

# Forecasts and expectations for 2020

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## **Economy**

### • **The growth of Kazakhstan's economy through fiscal expansion**

The year of 2019 for Kazakhstan in terms of economic growth was quite successful. The GDP growth rate accelerated from 4.1% achieved in 2017 and 2018 to 4.5%, surpassing even the most daring forecasts of analysts. The economy of Kazakhstan has not demonstrated such high growth rates since 2013, when oil prices were almost two times higher than the quotations in 2019 (\$ 64 per barrel of Brent crude oil). In 2019 growth accelerated despite the fact that the average crude oil price decreased by 10% yoy.

The main factors that triggered the acceleration of economic growth were the growth of consumption and investment. In 2019, total trade volumes increased by 7.6%, and investment in fixed assets grew by 8.5%, due to which the growth in construction work amounted to almost 13%.

Thanks to comprehensive measures of state support, real wages for 2019 increased by almost 9% and nominal - by almost 15%. At the same time, administrative measures to control state monopoly tariffs and gas prices contributed to maintaining a stable inflation rate of 5.4%.

Thus, the acceleration of economic growth was achieved due to internal factors that compensated for the negative external influence - trade wars between the USA and China, increased geopolitical tensions, a slowdown in the global economy and others.

### • **The negative external background will continue in 2020**

We expect that this year the external environment for Kazakhstan as a whole will be negative due to the strong dependence of our economy on oil, the sale of which is the main source of income for Kazakhstan - it accounts for about 70% of total exports. The current situation on the world oil market is characterized by excess supply over demand. According to the expectations of the International Energy Agency, the growth of oil supply from non-OPEC countries will amount to 2.1 million barrels per day, while global demand for black gold will grow by only 1.1 million barrels per day. As a result, excess oil will continue to put pressure on the market.

Due to this pressure, we saw only short-term spikes in hydrocarbon prices in response to rising tensions in the Middle East caused by attacks on Saudi oil infrastructure and the elimination of a prominent Iranian military leader by the United States.

According to our estimates, the average cost of Brent crude oil in 2020 will be \$ 62 per barrel, which is 3.4% lower than in 2019.

The outbreak of coronavirus in China may have additional pressure on the global economy and negatively impacted

business activity in this country and its partner countries. As a result, this can reduce the demand for raw materials (oil, metals) from one of the main consumers, and also have a negative impact on investment, transport, logistics, tourism and other industries on a global scale.

- **Internal factors will continue to support Kazakhstan's economic growth**

Domestic demand in 2020, as in the past, will depend on budget expenditures, which provide for the continued increase in public sector wages, for which in 2019-2021 a total of about 1trln tenge was laid down. In addition, the “Nurly Zhol” program was extended until 2025, and financing of housing construction programs continues. Rising housing prices and the development of the mortgage market should stimulate an additional influx of private investment.

The established low rates in the international capital market in the context of high yields on Kazakhstan’s financial instruments against the background of positive dynamics of macroeconomic indicators should contribute to attracting investments to the local market. Continued growth in household incomes due to increased government spending should also have a positive effect on retail sales and, consequently, on the growth of the entire economy.

Real wages can grow by 3% this year, mainly due to the public sector. The situation with rising prices will be determined by government interventions and we expect inflation at the end of the year to be at 5.5%. At the same time, we admit that the National Bank may go on a slight easing of monetary policy as the effect of the fiscal stimulus goes down. Within the current economic cycle, taking into account the strong indicators of the past year, we predict that Kazakhstan's GDP growth will remain at 4.5% in 2020, not excluding the possibility of higher economic growth rates.

- **We expect tenge to weaken under pressure from external and internal economic factors**

Compared to the previous year, in 2019, the tenge demonstrated higher stability. From January to August last year, the national currency rate was formed in the corridor of narrow values of 384.2-384.6 tenge per US dollar. Later, as a result of lower oil prices, from August to October, the national currency rate weakened to 390.1 tenge per dollar. In December 2019, the growth of oil quotes to \$ 68.4 per barrel coincided with the tax week, which affected the significant strengthening of the USDKZT pair to 378.6.

As a result, over the year, the national currency appreciated by 0.8% from 384.2 to 381.2 tenge per US dollar. At the same time, the average value of the tenge exchange rate for 2019 amounted to 382.75 tenge per US dollar, showing a weakening of 11% compared to 2018.

Given the negative expectations for foreign economic factors described in the previous sections, we predict that the national currency rate in 2020 will experience the pressure of the deficit in the current account and do not exclude its weakening by 3-4% by the end of the year.

## **Banking sector**

- **In 2019, the decline in the impact of the banking sector on the economy has been continued**

According to preliminary data, in 2019 the assets of the banking sector increased by 6.2%, and its loan portfolio grew by 7.1% compared to 1.3% in 2018. The main contribution to the portfolio growth was made by retail loans, which increased by 26% from the beginning of the year and amounted to 48% of the total portfolio. The sector's deposit base in 2019 expanded by 5.5% compared to 2.2% in 2018. The main contribution to the growth of deposits, as before, was made by household deposits, which were increased by 6.2% yoy. Following the reduction in the previous year, in 2019 corporate deposits grew by 4.7% yoy.

Despite the higher growth rates of the banking sector in 2019 compared to the previous year, its impact on the economy continued to decline. According to our estimate, the ratio of second group of banks loans to GDP for the year decreased from 22.3% to 21.4%, and the ratio of deposits to GDP also decreased - from 27.6% to 26.1%. Thus, taking into account real growth of GDP of 4.5% and inflation at 5.4%, the nominal growth of loans and deposits lagged behind the nominal growth of the economy.

As before, the main reasons for this lag were the structural problems of the economy of Kazakhstan, focused on the export of natural resources with a low share of added value, and characterized by a high degree of state presence. The result is a weak development of SMEs with ineffective state support, as well as a slow growth in real incomes in sectors that were not

affected by government measures to increase salaries. This situation is exacerbated by the low quality of corporate governance of individual banks, which led to the formation of a large amount of hidden problem loans, putting pressure on banks' capital and limit their lending opportunities.

• **The main trends in the development of the banking sector in 2020 will remain unchanged**

In our opinion, the main trends in the development of the banking sector that were observed in recent years will continue in 2020. This is primarily a continuation of the outstripping growth of retail lending compared to corporate lending and a decrease in the role of the banking sector in the economy.

Among the additional factors that can have a significant impact on the market, it is worth highlighting the AQR results of the NBK and related future decisions of the regulator, as well as the separation of the Agency for Regulation and Development of the Financial Market from the NBK.

In our opinion, the influence of the banking sector on economic growth will continue to decline due to the expected tightening of requirements for consumer lending, as well as due to the possible cancellation of bad debts by the results of AQR in a number of banks. Also, we do not expect significant changes in the base rate and, accordingly, in the cost of the loan, especially for business, in the face of significant inflationary pressures and continued excess liquidity in the market. At the same time, retail lending will continue to be the leading factor in the growth of the total portfolio, since the limited corporate lending market will remain in the absence of changes in the development of SMEs and due to the low efficiency of measures to solve structural problems. Consequently, as in the past year, the main role in ensuring the growth of the banking sector is likely to remain with consumer lending, although it may be possible to slow down in response to stricter regulation and saturation of the market, and bank loans and assets as a whole will grow more slowly than the economy countries in nominal terms.

We do not expect significant changes in the growth rate of deposits of individuals in connection with the stabilization of income growth. The total growth in corporate sector deposits will also remain well below nominal GDP growth. The impact on growth of deposits will have to restore confidence in the banking system and is expected to remain the growth rate of the economy at a level above 4%.

• **The share of problem loans could be increased, the pressure on the capital will increase, the sector will continue to consolidate**

At the end of 2019, the share of problem loans amounted to 8.13%, showing a slight increase compared to 2018. Coverage of NPL90 + provisions in the sector was at the level of 163.8%, and in most banks this indicator was above 100%. On the other hand, according to the IFRS 9 financial statements published by banks, the share of stress loans (loans included in Stage 2 and Stage 3) significantly exceeds the NPL sizes reflected in the statistics provided by banks to the NBK. Also, some banks have a significant gap between accrued and actually collected interest income. In this regard, we believe that the level of bad debts is probably underestimated and in reality their share can be significantly higher.

According to preliminary AQR results, although the prudential capital adequacy ratios k1 and k2 are carried out by banks in general, the entire banking sector, the regulator recognizes the need for additional capitalization of banks in the amount of T450bn. Consequently, the issue of capital adequacy of individual banks remains open. This situation is exacerbated by the low willingness of banks' shareholders to make additional capital injections under unsolved structural problems of the economy and the limited opportunities for growth.

The beginning of 2019 was remembered for the sale and accession of Tsesnabank to FHB, followed by rebranding at First Heartland Jýsan Bank. Later, the FHB voluntarily reorganized, which led to a reduction in the number of banks to 27. In 2020, we expect a further reduction in the number of banks through mergers or liquidations; mostly will depend on the results of AQR and related regulatory decisions.

• **Separation of powers between the NBK and the financial market regulation agency**

In mid-2019, a law was signed on the creation of a special agency for regulation and supervision of the financial market, reporting directly to the President of the Republic of Kazakhstan. The creation of the Agency for the Regulation and Development of Financial Markets and the transfer of some of the functions of the National Bank to this body is undoubtedly a positive event in the development of the financial sector of the country, as it should minimize the conflict of

interests between the monetary and regulatory functions. Moreover, the separation of powers between the NBK and the agency will be effective only if the independence of the agency from the government and the NBK is ensured.

## Stock market

### • Key drivers for stock market growth in 2019

The main drivers that influenced stock markets last year were geopolitical factors, such as the US-China trade conflict, uncertainty surrounding Britain's exit from the European Union (Brexit), and the slowdown in global economic growth. The world's second largest economy in China grew by 6.1% yoy in 2019 - slowest growth rate in 29 years. Against the background of weak statistics on economic growth in Europe and Japan, investor sentiment was also pressured by concerns about weakening demand for raw materials and global stagnation.

In order to stimulate economic growth, the leading central banks of the world were forced to weaken monetary policy. In 2019, the Fed lowered its base interest rate three times (July, September, October) to 1.5-1.75%. The rate cut in July was the first since the 2008 global financial crisis.

### • USA

Despite the volatility and geopolitical uncertainty, thanks to the support of the monetary authorities, major US stock indexes showed record growth: in 2019, the S&P 500 blue-chip index grew by 28.7%, the high-tech Nasdaq Composite index increased by 37.2% and the Dow Jones industrial index added 22.2%

In terms of sectors, technological (+ 44.3%), industrial (+ 33.8%) and financial (+ 29.3%) grew the most. Smaller relative growth was recorded in the energy industry (+ 13.5%), telecommunications (+ 17.3%), and the mining industry (+ 20.9%). The most significant growth was led by the company Advanced Micro Devices Inc. (+ 157%), while PG&E Corp (-73%) showed the largest decline.

Separately, it is worth highlighting the top 3 companies whose stocks had a greater impact on the growth of the S & P500 index. They are all representatives of the technology sector. Most of the growth in the index was reflected by the upward movement of 90% by one of the largest market capitalization companies in the world - Apple. Microsoft's stock growth in 2019 exceeded 59%; Facebook stock growth exceeded 53%.

### • Europe

The British FTSE 100 index for 2019 increased by 12% yoy. Uncertainty surrounding the Brexit situation negatively affected the FTSE 100: many global investors avoided UK stock due to the high level of economic and political uncertainty in the country. At the same time, a protracted trade conflict affected the export economy of oriented European countries, which led to a decrease in the manufacturing industry and worsening the situation on the labor market. The following sectors were the best: industrial (on average, shares in the sector in 2019 increased by 28.95%), financial (+27.3%), consumer (+26.98%). The shares of the energy, mining and technology sectors in 2019 were among outsiders, adding 6%, 12% and 14%, respectively. Among individual companies, shares of the London Stock Exchange Group (+93%) and clothing retailer Next PLC (+78.5%) increased the most, while NMC Health PLC (-34%) showed the largest decline in quotes.

The German DAX index grew by 25.2% yoy. The following sectors showed the greatest growth: utilities (+32.2%), technology (+29.3%) and financial (+27.4%). The telecommunications sector (+2.95%), the mining industry (+10.7%), as well as the consumer goods sector (+11.6%) turned out to be worse than the market. The shares of Adidas AG brought their shareholders in 2019 61% profitability due to the growth of quotations. Wirecard AG, on the other hand, lost 19% of its value over the same period.

The French CAC 40 index increased by 29.6% yoy. The main beneficiaries of the index are the technological (+45.4%), industrial (+36.5%) and financial (+33.8%) sectors. As for individual stories, the shares of technology company STMicroelectronics NV increased the most, adding 98.4%, while securities of the automobile concern Renault SA lost 16.7%.

### • Asia

Asian stock indices have shown significant growth, despite worries about the protracted trade conflict between the US and China and the slowdown in the domestic economy. The Shanghai SSE Composite Index increased by 23.7% yoy. The best industries by average annual profitability: technology (+55.4%), essential goods (+ 30.9%), financial (+ 27.1%). At the bottom of this list are: utilities (+ 12.7%), energy (+ 12.8%), as well as consumer (+ 13.6%) sectors. Separate mention is made by the results of the technology company Will Semiconductor Ltd, which shares increased by almost 400% over the year, as well as the telecommunications company Beijing Xinwei Technology Group, whose securities lost 79%.

Japan's Nikkei 225 Index increased by 20.9% yoy. In the Nikkei index, the technology sector reached impressive growth in 2019, with stocks rising on average 36% yoy, followed by telecommunications that grew by 21% and industrial production (+ 17.3%). Securities of the municipal and energy sectors lost an average of 8.8% and 0.6%, respectively, while the mining sector grew by 5.8% per year. The shares of the technological company Advantest Corp (+ 181.6%) grew more than the others in 2019, and the largest decline was noted for the pharmaceutical quotes Sumitomo Dainippon Pharma Co L (-38.2%).

The growth of Asia's largest stock market, the Hong Kong stock index Hang Seng, was 12.2% yoy, which is lower than the dynamics of the largest world exchanges. The main reason for the relatively weak dynamics was the protests in Hong Kong, which had a negative impact on key sectors of the region's economy. Consumer sector securities in 2019 grew by an average of 17.53%, bypassing the financial and essential goods industries, whose growth was 16.3% and 14.22%. The energy and telecommunications sectors recorded a decrease of 1.46% and 0.91% over the year, while the industrial sector grew by 4.96%. The largest increase in stock prices of individual companies was recorded by the representative of the pharmaceutical industry CSPC Pharmaceutical Group Ltd, which amounted to 68%, and the largest drop was observed in shares of China Railway Group Ltd by decreasing 34% over the year.

#### • **Kazakhstan**

Kazakhstan index KASE in 2019 increased by 3.05% to 2363.79p. A significant event in 2019 for the index was the listing of shares of NAC Kazatomprom JSC after its IPO on Astana (AIX) and London Stock Exchanges (LSE) in November 2018.

It is also worth noting the secondary public offering of Halyk Bank and Kazatomprom on the London Stock Exchange (LSE) and Astana International Exchange (AIX).

An IPO of Kaspi Bank is planned for 2020, an IPO of Air Astana, the oil-producing company KazMunaiGas, as well as an SPO of the Kazakhtelecom telecommunications company are also expected.

#### • **Expectations and forecasts for 2020**

Overall, 2019 was a successful year for global financial markets. However, a number of factors can bring increased volatility to global stock markets and increase the risks of a deep correction of indices in 2020:

**US-China Trade War.** On January 15, US President Donald Trump and Vice Premier of the State Council of the PRC Liu He signed an agreement on the first phase of the settlement of the trade dispute between the two countries, which slightly mitigated investors' concerns about the prospects for the development of the global economy. The key question remains whether China and the United States can advance in resolving the most acute problems in negotiations on further phases of the trade deal.

**US presidential election.** An important influence on the dynamics of stock markets will have presidential elections in the United States that can lead to volatility. Uncertainty in the US presidential election and its consequences lies largely in the possibility of raising the level of taxes that are necessary to replenish a record budget deficit (\$1trln).

**Brexit.** Britain exited the EU de jure on January 31, after that a transitional period began during which the parties would conduct trade negotiations. The potential decline in the role of London as a leading European financial center could have a negative effect on the capitalization of listed companies on the London Stock Exchange. As it known, many companies in the CIS countries choose the London Stock Exchange to place their shares. One of the first Kazakhstan companies entered the London Stock Exchange (LSE) in October 2005, was Kazakhmys (KAZ Minerals), with a 26.2% stake.

**The risks of a global recession.** According to the Financial Times, the US economy has been continuously growing for over 10 years. The average GDP growth is 2.3% per year. GDP has been increasing over 128 months. At the same time, the United States is experiencing the longest period of continuous economic growth after the year of 1854. In particular, America's previous record was 120 months of continuous GDP growth, when the economy grew from March 1991 to March

2001 and was interrupted by the collapse of the dotcom bubble. At the same time, macro statistics indicate the stability of the American economy: unemployment has fallen to its lowest levels over the past 50 years, the number of jobs and the growth of average hourly wages continues to grow.

As noted above, the growth of China's GDP, the second largest economy in the world has slowed to its lowest level in 29 years, 6.1% yoy in 2019. China is one of the largest consumers of natural resources and industrial raw materials in the world. Together with weak statistical data on the economic situation in Europe and Japan, this may lead to a decrease in demand for raw materials and lead to global stagnation.

Many analysts also see the outbreak of coronavirus in China as the "black swan," which could plunge the global economy into recession. It is believed that if the epidemic lasts longer than 2-3 months (the peak of the epidemic is expected in mid-February), China's economy may slow down to 4.5-5.0% yoy. The IMF forecast of October 2019 on the growth of the Chinese economy for 2020 is 5.8% yoy and does not take into account the effect of the spread of this disease. At the moment, it is safe to say that the tourism business (a share of about 5% in China's GDP), the transportation of goods and passengers by all means of transport, as well as food trade, and followed by the food industry, will show a decrease in growth in 2020. There is also an opinion that this could provoke defaults on Chinese corporate obligations, as China has a high debt burden on the corporate sector. According to preliminary data, in 2019, Chinese issuers could not meet the requirements of about \$ 18bn. Prior to agreeing on the first phase of a trade deal with the United States, it was repeatedly expressed that defaults in China's corporate sector could lead the world economy to recession.

The IMF has so far been cautious about the slowdown in the global economy (the current forecast for 2020 is 3.4%), but it is obvious that if the "main factory" of the global economy starts to slow down, it is bound to affect the overall growth of the world economy.

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