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Macroeconomic report

1Q2019

Abstract

The growth of the economy of Kazakhstan in the first quarter of 2019 slowed slightly to 3.8% yoy from 4.1% yoy in 2018 and was within the government's forecast for the entire current year. As the oil output set to decline due to technical works at the country's largest fields, it can be expected that the economy will also slow down in the second quarter. In this environment, the increase in government spending aimed at increasing the incomes of the population supports the growth of activity in the non-primary sector via increased consumption.

The price of oil throughout the entire first quarter was rising steadily, adjusting after slump at the end of 2018 to \$50 per barrel, and exceeds \$70 per barrel currently. The rapid recovery in oil prices nevertheless was not accompanied by a concomitant movement in the exchange rate, which was at the peaks near the mark of 380 per US dollar and 5.9 per ruble, once again demonstrating the high flexibility of the national currency in the toward weakening rather than to strengthening. Considering that \$70 per barrel is a relatively large burden for the global economy, which is expected to slow down this year, the impulses for growth of the Kazakhstan economy from oil prices and the oil-producing sector are limited.

The situation with the incomes of the population improved in 2018, the share of income in GDP increased to 34.1% from 33.9% in 2017. However, based on the components, the incomes of the population show a negative trend – the share of income from employment fell to a minimum of 63.3% in total income, income from self-employment and entrepreneurship did not change, as a result, the share of income from pensions sharply increased to 18.3%. It should be noted that, taking into account those employed in the public sector and national holdings, we estimate that together with pensions and benefits, about 40% of household's income come from public sector, which is about 5pp higher than before the fall in oil prices in 2014.

The reduction in the share of income from employment suggests that there are significant problems for the development of the non-primary sector, and the decision to raise the minimum wage stresses that private business is struggling because of which wages have not grown in recent years. As a result, it can be concluded that a fairly good economic growth in Kazakhstan in the past 2 years has not transformed into real wages growth that led, among other things, to the usage of funds of the National Fund and engage the mechanisms of non-market administrative measures to suppress inflation to improve the well-being of the population.

The increase of minimum wages, pensions in combination with double-digit real growth in consumer lending, mortgage subsidies from the state stimulate consumer activity at the same level as last year. The growth of retail trade was higher than 6% in annual terms in March 2019.

The labor market showed an increase in demand for labor force, the number of employees rose to the highest level in the entire history of 8.8 million. At the same time, the growth of nominal wages reached 10% yoy, but revenues from the individual income tax in the budget show a negative growth, which raises the question – whether wages are rising in reality.

Investment growth in the first quarter of 2018 remained at a high level of 7% yoy, but half of all investments went into oil and gas production, while in the manufacturing industry investments fell by almost 50% yoy.

Another increase in expenditures of the consolidated budget by 2.8pp to 23.4% of GDP, according to our estimates, will again increase the deficit of the consolidated budget, which has been observed for the fifth consecutive year. In addition to the National Fund, the use of extra-budgetary funds (NBRK, ENPF) is increasing, as a result, the consolidated budget can come to balance only by 2021, if external conditions will remain favorable. In the first quarter, there was an excess of receipts of funds to the National Fund over its use, overall for the year the fund's assets will increase only slightly.

In the first quarter of 2019, inflation slowed to 4.8% from 6.6% a year earlier. Inflation continue to ignore a strong inflation background: the impact of a weak tenge, a high level of inflationary expectations of the population, stimulating fiscal policy, thereby creating an accumulation of risks, especially as a result of the transition of monetary policy to softening.

During the first three months of this year, the base rate of the regulator remained unchanged at 9.25% with a discount window +/- 1%. Inflation risks of importing inflation from the Russian Federation and uncertainty in the energy markets were considered by the regulator as potential risks of inflation in the republic. In April, the regulator decided to cut the base rate to 9.0%. It is also necessary to understand that economic growth in 2019, according to our forecast, will slow down to 3.6%, and in such conditions it becomes obvious that in order to maintain economic growth, its growth must be stimulated both through a fiscal stimulus and through easing of monetary conditions. The reduction of the base rate, by definition of the regulator, kept the monetary conditions in the country at a neutral level. However, we believe that through lowering the base rate and supporting economic growth (the NBK has somewhat expanded its mandate), the regulator sends a clear signal to the market that it intends to move precisely towards easing its monetary policy. Our current forecast for the base rate of the regulator at the end of the year is 8.75%.

In March of this year, the new leadership of the National Bank under E. Dosayev made a statement about the continuity of the macroeconomic policy pursued jointly with the government of the republic. The NBK made a statement that it will provide stability in the FX market and has all the necessary tools to prevent speculative transactions with the tenge exchange rate. The continuity of the policy in terms of the exchange rate of the national currency also implies the preservation of its "free floating" regime.

Despite of the high level of energy prices and strengthening of USDRUB, the national currency is at stable “weak” level to eliminate currency arbitrage, to provide favorable conditions for export-oriented companies, as well as to manage trade deficit with the main countries-trading partners. Such an approach in terms of rate fixing is forecasted by us until the end of this year, provided that the current geopolitical and macroeconomic situation in the world remains.

The exchange rate of the national currency against the US dollar will vary within a narrow range of values of 374 tenge (support line) and 385 tenge (resistance line). According to the results of the current forecast round, our annual forecast for the USDKZT pair is 375 tenge per dollar at the end of the year and 376.5 tenge on average for the period.

Exports from Kazakhstan in January-February 2019, according to the preliminary data of the Committee on Statistics, showed rapid growth rates (+ 11.1% yoy) and amounted to \$ 9.9 billion compared with imports (+ 0.3% yoy), the volume of which amounted to \$ 4.5bn. In the first two months of the year foreign trade turnover increased by 7.5% yoy and amounted to \$ 14.3bn.

Analysis of the exports structure from Kazakhstan showed that in January-February 2019, the share of mineral products increased from 71.7% a year earlier to 74.7%. In nominal terms, exports of mineral products grew by 15.9% yoy and amounted to \$ 7.4 bn. According to the Committee for Revenue of the Republic of Kazakhstan, in January-February 2019, exports of crude oil and gas condensate grew by 18.7% yoy and amounted to 12.4 million tons. In nominal terms, this export increased by 16.6% to \$ 5.9 bn.

An analysis of imports, according to the Statistics Committee, showed that within two months in 2019, Kazakhstan increased imports of machinery, equipment, vehicles, instruments and devices by 2.0% yoy in nominal terms to \$ 1.7 billion (the share of imports increased from 37.8% in January – February 2018 to 38.5% in the same period of the current year. We associate the increase in equipment imports primarily with the maintenance works scheduled for March-April at the largest oil fields in the republic. The major part of those imports (49%) come from non-CIS countries, mainly China, Italy, Germany, Turkey and South Korea.

Comparing the data of two months of the current year with the annual data of previous years, it can be concluded that the structure of exports and imports as a whole remains relatively stable and highly likely will not suffer radical changes in the period.

Current account balance of the Republic of Kazakhstan in 2018, according to updated data of the NBK, has developed with a deficit of \$ 52mn (\$5.1bn in 2017). This is the minimum deficit in the last 4 years. The relative indicator of the current account deficit to GDP decreased from -3.1% in 2017 to -0.03% in 2018 (the indicator is calculated on the basis of preliminary GDP data for 2018).

According to an updated statistics of the NBK for 2018, the outflow of financial resources within the financial account amounted to \$2.6bn against inflows of \$5.5bn in 2017. An analysis of historical data showed that over the past five years there has been an inflow of capital in the republic (\$5.5 bn - \$9.7bn) in within the financial account, which was replaced by an outflow of \$2.6bn in 2018. The relative indicator of the outflow of financial resources within the financial account to GDP increased from -3.4% (inflow) in 2017 to 1.5% (outflow) in 2018. Thus, within the analyzed period, the acquisition of assets by residents within the financial account prevailed over their commitment to non-residents.

Consolidated international reserves in March 2019, according to preliminary data from the NBK, amounted to \$86.0bn. The consolidated assets since the beginning of the year amounted to 3.0% or \$2.6bn due to the reduction of the reserves of the NBK by 12.6% to \$27bn.

KASE index showed uneven growth in the first quarter of this year. Since the beginning of January of this year, the index has changed from 2,293.7p., evidencing growth in the middle of the month, to a minimum value towards the end of the month at 2,243.8p (the minimum for 1 quarter). Subsequently, there was a steady increase in the KASE index, whose figure as of the end of March updated the six-month maximum, reaching 2,461.3 p (+ 7.3% since the beginning of the year). The growth dynamics demonstrated by the index in the current year repeats the dynamics of last year in Q1, when the index reached its maximum of 2,456.3p.

The main external signals for the growth of the developing countries market, including the Kazakhstan stock exchange market, were positive news in the framework of trade negotiations between Beijing and Washington, as well as news from the US Federal Reserve about the suspension of the increase in the short-term rate, which remained at the level of December 2018 and amounted to 2.50%.

Scenario forecasts

At the end of 2018, on the back of negative developments in foreign markets, oil prices fell to \$50 per barrel, although the average annual price of Brent crude was \$71 per barrel. At the beginning of this year, oil prices began to adjust upwards, and oil price forecasts remain at \$70 per barrel, while the agreement to restrict the production of oil-producing countries is valid until June, and the US do not plan to prolong relief for certain countries from sanctions on the purchase of Iranian oil, which expires in May. In this regard, our forecast for oil prices in the current year stand at the level of \$68 per barrel on average.

We implemented the scenario forecasts of the main macroeconomic indicators with a symmetrical deviation from the baseline scenario, assuming an average annual oil price of \$68 per barrel in 2019 and in 2020 (based on the expectations of international organizations and market participants and our more conservative approach to estimating oil prices). Pessimistic – the average annual price of \$58/ barrel in 2019 and in 2020 and optimistic – the average annual price of oil at \$78/barrel in 2019 and in 2020.

Kazakhstan's economy, according to our expectations, will grow by 3.6% in 2019. Since 2016, oil prices have grown by almost 60%, their further growth is limited by the growth of the global economy, which has reached a plateau. According to our estimates, the average oil price will be \$68 per barrel. In view of the slowdown in the extractive industries, the contribution of the service sector to economic growth will moderately increase. Fiscal policy will be stimulating, the state budget deficit will grow moderately against the background of increasing social spending, accumulation in the National Fund, will grow insignificantly.

Increase of the minimum wage and wages of low-wage workers of the public sector will support the growth of wages, at the pace of economy growth. Meanwhile, limited supply of labor due to demographic factors will have a positive effect on employment.

Foreign trade conditions will develop favorably in 2019, since energy prices will be only slightly lower than 2018 (\$68 per barrel).

In 2019, we expect a slight expansion of the current account deficit due to an increase in investment imports in the framework of large oil projects, as well as due to the deepening of the deficit of the primary income account from investments of foreign investors.

We believe that the tenge exchange rate will be at the level of 375 per US dollar and will follow the Russian ruble, which will bear the effects of the expansion of sanctions, the fiscal rule.

Inflation will be closer to the middle of the NBRK target corridor at the level of 5.4% and will be largely determined by the delayed tenge weakening pass-through effect in 2018 and early 2019, which has not yet been realized, although it was expressed in a substantial increase in inflation and devaluation expectations since last fall. The NBRK will maintain its monetary conditions in 2019 at a relatively neutral level and by the end of the year will lower the base rate to 8.75%.

Table 1. Main macroeconomic indicators

	2017 Fact	2018 Estimate	Base		Pessimistic		Optimistic	
			2019	2020	2019	2020	2019	2020
Oil Brent, average, USD/bbl.	54.0	71.0	68.0	68.0	58.0	58.0	78.0	78.0
Real GDP, % yoy	4.1	4.1	3.6	3.6	2.8	2.9	4.0	3.8
Exchange rate USDKZT, eop	332.0	384.2	375.0	375.0	393.7	394.5	357.9	361.5
Exchange rate USDKZT, average	326.0	344.7	376.6	375.0	391.7	394	366.6	360
CPI, % change yoy	7.1	5.3	5.4	5.0	5.6	5.2	5.4	5.0
Government debt, KZT bn eop	13.5	15.4	16.4	17.2	16.6	18	16.1	16.9
Government debt, % GDP	25.4	25.8	25.5	25.2	25.7	25.4	24.8	24.6
Budget balance consolidated, % GDP	-7.4	-0.6	-3.6	-0.1	-3.9	-1.3	-2.9	0.3
Current account, % of GDP	-3.1	0.0	-0.9	-0.2	-1.0	-0.4	0.0	0.9

Sectors of the economy

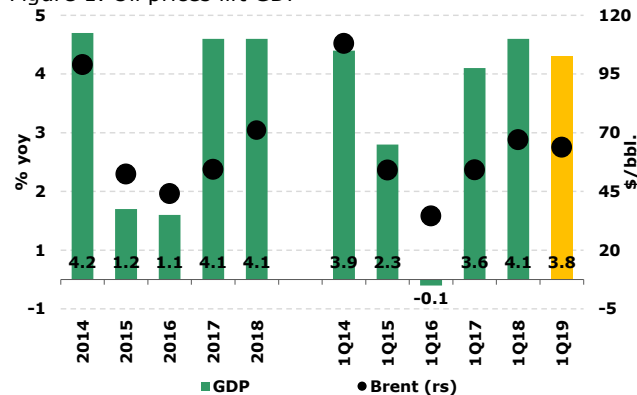
The growth of Kazakhstan's economy in the first quarter of 2019 slowed to 3.8% yoy from 4.1% yoy in 2018, while in January it was below 3% yoy, but in February and March stood at above 4% yoy (Fig. 1). As a result, a 3.8% economic growth in the first quarter was in line with the government's forecast for this year. The price of oil throughout the quarter grew steadily, adjusting after slump at the end of 2018, so in January its price was \$60 per barrel, in February \$64 per barrel, in March \$67 per barrel, and exceeds \$70 per barrel currently. The rapid recovery in oil prices nevertheless was not accompanied by a concomitant movement in the exchange rate, which was at the peaks near the mark of 380 per US dollar and 5.9 per ruble, once again demonstrating the high flexibility of the national currency toward weakening rather than toward strengthening. Considering that \$70 per barrel is burdensome for the global economy, which is expected to slow down this year, the impulses for growth of the Kazakhstan economy from oil prices are limited. In this regard, the increase in government spending, especially aimed at increasing the incomes of the population supports the growth of activity in the non-oil sector via consumption, will also offset the negative impact of the stop for the repair of large fields: Kashagan, Tenghiz.

In sectoral breakdown, the picture of the economy shows a slight slowdown in industrial output by 3.2% yoy (5.3% yoy in 1Q18), in transport by 4.4% yoy (4.6% yoy in 1Q2018), while construction accelerated to 8.9% yoy (5.9% yoy in 1Q18) and trade by 7.2% yoy (6.2% yoy in 1Q18). At the same time, the construction industry is growing mainly due to an increase in works in the extractive sector, while in trade growth is driven by the increase in the wholesale trade of oil.

The situation with the income of the population improved in 2018, the share of income in GDP increased to 34.1% from 33.9% in 2017 (Fig. 2). However, according to the components, incomes of the population show a negative trend – the share of income from employment fell to a minimum of 63.3% in 2018 compared to 2014 (69.7%). Revenues from self-employment and entrepreneurship over the same period almost did not change (10.9%). As a result, the share of income from pensions sharply increased to 18.3% from 12.8% in 2014. Considering that, taking into account those employed in the public sector and national holdings, we estimate that together with pensions and benefits, about 40% of household incomes are provided from public sector, which is about 5pp higher than before the fall in oil prices in 2014. Reduction in the share of income from employment indicates the presence of significant problems for the development of the non-commodity sector, and the decision to raise the minimum wage attests to the fact that private business is struggling because of which wages have not grown in recent years. As a result, we can conclude that a fairly good economic growth in Kazakhstan over the past 2 years has not transformed into real wages growth, and the government has to, among other things, use the funds of the National Fund and engage the mechanisms of non-market administrative measures to suppress inflation to improve the welfare of the population.

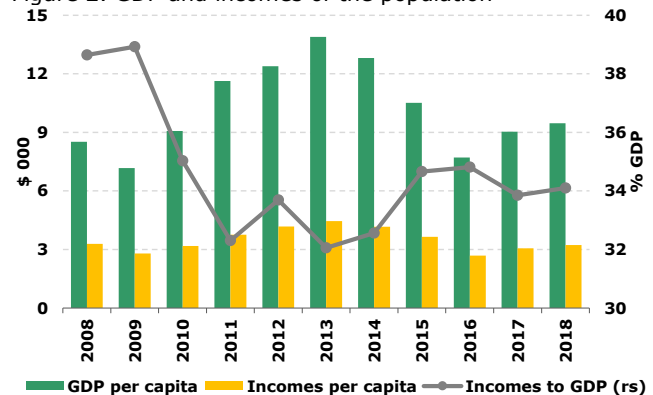
Domestic demand in the first quarter of 2019 maintained a positive trend due to an increase in wages, pensions and benefits from the budget, double-digit growth rates in consumer lending, which supported retail and wholesale trade growth (excluding oil trade) at the level of 5% yoy. In turn, the growth of investment by 7% was due to the increase in production capacity in the oil and gas industry, government programs in the housing, construction, infrastructure and other areas.

Figure 1. Oil prices lift GDP



Source: CS MNE, Bloomberg

Figure 2. GDP and incomes of the population



Source: CS MNE

Economic branches

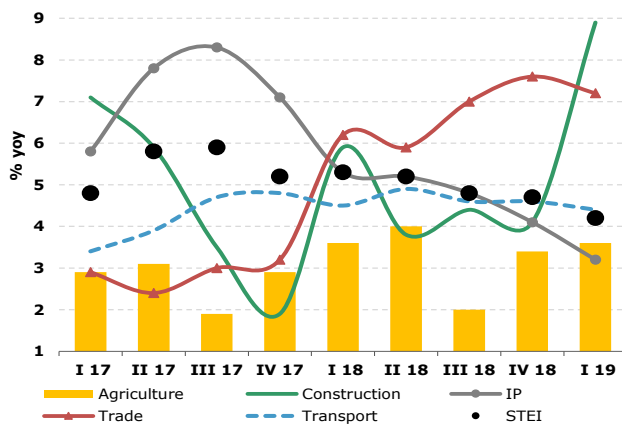
The growth of the short-term economic indicator (STEI) in March was 4.2% yoy and accelerated consistently from 2.9% yoy in January, 3.6% yoy in January-February. In quarterly terms, the growth of the short-term economic indicator shows a gradual slowdown since the second half of 2017 (Fig. 3), amid a decline in the dynamics in industrial production. From a more substantial drawdown the short-term economic indicator is kept by the construction industry and trade, while the transport sector shows a slight weakening of growth.

Industrial production for 3M2019 increased by 3.2% yoy, an increase of 8.1% compared to the previous month. Production growth in the mining industry amounted to 4.8% yoy and was determined mainly by the positive dynamics of metal ore production by 12.8% yoy, while crude oil production grew by 2.7% yoy. As noted earlier, in April, oil production at Kashagan

is expected to be suspended due to repair work, as a result production can be reduced by 300 thousand barrels per day, which is consistent with the republic's commitment to reduce oil production by 40 thousand barrels per day, under an agreement with OPEC. In addition to Kashagan, it is expected that repair work will be carried out at Tenghiz and Karachaganak, which will have a negative short-term impact on industrial production, including on the economy.

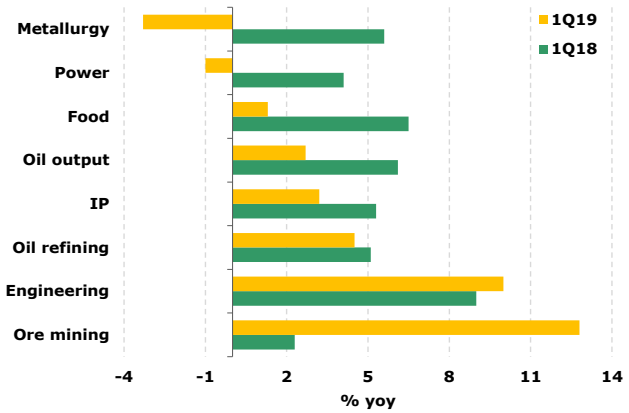
The production growth in the manufacturing industry over 3M2019 amounted to 1.6% yoy and reached the positive zone after negative figures earlier, which was largely due to the accident at Arcelor Mittal Temirtau at the end of 2018. In addition to ferrous metallurgy (-14.2% yoy), negative dynamics is observed in some small industries such as: pharmaceuticals (-6.7% yoy), electrical equipment manufacturing (-8.1% yoy) production of other food products (-20.2% yoy) In most other manufacturing industries, the situation is quite favorable: in oil refining a rise by 4.5% yoy, in non-ferrous metallurgy growth by 6.1% yoy, in chemistry by 9.8% yoy, in mechanical engineering by 10% yoy.

Figure 3. Acceleration only in trade



Source: CS MNE

Figure 4. Metallurgy and power are in slump

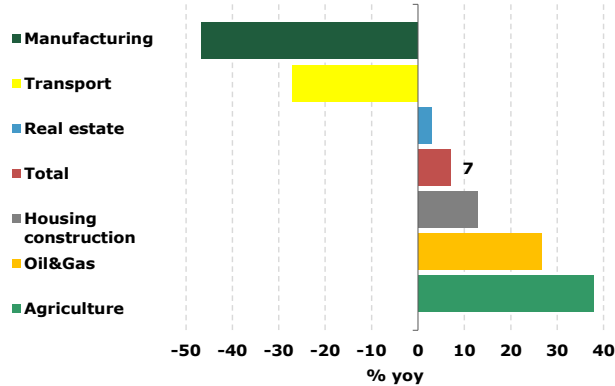


Source: CS MNE

Investment

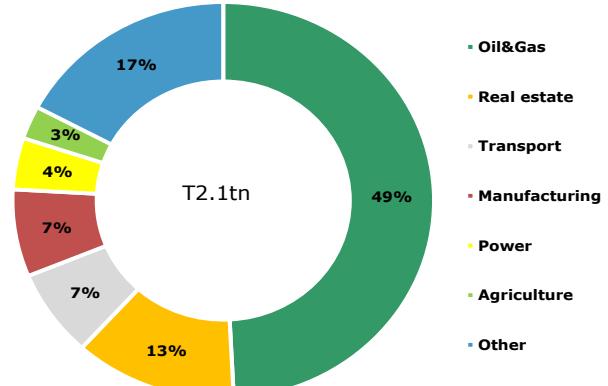
Growth of investments in fixed assets remained at a high level of 7% yoy in the first quarter of 2019, which is a very strong indicator given the growth of 39.5% yoy in the same period last year. Recall in 2018, investments have increased significantly by 17.2% yoy, reaching 18.9% of GDP, which was the best indicator since 2010. The rapid growth of investments is explained by the increase in investments in the resource sector, primarily in the project for the expansion of production capacity at Tenghiz. During the first three months, investments in the sphere of oil and gas production increased by 26.6% yoy, while their share accounted for half of all realized investments (Fig. 5).

Figure 5. Dynamics of investment



Source: CS MNE

Figure 6. Structure of investment



Source: CS MNE

Investments in the manufacturing industry fell by 46.6% yoy, which is explained by the fact that almost half of all investments in the manufacturing industry last year were secured by investments in oil refining, where the bulk of the investments fell on Shymkent refinery. In addition to oil refining, investments in the food industry decreased (-35.4% yoy), in pharmaceuticals (-37.1% yoy), and in paper production (-40.1% yoy). On the contrary, investments in metallurgy increased 62.9% yoy, in the production of motor transport +94.1% yoy. The share of investments in the manufacturing industry was 7% of the total, 12.5% of all investments were invested in real estate transactions, with an increase of 2.9% yoy, 7% in the transport industry with a decrease of 27% yoy, 2.7% was invested in agriculture with an increase of 37.9% yoy.

Investments in housing construction exceeded T240 billion (+12.9% yoy) in 3M2019. State programs support high activity in the housing construction market, thanks to which the share of state investment in housing construction reaches 24% in

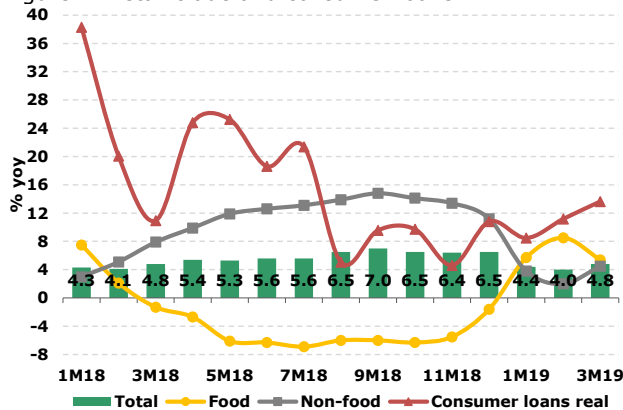
East Kazakhstan, 37% in Zhambyl Oblast and Shymkent, 42% in Northern Kazakhstan. In turn, the prices for primary housing in a year from March 2018 to March 2019 did not change in half of the regions of the republic. In Nur-Sultan, they slightly increased by 3.9%, in Almaty by 1%, in Karaganda did not change. 10% each added in Shymkent and Kostanay, approximately 20% each showed an increase in property prices in Semey, Taraz, Pavlodar.

Trade

In retail sales, indices slightly declined relative to 6.5% at the end of 2018 to 4.8% yoy for 3M2019, the annual growth in March remains at 6.2%. The turnover of food items increased by 5.4% yoy, an increase by 4.5% yoy for non-food items. As we have already noted, the improvement in the retail trade took place in 2017 and now there is a good growth going ahead of the economy as a whole. The increase in the minimum wage and pensions since the beginning of the current year are the drivers for the increase in retail turnover, and besides, an increase in public sector wages is planned from June, employing nearly 2 million people. In addition, the state actively subsidizes housing loans, which entails a demand for household appliances and household goods, thereby stimulating sales, including through consumer lending (Fig. 7). So in 2018, consumer lending growth in real terms exceeded 10% and at the beginning of the current year is also close in pace to this level. A negative point is the weakening of tenge by 15% since the beginning of the second quarter of 2018, as well as the increase in food prices by 6.7% yoy in March, which is higher than 5.5% in the same period of previous year, which is offset by a decrease in tariffs for services to 1.2% versus 6% respectively.

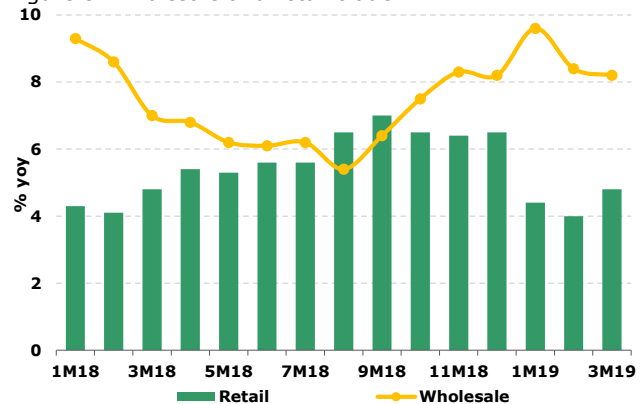
The growth in the wholesale trade turnover after the inclusion of trade in oil and oil products last year remains at a level of 8%, while the contribution of this trade in oil, according to our estimates, is about 3pp. This leads to an overestimation of economic growth by about 0.3pp as it does not imply any real contribution to the real growth of the economy, but it helps to achieve the level of growth of the economy targeted by the government at the level of 3.8% in the current year.

Figure 7. Retail trade and consumer loans



Source: CS MNE, NBRK, Halyk Finance

Figure 8. Wholesale and retail trade



Source: CS MNE

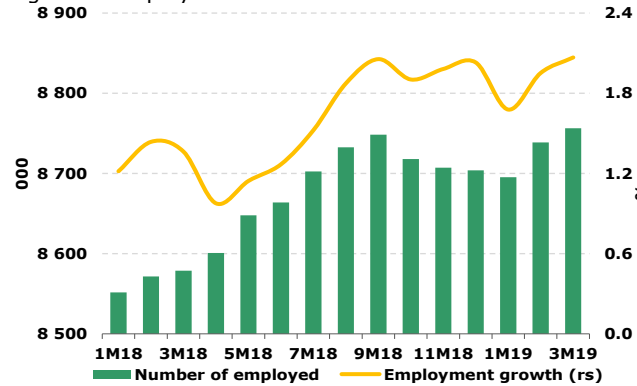
Labor market

Based on statistical data, the number of employed population increased by 2.1% yoy and amounted to 8.8 million in the first quarter of 2019. Employment growth has been observed continuously since the end of 2017, with a tendency toward acceleration in employment growth from 1.4% yoy in March 2018 to 2.1% yoy in March of the current year (Fig. 9). Against this background, the unemployment rate in the same period decreased from 4.9% to 4.8%. Nevertheless, against the background of low unemployment and external stability of the labor market, 3.8 million people, according to our estimates, do not have permanent, official work.

In terms of industry data for the first quarter is not yet published, however, we believe the growth in employment is due to the services sector, where currently the share of employed reaches 73%.

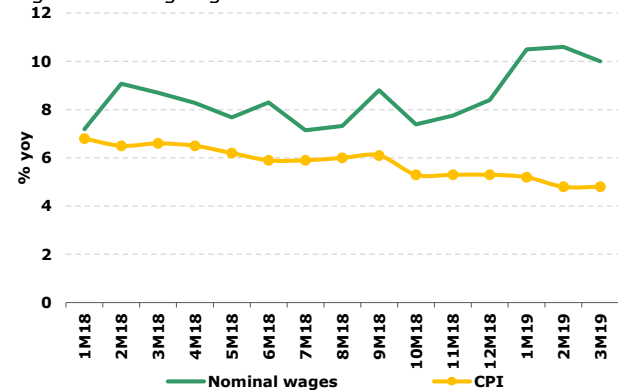
The growth of wages in early 2019 by 10% nominally seems to be determined by a raise in the minimum wage by 50% to T42.5 thousand. At the same time, data on individual income tax revenues to the state budget show a 2.6% drop compared to 1Q2018, which may indicate an overestimation of the official figures of wage growth against the background of government attempts to raise wages due to their separation from economic growth. Real wages on the back of a slowdown in inflation are kept at a level above 2% from the second half of 2018.

Figure 9. Employment on the rise



Source: CS MNE, Halyk Finance

Figure 10. Wages growth



Source: CS MNE

Fiscal policy

State budget in January-February 2019

State budget revenues (excluding transfers from the National Fund) increased by 17.4% yoy and amounted to T1.6 trillion in January-February 2019. Tax revenues to the state budget up 18.1% yoy to T1.5 trillion or 17% of the plan. The revenues from the CIT increased by 22% yoy, individual income tax (IIT) gained 1% yoy, social tax up by 5% yoy, VAT up by 25% yoy, excise taxes increased by 13% yoy. Transfers from the National Fund fell by 8.5% yoy, so state budget revenues by 21% were generated through transfers, which is lower than 26% in the same period of 2018.

Corporate income tax revenues show rapid growth, for example, over the same period in 2018, their growth was only 2.4% yoy, which may indicate an improvement in the administration of tax revenues. The weak growth of incomes by IIT by 1% is in conflict with the nominal increase in wages by 10.6% yoy, which may indicate an overestimated increase in wages recorded by statistics. The growth in VAT revenues by 25% significantly outpaces the growth of nominal trade turnover by 11% yoy and virtually unchanged import volumes in January-February 2019.

State budget expenditures increased by 19% yoy in January-February 2019 and amounted to T1.9 trillion (16% of the plan). Defense spending increased by 73% yoy, other state services rose by 25% yoy. In relation with the increase in pensions and benefits, social security expenditures increased by 19.5% yoy. Expenses on the economy decreased by 2% yoy: transport, industry, agriculture, etc. The cost of servicing the public debt increased by 19% yoy, which can be attributed to the weakening of the tenge in the current year, considering that the share of foreign borrowing accounts for a third in the total public debt.

The state budget balance in January-February 2019 was formed with a deficit of T51.1 billion (T106.7 billion for 2M18), with a planned deficit of T1.3 trillion for 2019 or 2.1% of GDP, against -1.5% previously planned before changes due to the increase in government spending aimed at improving the welfare of the population.

National Fund

The revenues of the National Fund from oil and gas enterprises increased by 54.6% yoy for 2M18 to T0.7 trillion. For all taxes except for excess profits tax and bonuses, a strong increase was observed.

The size of the expenditure part of the National Fund decreased by 8.4% yoy to T430.6 billion. According to 2M19 data, tax revenues exceeded the outflow by T138.6 billion, as a result, the assets of the National Fund increased by 0.6% compared to December, assets in foreign currency increased by 2.3%. Thus, the accumulation of assets in the National Fund temporarily resumed, however, due to an increase in the transfer to the state budget by T250 billion to T2.7 trillion and the allocation of targeted transfer of T370 billion, the assets of the National Fund may grow only marginally in the current year.

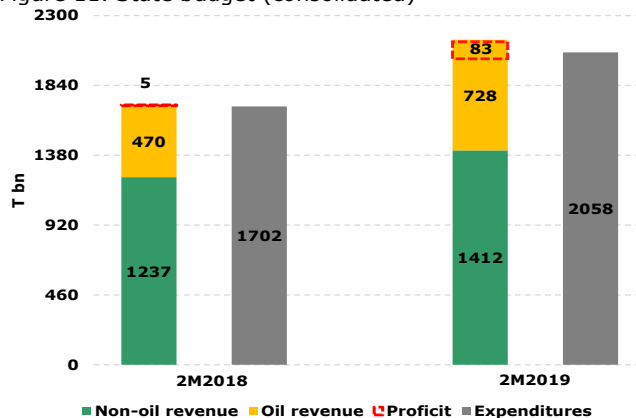
Consolidated budget balance

Rise in oil prices led to increase in oil revenues of the consolidated budget, that went up by 55% yoy over 2M19, aided by an increase in physical volumes of oil exports by 17% yoy, an increase in revenues of the National Fund by 55% and weakening of the tenge by 14%, which more than offset the drop in oil prices by 7% yoy. At the same time, the share of oil revenues in consolidated budget revenues increased to 34%, from 28% in the same period of 2018. Non-oil revenues increased by only 14% yoy to T1.4 trillion (Fig. 11).

Consolidated budget expenditures increased by 21% compared to the corresponding period of 2018. The consolidated budget surplus increased to T83 billion against T5 billion in January-February 2018. By the end of 2019, the deficit, according to our estimate, will reach -3.6% of GDP and increase from -0.6% in 2018.

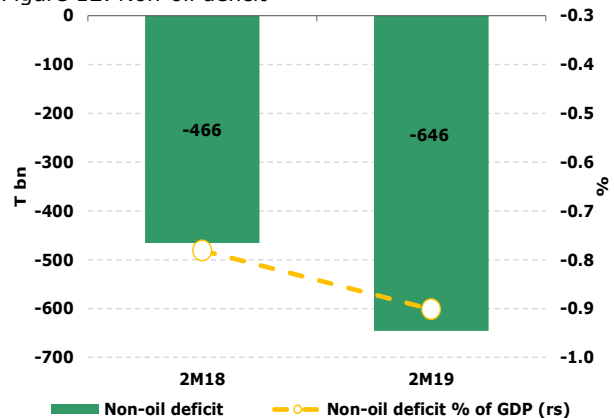
The non-oil deficit of the consolidated budget for 2M18 amounted to -T0.6 trillion and increased in comparison with 2M18 (-T0.5 trillion). In relative terms, the non-oil deficit slightly increased to -0.9% from -0.8% of GDP over 2M18.

Figure 11. State budget (consolidated)



Source: MOF RK, Halyk Finance

Figure 12. Non-oil deficit



Source: MOF, Halyk Finance

Inflation

In the first quarter of 2019, inflation has increased by 1.3% since the beginning of the year, compared with 1.8% in the same period last year. In annual terms, the rate of inflation slowed to 4.8% from 6.6% a year earlier and 5.3% in December 2018. The main contribution to the annual price growth was provided by food and non-food products +6.7% and +6.0%, while the majority of services regulated by the state added only 1.2% (Fig. 13).

The decorrelation between the weakening of the tenge and inflation from the end of the first quarter of 2018 raises questions about the reliability of the published statistics, given the weakening of the tenge by 15% from the end of March last year to January 2019. So if earlier the correlation coefficient between the tenge behavior and inflation was 62, then, since April 2018 it has drastically turned around and turned negative in -85. Thus, it began to reflect that the weakening of the tenge now leads to a decrease in inflation, and not vice versa. Such a significant weakening of the national currency by almost T60 from 320 to 378 was accompanied by a slowdown in the growth of prices for non-food products to 6%, which contrasts sharply with 9% in 2017, but with a slight strengthening of the tenge. In our opinion, an adequate assessment of the pass-through factor of the national currency depreciation to inflation could be a coefficient of 0.1-0.15pp, which, with a 15% weakening of the tenge, could add to the existing price level 1.0-1.5pp, which were not noted by official statistics. For example, in Russia, the weakening of the ruble and the behavior of inflation demonstrates the presence of a noticeable correlation. In addition, at the beginning of the current year, government agencies went for a substantial administrative reduction in tariffs for housing and utilities services, which led to inflation moving to less than 5%, and we estimated the effect of such a controlled suppression of inflation at a level of 1pp. As a result, the actual level of consumer price growth is about 2pp lower than the estimated values based on the historical relationships of inflation factors. Thus, if intervention in pricing is not taken into account, the estimated level of inflation would presumably be equal to 6.5-7.0%.

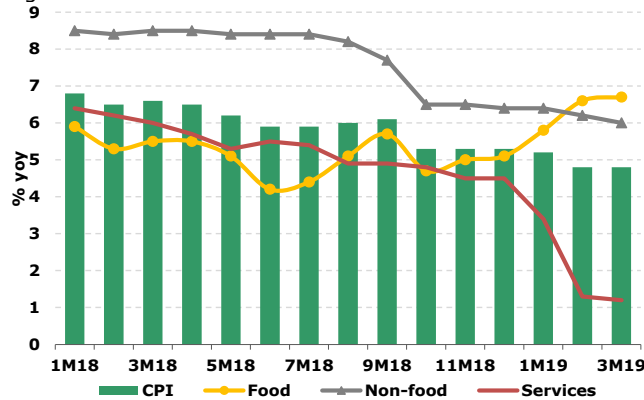
The results of population polls for March, published by the NBRK showed a continued growth in inflation expectations, while maintaining devaluation expectations. The share of respondents who expect price growth to accelerate in the next 12 months showed an increase for the second consecutive month to 18.8% in March (15.4% in March 2018), 28.2% at its peak in September 2018. The share of respondents expecting a decline or unchanged price position declined to the previous month to 9% (9.4% in March 2018), with a minimum of 5.8% in October 2018. In March 2018, the share of respondents who expected a rise in the US dollar decreased to 63.6% (47.1% in March 2018), which is below 70.7% at its peak in September 2018. At the same time, the amount of net expenses (T 296 billion) of the population on the purchase of cash dollars in the first quarter increased by 26% compared to the same period of 2018.

Additional budget expenditures on social programs, including from extra-budgetary funds of the NBRK and the ENPF, are estimated at about 2.5-3% of GDP in 2019, and taking into account the fact that a certain part will go to the consumer market (pay increase, social benefits) and in addition will act in the form of interest rate subsidies, the impulse to the increase in the demand for consumer loans, then, surely the pressure on inflation increases. The risks for inflation are the probable further increase in oil prices as a result the losses of local refiners will increase and after reaching a certain limit the prices for fuels and lubricants can be corrected, probably a weaker yield of agricultural products, the effect of weakening tenge in 2018 and the beginning of the current year, increasing inflationary and devaluation expectations of the population, which switched to growth in February after a continuous decline since November 2018.

State budget expenditures on wage increases and social expenditures in the current year are estimated at about T400 billion, and although this is less than 6% of last year's payroll fund, we should not forget that this will stimulate consumer lending. Thus, the effect of an increase in state budget spending on inflation is partly offset by lower tariffs and income taxes. According to our forecast, inflation in the current year will be 5.4%, however, often the behavior of inflation is not consistent

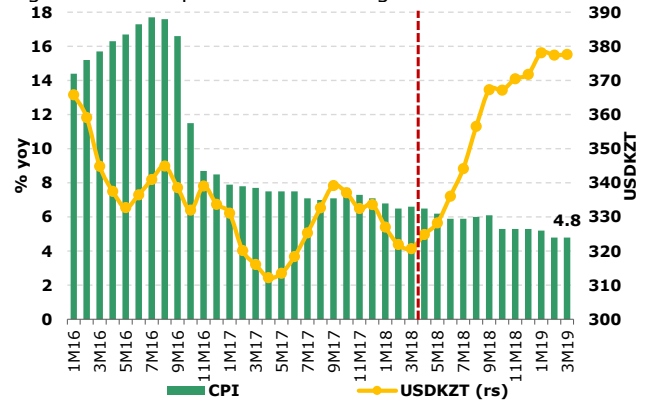
with proinflation factors, which causes doubts about the authenticity of the official statistics, especially if we take into account the fact that the lower the inflation, the higher the real wage growth, income and other indicators in which government bodies are interested. At the moment, we note that inflation is moving ahead of time into the boundaries of the new corridor of the National Bank of 4-6% in 2019.

Figure 13. Inflation on the decline...



Source: CS MNE

Figure 14. ...in spite of weaker tenge



Source: CS MNE, Halyk Finance

Monetary policy

Interest rate policy

During the first three months of this year, the base rate of the regulator remained unchanged at 9.25% with a discount window +/- 1%. Inflation risks of importing inflation from the Russian Federation and uncertainty in the energy markets were considered by the regulator as potential risks of inflation in the republic. The growth of consumer lending, income and business activity were considered by the regulator as internal pro-inflation risks. Despite these risks, the rate of consumer inflation in the country slowed down from 5.2% at the beginning of the year to 4.8% at the end of March. The above factors constrained the regulator to cut the base rate down. However, in April, the regulator decided to cut the base rate to 9.0%. The rate has been cut, because external inflationary factors has not materialized and the external background was moderately positive. The value of expected inflation by the population in the coming 12 months, according to the regulator, amounted to 4.5%. Although an analysis of the survey, which ranges inflation rates in the coming 12 months, showed that 65.1% of all respondents believe that inflation rates will range from 6-20% yoy and only 12.8% believe that the rate will be within the range of 1-5%yoy. It is also necessary to understand that economic growth in 2019, according to our forecast, will slow down to 3.6%, and in such conditions it becomes obvious that in order to maintain economic growth, its growth must be stimulated both through a fiscal stimulus and through easing of monetary conditions. The reduction of the base rate, by definition of the regulator, kept the monetary conditions in the country at a neutral level. However, we believe that through lowering the base rate and supporting economic growth (the NBK has somewhat expanded its mandate), the regulator sends a clear signal to the market that it intends to move precisely towards easing its monetary policy. Our current forecast for the base rate of the regulator at the end of the year is 8.75%.

Through the interest rate channel the regulator rather effectively influences the money market rates. With the decrease of the base rate of the regulator with discount window +/- 1%, the rates on automatic Repo with government securities are gravitate to the lower border of the window and are traded near it.

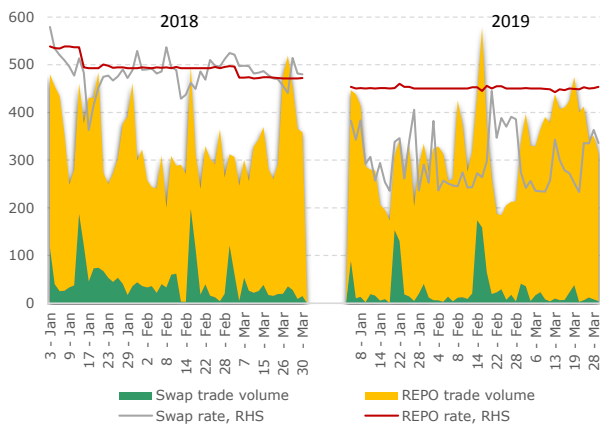
In the money market in the first quarter of 2019, 92.5% (87.5% in 1Q2018) of all transactions were made as part of automatic repos with government securities in the amount of T17,230 bn (+ 2.9% yoy, T16,751 billion in 1Q2018). The maximum volume of transactions in automatic REPO operations fell at the end of March 2019 and amounted to T436.6 bn. The average rate on automatic REPO operations in 1 quarter was 8.26% (8.78% in Q1 2018) while the range of rates was 8.16% - 8.37% (8.50% -9.28% in 1Q 2018). At the end of the analyzed period, the rate on automatic REPO operations was at the level of 8.29% (8.50% in Q1 2018). In the first quarter of 2019, the increase in the volume of automatic Repo transactions compared to the 4th quarter of 2018 amounted to 2.6% qoq.

USDKZT swaps in the first quarter of 2019 shared 7.5% (12.5% in 1 quarter of 2018) of all transactions in the money market. The total USDKZT swaps trade volume in the first quarter of this year decreased by 23.4% qoq and amounted to KZT1,390 billion. During the 1st quarter of 2019, the rates on swap deals USDKZT varied from 5.72% to 8.19% with an average of 6.49% in the period. (7.24% -9.76% in 1 sq. 2018, with an average of 8.66%). The maximum size of transactions amounted to T173.7 billion, with an average size of transactions in T24.4 billion. Currency swaps USDKZT in the money market decreased under the conditions of excessive liquidity denominated in tenge.

Excess liquidity is building up in the republic to sterilize which the NBK uses short-term notes (1,3,6 and 12 months). As part of withdrawal of excess liquidity, short-term weekly notes and 7-day deposits of the NBK were eliminated in order to

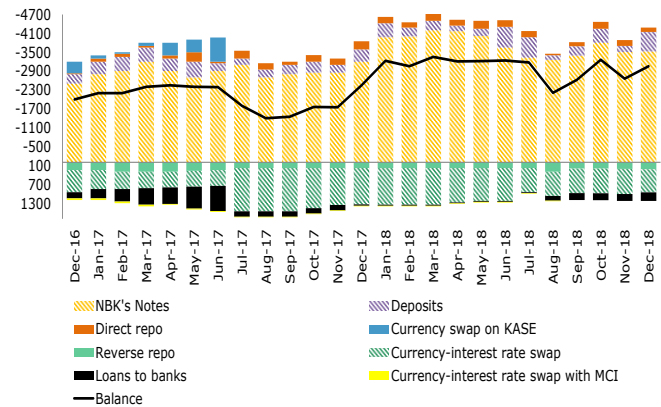
increase the efficiency of transmission through the interest rate channel. From February 20 of this year, the NBK in the with open access operations holds deposit auctions. As of the end of the first quarter of this year, the amount of excess liquidity increased by 20.9% qoq and amounted to about T5.2 trillion.

Fig. 15. Money market trade volume and rates



Source: KASE, Halyk Finance

Fig. 16. Excessive liquidity sterilization



Source: NBK, Halyk Finance

Sterilization of liquidity by the NBK's notes at the end of 2018 amounted to T3.5 tn., while at the end of February it increased to T3.98 t. and decreased to about T3.6 tn. at the end of March. The effective yield on the notes of the NBK in February amounted to 8.74%.

Foreign exchange policy

In March of this year, the new leadership of the National Bank under E. Dosayev made a statement about the continuity of the macroeconomic policy pursued jointly with the government of the republic. The NBK made a statement that it will provide stability in the FX market and has all the necessary tools to prevent speculative transactions with the tenge exchange rate.

The continuity of the policy in terms of the exchange rate of the national currency also implies the preservation of its "free floating" regime. The NBK reserves the right to participate in FX market in the form of currency interventions, as it happened in March of this year, when the regulator sold US304mn to smooth out the increasing volatility of the national currency.

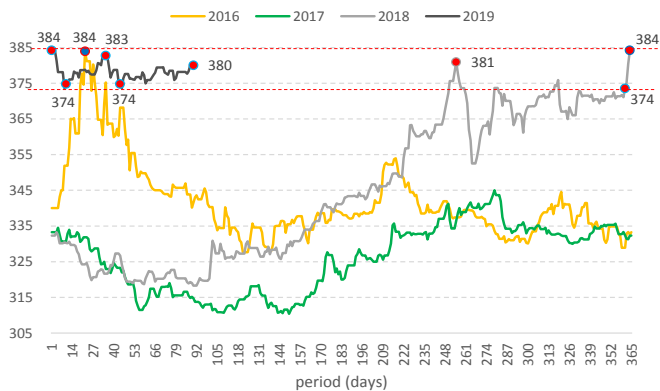
At the beginning of the first quarter of the current year, the USDKZT quotes continued its upward movement (weakening) caused by decline in oil prices at the end of last year to the level of US54.91bbl. Downtrend of oil prices "pulled" the Russian ruble, which weakened to the level of 69.45 rubles per US dollar. The former management of the NBK in terms of national currency exchange rate adhered to the policy of "weak" tenge against the Russian ruble, despite uptrend of oil prices throughout the past year, the national currency experienced a double weakening, updating the historical maximum of 384.2 tenge per US dollar.

However, the uptrend of oil prices throughout the first quarter of the year to US68.4 bbl and strengthening of the Russian ruble to the US dollar to 65.7 rubles (at the moment USDRUB FX rate reached 63.9 rubles) affected the national currencies that reached 380 tenge at the end of 1 quarter 2019 (at the moment the USDKZT rate reached 373.5 tenge, followed by a 2-3 day correction to 380 tenge). Despite the budget rule, strengthening of the Russian ruble was facilitated by the inflow of foreign capital into the sovereign debt of the Russian Federation, which again began to show interest in the emerging markets amid a postponement of monetary tightening by the US Federal Reserve (the rate from December 2018 remained at 2.50%).

Along with the relative fluctuation around the average level of 378.1 tenge per US dollar during the first quarter, with an average trade volume of US118 mn (US160mn in 1Q2018) at the KASE, the tenge weakened against the Russian ruble from 5.52 to 5.87 tenge per ruble. The analysis of the exchange rate for the RUBKZT quotes of the two previous years shows a similar seasonal movement observed in 2019. However, in the period of 45 days, when the exchange rate occurred at the level of 5.59-5.68 tenge per the ruble for three years, the exchange rate for the RUBKZT in 2019 continued the upward trend to the values of 5.87 tenge per ruble. This level corresponds to the beginning of September 2018, when the USDRUB quotes reached 69.90-70.54 rubles per US dollar. This movement of the Russian ruble was, on the one hand, due to the bellicose rhetoric of the United States administration over the new sanctions against the Russian Federation, on the other hand, by buying the currency of the Central Bank of the Russian Federation on the orders of the Ministry of Finance of the Russian Federation. It was during the summer months that the Ministry of Finance "sterilized" currency from the market in the amount of 16 to 19 billion rubles per day. Under the conditions of volatility due to the prospect of new sanctions, the ruble was excessively weakened. At this point, the oil quotes updated four-year highs of US77.48 and US86.29 bbl. Subsequently, it was decided to suspend the purchase of currency until September 2018, which corrected the exchange rate

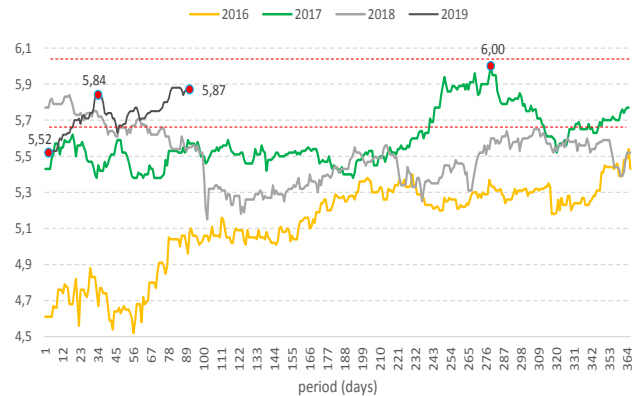
of the ruble itself and, as a consequence, the tenge. Thus, the tenge reacted to the volatility of the Russian ruble on sanctions and on the weakening effect of the “budget” rule.

Fig. 17. USDKZT quotes change



Source: NBK, Halyk Finance

Fig.18. RUBKZT quotes change



Source: NBK, Halyk Finance

This year we are witnessing the opposite movement, when the ruble follows the price of oil and the inflow of foreign capital in fixed rate domestic government bonds (OFZ), despite the weakening effect of the “budget” rule, and the tenge does not follow neither the ruble nor the oil. Strengthening the tenge rate this year to the levels of 373.6 tenge is explained by a rather narrow market by participants and by the volume of transactions and when the volume of trading increases significantly in the market in 2019, the tenge exchange rate noticeably reacts to this.

The loss of correlation of the movement of the national currency to the Russian ruble and the oil price is probably due to the state of the republic’s foreign trade accounts. Strengthening of the Russian ruble makes the purchase of consumer imports from the Russian Federation more profitable if the exchange rate will also be strengthened following the ruble and rising oil prices. Taking into account the fact that imports from the Russian Federation in the first two months of this year reached 41.2%, and Kazakhstan’s exports to the Russian Federation decreased to 7.7%, it becomes obvious that the weak exchange of tenge rate is holding back the inflow of Russian consumer imports and indirectly affects the expansion of trade deficit with the Russian Federation. An analysis of the real effective exchange rate of tenge to the currencies of the main trading partners as of the end of 2019 shows that the index decreased compared to the 3rd quarter of 2018, and the current levels correspond to the levels of the 2nd-3rd quarter of 2016. The index of KZTRUB made up 91.6%, on the KZTEUR it was at the level of 70.1% and on the KZTUSD of 57.1% in the 4th quarter of 2018. In February, there was a further decrease in the index of KZTRUB to 88.3%, while as for the other two currencies, a slight increase is observed up to 70.9 (KZTEUR) and 57.5% (KZTUSD), which indicates the cheapening of the Kazakhstan produced goods and makes imports more expensive.

Such a level of tenge can also be influenced by external geopolitical risks as pending sanctions against the Russian Federation, the imposition of which is still possible during this year. The regulator may retain such levels in order to exclude short-term volatility, which usually occurs with USDRUB due to the high speculative stance on the foreign currency market in the Russian Federation especially after the announcement of new sanctions. However, the rhetoric of the US administration has changed quite a bit after the publication of the results of the investigation by the special prosecutor Robert Muller, as well as after the scandal with the head of the CIA, Gina Hespel that resulted in recall of 60 Russian diplomats from the US. The probability of introducing of the sanctions against the public debt of the Russian Federation in the near future seems improbable to us, because in March, the Ministry of Finance of the Russian Federation sold OFZs for a record amount.

The policy of the “stably weak” tenge maintains a high level of devaluation expectations, which, although decreased in March, remain quite high. Thus, 63.6% of all respondents participating in the NBK polls believe that the tenge exchange rate will rise in price to the US dollar. The results are lower than in the autumn 2018 (70.7% were in this group in September), however, the group of respondents who find it difficult to determine the movement of the USDKZT rate increased to 20.6%, which indirectly indicates that there is no clear understanding in society of how and what influences the formation of the FX rate of the national currency.

Despite of the high level of energy prices and strengthening of USDRUB, the national currency is at stable “weak” level to eliminate currency arbitrage, to provide favorable conditions for export-oriented companies, as well as to manage trade deficit with the main countries-trading partners. Such an approach in terms of rate is forecasted by us until the end of this year, provided that the current geopolitical and macroeconomic situation in the world remains.

The exchange rate of the national currency against the US dollar will vary within a narrow range of values of 374 tenge (support line) and 385 tenge (resistance line). According to the results of the current forecast round, our annual forecast for the USDKZT pair is 375 tenge per dollar at the end of the year and 376.5 tenge on average for the period.

External Accounts

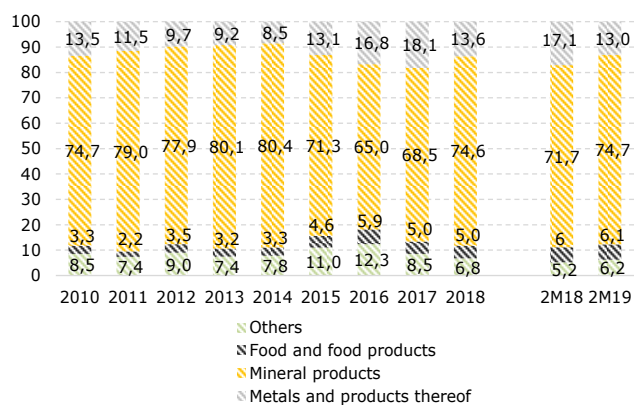
Exports and imports in January-October 2019 (according to the latest data of the Committee on Statistics and the State Revenue Committee)

Exports from Kazakhstan in January-February 2019, according to the preliminary data of the Committee on Statistics, showed rapid growth rates (+ 11.1% yoy) and amounted to \$ 9.9 billion compared with imports (+ 0.3% yoy), the volume of which amounted to \$ 4.5bn. In the first two months of the year foreign trade turnover increased by 7.5% yoy and amounted to \$ 14.3bn.

The geographical structure of exports in January-February 2019 is represented mainly by Italy (17%, 19.1% in January-February 2018), France (8.4%, 7.3% in January-February 2018) The Netherlands (6%, 10.4% in January-February 2018), China (13.2%, 11.5% in January-February 2018) and the Russian Federation (7.7%, 8.8 % in January-February 2018). The geographical structure of imports was represented mainly by the Russian Federation (41.2%, 39.6% in January-February 2018), China (15.3%, 16.8% in January-February 2018), Germany (3.6%, 6.2% in January-February 2018), Italy (3.2%, 2.8% in January-February 2018) and the USA (4.7%, 4.0% in January-February 2018). Thus, the concentration of Kazakhstan's exports into the five main trading partner countries for two months of 2019 accounted for 52.3%, down from 57.1% in 2M2018. The concentration of imports by 5 countries-trading partners of Kazakhstan decreased from 69.4% in 2M2018 to 68.0% in the analyzed period.

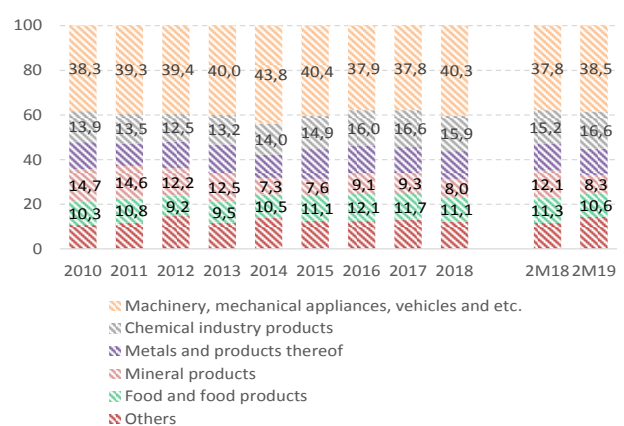
Analysis of the structure of exports from Kazakhstan showed that in January-February 2019, the share of mineral products increased from 71.7% a year earlier to 74.7%. In nominal terms, exports of mineral products grew by 15.9% yoy and amounted to \$ 7.4 bn. According to the Committee for Revenue of the Republic of Kazakhstan, in January-February 2019, exports of crude oil and gas condensate grew by 18.7% yoy and amounted to 12.4 million tons. In nominal terms, this export increased by 16.6% to \$ 5.9 bn.

Fig. 19. Exports' structure



Source: CS MNE, Halyk Finance

Fig. 20. Imports' structure



Source: CS MNE, Halyk Finance

The largest importing countries of Kazakhstan, according to the data of the Committee on Revenue of Kazakhstan, in January-February 2019 were Italy with crude oil and gas condensate imports from Kazakhstan 3.3 million tons (-1.6% yoy) and a total value of \$ 1.6 billion (-1.6% yoy), France imports of 1.6 million tons (+ 30.7% yoy) and a total value of \$790 mn (+24.8 % yoy), Spain with imports of 1.0 million tons (+2.6 times yoy) and a total cost of \$499 mn (+2.5 times yoy). The Netherlands reduced crude oil and gas condensate imports by 33.7% yoy to 981 thousand tons with a total value of \$477 mn (-35.3% yoy). South Korea continues to significantly increase imports of crude oil and gas condensate within the analyzed period. Thus, imports increased year-on-year by 3 times and amounted to 1.3 million tons, while in nominal terms imports amounted to \$639 mn (+2.8 times yoy). The share of imports of this country in the structure of imports increased to 11% (4.3% in 2M2018). China also significantly increased imports in physical terms under this item 2.4 times to 458 thousand tons with a total value of \$223 mn (+2.7 times yoy).

The second largest export item is metals and products from them. According to the Committee on Statistics, their share has decreased from 17.1% in January-February 2018 to 13.0% in the same period of the current year. In nominal terms, the export volume decreased by 15.4% yoy and amounted to \$ 1.3 billion. According to the data of the Revenue Committee of the Republic of Kazakhstan, in January-February 2019, the nominal value of Kazakhstan's exports of ferroalloys decreased by -12.8% yoy to \$ 316mn, with a simultaneous increase in exports in physical terms by 8.9% yoy to 263 thousand tons. The same trend is observed in the export of refined copper and copper alloys. With the growth of physical volume by 6.7% yoy to 78 thousand tons in January-February 2019, there was a decrease in exports in nominal terms by 7.76% to \$444 mn. The decline in the share of exports of metals and products from them in the analyzed period was due to the reduction of imports of metals by Iran, which raised the import duties by 25%, protecting its metallurgical enterprises, and also because of sanctions against the country, which, due to fear of sanctions, forces Kazakhstani exporters to reduce trade

relations with the country. Thus, the raw material concentration of Kazakhstan exports in the two largest export items in January-February 2019 was 87.7% against 88.8% in the same period last year.

The third largest item of exports is products of animal and vegetable origin, finished food products increased in the analyzed period to 6.1% from 6.0% in January-February 2018. In nominal terms, the share increased by 14.2% yoy to \$604mn. In January-February 2019, there is an increase in wheat and rye by 11.1% yoy to 1.2 million tons, which in value terms amounted to \$201mn (+ 25.6% yoy). Growth in barley exports was 25.6% yoy to 466 thousand tons or \$86mn (+ 44.6% yoy). Rice exports increased by 36% yoy to 15.4 thousand tons or \$ 4.4 million (+ 29.3% yoy). The main importing countries of Kazakhstan wheat and rice were Uzbekistan and Tajikistan with a share of 40.5% and 18.9% and 52.4% and 41.4%, respectively. The share of Iran in the export of Kazakh barley in January-February 2019 amounted to 91.6%.

In January-February 2019, an increase of "other export goods" is observed. The analysis of the structure showed an increase in the item "machinery, equipment, vehicles, devices and apparatus" from 1.1% to 1.5%. We associate the expansion of this trade item with the expansion of vehicles exports assembled in Kazakhstan to the countries of the region.

An analysis of imports, according to the Statistics Committee, showed that within two months in 2019, Kazakhstan increased imports of machinery, equipment, vehicles, instruments and devices by 2.0% yoy in nominal terms to \$ 1.7 billion (the share of imports increased from 37.8% in January - February 2018 to 38.5% in the same period of the current year. We associate the increase in equipment imports primarily with the maintenance works scheduled for March-April at the largest oil fields in the republic. The major part of those imports (49%) come from non-CIS countries, mainly China, Italy, Germany, Turkey and South Korea.

Expansion of imports is also observed in the supply of chemical products and related industries (including rubbers and plastics) by 9.4% yoy in in terms of value \$738mn, the share increased from 15.2% to 16.6% in the analyzed period, while the share of metals in the structure of imports decreased slightly from 11.9% to 11.7%. In value terms, the volume of imports of metals amounted to \$520 million (-1.6% yoy).

Analysis of imports from the Russian Federation in January-February 2019 showed that imports of motor gasoline for two months of the current year amounted to 17.2 thousand tons (142.9 thousand tons in 2M2018) worth \$6.6mn (\$73.8mn 2M2018). The reduction in imports of motor gasoline from the Russian Federation, has affected the overall decline in the share of imports of mineral products from 12.1% to 8.3% in the analyzed period of the current year. In value terms, the reduction of imports under this item was at 30.9% yoy and amounted to \$371mn.

Comparing the data of two months of the current year with the annual data of previous years, it can be concluded that the structure of exports and imports as a whole remains relatively stable and highly likely will not suffer radical changes in the period.

Trade Balance in 2018. (According to the National bank of Kazakhstan)

Trade balance

Exports of goods in 2018 increased by 26.1% yoy and amounted to \$ 59.6bn. Positive price dynamics in energy markets, observed from the beginning of last year (\$ 66.9) to October (\$ 84.2 per barrel of Brent crude), contributed to the growth of Kazakhstan exports in nominal terms. Since October 2018, oil market has seen an adjustment in oil prices from an annual maximum of 84.2 dollars to 52.2 dollars per barrel of Brent oil, which did not allow Kazakhstan to repeat the growth dynamics of 2017 at 33.3% yoy. However, increasing of exports of crude oil by 1.5% yoy to 69.8 million tons made it possible to level the consequences of this price plunge. The increase in volume of oil accounted for the first three quarters of last year, during which the price hike of oil was observed, while in the fourth quarter volumes decreased by 5.3% yoy and amounted to 17 million tons, according to statistics from TradeMap. In general, over the past year, exports of crude oil amounted to \$37.8bn.

Imports in 2018 increased by 8.8% yoy (+ 16.5% yoy in 2017) and amounted to \$33.3bn. Weakening of the national currency from 318.7 tenge per US dollar in spring to 384.2 at the end of last year led export dynamics over imports contributed to the expansion of the trade surplus by 57.6% yoy to \$ 26.4bn. The trade surplus expansion was observed throughout the year and its maximum value was formed in the 4th quarter of last year (\$5.0bn maximum quarterly value since 2014).

Current account

Current account balance of the Republic of Kazakhstan in 2018, according to updated data of the NBK, has developed with a deficit of \$ 52mn (\$5.1bn in 2017). This is the minimum deficit in the last 4 years. In addition to the expansion of the trade surplus of the current account, there has been an increase in the surplus of the secondary income account. Analysis of historical data showed that the surplus of \$ 272.3mn was positive for the first time in 16 years. Thus, according to the NBK, the surplus of the secondary incomes account was last time with a surplus in 2002 of \$ 113.7mn. The surplus of the secondary income account expanded due to an increase in the balance of government revenues due by 12% yoy and income receivable under the item personal transfers by 10% yoy, as well as due to a reduction under the item incomes of the general government to be paid by 6.6% and item income to receive under the item personal transfers payable to 7.9% yoy. A significant contribution to the growth of the current account deficit was made by the expansion of the negative balance of the primary income account, which increased by 21.7% over the year and amounted to \$ 22.1bn. Capital outflows under

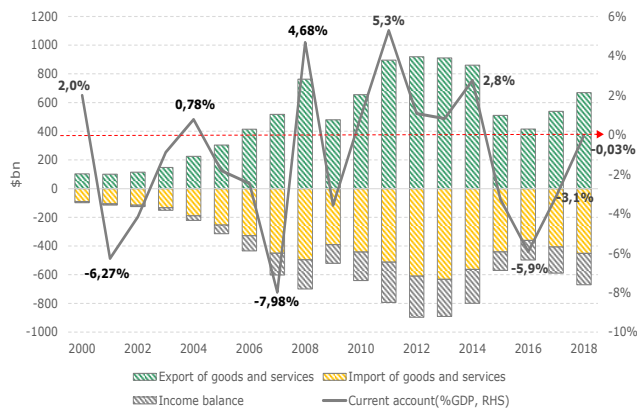
this balance item of the current account were due to the growth of income from direct investments by 23.7% yoy to \$20.5 bn. This size of capital outflow is commensurate with the values of 2013-2014. The expansion of the balance of services by 28.5% yoy to \$4.6bn also had a restraining effect on reducing the negative balance of the service account. In the period, there is an outpacing dynamics of growth in imports of services by 17.7% yoy over their exports (11.8% yoy).

The relative indicator of the current account deficit to GDP decreased from -3.1% in 2017 to -0.03% in 2018 (the indicator is calculated on the basis of preliminary GDP data for 2018).

Financial account (excluding reserve assets of the NBK)

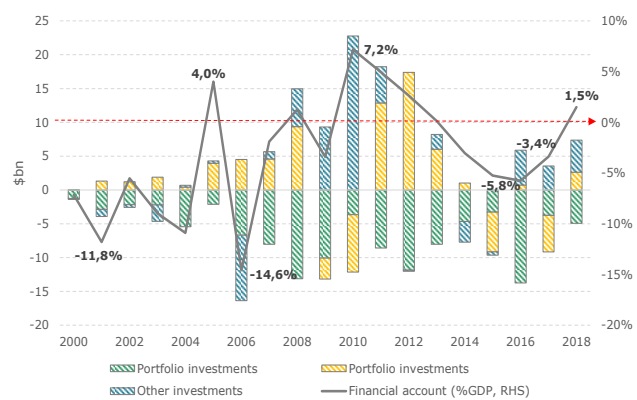
According to an updated statistics of the NBK for 2018, the outflow of financial resources within the financial account amounted to \$2.6bn against inflows of \$5.5bn in 2017. An analysis of historical data showed that over the past five years there has been an inflow of capital in the republic (\$5.5 bn - \$9.7bn) in within the financial account, which was replaced by an outflow of \$2.6bn in 2018.

Fig. 21. Current account deficit reduction



Source: NBK, Halyk Finance

Fig. 22. Financial account capital outflow



Source: NBK, Halyk Finance

The outflow of resources on the financial account was facilitated by net lending to non-residents in the amount of \$2.6bn within the "portfolio investment" account, in the "other investments" account in the amount of \$4.7bn. As part of portfolio investments, there was a decrease in residents' liabilities due to repurchase of shares and global depository receipts of KazMunaiGas Exploration Production JSC, due to an increase in the holding by residents of the sovereign debt of the republic from T8.6tn.up to 10.1 trillion (according to the Central Securities Depository), as well as due to a reduction in liabilities to non-resident banks (Kazkommertsbank JSC) in the amount of \$300mn. Within the other investments account, there is an increase in lending by residents as part of acquiring obligations of different maturity.

Net borrowing on the direct investment account increased over the year by 31% and amounted to \$4.9bn (inflow). An analysis of gross FDI inflows for 2018 showed that circa 50% of all investments went to the oil and gas industry, 13% to the wholesale and retail industry, and about 14% to the Republic's manufacturing industry.

The relative indicator of the outflow of financial resources within the financial account to GDP increased from -3.4% (inflow) in 2017 to 1.5% (outflow) in 2018. Thus, within the analyzed period, the acquisition of assets by residents within the financial account prevailed over their commitment to non-residents.

In the current year (in early April), the NBK introduced changes in the methodology for accounting and evaluating individuals' transactions (travel, "shuttle" trading, personal transfers) to improve the accounting of external account transactions. Also, the cost of transportation of crude oil through the territory of the Union countries was excluded from accounting for oil exports in the EAEU countries. Also, the residency status of foreign companies whose assets (construction and drilling companies) are located in the Republic of Kazakhstan was revised, and recognized them as residents of Kazakhstan. A change in the accounting methodology will probably affect adjustments of the updated data for 2018.

Consolidated international reserves

Consolidated international reserves in March 2019, according to preliminary data from the NBK, amounted to \$86.0bn. The consolidated assets since the beginning of the year amounted to 3.0% or \$2.6bn due to the reduction of the reserves of the NBK by 12.6% to \$27bn.

In the structure of the reserves of the NBK, a significant reduction was observed in the assets of foreign currency by 27.3% from the beginning of the year to \$12bn. Analysis of the structure of assets in foreign currency based on updated February data showed that the NBK reduced the share of assets in securities from 64.3 % (\$ 10.1bn) to 59.7% (\$7.9 bn). As of the end of February, according to updated data, the share of foreign exchange reserves of the NBK in the form of foreign currency and deposits amounted to 40.3% (\$5.3bn). The reduction of NBK assets in foreign currency in February by \$1.9bn was

facilitated by refinancing and repurchase of liabilities of KazAgro NMH, as well as a 37.4% reduction from the beginning of the year under the currency and deposits item in banks whose headquarters are located outside the country, up to \$1.8 bn.

According to reports, the NBK did not intervene in January-February of the current year. However, at the end of March, the NBK conducted interventions in the amount of \$ 304 million to support the national currency rate after the announcement of the resignation of the head of state.

The volume of gold in nominal terms in March of the current year in the NBK's assets grew by 4.3% from the beginning of the year and amounted to \$15bn. The physical growth in reserves contributed to the growth, which as of the end of February 2019, according to updated data of the NBK, amounted to 11.46 million troy ounces or about 356.4 tons (+ 1.7% from the beginning of the year). For 12 months, the increase in assets in gold amounted to 16.1% yoy. In February 2019, the price of gold reached \$1,341 per troy ounce (the maximum value since July 2018) and began to adjust down to the level of \$ 1,292 as of the end of March. Thus, the adjustment in the value of gold down by 3.6% in February-March affected the reserves of gold, which lost 1.12% of the nominal value over the month. Net international reserves of the bank decreased by 12.8% from the beginning of the year and amounted to \$ 26.5 billion.

Fig. 23. International reserves NBK

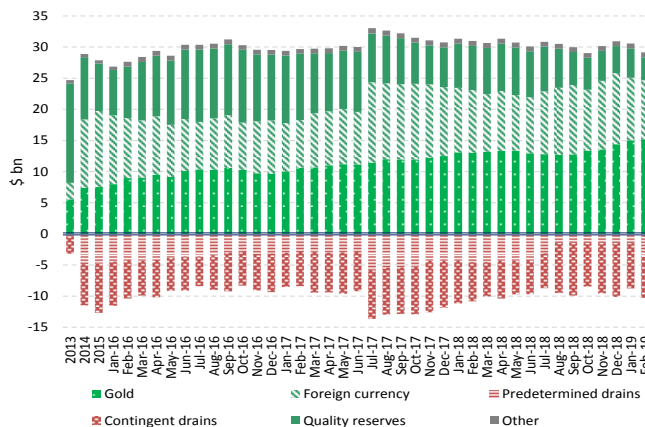


Fig. 24. Consolidated reserves



Source: NBK, IMF, Halyk Finance

Source: NBK, Halyk Finance

In March of this year, the assets of the National Fund (NF) increased by 2.2% from the beginning of the year and reached \$ 59 bn. It must be emphasized that if the dynamics of the assets of the NF are in the positive growth zone for the third month since the beginning of the year, then the change in NBK's international reserves in negative for the third month in a row and continues to grow. Correction of the cost of Brent crude oil from \$55 per barrel in early January to \$68 per barrel at the end of March of the current year (March 2018 \$ 70 per barrel), as well as expansion of oil and gas condensate production by 2.8% yoy in January-March 2019 contributed to an increase in the fund's income by 54.3% yoy to T720.4bn (\$1.9bn). The expenses of the fund decreased by 0.7% in annual terms and amounted to T790.7bn (\$2.1bn). However, if in February of the current year the balance of income over the fund's expenditures was positive, in March the fund's expenditures exceeded its revenues, which affected the fund's assets by -0.11% mom. The increase in the negative balance was due to an increase in the size of the guaranteed transfer by T360 billion (\$953mn) compared with February 2019.

Banking sector

The situation in the banking system is described in detail in a publication dedicated to this topic: [February 2019](#)

Stock market

KASE index showed irregular growth in the first quarter of this year. Since the beginning of January of this year, the index has changed from 2,293.7p., evidencing the growth in the middle of the month, to a minimum value towards the end of the month at 2,243.8p (the minimum for 1 quarter). Subsequently, there was a steady increase in the KASE index, whose figure as of the end of March updated the six-month maximum, reaching 2,461.3 p (+ 7.3% since the beginning of the year). The growth dynamics demonstrated by the index in the current year repeats the dynamics of last year in Q1, when the index reached its maximum of 2,456.3p.

The representative list of KASE has not changed and as of the end of March 2019 it included 7 companies - Bank CenterCredit (8.9 shares in the list), KazMinerals (15.3), People's Savings Bank of Kazakhstan (15.6), Kcell (15.3), KEGOC (14.8), Kazakhtelecom (16.4), KazTransOil (13.8). Shares of five companies on the list showed a steady growth trend in the first quarter of this year, while Bank CenterCredit quotes (-0.5%), Kazakhtelecom JSC (-11.9%) showed a downward trend.

The weighted average price per share of KazMinerals JSC for the three months of the current year increased from 2,523 tenge per share, first year to 3,189 tenge (+ 26.4%) per share, as of the end of the 1st quarter. The growth of quotations of shares of KazMinerals JSC takes place against the background of rising prices for copper and zinc, due to the expansion of production volumes and the forecast copper deficit in world markets.

After rising from 1,342 tenge per share to 1,420 tenge (+ 5.8%), quotes of KazTransOil JSC shares gradually lost in price and as of the end of March reached 1,395 tenge (+ 3.9% to the beginning year) per share.

In the first quarter of this year, KEGOC shares fell from KZT1,600.6 per share at the beginning of the year to 1,578 (-1.4% since the beginning of the year) at the end of March. However, during the last two trading days of March, they showed significant growth, reaching 1,712.9 (+ 7.0% from the beginning of the year) tenge per share. The observed growth in share prices of KEGOC JSC was supported by strong financial indicators for the 9 months of last year.

During January of the current year, quotations of shares of Kcell JSC showed a downward trend from 1,850 tenge to 1,773 tenge (-4.2%) per share. The dynamics of the weighted average share price of Kcell JSC since February has been steady and as of the end of March reached KZT2,010 (+ 8.6% from the beginning of the year) per share. Such a movement of quotes is still associated with a deal with the company Kazakhtelecom JSC.

Shares of Kazakhtelecom JSC began the year with falling prices from 33,499 tenge per share to 25,000 tenge (-25.4%) per share as of the end of January, repeating the dynamics of quotations of shares of Kcell. In the future, there was an adjustment in the share price to the level of 29,500 tenge (-11.9% from the beginning of the year) per share as of the end of the 1st quarter. Such a movement of quotations is explained by recent asset acquisitions.

Shares of Bank CenterCredit JSC showed an increase from 234.2 tenge in early January to 247.2 tenge (+ 5.6%) per share in early February. Subsequently, a steady downward trend was observed, and as of the end of the quarter, the weighted average cost of the issuer's shares reached 233 tenge (-0.5%) per share.

Shares of Halyk Savings Bank JSC began the year with a slight adjustment of the weighted average price for their shares down from KZT100.4 to KZT97.8 (-2.6%) per share as of the end of January. Over the next two months, a steady upward trend was observed and, as of the end of March, the weighted average price of the issuer was 112.01 tenge (+ 11.6% from the beginning of the year) per share. Such dynamics of the issuer's quotations were supported by good financial reporting of the bank, as well as the forthcoming payment of dividends.

The main external signals for the growth of the developing countries market, including the Kazakhstan stock exchange market, were positive news in the framework of trade negotiations between Beijing and Washington, as well as news from the US Federal Reserve about the suspension of the increase in the short-term rate, which remained at the level of December 2018 and amounted to 2.50%.its maximum value of 2,456.3 p.

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