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**May 19, 2023**

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*Due to good stance in the non-commodity sector in 1Q2023, Kazakhstan's economy showed solid growth at 4.9% yoy (the highest growth rate over the past 11 years). The high growth rates of the Kazakh economy occurred despite the persistence of tight monetary conditions in the republic (the base rate remained at the level of 16.75%), as well as against the backdrop of geopolitical tensions in the world. Taking into account the sticky external and internal pro-inflationary risks, the NBK expressed the need to maintain the base rate at the current level during 1H2023. Correction in energy prices in the global market and a reduction in physical volumes of oil supplies led to a decrease in the trade surplus in 1Q2023 by 58.3% yoy due to a 14.4% yoy decline in export volumes and a 41.4% yoy increase in imports. Such dynamics in the trade account combined with a reduction in the deficit on other large current account items led to a negative balance of \$1.6 billion. The republic's consolidated international reserves in 1Q2023 increased by 4.2% since the beginning of the year and amounted to \$94.6 billion. The growth of the country's reserves occurred both due to an increase in NF assets (+4.8% qoq) and NBK reserves (+3.2% qoq). The exchange rate of the national currency in the period strengthened by 3.2% qoq to 448 tenge per US dollar.*

*The macroeconomic picture in the republic in 2023, according to our forecasts, will be as follows: GDP growth rate will be 4% yoy against the background of a slowdown in inflation to 12.0% yoy, and the exchange rate will be at the level of 475 tenge per 1 US dollar as of the end of the current year.*

**The expansion of business activity in the non-primary sector of the economy against the backdrop of the pro-cyclical budgetary policy will ensure the growth of GDP by 4% in 2023.** We revised Kazakhstan's GDP growth forecast upward due to a significant acceleration of economic dynamics in the 1st quarter of this year, as well as due to an additional increase in budget expenditures by about KZT2 trillion. These budgetary funds will begin to go into the economy from the second quarter. In 1Q2023, the services sector was the main driver of economic growth due to double-digit dynamics in the telecommunications and construction sectors, domestic trade turnover, as well as due to a significant increase in investment activity in the republic. We expect high growth rates in these sectors to continue and contribute to the country's economic growth at the level of 4% in 2023. Growth factors will also include an increase in oil production in the country, a recovery in consumer demand amid slowing inflation and increased investment activity. Our forecast for the price of oil this year is \$80 per barrel, which is still quite a comfortable level for the republic's economy. In 1Q2023, government spending increased by 29.7% yoy, demonstrating the highest growth rate since 2020. An expected 27% yoy increase in state budget spending in 2023 will provide pro-cyclical support to the country's economy. The increase in wages along with the expansion of consumer lending contributed to the growth of household consumption in 1Q2023. The projected easing of monetary conditions in the country will support this process during the current year. The impact of Western sanctions against the RF has both a positive impact on the Kazakh economy (relocation of businesses and personnel, capital inflows) and a negative one (curtailment of Russian banks in Kazakhstan, disruption of supply chains, exchange rate volatility, etc.). Against the background of the expected tightening of sanctions against the RF, this impact on the economy of Kazakhstan will linger.

**Easing monetary conditions amid slowing inflation.** In 1Q2023, the NBK hasn't changed monetary conditions in the country, keeping the base rate at 16.75%. In addition, it stressed that it is advisable to keep the rate at the current level until the end of 1H2023 in order to create conditions for its slowdown in the medium term. Against the backdrop of a slowdown in consumer inflation to 12% by the end of this year, the NBK will begin to gradually reduce the base rate and by the end of the year, in our opinion, will bring it to 15% level. We revised our inflation forecast from 11.5% yoy to 12% yoy due to an increase in budget spending compared to the previous forecast, along with the government's plan to increase utility tariffs and energy prices. The implementation of these plans will create pro-inflationary pressure on the economy from aggregate supply side (increase in production costs), and the expansion of the budget impulse, along with the expected increase in household consumption, will create conditions for a more restrained slowdown in consumer inflation. We do not expect import of inflation through foreign trade channels, as inflation rates in the countries of trading partners are noticeably lower than in Kazakhstan. We also do not expect a serious deterioration in the geopolitical situation in the world, hence prices for imported food and non-food items will stay at levels close to the current ones.

**Exchange rate – reflects the existing macroeconomic dynamics.** In 1Q2023, the national currency strengthened due to a tax week and foreign exchange operations of quasi-state-owned companies and the NBK for the NF. The currency exchange operations of the NBK for the NF will continue to support the national currency during the current year. Recall that the size of transfers (guaranteed and targeted) this year will amount to T4 trillion (T4.6 trillion in 2022). The weakening of the US dollar on the global market and the enduring relatively comfortable level of prices for hydrocarbons and metals had a positive impact on the tenge. Dynamics of growth in import volumes in

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1Q2023 (+41.4% yoy) against the backdrop of a decrease in exports (-14.4% yoy due to an 8.4% yoy reduction in physical volumes of oil supplies) contained tenge from further strengthening. During this year, tenge will experience pressure from further expansion of imports, which will grow propelled both by the corporate sector and households. One of the factors that will really put pressure on the exchange rate of the tenge against the main reserve currencies will be the slowing down, but still persistent double-digit inflation in the country at 12%. Taking into account the emerging internal and external macro dynamics, the national currency exchange rate will be 475 tenge by the end of this year compared to our previous forecast of 480 tenge per US dollar.

Main macroeconomic indicators	2021	2022	Base		Worse case		Best case	
			2023	2024	2023	2024	2023	2024
Oil Brent, average, USD/bbl	70.4	99.8	80.0	80.0	60.0	60.0	100.0	100.0
Real GDP, % yoy	4.3	3.3	4.0	4.5	2.5	3.0	4.5	4.8
Exchange rate USDKZT, eop	431.7	462.7	475.0	495.0	510.0	525.0	460.0	480.0
Exchange rate USDKZT, average	426.0	460.5	463.0	490.0	490.0	522.0	456.0	473.0
CPI, % change yoy	8.4	20.3	12.0	7.5	16.0	10.0	9.5	6.5
Base rate, %	9.75	16.75	15.0	10.0	16.8	13.0	13.0	9.0
Budget balance consolidated, % GDP	-3.0	-2.1	-2.7	-2.7	-3.1	-3.1	-2.5	-2.4
Current account, % of GDP	-1.3	3.8	1.0	0.9	-0.5	-1.1	1.4	1.1

### Acceleration of economic growth in 1Q2023

Kazakhstan's GDP growth in 1Q2023 accelerated to 4.9% yoy from 4.6% yoy in 1Q2022 and reached its highest level since 1Q2012 (+5.7% yoy). At the same time, the growth dynamics of the Kazakhstani economy also looked noticeably better than the last three quarters of 2022, when growth did not exceed 3.3% on average. According to the Ministry of National Economy of Kazakhstan, GDP growth in January amounted to 5.6% yoy, which was facilitated by the low base of January last year (+1.4% yoy) due to the January events. In January-February, economic growth slowed down somewhat to 4.3% yoy.

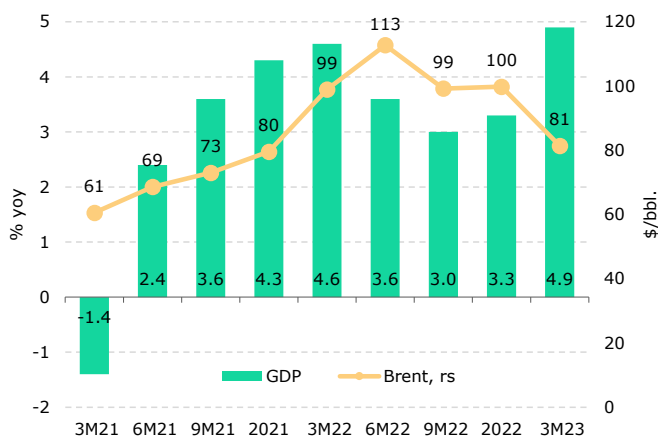
The acceleration of economic growth dynamics was mainly driven by the service sector, which showed an increase of 5.1% yoy compared to 3.1% yoy in 1Q2022. In the real sector, on the contrary, there was a slowdown to 4.3% yoy from 5.9% yoy in the same period.

In the oil sector of the republic, which experienced a decline of oil production last year, the situation has stabilized, but oil production volumes remained virtually unchanged (+0.7% yoy). Moreover, to the previously existing restriction of oil production under the OPEC+ agreement, a new one (-1.2 million b/d) was added in May. It may bring a slight decrease in the annual volume of oil production in the republic. At the same time, even taking into account this limitation, oil production in Kazakhstan can reach 90.5 million tons, which will be significantly higher than the 2022 volumes of 84.1 million tons.

The strengthening of the national currency in 1Q2023 had a positive impact on total domestic consumption, which saw double-digit growth in both investment and domestic trade turnover due to increased household consumption.

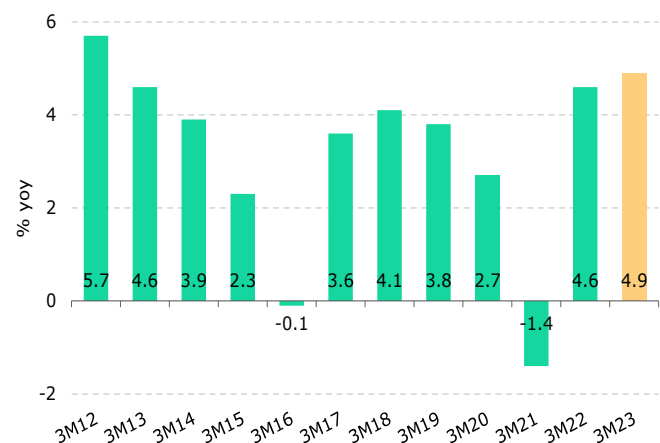
Active support for the economy through the expansion of budget expenditures continued this year with an increase in expenditures on the economy. The state budget expenditures were revised upwards by about KZT2 trillion and they are expected to flow into the economy in the second quarter of this year. In parallel with the increase in the incomes of state employees, the minimum wage was increased from KZT60 thousand to KZT70 thousand. In general, over two years, its increase amounted to almost 65%. This measure affected a significant part of the employed population of the republic and partly leveled the erosion of their income due to the growing inflationary pressure (+18.1%-21.3% yoy).

Fig. 1. GDP and oil prices



Source: BNS, \* GDP cumulatively

Fig. 2. GDP dynamics (2012-2023)



Source: BNS

In April, against the backdrop of the emerging crisis in the US banking system and persistently high levels of consumer inflation (6.0% compared to the target of 2%), according to IMF expectations, US GDP growth will slow down from 2.1% yoy in 2022 to 1.6% yoy. The US Federal Reserve has repeatedly reviewed the growth of the US economy since last year downward and, according to the March forecast, it will be 0.6% yoy. The IMF also downgraded its global economic growth forecast for 2023 to 2.8% yoy from 3.4% yoy in 2022. At the same time, many of the crisis phenomena that had a negative impact last year (the military conflict in Ukraine, high inflation rates and the persistence of tight monetary conditions) will retain their impact on the global economy this year as well. While global inflation will slow from 8.7% in 2022 to 7%, the Fund believes that monetary conditions will remain tight for longer.

### Recovery in the majority of sectors of the economy

In 1Q2023, the downward trend in the growth of sectors of the economy that emerged in the second quarter of 2022 was reversed. Some sectors showed double-digit growth, mainly due to the expansion of aggregate domestic demand.

In 1Q2023, industrial production growth accelerated to 2.8% yoy, after only 1.1% yoy growth that was recorded in 2022. Of course, this is still a low value compared to the industrial output dynamics of 5.8% yoy in 1Q2022. Nevertheless, there is reason to expect further acceleration of industrial production growth against the background of stable external demand and the recovery of the Kazakh economy.

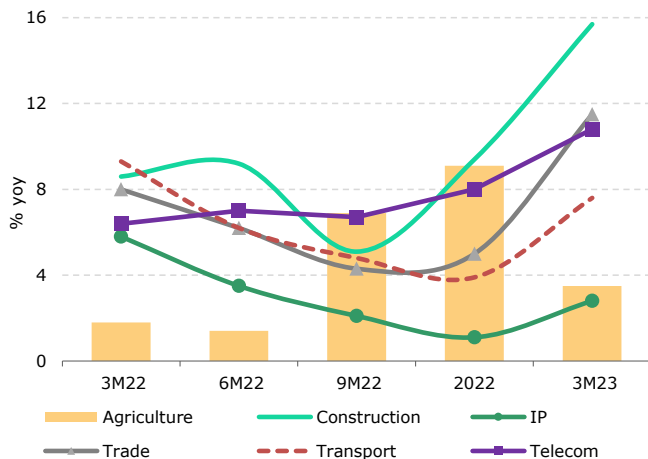
The mining sector, which ended 2022 with a decline of 1% yoy, in January-March 2023 showed an increase in production by 0.2% yoy. Oil production volumes increased by 0.7% yoy, and gas production by 1.2% yoy. At the same time, there was a decrease in coal production (-13.7% yoy) and metal ores (-0.6% yoy). The level of oil production in the first quarter was unstable. So, if in January the volume of oil production was at the level of 8 million tons, then in February it fell to 7.1 million tons and partially recovered in March to 7.8 million tons. We attribute these changes in the volume of oil production to the influence of seasonal factors, inherent to the beginning of the year.

There was a correction in the hydrocarbon market in 1Q2023, as a result the price of oil fell by about 8% qoq and by 18% yoy, amounting to \$81.4 per barrel of Brent (WB data). The news about the cut in oil production by OPEC+ countries managed to push quotes to \$85 per barrel of Brent for a very short time, after which they again "rolled back" to previous levels. Despite this market situation at the moment, fundamentally the global hydrocarbon market should at least remain at current levels, while as a maximum, prices have a chance to even increase in 2H2023.

The reason for optimism is the continuing lack of sufficient oil supply, including due to the actions of the OPEC+ countries, as well as the recovering demand for hydrocarbons, primarily from China (the second largest consumer of oil in the world), whose economy started growing rapidly after the lifting of anti-covid restrictions.

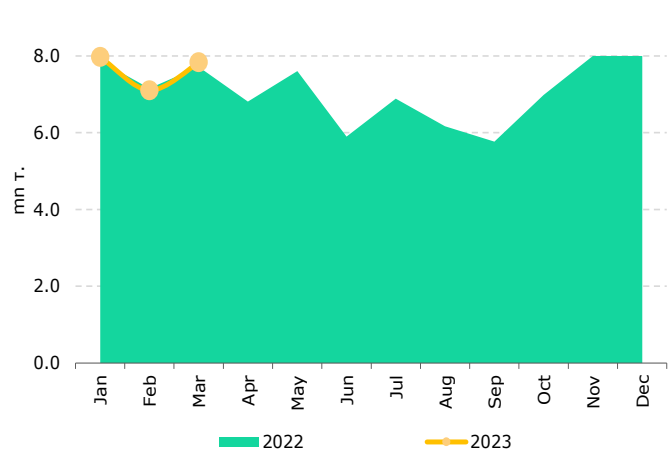
Growth in the manufacturing industry came in at 5.4% yoy (+3.4% yoy in 2022), where a significant contribution was provided by mechanical engineering (+35.3% yoy), automotive industry (+39.3% yoy), electrical equipment manufacturing (+60.1% yoy), food (+8.1% yoy), beverages (+12.5% yoy), pharmaceutical products (+8.1% yoy), and light industry (+37.8% yoy). In addition, over 6% in annual terms showed growth in the utilities sector.

Fig. 3. Output by sector



Source: BNS

Fig. 4. Oil output



Source: BNS

The growth rate of the construction industry continued the acceleration that began at the end of 2022 and in 1Q2023 reached 15.7% yoy (the highest rate since 2006). The main drivers of growth in the industry were the construction of non-residential buildings (+21.1% yoy) and structures (+18.1% yoy). In turn, the volume of residential real estate construction increased only by 4% yoy after 13.7% yoy in 2022.

In addition to the construction sector, growth rates accelerated in domestic trade (wholesale and retail), where the growth dynamics was at 12.1% yoy in retail (the highest value since 2013) and 11.1% yoy in wholesale trade. The telecommunications sector also recorded double-digit growth at 10.8% yoy. In the transport sector, the dynamics was at the level of 7.6% yoy, which was better than the growth rate of 3.9% yoy in 2022. Growth in the industry was mainly provided by the transportation of passengers, which increased by 16.2% yoy, while air transportation

increased immediately by 39.5% yoy. In agriculture, the output growth rate amounted to 3.5% yoy, which was higher than the 1.8% yoy in the 1st quarter of the last year.

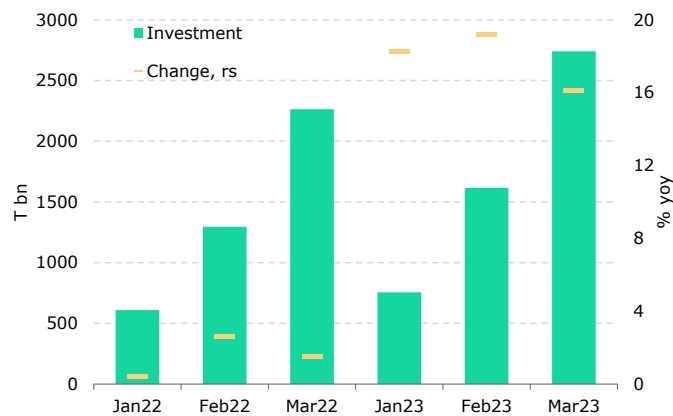
**Quarterly growth of domestic consumption**

As was noted earlier, tight monetary conditions in Kazakhstan and the world did not become an obstacle to increasing investment activity in the republic. The volume of investments in fixed assets showed an increase of 7.9% yoy in 2022, however, their growth did not stop there and reached 16.1% yoy in 1Q2023. In nominal terms, the volume of investments amounted to T2.7 trillion, having increased from T2.3 trillion in 1Q2022.

The acceleration of investment growth was facilitated by their dynamics in the oil sector, where their volume increased immediately by 22.2% yoy and amounted to T791 billion. Investments in the extraction of metal ores increased by 31% yoy, and their growth in coal production was 146% yoy. Investment in fixed assets in the manufacturing industry decreased by 0.5% yoy compared to a decline of 5.6% yoy in 2022. Despite a slight decline of investments, the progressive realization of investments was noted in the chemical industry (+26% yoy), pharmaceuticals (+44.6% yoy), rubber and plastic products (+242% yoy), as well as in the production of refined petroleum products, where a 4-fold increase yoy has happened.

In terms of industries, a significant increase in investments in fixed assets was observed in telecommunications (+59% yoy, T24.3 billion), trade (+44.5% yoy, T75.5 billion), transport (+27.3% yoy, T235.6 bn), agriculture (+26.9% yoy, T141.8 bn) and real estate (+12.9% yoy, T588 bn).

Fig. 5. Investment in fixed assets



Source: BNS

Fig. 6. Wages and retail trade dynamics



Source: BNS

Wages in the first quarter of this year increased by 19.3% yoy in nominal terms and amounted to KZT340.6 thousand (\$749). Wages in construction (+34.5% yoy) and in agriculture (+24.5% yoy) grew at an accelerated pace, above the national average. More restrained rates of growth were noted in the industry (+21.7% yoy), in the public sector (+16.6% yoy), in real estate transactions (+9.8% yoy) and in the provision of other types of services (+9.7% yoy). Thus, a significant increase in wages, including at the expense of the public sector, had a stimulating effect on consumer sentiment and household consumption, which remained subdued throughout the past year (+2.1% yoy). An important role in improving consumer sentiment in the country was played by the strengthening of the tenge against major currencies, along with the payment of a 10% state premium on household deposits in tenge in March.

Retail trade turnover in 1Q2023 increased immediately by 12.1% yoy after a more subdued growth of 2.1% in 2022. In nominal terms, retail sales grew by 33.8% yoy and amounted to T3.6 trillion compared to T2.7 trillion in 1Q2022. Food sales increased by 17.9% yoy in nominal terms, while sales of non-food products increased by 41.3% yoy. In Astana, retail sales increased by 7.5% yoy, while in Almaty it increased by 26.3% yoy, and Shymkent led the way in retail sales growth with 28.3% yoy. A significant increase in sales was accompanied by an increase in the volume of consumer loans by 9.1% since the beginning of the current year, while the volume of household deposits expanded only by 0.5%. This indicates that households are switching from a savings model to a more active consumption behavior.

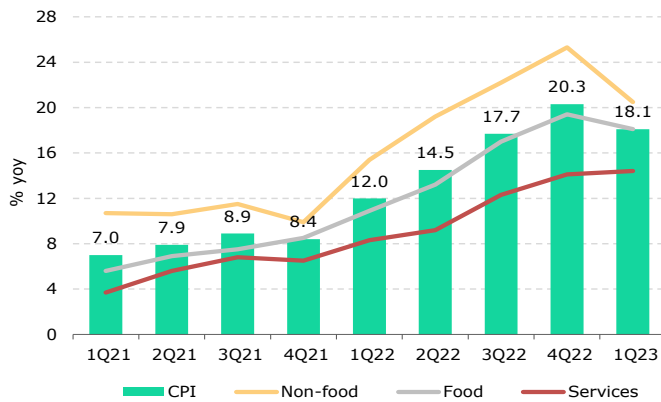
**"Technical" reduction in inflation due to the base effect of last year**

In March this year, consumer inflation slowed down to 0.9% mom (+1.3% mom in February). Moreover, a similar pattern was observed in annual terms, as inflation slowed down from 21.3% yoy in February to 18.1% yoy in March. The consumer price index in annual terms shows a "technical" decline, which is directly related to the base of last year (+3.7% mom, +12.0% yoy in March 2022), the effect of which will persist throughout the year.

The dynamics of price growth slowdown was observed across all components of consumer inflation. Thus, the growth in prices for food products slowed down to 20.5% yoy (+26.2% yoy in February), for non-food products - to 18.1% yoy (+20.5% yoy in February), and for paid services slowdown was less pronounced and amounted to 14.4% yoy (+15.0% yoy in February). Moreover, inflation rates were affected by quarterly strengthening of the tenge against the US dollar by about 3% qoq and the Russian ruble by 16.5% qoq.

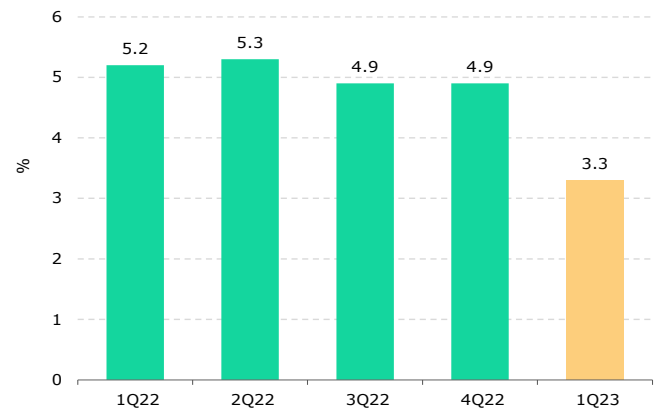
Despite the disinflation, inflation rates are still high. Concerns about high inflationary pressures in the country prompted the government to develop a comprehensive plan to contain inflation through measures to increase production volumes, measures in the field of storage and logistics of goods, retail, price control, antitrust and foreign trade regulation. In our opinion, these measures once again duplicate the measures already included in state programs and national projects that have been implemented in the republic for many years and are unlikely to have an effect on the price situation in the country.

Fig. 7. CPI



Source: BNS

Fig. 8. CPI by quarter



Source: BNS

Despite state regulation of prices in the consumer market of the republic, the government had to make a decision and increase the marginal retail prices for fuel. The decision was dictated by the need to equalize the cost of petroleum products between neighboring countries, because cheaper Kazakh fuel was in high demand among drivers of transit vehicles in the border areas. In addition, within the framework of the Strategic Directions for the Development of Eurasian Economic Integration until 2025, the participating countries plan to create all the necessary conditions for the functioning of a single market for oil and petroleum products, which involves bringing energy prices to a single level so as not to create imbalances in the common market. Movement in this direction will continue in the future. In addition, the President of Kazakhstan made a statement that it is necessary to gradually increase the tariffs for utilities and bring them closer to market rates, and allocate funds for the modernization of utility sector infrastructure. The problems of the past year (breakdown of the heat supply system in the city of Ekibastuz, in Rider and a break in the supply of cold water in Almaty) indicate a significant wear and tear of the utility infrastructure that arose due to administrative regulation of tariffs in this area for many years.

The implementation of government plans to increase prices for fuel and utilities and utility tariffs will create pro-inflationary pressure in the economy from the side of aggregate supply (growth in production costs), and the expansion of the budget impulse, along with the expected growth in household consumption, will create conditions for a more restrained slowdown in consumer inflation in the country.

**Interest rate policy – NBK took a pause**

During 1Q2023, the NBK maintained relatively tight monetary conditions. In December 2022, the NBK's MP Committee decided to raise the base rate from 16.00% to 16.75%. Based on the results of the Committee's last meeting in 2022, an official statement was made that the NBK has approached the end of the cycle of tightening monetary conditions in the country and the achieved level of the base rate will remain for quite a long time. Following the statement, the NBK kept monetary conditions in the republic unchanged throughout 1Q2023.

The rhetoric of the regulator at the first two meetings of the committee at the beginning of this year was similar and pointed to a shift in the balance of risks towards pro-inflationary pressure in the economy, growth of inflationary expectations against the backdrop of relatively high economic activity within the country, also noted a pro-inflationary stimulating budget policy and increasing rates inflation (20.7%-21.3%). At the April meeting, the NBK emphasized that internal pro-inflationary factors are being implemented in the republic in the form of an increase in inflation



expectations (from 14.2% to 16.5%), an increase in government spending and the start of reforms in the fuel and utilities market. Pointing to inflationary processes, taking into account the initiated reforms and the general pro-inflationary background, the NBK made a statement about the expediency of maintaining the base rate at 16.75% during 1H2023 in order to create conditions for its slowdown in the medium term.

In 1Q2023, high pro-inflationary pressure in the economy was observed both from the side of aggregate supply (GDP growth amounted to 4.9% yoy) and from the side of aggregate demand. Thus, state budget expenditures in 1Q2023 increased by 29.7% yoy. Domestic household consumption also increased, as evidenced by the growth of domestic retail trade, whose index went up by 12.1% yoy in 1Q2023. Growth in investment in fixed assets in 1Q2023 accelerated to 16.1% yoy. Along with the growth of imports (+41.1% yoy) and the decline in exports (-14.4% yoy), there was a high upward growth in import prices (+14.2% yoy of the CIS countries), that inflation was imported into the country through foreign trade channels.

Taking into account the fact that from July to November of this year the NBK has scheduled 4 meetings of the MP committee, the decrease in the base rate will most likely be even and by the end of 2023 it will reach the level of 15%. We believe that reforms in the fuel and utilities sector, as well as an increase in budget spending, will put pro-inflationary pressure on the economy and this will deter the NBK from a more significant reduction in the base rate this year. In addition, as the economy has shown fairly strong growth at a rate of 16.75%, the regulator will be less inclined to significantly ease monetary conditions, as this can create additional inflationary pressure through the credit channel.

### **Money market – multidirectional dynamics**

The rate on automatic REPO operations (TONIA) at the end of March 2023 was at the level of 17.1% (17.6% at the end of December 2022) with an average value of 16.2%. The volume of transactions on automatic REPO in 1Q2023 increased by 3.5% qoq (-12.4% yoy) and amounted to KZT33,213 bn, while the average value of daily transactions for the period amounted to KZT562.9 bn (KZT509.2 bn in 4Q2022). The maximum daily volume of transactions of automatic REPO operations occurred at the end of March 2023 and amounted to KZT863.8 billion (KZT784.2 billion in the 1st decade of December 2022).

The volume of transactions on overnight swaps on the USDKZT pair in 1Q2023 decreased by 26.4% qoq to KZT4 161.3 bn. As of the end of 1Q2023 the rate on 1-day swaps stood at 15.5% (18.6% at the end of 4Q2023) with average at 15.9% (15.8% in 4Q2022). The maximum volume of overnight swaps occurred at the beginning of January and amounted to T146.3 bn, with an average quarterly value of T73 bn (an average quarterly value of the nominal volume of transactions was T97.5 bn in 4Q2022).

The volume of transactions on two-day swaps on the USDKZT pair in 1Q2023 increased by 3.4 times qoq to KZT7,719 billion. At the end of 1Q2023, the USDKZT two-day swap rate stood at 15.8% (18.7% at the end of 4Q2022) at a quarterly average value of 16.3% (15.7% in 4Q2022). The maximum volume on two-day swaps fell on the last days of March T189.0 bn, with an average quarterly value of T135.4 bn (an average quarterly value of transactions of T42.2 bn in 4Q2022).

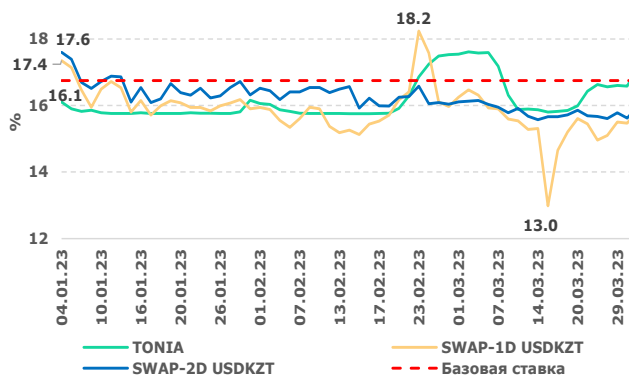
In general, in 1Q2023, the volume of the money market of the Republic of Kazakhstan increased by 16.9% yoy and amounted to KZT63,780 bn. About 81.0% (91.4% in 1Q2022) of the market, or KZT51,651 bn, accounted for REPO operations.

The volume of excess liquidity in the financial system of the Republic of Kazakhstan increased by 10.1% qoq (+60.5% yoy) and at the end of March amounted to KZT4,127 billion. In 1Q2023, there was an increase in liquidity withdrawals via NBK notes (63.8% share vs. 59.7% in 4Q2022) by 17.7% qoq (+83.7% yoy) to KZT2,632 bn. At the same time, the effective yield on NBK notes in circulation in March 2023 was at the level of 16.7% (18.1% in December 2022 and 11.6% in March 2022). The effective rate of the NBK notes placed in March 2023 was 16.73% with the placement volume of KZT2 631.8 bn compared to the rate of 16.72% and the initial placement volume of KZT2 236.2 bn in December 2022.

The decline in money market transactions was accompanied in 1Q2023 by a contraction in the money supply (MS) by 1.1% YTD (-3.8% in February). The most significant contraction since the beginning of the year was observed on the part of the M1 aggregate (-8.4%) due to the reduction in transferable deposits of non-bank legal entities in tenge (-11.1%) and transferable household deposits (-9.9%).

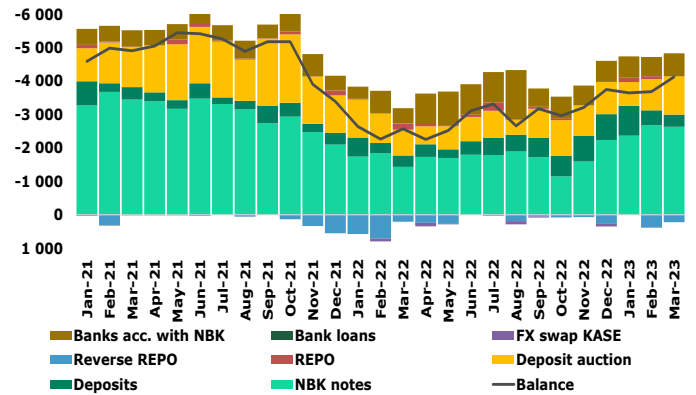
In 1Q2023, the money market rate inched closer to the middle of the NBK's liquidity management interest band, while the FX swap rate was at 16.1%. During 1Q2023, there was volatility in the money market from currency swaps due to a significant strengthening of the national currency against the backdrop of tax payments and the sale of export earnings by quasi-state-owned companies.

Fig. 9. Money market rates



Source: KASE, Halyk Finance

Fig. 10. Excess liquidity absorption



Source: NBK, Halyk Finance

### Exchange rate - strengthening of the national currency

As of the end of March this year, the national currency appreciated by 3.2% since the beginning of the year to 448 tenge per US dollar (strengthening by 2.2% yoy), while the average value of the exchange rate was 454.93 tenge per US dollar in 1Q2023. At some point the national currency reached 466.2 tenge per US dollar. The strengthening of the national currency mainly took place in February due to the tax week, when the budget received tax payments and had been sale of foreign exchange earnings of quasi-state companies (\$295 million).

In 1Q2023, there was an increase in the NBK foreign exchange operations for the NF by 72.3% qoq (-26.6% yoy) to \$1,539 million. In February, the volume of these operations increased 2.6 times and amounted to \$590 million. There was also an influx of foreign capital into government securities in the period. For example, nominal holding of short-term NBK notes by non-residents increased by 9.4% qoq and amounted to KZT109.4 bn.

In the foreign exchange market, in the segment of exchange trading for the USDKZT pair in 1Q2023, there was a decrease in foreign exchange operations by 6.0% qoq to \$7,775 million (-10.4% yoy). The minimum volume of foreign exchange transactions on KASE occurred in January and amounted to \$2,601 million. The volume of purchases of US dollars in exchange offices for 1Q2023 decreased by 12.7% yoy (-36.2% qoq) to T385.5 billion (\$847.4 million with the average rate of 454.9 tenge per US dollar).

The change in the cost of oil on global markets from a quarterly average of \$88.6 in 4Q2022 to \$81.4 per barrel of Brent in 1Q2023 (at the moment the price of oil fell to \$72.9) affected the amount of merchandise export earnings, which decreased by 14.4% yoy with simultaneous growth of imports by 41.4% yoy. The growth in demand for foreign currency as part of import operations had a restraining effect on the strengthening of the national currency in the period. A moderate outflow of capital from the country on the financial account in the amount of \$680 million also held back further strengthening of the national currency of Kazakhstan.

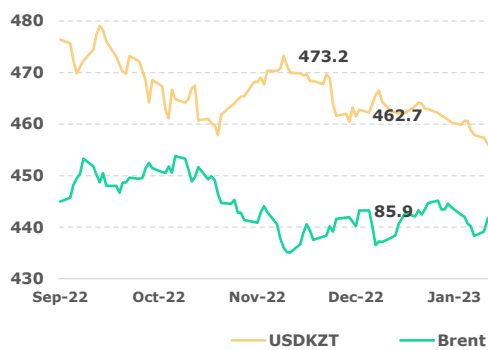
The movement of the USDRUB pair in 1Q2023 was largely determined by the embargo on the purchase of the main export goods of the RF. Thus, oil and gas revenues of the RF federal budget in 1Q2023 decreased by 45% to 1.6 trillion rubles. The current account surplus in 1Q2023 decreased 3.8 times yoy to \$18.6 bn due to a 2.9-fold reduction in the trade balance surplus to \$29 bn, with the reduction occurring both due to a decrease in export volumes (-35% yoy) and imports (-19% yoy). The financial account saw an outflow of \$21.4 billion. Such macro dynamics put pressure on the exchange rate of the Russian currency, which depreciated by 9.6% qoq as of the end of 1Q2023 to 77.1 rubles per dollar. The weakening of the Russian currency against the US dollar affected the appreciation of the RUBKZT pair by 9.5% qoq to 5.82 tenge per ruble at the end of the period.

We believe that the exchange rate of the national currency this year will be supported by the price of oil at \$80 per barrel of Brent against the background of the expected expansion of oil production (forecast of the Ministry of Energy of the Republic of Kazakhstan at the level of 90.5 million tons in 2023). However, demand for imports from businesses and households will have a negative impact on the exchange rate of the Kazakhstani tenge. Maintaining double-digit inflation rates (12% yoy) will put the main pressure on the exchange rate of the national currency against the main reserve currencies. The tenge exchange rate will be supported by the NBK's currency exchange operations for the National Fund. Recall that the size of transfers (guaranteed and targeted) this year will amount to 4.0 trillion tenge (4.6 trillion in 2022). Maintaining tight monetary conditions in the US (the Fed's key rate will remain at 5.10%) will allow non-residents of the RK to receive a risk-free yield of 3.41% (10-year US GS) and 3.71% (2-year US GS). In addition, the threat of secondary sanctions due to the re-export of imported goods to the RF through the territory of the RK may have a negative impact on the inflow of portfolio investors into the country. We do not rule out that a



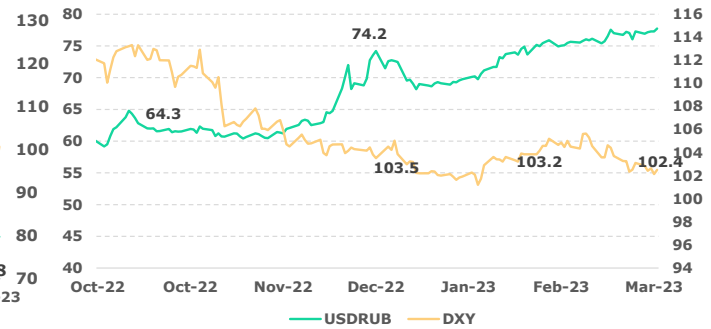
moderate inflow of foreign capital through this channel will continue, however, its impact on the formation of the tenge exchange rate will be limited.

Fig. 11. USDKZT vs Brent



Source: Bloomberg, Halyk Finance

Fig. 12. USDRUB vs DXY



Source: Bloomberg, Halyk Finance

Taking into account the projected macroeconomic and geopolitical dynamics, we believe that the exchange rate of the Kazakhstani tenge will be at the level of 475 tenge per US dollar by the end of this year.

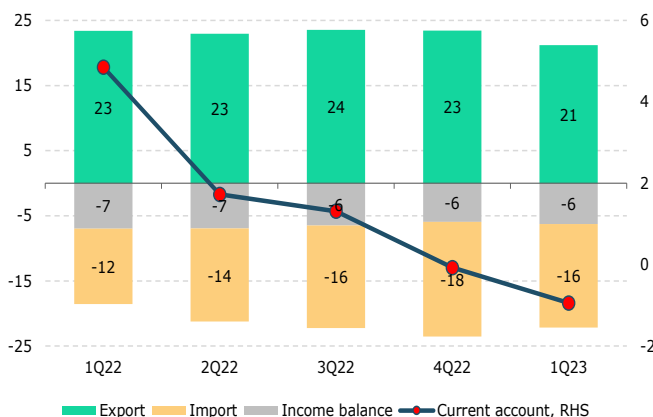
**The current account deficit**

The current account<sup>1</sup> of the Republic of Kazakhstan in 1Q2023 developed with a deficit of \$1.6 billion (surplus of \$4.8 billion in 1Q2022). The surplus of the trade account in the Republic of Kazakhstan in the period formed at the level of \$5.1 billion (-58.3% yoy) due to the outstripping growth of imports (+41.4% yoy to \$13.7 billion) over exports, the nominal size of which decreased by 14.4% yoy to \$18.8 bn. The deficit on the current account was facilitated by the reduction of the surplus on the trading account, as in the primary income account, the deficit decreased by 12.5% yoy to \$6.0 bn, and in the services account, the deficit decreased by 0.1% yoy to \$433.3 million. A significant deepening of the deficit was observed in the secondary income account (2 times yoy), however, in absolute terms, the negative balance amounted to \$252 million.

The decrease in Kazakhstani exports (-14.4% yoy) was driven by an 8% qoq decrease in the average quarterly oil price to \$81.4 per barrel of Brent, while at the same time there was a decrease in oil exports in physical terms (-8.4% yoy). Recall that in 1Q2023, there was a temporary stoppage of oil transportation through the CPC, as well as a decrease in oil production at the Tengiz field due to the temporary withdrawal of one of the six production lines.

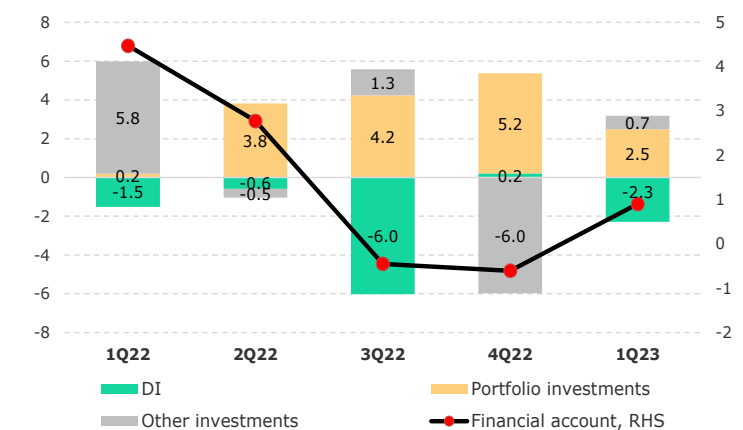
The reduction in the deficit in the primary income account was not only due to a decrease in the net income on direct investment by 7.5% yoy to \$6.0 billion, but also due to an increase in interest on reserves and assets of the National Fund of the RK by 69.0% yoy to \$428 million.

Fig. 13. Current account, \$ bn



Source: NBK, Halyk Finance

Fig. 14. Financial account outflow, \$ bn



Source: NBK, Halyk Finance

<sup>1</sup> Preliminary NBK data

**Financial account (excluding reserve assets of the NBK)**

The financial account saw a decline in capital outflow from \$4.5 bn in 1Q2022 to \$680 mn in 1Q2023. Decline in capital outflow on the financial account was driven by a 53.9% yoy increase in direct investment inflows to \$2.3bn amid a 12.9x increase in portfolio investment outflows to \$2.5 bn and a 6.4x reduction in other short-term capital flows to \$1.2 bn. Contraction of capital outflow on the financial account by sector was supported by the decline in acquisitions of financial assets by the Government and the NBK by 66.1% yoy to \$491 million, while the acquisition of financial assets by banks decreased by 31.9% yoy to \$859 mn. At the same time, in other sectors of the economy, an increase in the liabilities by residents to \$471 mn was observed (acquisition of assets in the amount of \$3.7 billion in 1Q2022).

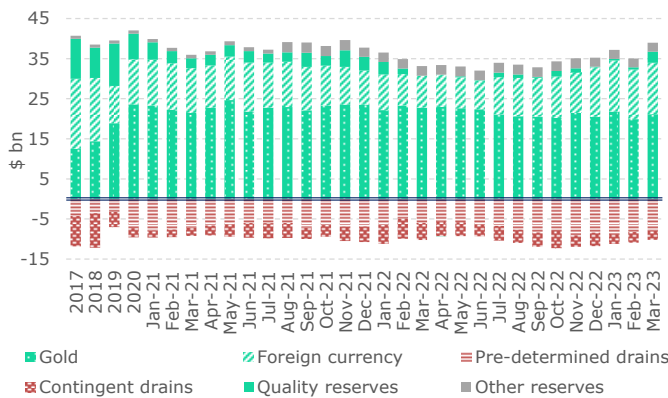
**International reserves of Kazakhstan increased**

Consolidated international reserves at the end of 1Q2023 increased by 4.2% YTD (+9.9% yoy) and amounted to \$94.6 bn. The increase in reserves occurred both due to an increase in NF assets by 4.8% (+10.3% yoy) to \$58.4 billion, and due to the reserves of the NBK, increased by 3.2% which since the beginning of the year (+9.3% yoy) to \$36.2 billion.

The growth dynamics of the NBK reserves since the beginning of the year has been positive for all assets, however, in annual terms, the nominal value of gold holdings decreased by 7.2% (+3.1% YTD) to \$21.1 billion. The reduction of holdings in gold was facilitated primarily by a decrease in its physical volume by 5.6% YTD (-9.8% yoy) to 10.7 million troy ounces (332.8 tons) as in nominal terms, its value increased by 10.1% on average per quarter to \$1,892 (XAU spot) per troy ounce. As of the end of 1Q2023, the share of gold in the structure of the NBK's gold reserves has decreased since the beginning of the year from 58.4% to 58.3% (57.8% in February) and represents one of the three minimum values since May 2019.

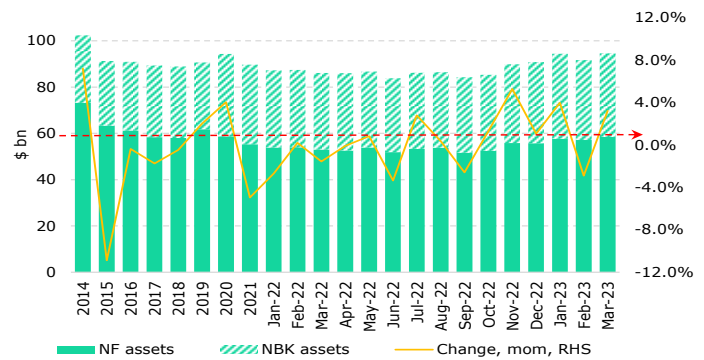
In 1Q2023, hard currency assets and deposits demonstrated significant growth dynamics, the volume of which increased by 3.9% YTD (+61.6% yoy) to \$12.8 billion. The share of assets in hard currency, according to the NBK, increased from 41.6% YTD to 41.7% in March (42.2% in February) and roughly corresponds to the share of hard currency in May 2019 (44.9%), when the NBK actually began to dynamically build up assets in gold. According to the IMF data, the NBK increased its assets in hard currency in other national banks, in the IMF and the BIS, and increased them from the beginning of the year by 19.2% (+46.9% yoy) to \$3.5 billion.

Fig 15. NBK intl. reserves



Source: IMF, Halyk Finance

Fig. 16. Consolidated reserves



Source: NBK, Halyk Finance

We believe that the NBK's rebalancing of the NBK's gold reserves into its most liquid form (CLE) was partly driven by the movement of gold prices in global markets, which moved from \$1,628 to \$1,993 per troy ounce in November 2022 in March 2023. Starting since November 2022, holdings of gold in physical form began to decline from 12.23 million to 10.68 million troy ounces. We do not rule out that the NBK could take advantage of favorable market conditions to replenish its assets in hard currency.

In the structure of NBK assets in March 2023, there was a decrease in holdings in securities by 2.1% YTD (+54.3% YoY) to \$7.8 billion. Government securities against the background of tightening the monetary policy of the US Federal Reserve presented an opportunity to receive investment income. We do not rule out that under these conditions the NBK could also have transferred its gold assets to government securities in order to obtain a better yield on its assets.

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Contacts:

**Research department** mail to: [research@halykfinance.kz](mailto:research@halykfinance.kz)

**Sales department** mail to: [sales@halykfinance.kz](mailto:sales@halykfinance.kz)

**Address:**

Halyk Finance  
Abay av., 109 «B», 5th fl  
A05A1B4, Almaty, Kazakhstan  
Contact. +7 727 357 59 77  
[www.halykfinance.kz](http://www.halykfinance.kz)

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