Macroeconomic report 2Q2019

07 August 2019

Growth of the economy of Kazakhstan remained above 4% in the first half of 2019, demonstrating resistance to lower oil prices and the suspension of oil production in Kashagan due to high investment activity in the extractive sector and increasing government spending to compensate for weakening external demand. Inflation has slowed to 5.4% from 5.9% a year earlier, and the unemployment rate fell slightly to 4.8% from 4.9%. However, we note growing inflationary pressures and continued dependence on oil revenues. Based on the current dynamics of the main macroeconomic factors, we expect GDP growth of 4% in the base case for 2019, inflation at 5.4%, and the national currency - 385 tenge per dollar at the end of this year.

The economy has maintained growth rates above 4%, despite declining production volumes and oil prices. The growth of the economy of Kazakhstan in the first half of 2019 slowed down slightly to 4.1% from 4.2% in 1H2018, while in April-June, the economic growth was about 4.4% yoy the highest since the 2nd quarter of 2017. The average level of oil prices decreased by 7% yoy to $66 per barrel in 1H2019, and production decreased by 2% yoy to 44.3 million tons. From a sectoral perspective, a slowdown in industry and agriculture is evident, while the transport sector, trade, and construction have been a significant drivers of economic growth. In the first half of the year, there was also a strong growth of investments in fixed assets in the amount of 11.7% yoy, however, according to our estimates, the share of raw materials industry in the growth of all investments amounted to almost 100%. After spring scheduled maintenance at Kashagan a planned shutdown of oil production at the largest oil field in Kazakhstan - Tengiz is expected this fall, the production volumes of which are twice as high compared to Kashagan. In addition, scheduled repairs will also be carried out on Karachaganak. As a result, according to the results of the current year, oil production will drop to 89 million tons from 91 million tons in the past year, which will negatively affect the performance of industry and exports. The effect of stops at the three largest fields of the country and unfavorable external conditions in the current year will be smoothed out by an increase in government spending to 20.5% of GDP from 19% of GDP in 2018.

The current account deficit in the first half of 2019 expanded to $2bn, and there was also capital outflow on the financial account by $4bn. According to preliminary data from the NBK, a positive account balance of $361mn in the first quarter of 2019 was covered by a deficit of $2,347mn. in the second one. The expansion of the current account deficit was facilitated by a decrease in the trade balance by 10.3% yoy $11.3bn. At the same time, the nominal export volume grew by 1.1% yoy and amounted to $28.5bn, while imports increased by 10.2% yoy and amounted to $17.3bn. The widening of the deficit in the balance of services account in the first half of this year by 13.9% yoy to $2.2bn also contributed to the expansion of the current account deficit. According to the financial account, there was an outflow for two consecutive quarters and for the first half of 2019 amounted to $4bn. Thus, according to the country's external accounts, the total outflow amounted to about $6bn.

Growing inflationary pressures and an increase in the share of the National Fund transfers in the budget revenue amid falling revenues from other sources. In the first half of 2019, despite the reduction in tariffs, inflation accelerated to a similar level a year earlier at 2.6%. Pressure on the consumer market is created by the weakening of the national currency, high inflationary and devaluation expectations of the population, increased inflationary budget expenditures and external factors. The revenue flow of the state budget for six months of this year is worse than in the last three years, against which the share of transfers of the National Fund increased to 29% of all revenues. The state budget deficit in January-June expanded to -T112 billion from -T79 billion in the same period in 2018, but is within the planned limits. The use of the National Fund in 1H2019 exceeded the receipt of funds.

Growth of demand for consumer loans and real wages amid unprecedented government measures to reduce the debt burden of the population. Consumer lending, which showed double-digit growth in real terms in the first quarter, began to show an increase in activity in the second (13.4% yoy vs. 14.1% yoy). The labor market experienced a slight weakening in demand for labor, the number of employees at the end of June amounted to 8.8 million. Real wage growth was around 7.4% yoy. Together with an increase in demand for consumer loans, this stimulates trade turnover, showing growth above 5%.

Amid a slowdown in the global economy, the national currency of Kazakhstan will remain at approximately current levels to stimulate Kazakhstani exports. Despite lower oil prices, the exchange rate of the tenge in the first half of the year was on average at 379 per US dollar, while against the Russian currency it weakened by 8% to 6.1 per ruble, although the Russian economy did not demonstrate a faster pace of economic growth. "Weaker" tenge until the end of the year will contribute to a better execution of the state budget, which was made up based on 370 tenge per dollar and 55 dollars per barrel of oil. Maintaining a balance of interests of the external (exporters) and domestic sector (population), the NBK will most likely refrain from a significant weakening of the national currency, provided that there is no significant "drawdown" in oil quotes.

Monetary conditions, despite the reduction in the base rate, remained neutral. In the second half of June this year, the NBK placed short-term notes at rates of return (about 9.5-10%) significantly higher than previous placements (8.7% - 9.0%). The shift in rates of return occurred by 0.7% -1.0% up. At the same time, money market rates formed at the level of the lower boundary of the base rate corridor. The actions of the NBK in terms of increasing the yield on its instruments without tightening monetary conditions by raising the base rate are aimed at moving excess volumes of liquidity from short placement terms to more distant ones.

International reserves. Gold holdings reached a share of 60.4% of international reserves, which fell by almost 9%. According to the NBK, the consolidated international reserves of Kazakhstan in June 2019 amounted to $88.2bn, having decreased by 2.8% since the beginning of the year due to a decrease in the NBR gold reserves by 8.8% to $28.2bn, the size of the National Fund increased by 3.4% to $60.0bn. The NBK significantly reduced its holdings in securities from $10.1bn at the beginning of the year to $7.2bn in June (-29.5%), as well as in foreign currency and deposits by 42.4% to $3.2bn. In the structure of NBK assets, the volume of gold in nominal terms increased by 18.5% from the beginning of the year and amounted to $17.1bn or 60.4% (the maximum value for the entire observation period). In June, the revenue of funds in the NF increased 3.2 times in annual terms and amounted to T1.952bn or $5.1bn (+ 32.5% m / m). Direct tax revenues from oil companies increased by 10.5% yoy to T1.516bn.

In the base case we expect GDP growth of 4% in 2019, inflation at 5.4%, and the national currency rate - 385 tenge per dollar at the end of the year. As a result of the escalation of trade disputes of the largest countries and the growth of uncertainty regarding the further actions of world central banks, a slowdown in global economic growth is expected. In particular, the IMF lowered its forecast for global economic growth to 3.2%, and global trade growth to 2.5%. Quotations of black gold react extremely weak to reduced production under OPEC + agreements and growing geopolitical risks (hijacking of tankers, instability in individual oil-producing countries), which may indicate weakening demand. Accordingly, our expectations for oil prices are shifting down from $68 to $65.4 per barrel this year. Thanks to numerous government measures to stimulate consumption, domestic demand in the economy of Kazakhstan compensates for the weak external environment and will support economic growth. At the same time, we see the risks of a more significant increase in consumer prices as a side effect of a sharp increase in social spending with a parallel depreciation of tenge. The forecast for GDP growth was increased from 3.6% in 2019 and 2020 to 4% and 4.2%, respectively. The forecast for the tenge exchange rate at the end of this and the next year against the US dollar was revised downward from 375 to 385 (baseline scenario). We implemented scenario forecasts of the main macroeconomic indicators with a symmetrical deviation from the baseline scenario, assuming an average annual oil price of $65.4 per barrel in 2019 and $65 per barrel in 2020. Pessimistic - the average annual price of $60.4 per barrel in 2019 and $55 per barrel in 2020, optimistic - the average annual oil price of $70.4 per barrel in 2019 and $75 per barrel in 2020.

Main macroeconomic indicators	2017	2018	Base		Pessimistic		Optimistic	
	Fact	Estimate	2019	2020	2019	2020	2019	2020
Oil Brent, average, USD/bbl.	54.0	71.0	65.4	65.0	60.4	55.0	70.4	75.0
Real GDP, % yoy	4.1	4.1	4.0	4.2	3.8	3.6	4.2	4.6
Exchange rate USDKZT, eop	332.0	384.2	385.0	385.0	394	405	370	375
Exchange rate USDKZT, average	326.0	344.7	382.5	385.0	387.0	399.5	377.5	372.5
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	16.8	18.1	16.8	18.3	16.6	17.4
Government debt, % GDP	25.4	25.8	25.3	24.8	25.8	25.7	24.7	23.3
Budget balance consolidated, % GDP	-7.4	-0.2	-2.1	-0.3	-2.4	-0.4	-2.3	-0.3
Current account, % of GDP	-3.1	0.0	-0.9	-0.2	-1.1	-1.0	-0.4	0.9

Sectors of the economy

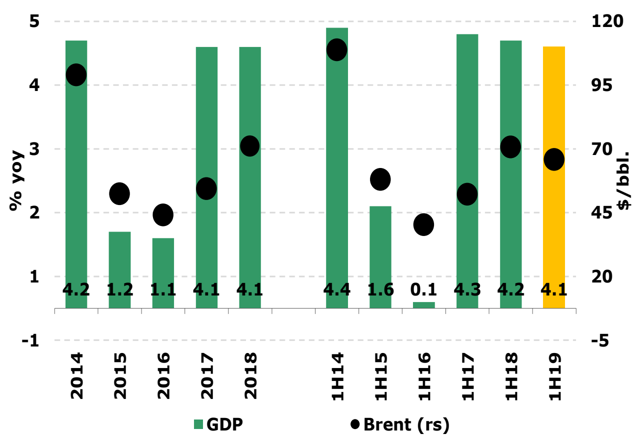
The growth of the economy of Kazakhstan in the first half of 2019 slowed down slightly to 4.1% yoy from 4.2% yoy in 1H2018 (Fig. 1), while in April-June there was a rather high economic growth at around 4.4% yoy, which is the strongest growth since the 2nd quarter of 2017 (4.9% yoy) and much better than less than 3% registered in January. A marked acceleration of economic growth from 3.8% yoy in the first quarter of this year occurred despite the shutdown of oil production at Kashagan in April-May, it is expected that production growth at this field will reach 400 thousand barrels per day, and overall yearly production volumes may increase there by more than 10% compared to last year.

The increase in oil prices observed in the first quarter continued in the second, amounting to $68 per barrel against $63 per barrel in the first quarter. In annual terms, the cost of oil in 1H2019 was lower by 7% ($66 compared to $71 per barrel). Bear in mind, that this fall a planned shutdown of oil production at the largest Kazakhstani Tengiz oilfield is expected, whose production volumes are about two times higher than at Kashagan and, as a result, this will more strongly affect the indicators of industrial production and exports, in addition, it is expected that Karachaganak will also carry out scheduled repairs. Thus, this year the effect of planned technical works at the three largest fields in the country, which form 60% of all oil production, will be offset by large government spending, whose planned level is increased by 1.5pp to 20.5% of GDP from 19% of GDP in 2018.

Comparative data on key economic indicators in the first half of this year looked pretty good (Fig. 2). Inflation slowed down to 5.4% yoy from 5.9% yoy in 1H2018, although the cumulative result for 6 months remained at 2.6%, the same as in the last year. The unemployment rate slightly decreased to 4.8% from 4.9% in 1H2018, it can also be noted here that employment growth in June this year slowed to 1.3% yoy, which corresponds to the figure of June 2018. As a whole, it can be stated that the situation in the economy is stable and is supported by high investment activity in the extractive sector, increasing government spending, and acceptable oil prices above $60 per barrel.

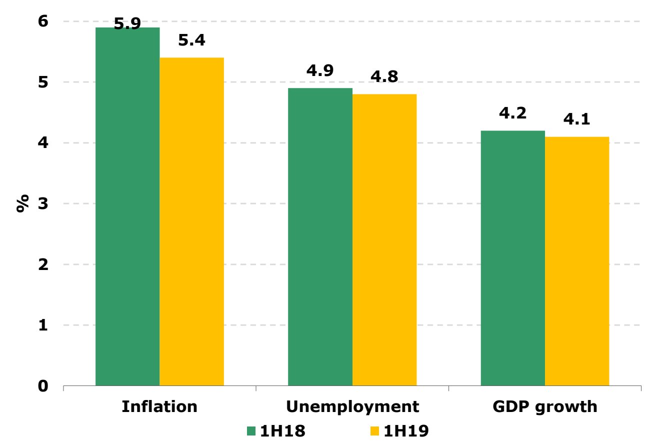
Breakdown by industry demonstrate that, there was a further slowdown in industrial production growth to 2.6% yoy in the first half of 2019 (5.2% yoy in 1H18), agricultural output weakened to 3.8% yoy (4.0% yoy in 1H18). At the same time, transport sector markedly improved to 5.3% yoy (4.9% yoy in 1H18), in trade 7.5% yoy growth (5.9% yoy in 1H18) and the acceleration of growth in construction lead to 11.1% yoy (3.8% yoy in 1H18). The construction industry is growing mainly due to an increase in works in the extractive sector, while in trade the growth is due to an increase in the wholesale trade of oil, which by the way looks contradictory, given the decrease in oil production and its export.

Figure 1. Oil prices and economy



Source: *CS MNE, Halyk Finance*

Figure 2. Inflation, unemployment, GDP



Source: *CS MNE, Halyk Finance*

Branches of the economy

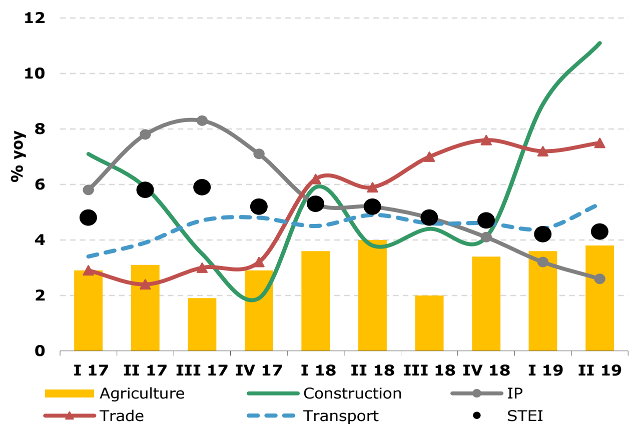
According to the results of the first half of 2019, the short-term economic indicator came in at 4.3% yoy, showing the best result for 6 months, sequentially accelerating from 2.9% yoy in January and 4.2% yoy in January-March. In quarterly terms, the growth of the short-term economic indicator shows a gradual deceleration from the second half of 2017 against the background of a decrease in the dynamics of industrial production and a higher base of 2017-2018. (Fig. 3). The short-term economic indicator is primarily supported by the construction industry and trade. The volume of construction works in 1H2019 increased by 11.1% yoy, and such a strong growth was not observed even during the construction boom on the eve of EXPO2017. However, unlike that period, the main contribution to the growth of construction now comes from the expansion of oil production capacities. For example, the growth of construction in the Atyrau region for 6 months reached 35%, and the share of the region in the total construction volume is more than 21%. At the same time, according to the results of the 1st quarter of this year, the gross regional product of this region increased by 15% yoy, while construction volumes in the city of Nur-Sultan, on the contrary, fell by 19% yoy, while the GRP in the first quarter decreased by 0.6% yoy.

Prices of manufacturers of industrial products, taking into account industrial services, increased by 10.2% yoy in June, in production – up by 14.4% yoy, in manufacturing – up by 7.5% yoy, in the field of industrial services – went up by only 0.3% yoy.

Industrial production in 6M2019 increased only by 2.6% yoy, compared to the previous month, the growth was 6.8%. The resumption of oil production at Kashagan after the repair can be considered as the most important factor in maintaining a positive growth of industrial production. Out of 17 regions 10 regions demonstrated a decline of production in June, including the cities of Almaty and Shymkent. In the mining industry, output increased by 2.1% yoy with a drop in oil production by 2% yoy for 6 months, which was affected by a decrease in production at Kashagan. At the same time, oil production against the previous month grew by 12.3%, which indicates a rapid recovery in output volumes. Metal ore production increased by 16% yoy, driven mainly by an increase in the copper ore segment, iron ore mining showed a decline of 0.9% yoy.

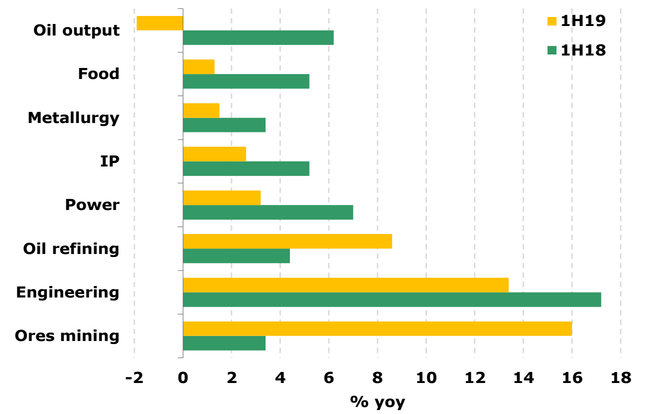
The growth in manufacturing amounted to 3.4% yoy in 6M2019, in oil refining an increase of 8.6% yoy, in non-ferrous metallurgy – by 8.9% yoy, in machine building – by 13.4% yoy, electricity generation added 3.2% yoy. The consequences of the accident at Arcelor Mittal Temirtau at the end of 2018, as well as lower prices for ferrous metals, which decreased by 14% yoy, still affect output in the industry, which showed a decline of 7% yoy.

Figure 3. Trade and construction the fastest



Source: CS MNE, Halyk Finance

Figure 4. Industrial output slower



Source: CS MNE, Halyk Finance

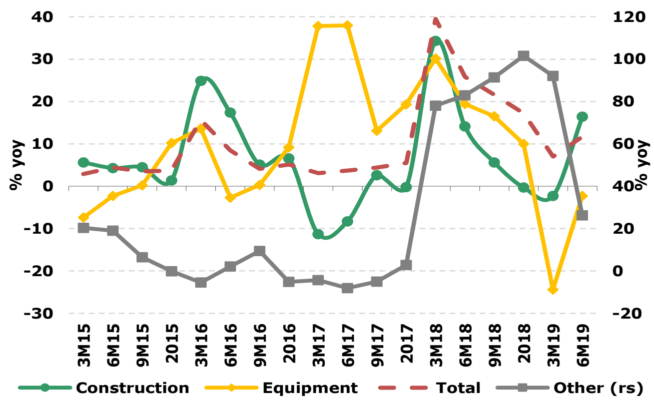
Investment

The growth of investments in fixed assets in 1H2019 intensified again and reached 11.7% yoy after 7% yoy in the first quarter, although it was weaker than 25.8% yoy in 1H2018. Strong investment growth is explained by the increase of investments in the commodity sector, primarily in the project to expand mining capacities at Tengiz. Over 6 months, investments in oil and gas production increased by 30.8% yoy, while they accounted for 44% of all realized investments (Fig. 5). It is worth noting that due to the strong growth of investments in the oil and gas sector, the accrued growth of investments in the first half of 2019, according to our estimates, depended by more than 80% on this sector, and the total share of mining industry in the accrued growth of all investments amounted to almost 100%. Thus, judging by the structure of investments at this stage, the future development of the economy will entirely depend on the volatile extractive sector, although this industry provides only 3% of the total employed population with work. At the same time, almost complete absence of growth in investments in the non-primary sector emphasizes the presence of systemic problems for doing business.

Investments in the manufacturing industry fell by 38% yoy, which is explained by the fact that almost half of all investments in this sector last year were secured by investments in oil refining, where the bulk of it fell on the Shymkent oil refinery. In addition to oil refining, investments in the food industry decreased (-34.7% yoy), in pharmaceuticals (-38% yoy), and in furniture manufacturing (-60.8% yoy). On the contrary, investments in metallurgy increased +38% yoy, in the production of motor vehicles +95% yoy, in the production of rubber and plastics +52% yoy in chemistry +124% yoy. The share of investments in manufacturing industry amounted to 7% of the total volume, 14% of all investments were invested in real estate operations with an increase of 2.9% yoy, 8% in the transport industry with a decrease of 33% yoy, 4% was invested in agriculture with an increase of 62.7% yoy, 5% in electricity and related segments with an increase of 56.5% yoy.

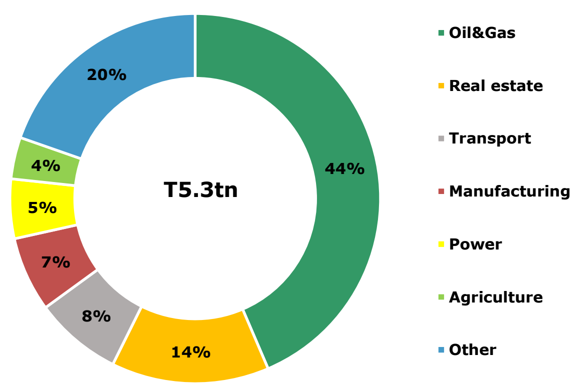
Investments in housing construction amounted to T605.7 billion (+15.5% yoy) for 6M2019. State programs support high activity in the housing construction market, hence, the share of state investments in housing construction reaches 32.5% in East Kazakhstan, 34% in Northern Kazakhstan, 29% in Shymkent, 37% in Pavlodar. Housing commissioning for the first half of this year decreased by 1.9% yoy to 5.7 million sq.m. In the city of Nur-Sultan, housing commissioning decreased by 36.8% yoy to 859.4 thousand sq.m., in Almaty there was a slight increase of 2% yoy to 954.4 thousand sq.m., in general these two cities accounted for about 32% of all commissioned housing in the republic. In almost all areas except Mangistau, there was an increase in housing commissioning, for example, housing commissioning in the newly formed Turkestan region almost doubled over the period. In turn, prices for primary housing for the year from June 2018 to June 2019 increased by 7%, in Nur-Sultan they increased slightly by 5.4%, in Almaty by 3.3%, in Karaganda has not changed, 10.6% added prices in Kostanay, about 20% each in Semey, Taraz, Pavlodar.

Figure 5. Investment dynamics



Source: CS MNE, Halyk Finance

Figure 6. Structure of investments



Source: CS MNE, Halyk Finance

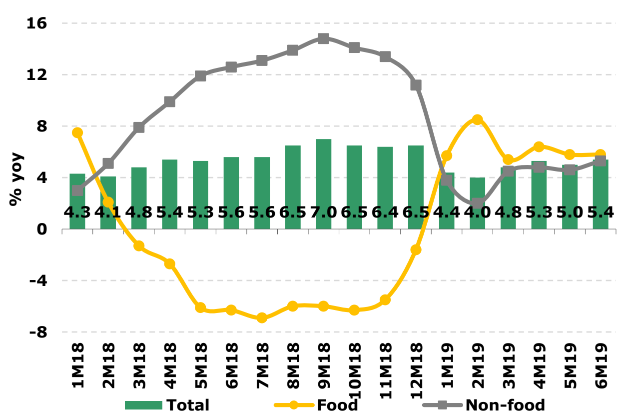
Trade

Retail trade, started the year with an increase of 4.4% yoy in January, gradually accelerated to 5.4% in 6M2019 (Fig. 7), which is only slightly lower than 5.6% yoy in the same period of 2018. Its main components, food and non-food products trade turnover, showed similar dynamics, having increased by 5.8% yoy and 5.3% yoy, respectively. Retail trade growth is ahead of economic growth. Among the drivers of increasing retail turnover, we can note an increase in the minimum wage, salaries of public sector employees and pensions from the beginning of this year, tax breaks, lower tariffs for communal services, and containment of fuel prices. In addition, starting in June, a major increase in public sector salaries was planned, employing nearly 2 million people. At the end of June 2019, the President signed the Decree "On measures to reduce the debt burden of citizens of the Republic of Kazakhstan", which provides for the repayment of debts on unsecured consumer loans for certain categories of citizens in banks and microfinance organizations in the amount of up to T300 thousand per head, writing off to all citizens of Kazakhstan accrued fines and penalties for unsecured consumer loans. Budget expenditures on these measures will amount to T89.2 billion and T17.5 billion from the issuance of Problem loans fund's bonds.

It is interesting to note that against the backdrop of unprecedented measures by the state to reduce the debt burden of the population, the demand for loans from the population has increased even more. Consumer lending, which showed double-digit growth rates in real terms in the second quarter, began to show increased activity, for example, if in the first quarter the volume of consumer loans was T854 billion (T711 billion 1Q2018), then in April-June amounted to T1.1 trillion (T930 billion April-June 2018), thereby the demand for consumer loans remains high and may even increase in the second half of this year.

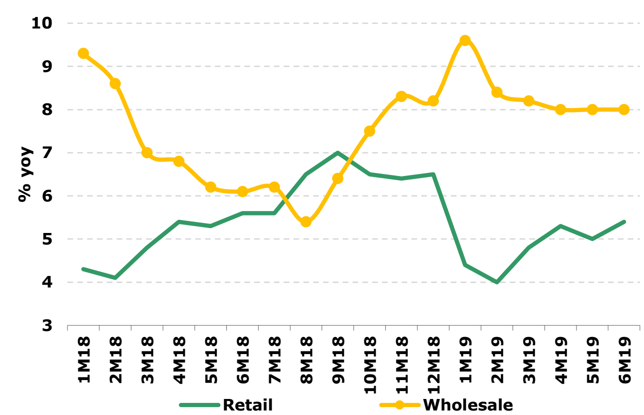
The growth of wholesale trade turnover after the inclusion of oil and oil products trade last year is kept at 8%, while the contribution of oil trade, according to our estimates, is approximately 2.5ppt, which is higher than the contribution of all trade in Almaty, which accounts for almost half of the republic's wholesale trade at 2.1pp. This leads to an increase in economic growth by approximately 0.3 pp, but does not imply any real contribution to economic growth, helping to achieve the targeted by the government economic growth at 3.8% this year.

Figure 7. Retail sales



Source: CS MNE, Halyk Finance

Figure 8. Wholesale and retail sales



Source: CS MNE, Halyk Finance

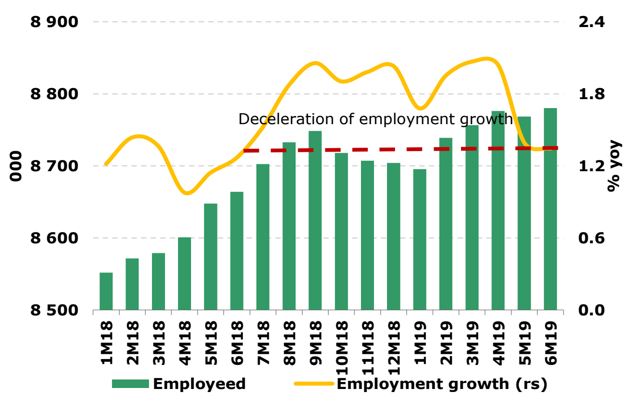
Labor market

Based on the statistics, the employed population grew by 1.3% yoy and amounted to 8.8 million in the second quarter of 2019 (8.7 million at the end of 2Q2018). Employment growth has been observed continuously since the end of 2017, but in the second quarter, the trend of accelerating employment growth went in reverse after a peak of 2.1% yoy in March 2019 and returned to 1.3% yoy in June last year (Fig. 9). Against this background, the unemployment rate remained at a minimum level of 4.8% since the second half of 2018.

In the first quarter, there was a strong demand for workers in other services by 21.4% yoy (+51 thousand employees), in the utility sector +13.7% yoy (+10 thousand employees) in the field of art, entertainment and recreation – an increase of 12.8% yoy (+17 thousand employees). The reduction in the number of employees was observed in real estate transactions – 7.4% yoy (-11 thousand employees), in telecommunications – 6.3% yoy (-12 thousand employees). The employment structure in the first quarter of 2019 did not change for the year, the service sector provided employment for 73% of employees, the largest share of employees was noted in trade 16%, in agriculture 13.8%, 12.6% in industry and education each, 7.3% in transport sector, 7.2% in construction, 5.7% in healthcare and 5.6% in government.

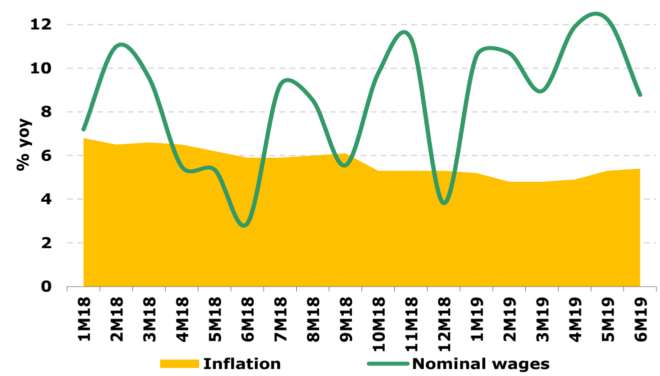
The average monthly wage in June 2019 increased by 8.8% yoy to T178 thousand. Recall that this year the minimum wage was increased by 50% to T42.5 thousand. As a result, there has been an increase in salaries by an average of 13% over the 6 months of this year, which is noticeably higher than 7% on average in the same period last year. Thus, the growth in real wages amid a slowdown in inflation was at about 5%, which is largely the result of the state's initiative to improve the welfare of the population, according to which it is planned to spend about T1 trillion over the span of next three years on increase of wages.

Figure 9. Job growth and employment



Source: CS MNE, Halyk Finance

Figure 10. Wages on a growing path



Source: CS MNE, Halyk Finance

Fiscal policy

State budget revenues (excluding transfers from the National Fund) for January-June 2019 increased by 14.8% yoy and amounted to T4.4 trillion. Tax revenues of the state budget added 15.3% yoy to T4.2 trillion or 46.7% of the annual plan, which is a rather weak indicator compared to 47.6% for 6M2018, and 48.3% for 6M2017. The income from CIT increased by 17% yoy, IIT – by 2% yoy, social tax – by 11% yoy, VAT – by 27% yoy, excise taxes – by 8% yoy. Transfers from the National Fund grew by 27% yoy, thus, the state budget revenues were by 29% generated from transfers, which is higher than the 27% in the same period of 2018.

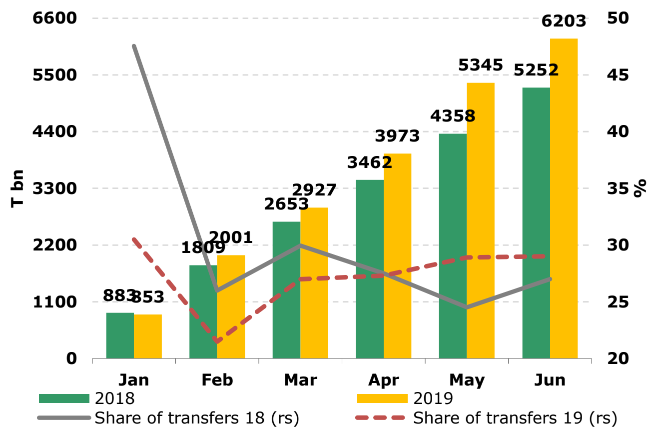
Corporate income tax revenues show good growth, for example, over the same period of 2018, their growth was only 4.6% yoy, which may indicate, among other things, improved tax administration, weaker taxes from banks in 2018. A sluggish increase in income from IIT by 2% yoy is in contradiction with the nominal increase of salaries by 13% yoy. Such a decrease in the growth of income from IIT cannot be explained by the reduction in IIT for low-wage workers, which has been implemented since the beginning of the year, so for the budget the losses from this measure are low. Recall that from 2019, the size of IIT was reduced by 10 times for people with a salary of less than 25 MCI (T63 thousand) per month. According to government agencies, more than 2 million people receive such a salary, mainly in agriculture and trade. The increase in VAT revenues by 27% is slightly ahead of the growth of the nominal trade turnover by 12% yoy and the increase in imports by 18% in January-June 2019. Note that this year the list of activities that are required to use online cash desks has been expanded, which could also contribute to an increase in collection sums.

State budget expenditures increased by 16.8% in January-June 2019 and amounted to T6 trillion (40.4% of the plan, 44.9% for 6M2018). Spending on defense increased by 11.5% yoy, spending on other government services increased by 14% yoy. Due to the increase in pensions and benefits, social security expenses increased by 24% yoy. Expenditures on the economy increased by 20% yoy: transport, industry, agriculture, etc. Public debt servicing expenses increased by 28.2% yoy, which can be attributed to weakening tenge this year, and the tangible share of external borrowing that accounts for a third of the total public debt. Expenses under the item "Other" increased significantly, where the largest expense item is the targeted transfer of T390 billion for the Astana International Financial Center Administration.

The balance of the state budget in January-June 2019 developed with a deficit of T112 billion (-T79 billion for 6M18), while planned for the whole year deficit stand at T1.4 trillion for 2019 or 2.1% of GDP, against 1.5%, previously planned before the introduction of changes in relation with an increase in government spending this year.

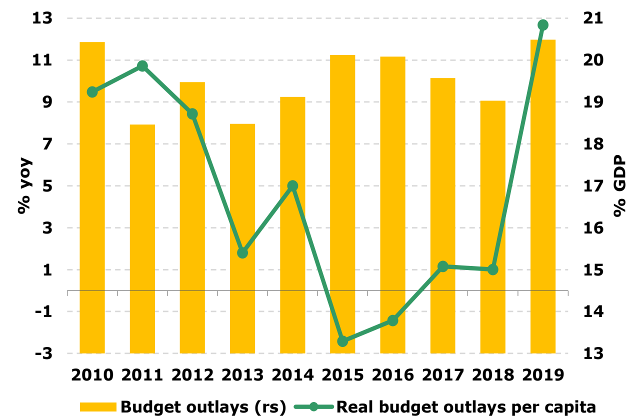
Per capita budget expenditures this year reach T61 thousand per month, increasing by almost 20% from T51 thousand in 2018. In real terms, their growth will be at approximately 13% yoy, which is the highest reading since 2010-2011, when there was an increase in spending on anti-crisis measures that, however, were not fully effective. As practice shows now, based on the example of KazAgro, which the President criticized, government spending was inefficient and often financed non-viable projects, that later turned into bad loans on the balance sheets of individual second-tier banks. Here you can also recall the investigation of the theft of budget funds during the construction of LRT in the city of Nur-Sultan. Thus, it becomes obvious that the economic return from numerous projects implemented at the expense of the budget is significantly thwarted and, accordingly, economic growth could have been higher if macroeconomic management relied more on market mechanisms. The current increase in the stimulatory effect is expressed in an increase in the share of state budget expenditures by 1.5 pp to 20.5% of GDP (Fig. 12) and, as we believe, is already leading to accelerated economic growth, while the external environment has somewhat worsened.

Figure 11. State budget revenues



Source: Minfin RK, Halyk Finance

Figure 12. State budget expenditures



Source: Minfin RK, Halyk Finance

National fund

Revenues to the National Fund for 6M2019 from the oil and gas sector increased by 10.5% yoy to T1.5 trillion. For all taxes except the mineral extraction tax, strong growth was observed. Note that the mineral extraction tax revenues substantially depend on the one-time payments of the subsoil developers.

The amount of the National Fund's expenditures increased by 26% yoy to T1.8 trillion due to the introduction of a targeted transfer in the amount of T370 billion this year. According to data for 6M2019, the use of the Fund's means exceeded tax revenues by T313 billion, therefore, the assets of the National Fund could grow only slightly this year, mainly due to investment income. The National Fund's assets amounted to T26.2 trillion at the end of May against T25.4 trillion at the beginning of the year, foreign exchange assets rose to \$58.7 billion from \$57.7 billion (85% of the total).

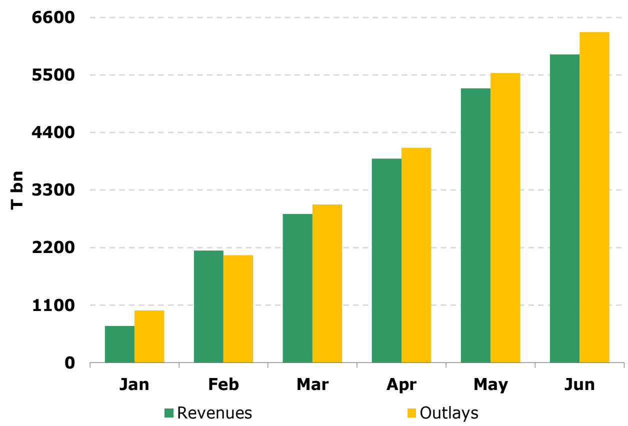
Consolidated budget

Oil revenues in consolidated budget (including operations of the National Fund) showed an increase of 13% yoy in 6M2019 due to an increase in physical volumes of oil export by 3% yoy, an increase in revenues of National Fund by 10% and a weakening of tenge by 14%, which offset the drop in oil prices by 7% yoy. At the same time, the share of oil revenues in the consolidated budget revenues increased to 35%, from 26% in January 2019, steadily increasing together with rising oil prices. Non-oil revenues increased by 14% yoy, which turned out to be better than the indicator for 6M2018 at 11%. The total revenues of the consolidated budget increased by 14% yoy and reached T5.9 trillion (Fig. 13).

Consolidated budget expenses increased by 18% compared to the corresponding period of 2018. Consolidated budget deficit increased to –T425 billion against a surplus of T156 billion in January-June 2018. The deficit in 2019, in our estimates, will reach 2.1% of GDP and will increase from -0.2% in 2018.

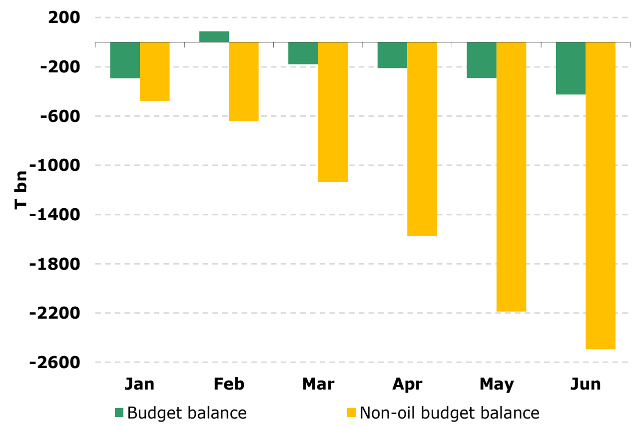
The non-oil deficit of the consolidated budget for 6M2019 amounted to T2.5 trillion and increased compared to –T2 trillion for 6M2018.

Figure 133. State budget (consolidated)



Source: Minfin RK, Halyk Finance

Figure 144. Budget balance (consolidated)



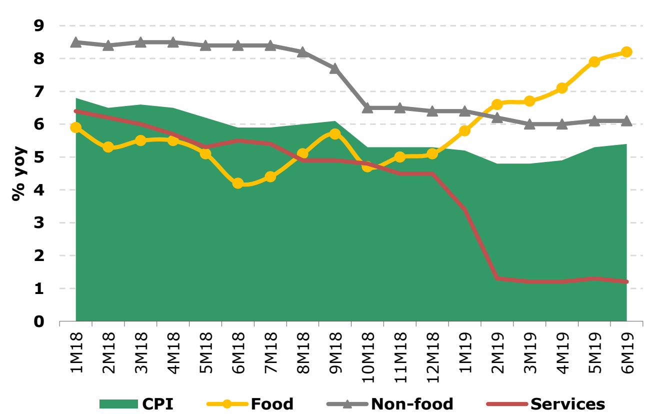
Source: Minfin RK, Halyk Finance

Inflation

According to the results of first half of this year, inflation increased by 2.6% from the start of 2019 and have equaled the same figure in 1H2018. In annual terms, the inflation rate slowed to 5.4% from 5.9% a year earlier. The main contribution to the price increase over the six months of this year was provided by food products (2.2pp out of 2.6%), non-food products added 0.7pp, which is approximately the same as last year, while services under the influence of state intervention took away -0.3pp out of the total increase in consumer prices (Fig. 15,16). At the beginning of this year, tariffs for housing and communal services were cut and frozen, which immediately affected the decline in the cost of services as a component of the consumer price index by 1.5% in February. However, due to rising food prices and pro-inflationary pressures, including those caused by increased spending by the state budget, at the end of first half of this year, services have already reduced the fall to 0.9%, i.e. the effect of tariffs regulation is gradually decreasing. At the same time, the actual inflation rate could have been higher if it had not been for tariffs intervention and the weakening of the national currency.

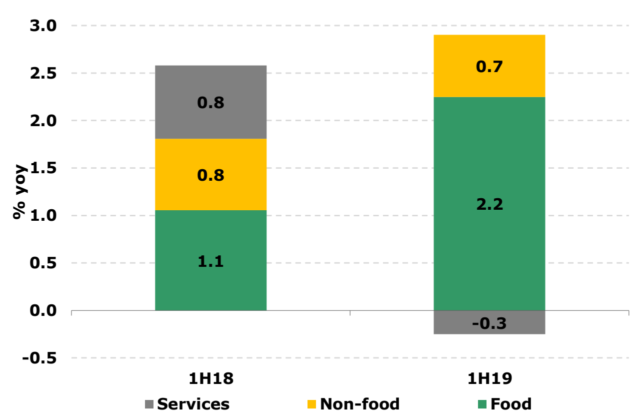
The results of June polls published by the NBK showed an increase in inflationary and devaluation expectations of the population. The proportion of respondents expecting acceleration in price growth in the next 12 months increased to 24.3% in June from 21.9% in May (18.9% in June 2018, 28.2% at the peak in September 2018). The share of respondents expecting a decrease or unchanged prices did not change from the previous month - 10.6% (8.5% in June 2018) with a minimum of 5.8% in October 2018. In June 2019, the percentage of respondents expecting a weakening of tenge vs. US dollar, rose to 67.1% compared with 65.7% in the previous month (49.9% in June 2018), which is slightly lower than 70.7% at its peak in September 2018. At the same time, the amount of net expenses of the population on the purchase of cash dollars in January-June increased by 140% compared to the same period in 2018 to T939.4 billion. June was a record month when the population acquired on a net basis more than $1 billion ($200-300 million in June 2017, 2018), which is the highest level since July 2015, it should be noted that the dollar was worth about half then – 187 tenge. Thus, it can be seen that the devaluation expectations of the population stand at a very high level.

Figure 15. Food inflation main driving force



Source: CS MNE, Halyk Finance

Figure 156. Components of inflation



Source: CS MNE, Halyk Finance

In contrast to the previous years, additional budgetary expenses related to the decision to increase the welfare of the population directly affect the consumer market, as they include increasing salaries, pensions, improving housing affordability, writing off expired consumer loans and many other measures. Naturally, prices in the consumer market are already adjusting to the expectations of higher demand. Despite the lack of pass-through effect of weakening national currency on current prices, this factor will show up sooner or later in official statistics. Recall that the weakening of the tenge against the dollar in January-June of this year amounted to 14% yoy, a similar change to the ruble amounted to slightly more than 5% yoy. In addition to internal factors, the situation in external markets is aggravating, in particular, the FAO (Food and Agriculture Organization of the United Nations) notes the increase in food prices in the world since the beginning of this year, which is also affected by floods and droughts in different parts of the world. Increasing inflationary and devaluation expectations of the population, which began to grow at the beginning of this year, are not far from the peak reached at the beginning of last fall, and accordingly, pressure on consumer prices is significant. According to our forecast, inflation will reach 5.4% by the end of this year.

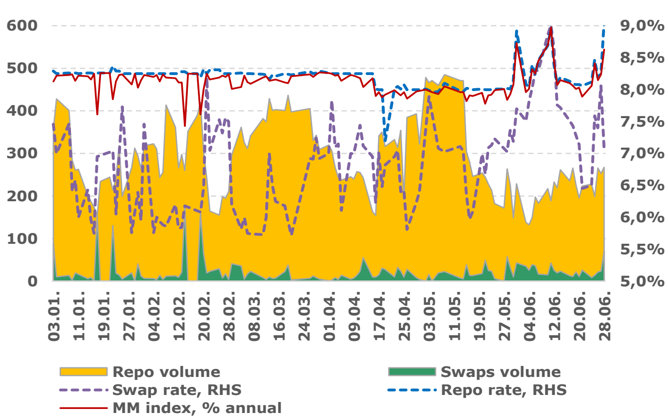
Monetary policy

Interest rate policy

During the first three months of this year, the base rate of the regulator remained unchanged at 9.25%, however, at the April meeting of the NBK, it was decided to lower the rate by 0.25% while maintaining the corridor for the provision and withdrawal of liquidity +/- 1%. The decision to lower the rate took place against the background of a decrease in annual inflation to 4.8% in March, which was accompanied by an increase in inflation expectations. At the same time, upward dynamics of oil prices was observed in global markets from the beginning of the year to $74.6 in April. Inflation in the Russian Federation reached 5.3% yoy in March. Domestic demand was supported by growth in real income, growth in business activity and growth in consumer lending. Monetary conditions, despite the reduction of the rate, remained neutral. At the June meeting, the regulator left the base rate at 9.0% while maintaining the interest rate band. The decision on the rate was taken against the backdrop of accelerated inflation to 5.3% yoy and increased volatility in the oil markets and low inflation in the countries of trading partners. Among the main risks hindering a further slowdown in inflation, which the regulator identified, were an increase in aggregate supply and domestic demand. The regulator pointed to the gap when the actual GDP is higher than the potential, which creates inflationary pressure on the economy. Domestic demand was still supported by growth in real incomes, expansion of consumer lending (+ 14.6% yoy) and an increase in the size of social payments and wages. The regulator estimated the contribution to inflation from the implementation of social initiatives not more than 0.3%.

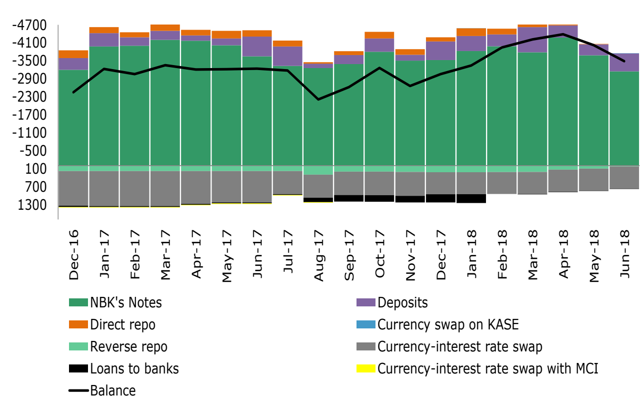
In the money market in the second quarter of 2019, 93.2% (91.3% in the 2Q2018) of all transactions were carried out as part of automatic repos with government securities in the amount of T16.807bn (+ 5.3% yoy), T15.955bn in 2Q 2018). The maximum transactions on automatic REPO operations fell in May and amounted to T471bn. The average rate on automatic REPO operations in the 2Q2019 amounted to 8.15% (8.30% in 2Q 2018), while the range of change in rates was 7.20 % - 9.04% (8.02% -9.08% in 2Q2018). As of the end of June, the rate on automatic repos was at 9.04% (8.02% in 2Q2018). In the second quarter of 2019, there was a decrease in the volume of automatic REPO transactions compared to the 1Q2019 by 2.5% qoq.

Figure 17. Money market rates and deals



Source: NBK, Halyk Finance

Figure 18. Excessive liquidity sterilization



Source: NBK, Halyk Finance

The share of USDKZT swaps in the second quarter of 2019 amounted to 6.8% (9.5% in 2Q2018) of all transactions in the money market. The total volume of USDKZT swaps in the second quarter of this year decreased by 11.5% qoq and amounted to T1.231bn. Rates on USDKZT swaps during the 2Q2019 varied from 5.81% to 9.01% with an average value of 7.17% in the period (6.44% -11.25% in the 2Q2018, with an average value of 8.14%). The maximum size of transactions amounted to T71.1bn with an average size of T20.8bn. A decrease in the share of USDKZT currency swaps in the money market occurs in conditions of excess liquidity in tenge.

The composite MM index in the second quarter of this year was at the level of 8.63% with an average value of 8.10% (7.82% at the end of the period with an average value of 8.30% for the 2Q2018). The total volume of transactions in the money market in the second quarter of 2019 increased by 3.2% yoy (-3.0% qoq) and amounted to T18.031bn.

Sterilization of liquidity with NBK notes at the end of June of this year amounted to T3 148bn, while the effective yield was at the level of 9.02% (8.67% in June 2018). Note that the NBK in the second half of June this year placed short-term notes at rates of return significantly higher than previous placements. The shift in rates of return occurred by 0.7% -1.0% up. At the same time, money market rates formed at the level of the lower boundary of the base rate corridor. However, we believe that money market rates will also gradually adjust upward. The actions of the NBK in terms of increasing the yield on its instruments without tightening monetary conditions by raising the base rate are aimed at moving excess liquidity volumes from short placement terms to more distant ones. In addition, by offering higher returns, the regulator increases the attractiveness of placing funds in tenge (compared to instruments in global markets with lower returns), not only for residents, but also for non-residents. And this, in turn, should provide additional support to the national currency in the context of volatility of energy prices.

As of the end of June this year, according to preliminary data from the NBK, the amount of excess liquidity amounted to about T4.3trn. (8.2% yoy, -17.0% qoq). In the structure of related liquidity, at the end of the period, a decrease in the volume of NBK notes with a simultaneous increase in the share of deposits and deposit auctions was observed.

Foreign currency policy

At the beginning of the second quarter of this year, the USDKZT exchange rate strengthened to 377.1, following the upward prices move of a barrel of Brent crude oil, which reached an annual high of $74.57 per barrel on April 20. Having reached its high, the uptrend gave way to a correction to the level of $59.97 per barrel in mid-June of this year. At that level, the tenge exchange rate amounted to 384.1 tenge per US dollar. At the end of the second quarter, a barrel of oil was adjusted to the level of $66.55, and USDKZT exchange rate reached 380.53 tenge per US dollar (384.2 tenge per US dollar at the beginning of the year).

Unlike the Kazakhstan tenge, the Russian ruble, on the contrary, was strengthening (+ 8.8% from the beginning of the year), having a solid support in the inflow of foreign capital into the sovereign debt of the Russian Federation. So, if for the whole last year the Ministry of Finance of the Russian Federation placed FBBs (financial borrowing bonds) in the amount of slightly more than 1.0trn. rubles (16.4bn US dollars), for the first two quarters of the current year, the volume of nominal placement of FBBs amounted to 1.1trn. rubles (17.7bn US dollars). At the same time, there is an increase in the share of non-residents in the structure of Russian debt to 30.1% (24% at the beginning of the year). In Kazakhstan the opposite trend is observed. Thus, according to the Central Securities Depository of the Republic of Kazakhstan, in the second quarter, there is a steady tendency in reduction of the nominal holding of government securities by non-residents from T173bn in April to T116bn in June, i.e. Kazakhstan tenge did not have support in the form of an inflow of short-term foreign investments, and therefore was more sensitive to oil prices downtrends. The strengthening of the Russian ruble (62.55 rubles per dollar at the moment) led to desynchronization of the movement of the national currency against the dollar with an increase in parity from 5.5 to 6.04.

In the first half of the year, the national currency rate moved within a rather narrow corridor, under resistance line, which we determined at the beginning of the year at 385 tenge per US dollar. We see the efforts of the regulator in terms of ensuring a stable exchange rate of the national currency through tightening of foreign exchange regulation and presence in the foreign exchange market. However, the policy of the "weak" tenge of the past leadership of the NBK led to an increase in public mistrust in the national currency, which is expressed, on the one hand, by high devaluation expectations (67.1% of respondents, the maximum value for the current year, believe that the dollar will rise in price). On the other hand, the population, despite higher interest rates on deposits in tenge, hedges its risks by converting its savings into US dollars. Statistics of US dollars sales by exchange offices shows a noticeable increase in US dollar buys by the population. So, if for 6 months of last year US dollars were purchased by the population in the amount of T392bn, then only in June of this year the population bought US dollars in the amount of T384bn, and for 6 months of this year the volume of dollars amounted to T939bn. People votes "with their feet" in favor of the US dollar. This trend may continue in the second half of this year.

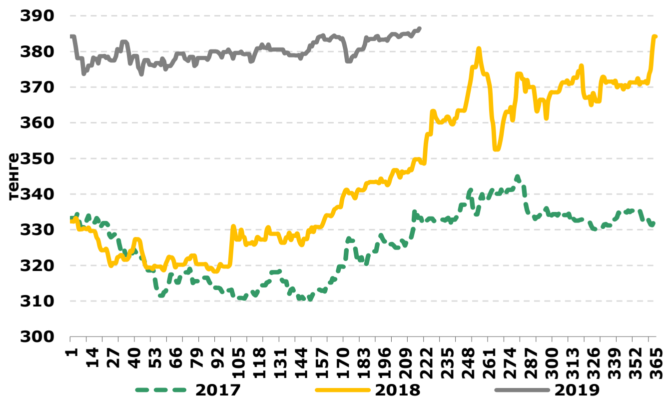
We believe that due to increasing uncertainty associated with the trade wars and, as a consequence, the slowdown in the global economy, oil prices will be $65 per barrel in 2019, which is three dollars lower than our previous forecast. In the second half of this year, we do not expect the imposition of sanctions against the state debt of the Russian Federation, and it will continue to be in demand from foreign investors, which will further support the Russian ruble. The ruble will also be supported by the level of energy prices at the level of $65 per barrel.

Fundamentally, for Kazakhstan, macroeconomic conditions are such that, against the backdrop of a slowing global economy and lower oil prices, the national currency of Kazakhstan will weaken slightly.

The "weak" tenge will also contribute to a better state budget execution (the budget was planned up on 370 tenge per dollar and 55 dollars per barrel). Maintaining a balance of interests of the external (exporters) and domestic sector (population), the NBK will refrain from weakening the national currency significantly above the levels of 385 tenge at the end of the period (provided that there is no significant "drawdown" in oil quotes).

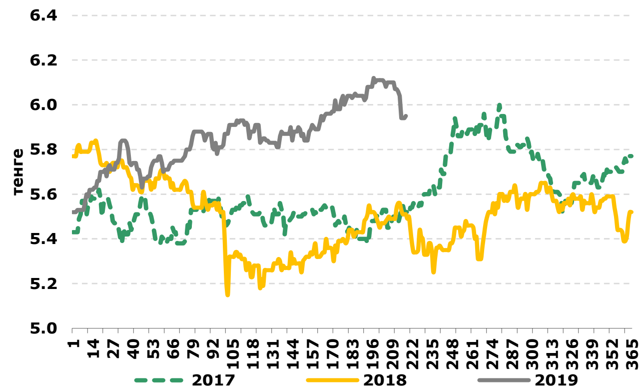
Based on the foregoing, we are shifting our forecast for the USDKZT pair to 385 tenge per dollar. The resistance line, which we determined at 385 tenge per US dollar at the beginning of the year, is shifting to 388. The support line, which we earlier determined at 374 tenge, is shifting to 377 tenge per US dollar.

Figure 19. USDKZT quotes change



Source: NBK, Halyk Finance

Figure 20. RUBKZT quotes change



Source: NBK, Halyk Finance

External accounts

Export and import in January-June 2019 (according to the latest data from the Committee on Statistics and the State Revenue Committee)

The imports from Kazakhstan in January-June 2019, according to preliminary statistics from the Committee on Statistics, increased by 7.9% yoy and amounted to $17.1bn, while export decreased by 1.6% yoy and amounted to $28.6bn. Foreign trade turnover for 6 months of this year increased by 1.7% yoy and amounted to $45.6bn.

There were no significant changes in the geographical structure of exports. A significant increase is observed in the share of China in the export structure (+ 4.6%) to 14.1%. For 6 months of this year, there has been a noticeable reduction in the share of Italy by 4.0pp to 14.8%. In the structure of imports, a decrease in the share of the Russian Federation by 3.1 pp to 36.6%, by 2.2 pp - in Germany to 3.6% and an increase in the share of the Republic of Korea by 5.7 pp to 7.4%.

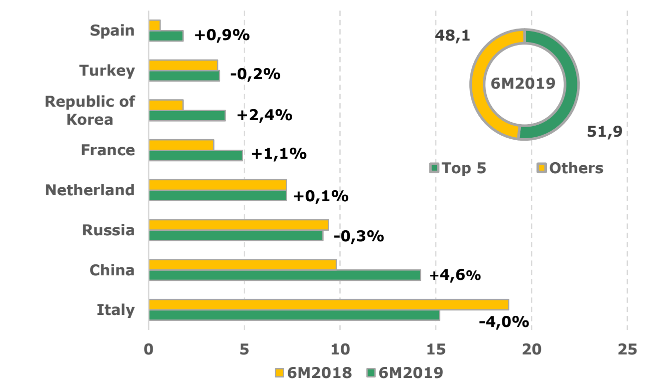
The concentration of Kazakhstani exports in the five main trading partner countries (with a share of ≥ 5%) for the six months of 2019 amounted to 51.9% and decreased by 4.0% in the same period last year. The concentration of imports across 5 Kazakhstan's trading partner countries (with a share of ≥4.2%) for the 6 months of 2019 increased by 4.5% to 69.0% in the analyzed period.

An analysis of the structure of exports from Kazakhstan evidenced that in January-June 2019, the share of mineral products decreased to 72.5% from 73.8% a year earlier. In nominal terms, the volume of exports of mineral products decreased by 3.3% yoy and amounted to $20.7bn. According to the Committee on State Revenues of the Republic of Kazakhstan, in January-June 2019, the physical volume of exports of crude oil and gas concentrate decreased by 0, 2% yoy and amounted to 34.6 mn tons. In nominal terms, this export item decreased by 6.6% yoy and amounted to $16.5bn.

A noticeable structural shift in the export deliveries of crude oil and gas condensate in January-June 2019 was observed from Italy, whose supply decreased by 16.4% yoy to 8.7 mn tons, and the share decreased from 30.0% a year earlier to 25.1%. A noticeable change is also observed on the part of Kazakhstani oil imports to the Netherlands, supply decreased by 39.6% to 3.2 mn tons, and the share fell from 15.2% to 9.2%. Crude oil exports to France increased by 5.7% yoy to 3.9 mn tons, while the share increased by 0.6% to 11.3%. Switzerland reduced the import of Kazakh oil and gas by 19.7% yoy to 2.4 mn tons, reducing its share in the supply structure from 8.6% a year earlier to 6.9% in January – June 2019. The Republic of Korea shows a positive dynamics of Kazakhstan's oil export growth, which grew by 43.8% in annual terms and amounted to 2.8 mn tons, while the share increased from 5.6% to 8.1%. Turkey is demonstrating a substantial 19-fold increase in the supply of crude oil and gas condensate to 1.6 mn tons, while increasing its share in the structure of crude oil exports from 0.3% to 4.7%. The six largest importers of Kazakhstan's crude oil and gas condensate account for 66.8% of all exports.

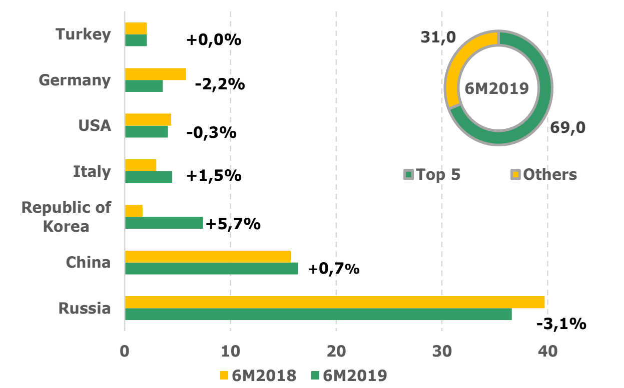
The export of metals and products from them, according to the Committee on Statistics, shows a decrease of 6.0% yoy in nominal terms to $4.1bn, while there is a decrease in the share in the export structure from 15.2% a year earlier to 14 , 5% in January-June. According to the data of the Committee on State Revenues of the Republic of Kazakhstan, in January-June 2019, there is an increase in supplies, due to which the reduction in the nominal value of the export of metals due to lower prices is compensated. Exports of raw zinc in physical terms doubled to 131 thousand tons, while in nominal terms the value of exports increased by 54.4% yoy to $321 mn (quotations on global markets -12.6% yoy). Unprocessed lead exports in physical terms increased by 81.6% to 67.3 thousand tons, while in nominal terms, export value increased by 0.4% yoy to $88mn (quotes in global markets -19.8% g / g). An increase in the physical supplies of refined copper by 14.2% yoy to 225 thousand tons offset the decrease in the cost of metal in global markets by 10.8% yoy and export in nominal terms increased by 2.2% yoy and amounted to $1.3bn.

Figure 21. Exports by country, %



Source: CSK ME, Halyk Finance

Figure 22. Imports by country, %



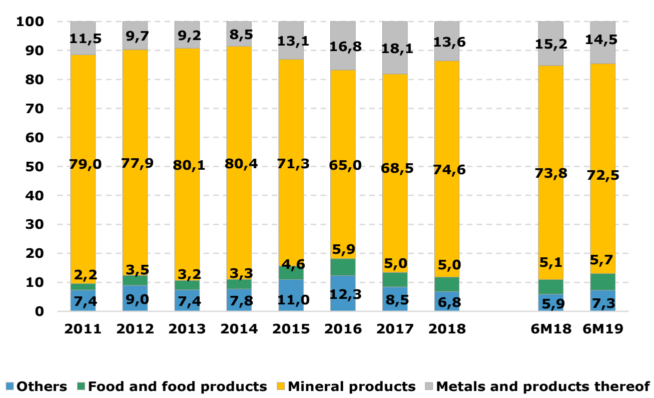
Source: CSK ME, Halyk Finance

The raw material concentration of Kazakhstan's exports of those two largest export items decreased in January-June 2019 to 87% against 89% in the same period last year.

The third largest Kazakhstan export item - animal and vegetable products, prepared food products, increased in the analyzed period to 5.7% from 5.1% in January-June 2018. In nominal terms, the share grew by 10.8% yoy to $1.8bn. In January-June 2019, there was a significant increase in the export of meat and offal by 66.4% yoy to 2.4 thousand tons. At the same time, the value of exports increased by 74.6% to $11.5mn. Iran is the largest importer of Kazakhstan's meat with a share of 71.9%.

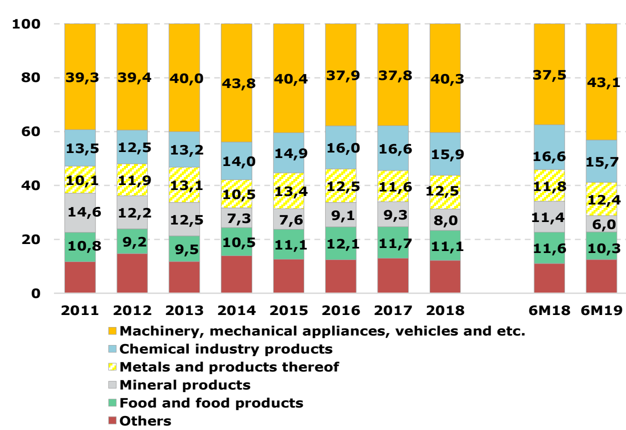
Exports of wheat and a mixture of wheat and rye decreased by 3.2% yoy to 2.7 mn tons, however, in value terms, exports grew by 15.0% yoy and amounted to $497mn. About 39.8% of the volume Uzbekistan imported all Kazakhstan's wheat exports. Growth in barley exports amounted to 7.5% yoy to 803 thousand tons or $153mn (+ 24.7% yoy). The share of barley exports to Iran amounted to 93.0% of all barley exports in the period. Rice export increased by 32.9% yoy to 39 thousand tons or $11.4 mn (+ 19.8% yoy). The main importing countries of Kazakhstani rice were Uzbekistan (48.4%) and Tajikistan (40.3%).

Рисунок 23. Goods exports' structure



Source: CSK ME, Halyk Finance

Рисунок 24. Goods imports' structure



Source: CSK ME, Halyk Finance

In the export structure in January-June 2019, an increase in the share of the article "machinery, equipment, vehicles, devices and apparatuses" was observed from 1.0% to 1.6%. The main importers of this export item are Uzbekistan and Azerbaijan.

The largest article of Kazakhstani imports (43.1%), according to the Committee on Statistics for 6 months of this year, is the import of machinery, equipment, vehicles, instruments and apparatuses, which over the year increased in nominal terms by 23.8% and reached $7.3 bn. Over the 6 months of this year, there has been a slight decrease in the share of imports of chemical products and related industries (including rubbers and plastics) to 15.7% from 16.6% yoy. The growth in this import item amounted to 2.2% yoy to $2.7 bn. In the import structure this year, there is a slight increase in the share of imports of metals and metal products by 0.6% to 12.4% compared with the same period last year. In value terms, metal imports grew by 11.3% YoY and amounted to $2.1bn.

An analysis of imports from the Russian Federation in January-April 2019 showed that import of motor gasoline amounted to 16.7 thousand tons (347 thousand tons in 4M2018) worth $6.8mn (177 mn tons 4M2018).

The reduction in motor gasoline imports from the Russian Federation affected the overall reduction in the share of imports of mineral products from 11.4% to 6.0% in the analyzed period. In value terms, the reduction in imports under this item occurred by 42.7% yoy and amounted to $1.0bn.

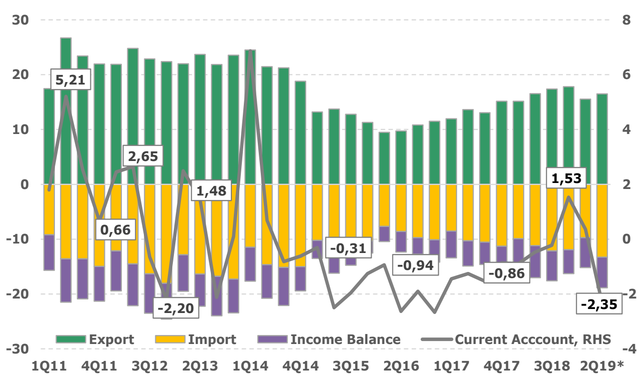
The structure of exports and imports as a whole remains relatively stable, but a dynamic increase in the share of animal and vegetable products is observed in the export structure. In the structure of imports, there is a further reduction in the supply of mineral products and an increase in imports of machinery and equipment.

Balance of Payment 1H2019 (National Bank of the Republic of Kazakhstan)

Current account

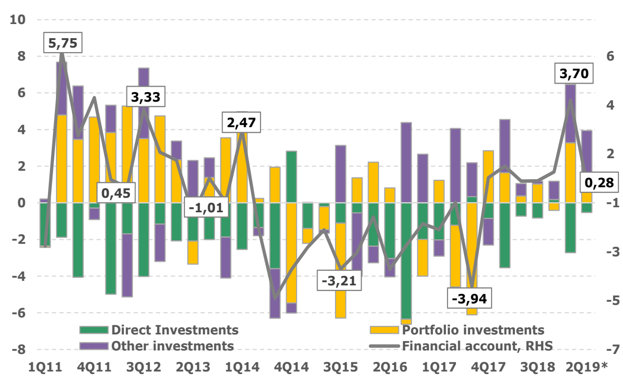
The balance of the current account of the Republic of Kazakhstan in the first half of 2019, according to preliminary data from the NBK, was formed with a deficit of $1,986mn (deficit of $1,362mn in 1H2018). The positive account balance of $361mn in the first quarter of 2019 was covered by a deficit of $2,347mn in the second. The expansion of the current account deficit was facilitated by a decrease in the trade balance by 10.3% yoy to $11.3bn. At the same time, the nominal growth in exports amounted to 1.1% yoy ($28.5bn), while the volume of imports increased by 10.2% yoy and amounted to $17.3bn. The widening of the deficit in the balance of services account in the first half of this year by 13.9% yoy to $2.2bn also contributed to the expansion of the current account deficit. The reduction of the deficit on the balance of primary income by 7.0% to $11.2bn and the expansion of the positive balance on the balance of secondary income by 3.6 times to $144mn had a restraining effect on the expansion of the current account deficit. According to the NBK, in the first quarter of 2019 the majority of FDI payable income comes from the crude oil and natural gas production sector (65.5%), metal ore production (5.5%) and transportation and storage (6.3 %).

Figure 25. Current account abrupt deficit, $bn.



*Source: NBK, Halyk Finance, *prelim*

Figure 26. Financial account outflow, $bn.



*Source: NBK, Halyk Finance, *prelim*

Preliminary data for the first half of 2019 show that under the primary income, there is a decrease in the amount of payments on direct investment income by 6.6% yoy to $10.1bn. There are no preliminary data on the secondary income balance, but data for the first quarter 2019 shows that the expansion of the secondary income surplus was facilitated by the positive dynamics of the growth of government revenues receivable (+ 11.6% yoy, $368mn) and personal transfers receivable (+ 12.7% yoy, $124mn) compared with negative dynamics general government revenues payable (-4.4% YoY, $129 million) and personal transfers payable (-7.0% YoY, $209 million).

Preliminary statistical data for the first half of 2019 show that under the primary income account, there is a decrease in the amount of payments on direct investment income by 6.6% yoy to $10.1bn. There are no preliminary data on the secondary income balance, but statistics for the first quarter 2019 shows that the expansion of the secondary income surplus was facilitated by the positive dynamics of the growth of government revenues receivable (+ 11.6% yoy, $368mn) and personal transfers receivable (+ 12.7% yoy, $124mn) compared with negative dynamics general government revenues payable (-4.4% yoy, $129mn) and personal transfers payable (-7.0% yoy, $209mn).

A large share of personal transfers to Kazakhstan in the 1Q2019 (data for the 2Q2019 are not available) accounted for transfers from the Russian Federation and amounted to 46.9% (47.5% in the 1Q2018). In annual terms, the growth of transfers by 11.4% to $58.2mn is observed. The main recipient countries of personal transfers from Kazakhstan this year were the Russian Federation (41.4%), the Republic of Kyrgyzstan (14.4%) and Uzbekistan (11, 9%). And if in the analyzed period the outflow of capital in the form of personal transfers to the Republic of Kyrgyzstan increased by 4.7% yoy and to Uzbekistan by 25.5% yoy, then transfers to the Russian Federation decreased by 37.5% yoy.

In terms of primary income, there is a negative dynamics for all types of income, except portfolio investments, which grew by 7.9% yoy and 2.1% qoq to $309.7mn. Remuneration on reserves and assets of NFs decreased 1.1% yoy (-3.1% qoq) to $ 309.9mn.

The relative current account deficit to GDP ratio decreased from -0.5% ($ 893 million) in the first quarter of 2018 to a surplus of 0.2% ($361.4mn) in the 1Q2019 (the indicator is calculated based on reporting data on GDP for 2018 and for the first quarter of 2019). According to our estimates, the current account deficit in the first half of this year is about -1.1% of GDP.

Financial account (w/o NBK's international reserves)

According to preliminary statistical data from the NBK for the first half of 2019, a significant outflow of capital (i.e., lending to residents of foreign countries) in the amount of $4.0bn is observed under the financial account. The outflow is 2.9 times more than the outflow of capital in the first half of the year last year.

The outflow of capital under the financial account for the entire last year amounted to $2.6bn. The last time a quarterly outflow of capital on the account in a comparable volume was observed in the 4Q2011 ($3.8bn).

According to the direct investment account, in the first half of this year there is an influx of financial resources in the amount of $3.2bn versus an inflow of $4.3bn in the same period, while the net adoption of liabilities amounted to $782mn, and the net acquisition of financial assets amounted to $ 2.5bn.

The gross inflow of FDI in the first quarter of 2019 (data for the second quarter are not available) to the republic amounted to $6.0bn (7.7% yoy). 55.4% of all investments were directed to the crude oil and natural gas production sector, 15.5% went to the metallurgical industry, 9.8% of which went to the wholesale and retail trade. The main geography of gross FDI flows to Kazakhstan is represented by the Netherlands (30.2%), the USA (24.3%), Switzerland (10.9%), and China (6.1%). The annual growth in gross FDI in these countries amounted to: the Netherlands (+ 18.3%), the USA (+ 22.6%), Switzerland (+ 6.9%), China (-13.8%).

The outflow of financial resources for portfolio investments increased 2.1 times in annual terms and amounted to $4.2bn. The increase in outflows for portfolio investments was facilitated by an increase in the net acquisition of financial assets in the amount of $3.1bn in the first half of 2019 against the observed inflow of this article in the amount of $614mn last year in the same period. The net acquisition of residents' liabilities to non-residents as part of portfolio investments decreased from $2.6bn in the first half of last year to $1.1bn in the reporting period. According to the data for the first quarter, residents of the Republic of Kazakhstan increased their assets of portfolio investments through the acquisition of foreign securities by the Government of the Republic of Kazakhstan and the National Bank of the Republic of Kazakhstan ($875mn) and other sectors ($1.6bn).

According to the NBK preliminary data on the balance of payments for the first half of 2019, there is a noticeable outflow under the item "other short-term capital flows" in the amount of $2.9bn (-11.6% yoy).

The relative indicator of the outflow of financial resources in the financial account to GDP, according to our estimate, increased from 0.85% ($1.4bn) in the first half of 2018 to 2.3% ($4.0bn) in the first half of 2019.

Thus, within the analyzed period, the expansion of the acquisition of assets by residents within the financial account (7 consecutive quarters) over their incurrence of obligations to non-residents continues.

Consolidated international reserves

Consolidated international reserves in June 2019, according to the updated NBK data, amounted to $88.2bn. Since the beginning of the year, consolidated reserves (according to the updated data) decreased by 0.8% due to a decrease in NBK's international reserves by 8.75% to $28.2bn

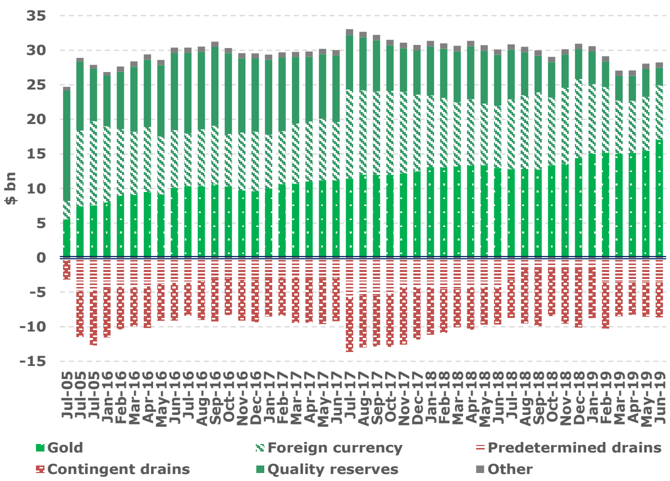
Since the beginning of the year, there has been a decrease in the most liquid part of international reserves. Thus, according to updated data, in June assets in hard currency decreased by 32.5% from the beginning of the year and amounted to $11.2bn. Moreover, the share of assets in hard currency decreased in June to 39.6% from 44.9% in May.

According to the reports of the International Monetary Fund (IMF) on the NBK international reserves (IRFCL), the NBK significantly reduced its holdings in securities from $10.1bn at the beginning of the year to $7.2bn in June (-29.5%), as well as in foreign currency and deposits by 42.4% to $3.2bn. The reduction of assets in hard currency occurred by the withdrawal of foreign currency funds of residents of the republic from foreign currency accounts of the NBK and their transfer to accounts abroad. An important role in the reduction of hard currency was played by the closure of the NBK position on foreign currency swap with second-tier banks in the amount of about $2mn.

The volume of gold in nominal terms in June this year increased by 18.5% from the beginning of the year and amounted to $17.1bn or 60.4% (the maximum value for the entire observation period) of the total international reserves.

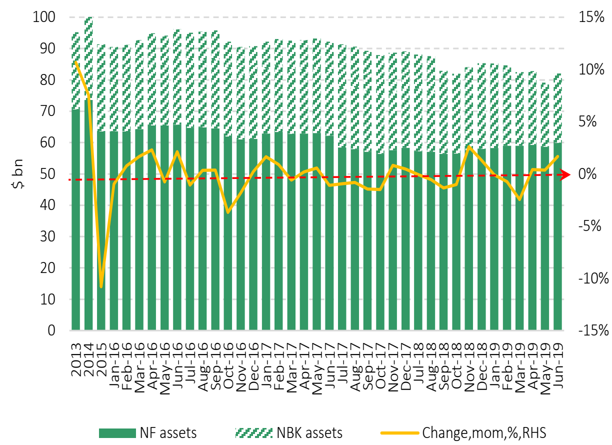
According to the IMF, the physical volume of gold of the NBK in June 2019 amounted to 12.07mn troy ounces (+ 7.1% from the beginning of the year) or 375 tons. The nominal growth of gold in the gold and foreign currency reserves occurred due to the positive dynamics of prices in global markets. With average gold prices of $1.285 per troy ounce in April and May, the growth of reserves in gold amounted to 5.3% and 7.4% since the beginning of the year. The rally of gold prices in June to 1.384 US dollars (+ 8.0% mom, at the time quotes on the spot market reached 1.423 US dollars) contributed to a significant nominal revaluation of the NBK's gold holdings.

Figure 27. NBK's international reserves



Source: NBK, IMF, Halyk Finance

Figure 28. Consolidated reserves of Kazakhstan



Источник: NBK, Halyk Finance

According to the NBK reporting, the net volume of foreign exchange operations of the bank in the foreign exchange market in the second quarter is zero. In the first quarter of this year, foreign exchange operations of the regulator is also equal to zero. This means that currency interventions carried out by the NBK, according to the statement of Yerbolat Dosaev, in the amount of $ 304 million in March this year to maintain the national rate, were "netted" by the purchase of foreign currency in the same amount.

According to updated NBK data for June of this year, net international reserves decreased by 8.9% at the beginning of the year and amounted to $27.7bn. According to the schedule of payments for servicing public sector external debt, in an expanded definition, the external debt of the public sector at the beginning of the second quarter amounted to $34.1bn. At the same time, the amount of payments for the second quarter of this year is $1.7bn. The amount of mandatory payments by government bodies was $193mn, while the amount of quarterly payments by the NBK was $359mn. The rest of the obligatory payments is due to banks, other sectors and intercompany debt. At the moment, according to the NBK, about $4.3bn of the external public and quasi-public sector has been repaid, part of this amount has been repaid from internal accounts, which contributed to the reduction of gold and foreign currency reserves in hard currency.

As part of the short-term conditional net expenses of the NBK in foreign currency, a decrease of liabilities by 41.3% from the beginning of the year to $5.1bn is observed. As of the end of June 2019, short position of $2.1bn arose in the structure of the short-term expenses, which, according to the IMF classification, corresponds to a currency swap or a forward contract.

It is known that the NBK is considering the possibility of selling refined gold on global markets, with a delivery of 3 tons (previously indicated in the 2nd quarter) in the amount of 2 tons (64.301 troy ounces or $96.6 mn at the current price of $1.503 per ounce). We believe that due to the growing load on the NBK's quality assets (the most liquid reserve assets in hard currency, which decreased by 32.7% in June since the beginning of the year), it will be forced to re-shape its reserves structure to increase the liquid position in hard currency.

In June of this year, the assets of the National Fund (NF) increased by 3.4% since the beginning of the year and reached $60.0bn. In June, revenues from the NF increased 3.2 times in annual terms and amounted to T1.952bn or $ 5.1 bn (+ 32.5% mom). Direct tax revenues from oil companies increased by 10.5% YoY and amounted to T1.516bn. In June of this year, the NF recorded investment income of T406bn against a loss of T785bn in the same period last year.

Fund expenditures as of the end of June increased by 26.2% in annual terms and amounted to T1.830bn or $4.8bn (+ 18.3% mom). In June of this year, the balance of receipts to the Fund was positive for the last 4 months and amounted to T122.4bn ($322mn at the average rate for the 2nd quarter of 380.55). As of June of this year, the guaranteed transfer to the budget increased by 1.1% yoy and amounted to T1.454bn or $3.8bn. The size of the targeted transfer directed to the budget amounted to T370bn or $972mn.

Correction of the cost of Brent crude oil from $71.2 dollars per barrel in the first half of 2018 to $66.2 in the first half of this year, along with a decrease in oil production in January-June by -2% yoy and an increase in gas condensate production by 0.1% yoy, as well as an increase in the load on the Fund in the form of a guaranteed and targeted transfer to the budget, ensured the current growth dynamics of the fund's assets.

Banking sector

The situation in the banking system is described in detail in a publication devoted to this topic: Банки Казахстана в июне 2019 года.

Stock market

KASE index since the end of January of this year showed a progressive upward trend and as of the end of March it updated a six-month high, at around 2,461.3p (+ 7.3% since the beginning of the year). In mid-April 2019, the index reaches the current annual high of 2,499.5p (+ 9.7% since the beginning of the year). Subsequently, an almost vertical correction of the index is observed to the level of 2 179.5p (-5.0% from the beginning of the year) at the beginning of June of the current year, fixing an 8-month low. The uptrend that formed in September last year is over. By the end of June this year, the index is being adjusted from its low in early June to the level of 2,289p (-0.2% since the beginning of the year, + 5% from the local low levels in June). And if last year the downward index adjustment occurred in mid-May, then this year the market corrected already in mid-April. The volume of transactions since the beginning of the year amounted to T24.4 trn. (-13% yoy) or $64.2mn (-25.5% yoy).

The KASE representative list has not changed and as of the end of June 2019 it included 7 companies - Bank CenterCredit (10.6 share in the list), KazMinerals (14.0), Halyk Savings Bank of Kazakhstan (17.0), Kcell (15.9), KEGOC (15.1), Kazakhtelecom (14.4), KazTransOil (13.1). As of the end of June 2019, the shares of five listed companies showed a steady growth trend in quotes, while the prices of ordinary shares KEGOC and Kazakhtelecom showed a negative trend.

The weighted average price per share of KazMinerals JSC decreased from KZT3195 per share at the end of the first quarter to KZT2964 (-7.2% qoq, + 17.3% from the beginning of the year) per ordinary share as of the end of 2 quarter. The price adjustment for the issuer's ordinary shares took place against the background of a downward adjustment in copper prices, as well as the attraction of DBK's credit line as part of the expansion project at the Aktogay deposit.

Quotations of ordinary shares of KazTransOil JSC lost 23.2% qoq and as of the end of the second quarter their value amounted to 1,071.2 tenge, since the beginning of the year the shares lost 20.2%. The company's stock quotes decreased due to the payment of dividends for 2018.

Quotations of shares of KEGOC JSC in the second quarter of this year decreased by 5.8% qoq from 1712.9 per share at the end of March to 1,614 tenge (+ 0.8% from the beginning of the year) at the end of June. At the end of April, trades in the amount of T319mn were held on common shares of the company. The maximum trading volumes were in mid-May of this year in the amount of T436mn.

Since February, stock quotes of Kcell JSC showed a moderate uptrend and as of the end of June amounted to KZT2050, an increase of 2.0% qoq (+ 10.8% since the beginning of the year). A significant volume of transactions on ordinary shares of Kcell JSC took place in early May of this year and amounted to about T1bn. Such a movement of quotes is still associated with a transaction with the company Kazakhtelecom JSC.

Shares of Kazakhtelecom JSC started the year with a drop in quotations from 33,499 tenge per share to 25,000 tenge (-25.4%) as of the end of January, in April there was a local correction to the level of 31,600 tenge per common share. However, by the end of June quotes for common shares began to update annual lows and as of the end of June formed at the level of 24,205 tenge (-17.9% q / q, -27.7% since the beginning of the year) per share. The observed movement of the issuer's quotes is due, on the one hand, to the acquisition of a controlling stake in Kcell JSC, and, on the other hand, to the consolidation of the assets of Tele2 JV. The acquisition and consolidation of assets occurred through the issuance of bonds and a credit line.

Shares of Bank CenterCredit JSC showed growth from 234.2 tenge at the beginning of January to 242.5 tenge (+ 3.5% from the beginning of the year) per share at the end of June. In April, the issuer's quotes updated the annual minimum of 231 tenge per share. In May, stock quotes recorded a local maximum of 245 tenge per share after trading in the amount of T120 million a day earlier. Quarterly growth of quotations amounted to + 4.1%.

The shares of Halyk Savings Bank JSC began the year with a slight adjustment of the average weighted price for their shares from KZT100.4 to KZT112 at the end of the first quarter. Quotation growth at the end of the first quarter continued in April and ended with a correction. However, at the end of the second quarter there was a pronounced progressive dynamics, as a result of which the weighted average cost of shares was at the level of 116.7 tenge (+ 4.2% qoq, + 16.2% from the beginning of the year). Such dynamics of the issuer's stock quotes was supported by the declared dividend payment in April in the amount of 50% of net profit (regulatory restriction formatted by the policy of the joint-stock company), as well as good financial results (net profit growth in 2018 amounted to 46% yoy).

Research Department		**E-mail**
Stanislav Chuyev	Head	s.chuyev@halykfinance.kz
Assan Kurmanbekov	Macroeconomics	a.kurmanbekov@halykfinance.kz
Dmitriy Sheikin	Macroeconomics	d.sheikin@halykfinance.kz
Altynay Ibraimova	Equity	a.ibraimova@halykfinance.kz

Sales Department		**E-mail**
Mariya Pan	Head	m.pan@halykfinance.kz
Moldakhmetova Aizhana	Institutional	a.moldakhmetova@halykfinance.kz
Shynar Zhakanova	Institutional	sh.zhakanova@halykfinance.kz
Dariya Maneyeva	Retail	d.maneyeva@halykfinance.kz
Alya Abdumazhitova	Retail	a.abdumazhitova@halykfinance.kz

Address:
Halyk Finance
Avay av., 109 «B», 5th fl
A05A1B4, Almaty, Kazakhstan
Contact: +7 727 357 31 77
www.halykfinance.kz

Bloomberg
HLFN
Thomson Reuters
Halyk Finance
Factset
Halyk Finance
Capital IQ
Halyk Finance