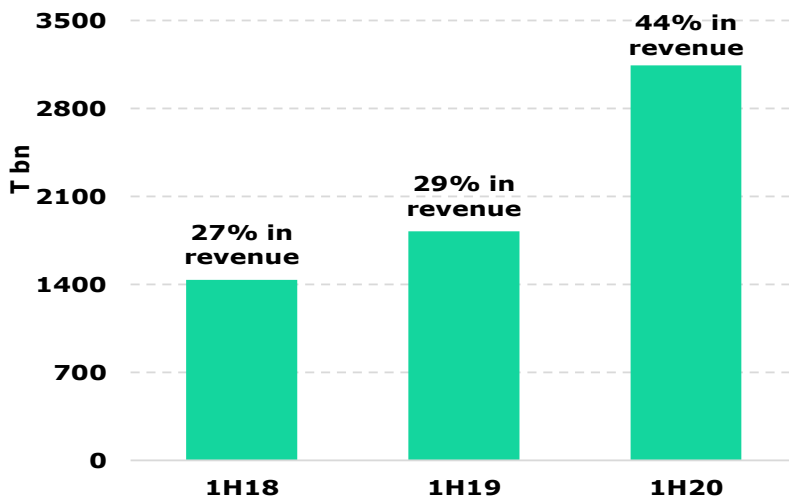
Figure 5. State budget revenue structure, 1H2020



Source: Minfin RK, CS MNE

Transfers of the National Fund this year play an important role in replenishing the revenue side of the state budget. In the first half of the year, transfers from the National Fund increased by 72% to T3.1 trillion, which corresponds in size to 11% of GDP over the same period. At the same time, the share of the transfer, as already noted, reached 44% in the total revenues of the state budget, which was the second largest result in history. The maximum level of use of the transfer was reached in 2015 and was equal to 47% of all revenues, by the way, then the increase in its use was also caused by the fall in oil prices and was accompanied by the transition of the tenge to a free floating regime.

Figure 6. Transfers and its share in budget revenues

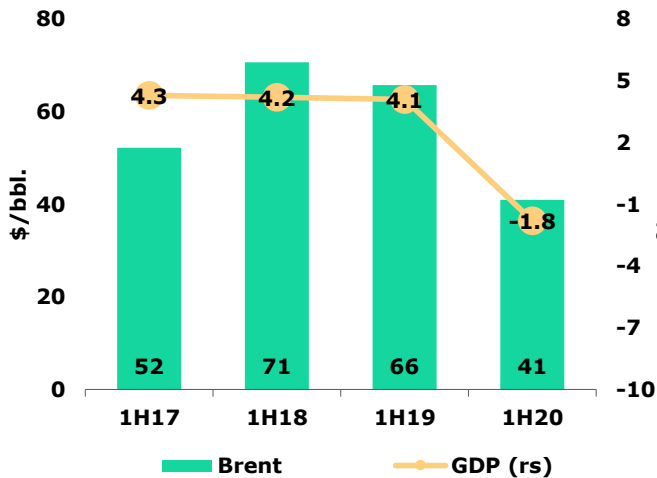


Source: Minfin RK, CS MNE

**Growth of expenditures outrun growth in revenue, reached 25% yoy in 1H2020**

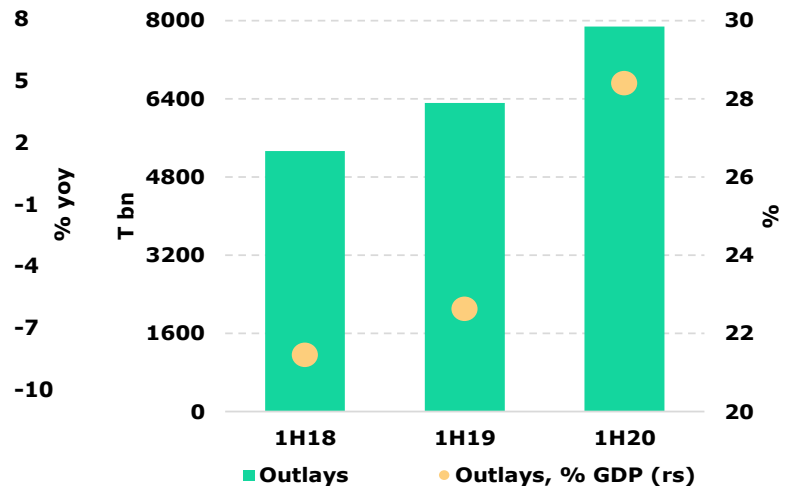
The pandemic-triggered drop in prices for hydrocarbons and other raw materials, as well as isolation measures, pushed the economy into a recession in the second quarter. In response, state budget expenditures were sharply increased by 25% yoy to T7.9 trillion. As a result of a decrease in nominal GDP in the first half of the year with a simultaneous increase in spending, the state budget expenditures increased to 28.4% of GDP, from 22.6% of GDP in 1H2019. This clearly indicates that the state has gone to a serious increase in support for the economy, without which the economic recession could have been deeper. At the same time, it is possible that government spending may further increase, depending on the development of the situation in the epidemiological sphere, for example, spending on healthcare in the first half of the year increased by 45% yoy, against 25% yoy in aggregate.

Figure 7. Decline in GDP growth and oil prices



Source: Bloomberg, CS MNE

Figure 8. Budget outlays dynamics

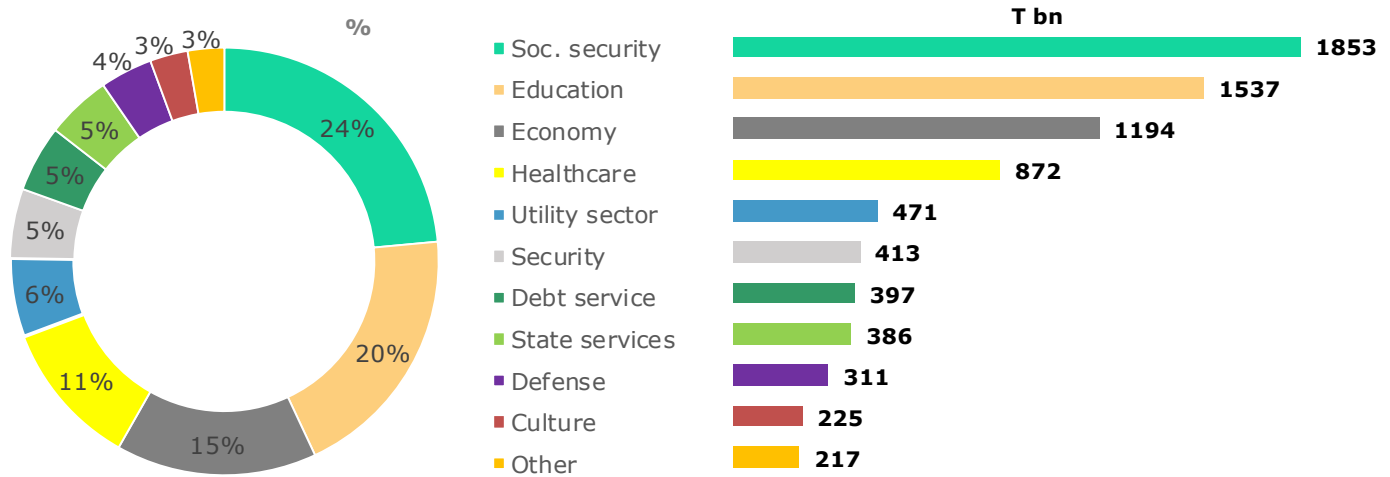


Source: Minfin RK, CS MNE

**Social sphere and investment are – main direction of budget spending in crisis**

In the first half of 2020, the structure of state budget expenditures did not undergo significant changes. The social block retains its first place: social security, education and health care with a share of 54% of total outlays. Apart from industry (the share of costs is not high), the most significant increase was observed in housing and utilities costs + 54% yoy, which includes costs for Nurly Zher, which in turn more than doubled. Investments in fixed assets at the expense of the budget in the first half of the year increased by 33% yoy, which indicates the stimulating nature of spending in the context of the onset of the crisis. In addition to health care, spending on education was also significantly increased +35% yoy, where teachers' salaries were increased and per capita financing of secondary education is being introduced. The weakest growth was recorded in spending on culture +3% yoy and defense +4% yoy.

Figure 9. Structure of budget expenditures

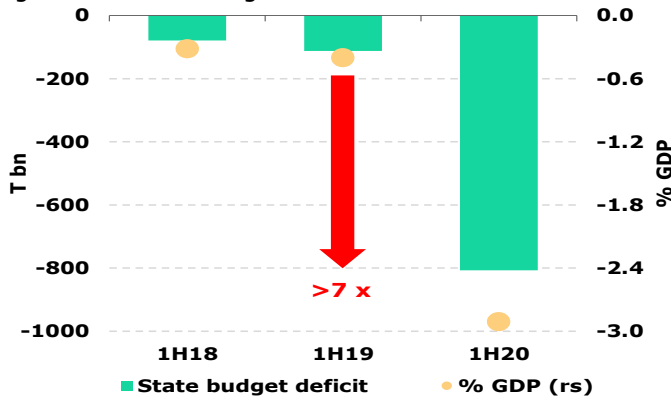


Source: Minfin RK, CS MNE

**State budget deficit rose sharply to 3% of GDP in 1H2020**

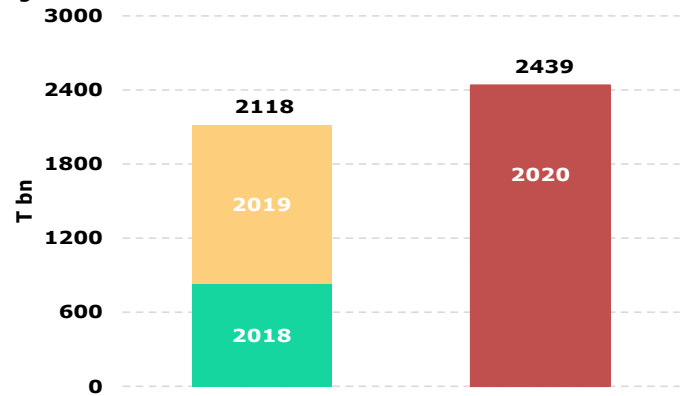
With observed strong decline in tax revenues and increased costs, the size of the state budget deficit has sharply increased. At the end of the first half of the year, the state budget deficit was T0.8 trillion, which is more than seven times higher than the indicator for the same period in 2019. In relative terms, the state budget deficit increased from 0.4% of GDP to 2.9% of GDP. According to the government's forecast, the state budget deficit this year will reach T2.4 trillion, which will be higher than its level in the previous two years combined and the deepest in the last 20 years at 3.5% of GDP. Note that the projected deficit in Kazakhstan is relatively moderate, given the global nature of the current crisis. So, the expected deficit in Russia this year is 4.8% of GDP (Focus Economics), in Uzbekistan at a similar level, in Ukraine 7.1% of GDP, in Azerbaijan 7.2% of GDP, in Georgia 7.7% of GDP.

Figure 10. State budget deficit



Source: Minfin RK, CS MNE

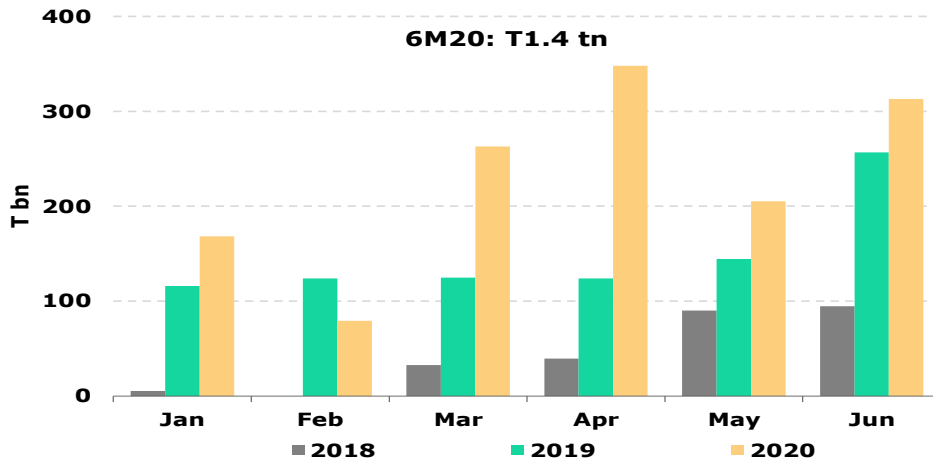
Figure 11. Deficit size



Source: Minfin RK, CS MNE

As a result of an increase in the need for financing, over 6 months of 2020, the placement of obligations of the Ministry of Finance in the domestic market increased by 55% compared to the same period in 2019. In January-June, the Ministry of Finance raised about T1.4 trillion in the market through bonds. At the beginning of the year, the volume of funds attracted was rather small, but already in April they approached T350bn, in June their volume slightly decreased to T313bn. The amount of debt obligations issued by Minfin could have been significantly higher, however it was in check due to large use of transfers from the National Fund, the size of which reached T3.1 trillion in January-June 2020 (+72% yoy).

Figure 12. Emission of Minfin debt obligations

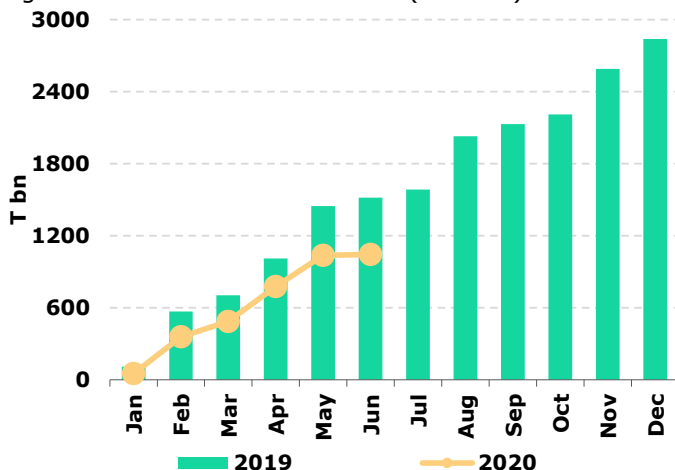


Source: NBK

**National fund revenues declined by 31% yoy, while the use of its funds rose by 72% yoy**

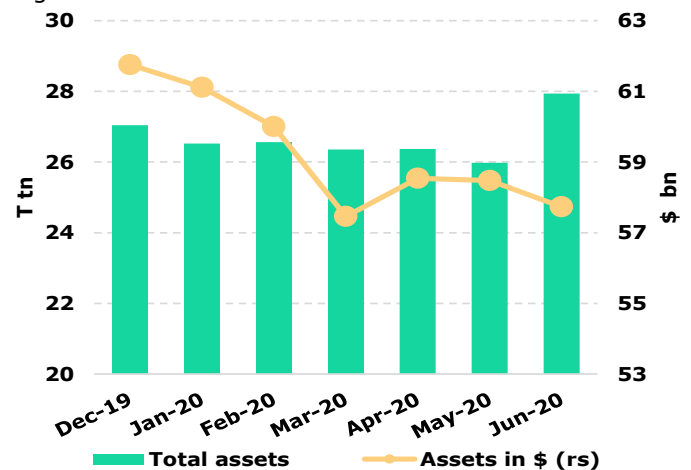
Revenues of the National Fund amounted to T1 trillion in the first half of this year, which is 31% or T0.5 trillion less than in January-June 2019. There was a decrease in all tax revenues, but the main decrease was in CIT revenues by 42% yoy. Investment income in the period reached T2.6 trillion or almost 10% of total assets and exceeds the depreciation of the tenge against the dollar by about 6% over the six months of this year. In turn, the size of the transfer to the state budget increased by 72% yoy. Taking into account the investment income, the size of the fund's assets in the first half of the year increased by 3% to KZT27.9 trillion. The portfolio of foreign exchange assets, on the contrary, decreased by \$4 billion to \$57.7 billion. By the end of the year, the use of the transfer will amount to T1.1 trillion, excluding almost half a trillion tenge used in July. At the same time, receipts to the National Fund in the time remaining until the end of the year will probably be insignificant, since oil prices will remain at a level slightly above \$40 per barrel, in addition, part of this year's tax receipts was transferred to the next.

Figure 13. National fund revenue (accrued)



Source: Minfin RK, CS MNE

Figure 14. National fund assets



Source: Minfin RK, CS MNE

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