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**August 6, 2021**

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*The government's stimulus measures, the influx of pension savings, and the growth in the cost of raw materials provided significant support to the economy, which moved from a recession in the first quarter to an increase of 2.2% yoy in the first half of the year. Faster economic recovery is hindered by the continuation of quarantine measures, as well as restrictive quotas under the OPEC+ agreement and the continuing decline in investment in the oil and gas sector. After the slowdown in inflation at the beginning of the year to 7.0-7.2%, the rate of price growth accelerated significantly to 7.9% yoy in June (8.4% yoy in July). The NBK kept the monetary conditions unchanged during 1H2021 but raised the base rate by 25 bps in July to 9.25%. The exchange rate of the national currency has weakened by 1.7% since the beginning of the year to 427.79 tenge/\$, despite a 45% increase in the oil price. Consolidated reserves for 1H2021 decreased by 2.1% from the beginning of the year (+1.9% yoy) to \$92.4 bn. By the end of 2021, we forecast GDP growth of 3.2%, inflation at the level of 8.5-8.7% yoy, and the tenge exchange rate at the level of 435 tenge/\$.*

**State support of the economy contributes to the improvement of the economic situation.** In the second quarter, there was a slight easing of quarantine restrictions, which affected the dynamics of recovery processes in the economy. Under these conditions, the expansion of state spending and the inflow of pension funds of citizens in 1H2021 (1.4 trln) provided significant support to the economy. In the second quarter of this year, double-digit growth in nominal wages continued, while an increase was observed not only in the public sector but also in the private sector. Household consumption has grown significantly, judging by the growth of retail sales in the field of domestic trade in 1H2021 by 7.6% yoy, but it is still below pre-crisis values.

**The positive impact of rising oil prices is limited by production quotas.** In the second quarter of this year, most sectors of the economy emerged from the crisis. Double-digit growth was recorded in the construction sector (+11.9% yoy) and telecommunications (+12.2% yoy). Despite the more than twofold increase in the average oil price to a three-year high in the second quarter, restrictive quotas under the OPEC+ agreement are holding back a potential recovery in the extractive sector of the economy, which showed a 3% yoy decline according to the results of 1H2021. Nevertheless, the peak of the decline in oil production has been passed, and its recovery will begin in the future. Industrial production for 1H2021 showed an increase of 1.5% yoy, primarily due to the high growth rates of the manufacturing industry (+5.6% yoy).

**The reduction in capital investment has reached an annual minimum.** The slump of investments in the second quarter amounted to 1.8% and was at the lowest level over the year. Projects postponed due to the pandemic began to be actively implemented this year. As a result of which, an increase in investments in the manufacturing industry amounted to 88.3% yoy, in agriculture 45.9% yoy, in construction 157.6% yoy, in domestic trade 54.1% yoy, and in telecommunications 50.5% yoy. Investment decline in 1H2021 in the oil industry has not yet been overcome (-38.1% yoy), however, double-digit growth in capital investments is expected for large oil and gas projects this year.

**Acceleration of inflation.** After a temporary slowdown in inflation in the first quarter of this year to 7% yoy, the inflation rate accelerated sharply in the second quarter and reached 7.9% yoy in June. The acceleration of inflation was provoked by rising prices on foreign markets, the resumption of the weakening of the tenge and the increase in prices for motor fuel against the background of a stimulating budget policy.

**Interest rate policy – tightening of monetary conditions is inevitable.** During 2Q2021, the regulator did not change monetary conditions, keeping the base rate at 9% (+/-1%) against the background of disinflationary processes observed from January to May of this year (the slowdown in inflation from 7.5% in December 2020 to 7.0% yoy in April and 7.2% yoy in May). However, against the background of sharply accelerated inflation, on July 26, the National Bank tightened monetary conditions in the country, raising the base rate by 25 bps to 9.25% while maintaining the interest rate corridor for liquidity management at the level of +/-1%.

**Tenge – the rate of weakening.** As of the end of 2Q2021, the national currency weakened by 1.7% from the beginning of the year to 427.79 tenge per US dollar, while the tenge lost 5.9% of its value over the year. The average value of the exchange rate increased from 419.70 tenge in 1Q2021 to 428.36 tenge per US dollar in 2Q2021. The weakening of the national currency exchange rate occurred against the background of an increase in the cost of oil

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by 18.2 qoq (45% for 6M2021) to \$75 per barrel, an increase in foreign currency sales from the National Fund of the Republic of Kazakhstan by \$574 mn (+30.9% qoq) to \$2.4 bn and a quarterly reduction in the nominal holding of portfolio investments of non-residents in the State securities of the Republic of Kazakhstan by T8.4 bn to T791.4 bn in June. The outstripping quarterly dynamics of export volume growth in 2Q2021 by \$4.0 bn (+35.1% qoq, +3.4% yoy for 6M2021) against the background of import growth by \$2.3 bn (+30.0% qoq, +9.2% yoy for 6M2021) did not lead to a noticeable strengthening of the Kazakhstani tenge against the US dollar.

**Growth of the current account deficit in 1H2021.** The current account of the Republic of Kazakhstan for 1H2021, according to the preliminary assessment of the NBK, developed with a deficit of \$1.7 bn compared to a surplus of \$801 mn in 1H2020. The expansion of the current account deficit was primarily facilitated by a reduction in the trade balance by 5.9% yoy to \$9.4 bn, an expansion of the primary income balance deficit by 36.1% yoy to \$10.1 bn, as well as the existing deficit of the secondary income balance at \$195.5 mn (the deficit in 1H2020 at \$32.9 mn). According to the financial account, there was a decrease in the volume of capital inflows from \$6.1 bn in 1H2020 to \$4.3 bn in 1H2021. The positive dynamics of capital inflows in the Republic of Kazakhstan was facilitated by the expansion of capital inflows in the portfolio investment account by 98.7% yoy to \$7.2 bn.

**Consolidated international reserves are declining.** Kazakhstan's consolidated reserves for 1H2021 decreased by 2.1% (+1.9% yoy) to \$92.4 bn due to a 1.7% reduction in the volume of the NBK's gross gold reserves to \$35.0 bn (+6.6% yoy) and a 2.4% reduction in the volume of the National Fund's assets from the beginning of the year to \$57.3 bn (-0.7% yoy). In the structure of the NBK's assets, there is a decrease in assets in gold by 7.5% since the beginning of the year to \$21.8 bn (+1.2% yoy). The decrease in the NBK's gold assets is primarily due to the decline in the value of gold on global markets (6.8% since the beginning of the year) and their revaluation by the NBK. The share of assets in gold at the end of 1H2020 amounted to 62.2% of the gold reserves, having decreased from 66.2% since the beginning of the year.

**Forecast for 2021: GDP growth of 3.2%, inflation of 8.5%-8.7%, the FX rate of T435 per US dollar.**

According to our forecasts, the pace of recovery of the Kazakh economy this year will be restrained. According to our forecast, Kazakhstan's GDP growth will be 3.2% in 2021. The expansion of government spending this year, along with the influx of pension savings into the economy and the increase in prices for "black gold" will have a positive impact on the growth of the economy of Kazakhstan. On the other hand, the continuing difficult epidemiological situation, both in the world and in Kazakhstan, will have a negative impact. The rate of vaccination against COVID-19 shows moderate dynamics, with the share of vaccinated people at 17% of the total population at the end of July 2021, which is not enough to lift quarantine restrictions. According to our assessment, large budget allocations, increasing external inflationary pressure, unanchored inflationary expectations of the population, together with the inefficiency of state regulation of prices of natural monopolies, will lead to an acceleration of inflation to 8.5%-8.7% by the end of this year.

Main macroeconomic indicators	2019	2020	Base		Pessimistic		Optimistic	
	Fact	Fact	2021	2022	2021	2022	2021	2022
Oil Brent, average, USD/bbl.	64.2	42.3	65.0	65.0	57.3	50.0	72.3	80.0
Real GDP, % yoy	4.5	-2.6	3.2	3.6	2.4	2.9	3.9	4.3
Exchange rate USDKZT, eop	381.2	420.7	435.0	440.0	445.0	451.0	420.7	418.5
Exchange rate USDKZT, average	382.8	413.0	428.3	437.5	431.6	448.0	424.2	419.5
CPI, % change yoy	5.4	7.5	8.5-8.7	7.5	9.5	8.0	8.2	6.5
Government debt, % GDP	9.3	9.0	9.5	9.0	10.5	9.5	9.3	8.5
Budget balance consolidated, % GDP	-1.8	-4.0	-3.3	-3.0	-3.8	-3.9	-2.8	-2.5
Current account, % of GDP	-4.0	-3.7	-2.0	-2.5	-3.4	-4.0	-1.0	-0.8

## Despite the growth of oil prices, the economic recovery is being held back by quarantine measures

In 2Q2021, the economic situation continued to gradually improve, which was facilitated by an increase in oil production volumes (+0.9% qoq) and oil prices (+13.3% qoq). As a result, in the first half of the year, GDP expanded in real terms by 2.2% compared to 1H2020. This result partly reflects the low base of last year, when GDP in the first half of the year decreased by 1.8% yoy. In addition, the revision of the Bureau of National Statistics of the previous estimate of the fall in GDP in the first quarter of this year from -1.6% yoy to -1.4% yoy had a positive impact. It should be noted that the second quarter of this year was the first with positive dynamics of GDP growth after four quarters of continuous decline caused by a reduction in export revenues and measures to limit the spread of COVID-19.

Quarantine restrictions, which eased quite slightly compared to the previous quarter, mainly harmed the service sector. The index of the severity of administrative restrictions (COVID-19 Government Stringency Index of the University of Oxford) in the second quarter fell to 63.9 out of 100, which is slightly lower than 64.5 points in the first quarter. Relative to the most restrictive second quarter of 2020, the index decreased by almost 26%. At the same time, quarantine measures in Kazakhstan were more stringent in comparison with neighboring countries and only slightly weaker than in China. As a result, anti-covid restrictions continue to restrain the growth of business activity in Kazakhstan, which is reflected in the slow economic recovery.

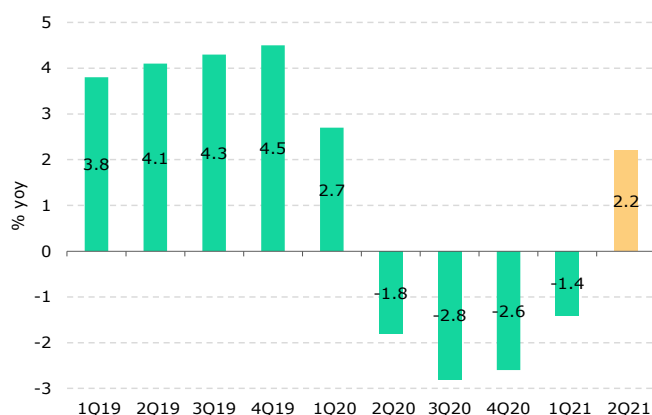
External conditions in the second quarter of this year were marked by a continued increase in energy prices – the price of oil in June exceeded \$70 per barrel. At the same time, prices for agricultural products in the world market have also sharply increased, which increases the costs of producers along the chain.

The high discipline of the OPEC+ countries to limit oil production has had a positive impact on the quotations of hydrocarbons on the world market. Brent crude oil prices exceeded \$60 per barrel in the first quarter, and by the end of the second quarter, they rose to over \$70, reaching a three-year high. Taking into account the fact that sanctions against Iran will remain in force for the time being, we can expect that oil prices will continue to grow in the third quarter of this year, against the background of the fact that oil reserves in the world are already below pre-crisis indicators and will decline for some time.

Given that the OPEC countries have made the greatest efforts to reduce the volume of oil supply, the cartel's oil production decreased by 4.8% compared to 1H2020, while oil production in the Russian Federation decreased by only 3% in the same period, but, for example, Canada increased oil production by 3.5% yoy. Oil production in the United States decreased by 3.3%, as a result of which the country again became a net importer of hydrocarbons.

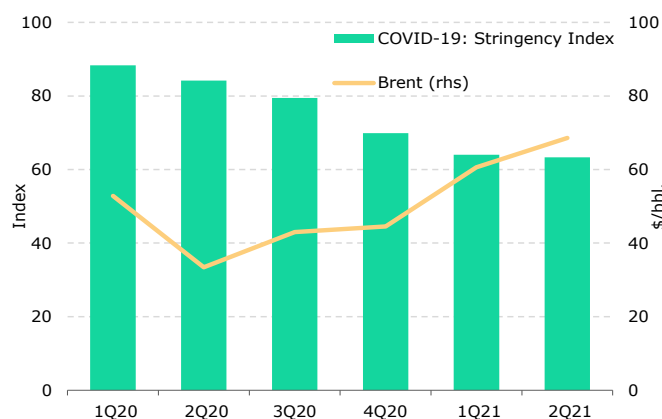
In turn, oil production in Kazakhstan, although it decreased by 5.7% yoy in the first half of the year, in June oil production was already higher by 9.1% compared to the indicator of June last year. At the same time, according to OPEC quotas for Kazakhstan, in the second half of this year, oil production in the republic will increase by about 1% monthly, which will eventually amount to 86 mn tons of production volume projected by the Ministry of Energy for the current year (+0.4% yoy).

Fig. 1. GDP of the Republic of Kazakhstan by quarters in annual terms (accumulated)



Source: BNS

Fig. 2. Index of strictness of restrictions against COVID-19, Kazakhstan and oil prices



Source: Oxford Covid-19 Tracker, Bloomberg

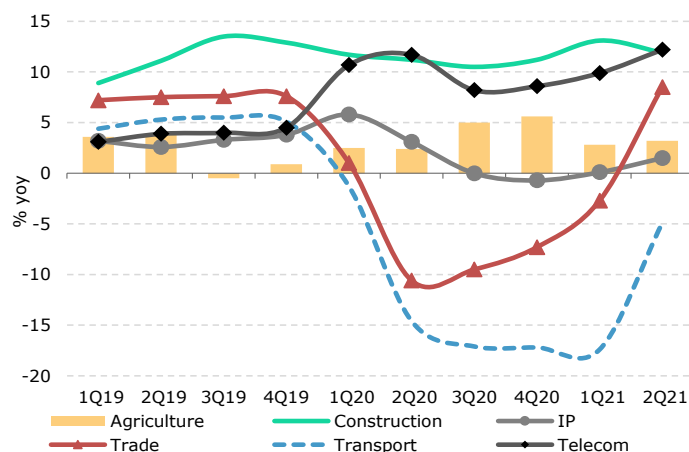
## The main sectors of the economy are entering a positive zone

The construction and telecommunications sectors, which showed high growth in 2020, continued to act as drivers of economic growth this year. According to the results of 1H2021, the telecommunications sector increased output by 12.2% yoy as digitalization, which received a strong impetus to development last year, continues to penetrate all spheres of the social and economic life of the country. In the construction sector (+11.9% yoy in June), there is a construction boom in the housing sector, where investments increased by 26.6% yoy. For six months of this year, almost 1.4 trln rubles were transferred from the UAPF to the population for improving housing conditions, which is comparable to 70% of the total investment in the construction of residential real estate in 2020.

The industry moved to a more confident growth in the second quarter and in June there was an increase in output by 1.5% yoy, after 0.1% yoy in the first quarter. The manufacturing industry is confidently leading (+5.6% yoy), where double-digit growth rates are demonstrated by the sectors of production of machine-building products (+22.1% yoy), furniture (+19% yoy), other finished products (13.4% yoy). Gasoline production in the first half of the year increased by 6.1% yoy, diesel fuel by 4.6% yoy, and kerosene by 24.3% yoy. Against the background of the pandemic, the production of pharmaceuticals increased by 26.3% yoy, and medicines by 53.5% yoy. The housing construction boom stimulates the production of building materials – cement production increased by 24.7% yoy, and concrete products by 10.2% yoy.

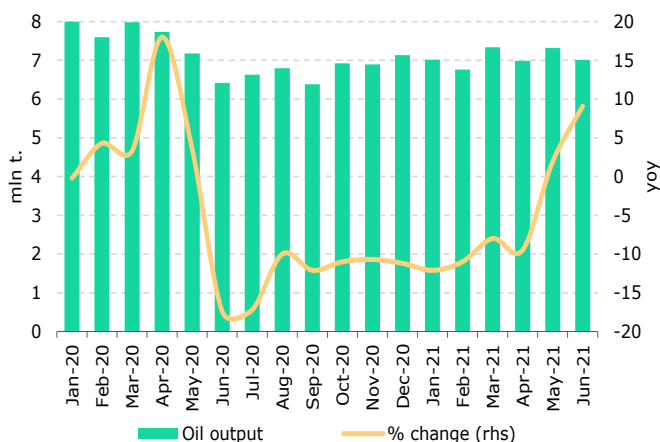
In agriculture, output increased from 2.8% yoy in the first quarter to 3.2% yoy in the first half of the year. The trade sector moved from recession to growth (+8.5% yoy), which was further facilitated by the low base of the first half of last year (-10.6% yoy). In the transport industry, the depth of the decline significantly decreased from -17.4% yoy in the first quarter of this year to -4.9% yoy in the second. At the same time, the volume of cargo turnover slightly, but still exceeded the indicators of the previous year (+0.3% yoy), while passenger turnover due to the current restrictive measures is at the level of 55.7% of the indicator of the same period last year.

Fig. 3. Output by industry



Source: BNS

Fig. 4. Dynamics of oil production volumes, Kazakhstan



Source: BNS

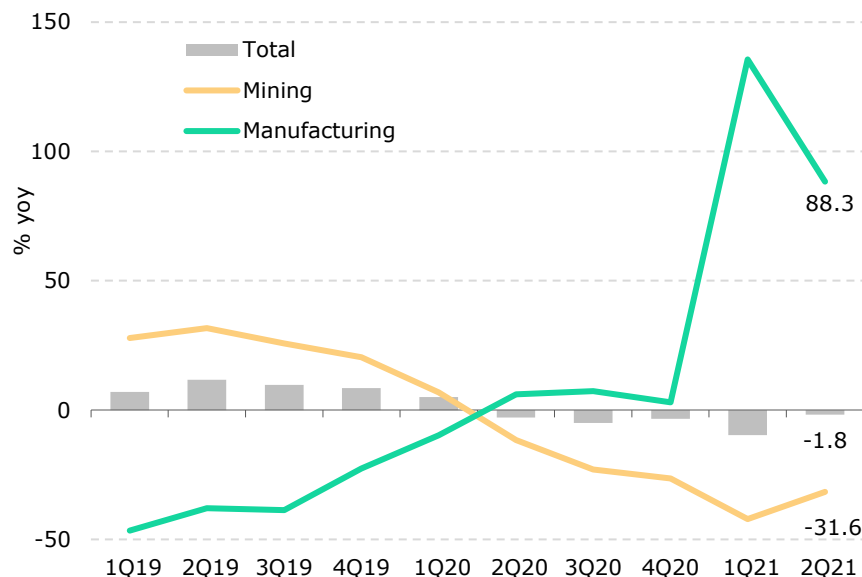
## Investment activity in the non-resource sector compensates for the decline in the oil production industry

Investment activity in the country is gradually recovering after experiencing a decline of 9.6% yoy last year. In January-June of this year, the total volume of investments in fixed assets amounted to 5.25 trln, slightly increasing compared to T5.22 trln in the same period a year earlier. In real terms, there is still a decrease of 1.8% yoy. The decline in investment in the mining industry continues, in the first quarter of this year, the decline in investment amounted to 48% yoy, according to the results of the first half of the year, the depth of the decline decreased to 31.6% yoy. The volume of investments in oil production has significantly decreased from T2 trln in 1H2020 to 1.3 trln in 1H2021.

Such a significant decline occurred both due to quarantine restrictions and as a result of the deterioration of the investment attractiveness of the oil industry and the growth of uncertainty at the global level. Thus, in 2020, according to the International Energy Agency, the volume of investments in "upstream" projects decreased by 31%, which is close to the 30% drop that occurred in Kazakhstan. At the same time, according to the expectations voiced by the Prime Minister of the Republic of Kazakhstan, the volume of investment development at Tengiz this year will reach T2.4 trln (+24% yoy), and at Karachaganak T142 bn (+17% yoy).

The decline in investment in the extractive industry is offset by a significant increase in the manufacturing industry, wherein in the first half of this year, investment growth amounted to 88.3% yoy (T720 bn vs. T373 bn). The main sectors for investment were the chemical industry (investment growth by 6 times yoy), which accounted for 39% of all investments in the manufacturing industry and the metallurgical industry (+27.3% yoy), 33% of the investment volume, respectively. In addition, investment growth in agriculture was 45.9% yoy, in construction +157.6% yoy, in trade +54.1% yoy, in telecommunications +50.5% yoy, and in real estate transactions +17.4% yoy. Taking into account that last year there was a more moderate increase in investment in these sectors or their decline, this year projects are being implemented that were postponed due to stricter quarantine measures to combat coronavirus in 2020.

Fig. 5. Minimum annual reduction of investments



Source: BNS

### Cautious wage growth in the private sector, consumer activity is still restrained

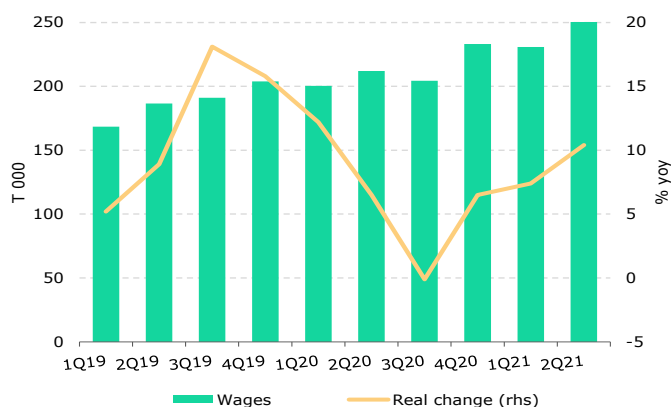
As the economy gradually emerged from the crisis, the average nominal wage continued to grow in the republic. At the same time, if last year it was almost entirely determined by the increase in salaries of public sector employees, this year the growth is also observed in the private sector. In the second quarter, the wage growth rate accelerated to 10.4% yoy in real terms from 7.4% yoy in the previous quarter. It should be noted that wages have been continuously growing in real terms since 2018. In dollar terms, the salary corresponds to \$588 and is at the highest level since 2016, but below the maximum value of \$717 in 2013.

Wages continued to grow at a faster pace, both in education (+18.1% yoy) and healthcare (+25.6% yoy), and in the private sector in telecommunications (+15.5% yoy), in trade (+16% yoy), in the segment of accommodation services (+35.8% yoy). In the manufacturing industry, wages increased by 9.9% yoy, in agriculture by 6.5% yoy, in construction by 10.4% yoy, in the transport industry by 7.3% yoy, and in the financial sector by 13.8% yoy.

Against the background of wage growth in the first half of this year, retail trade turnover increased to T5.3 trln from T4.6 trln in 1H2020 (T4.9 trln 1H2019). In real terms, retail trade turnover increased by 7.6% yoy, but relative to the pre-crisis 2019, the reduction in trade turnover minus inflation for 2 years (15.4%) was 6.3%. The structure of retail trade is still shifted towards the predominance of food products (34.7% vs. 32.5% in 1H2019).

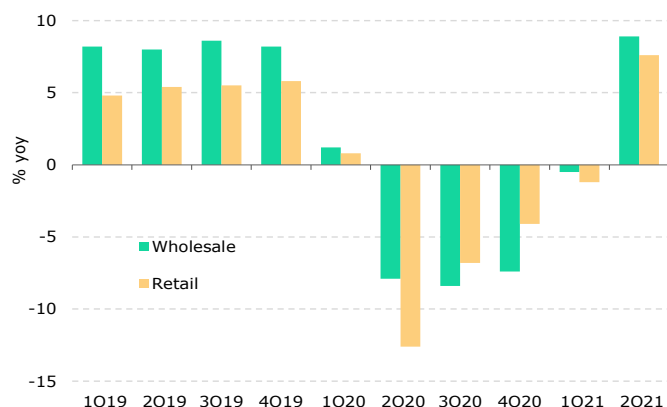
In turn, deposits of the population with banks by the end of June 2021 increased by a significant 1.5 trln, or by 13.3% since the beginning of the year. In addition, the real estate market is experiencing a strong increase in demand for housing, as a result of which, the number of transactions in 1H2021 increased by 2.3 times, investments in real estate are also long-term investments. In addition, partially pension savings also contributed to the growth of household deposits in banks. Thus, it is obvious that the population continues to adhere to the savings model of behavior, which reflects the desire of consumers to moderate current consumption due to the uncertainty caused by the pandemic.

Fig. 6. Dynamics of average wages in the Republic of Kazakhstan



Source: BNS

Fig. 7. Growth of wholesale and retail trade turnover (in real terms)



Source: BNS

### Inflation accelerated significantly in the 2nd quarter of 2021

Inflation in June accelerated significantly to 1.1% mom from 0.7% mom in May. In annual terms, the consumer price index in June reached the highest since 2017 at 7.9% (7.2% in May 2021). The growth of prices for food products accelerated to 10.6% yoy, and the cost of non-food products increased by 6.9% yoy. Paid services rose by 5.6% yoy.

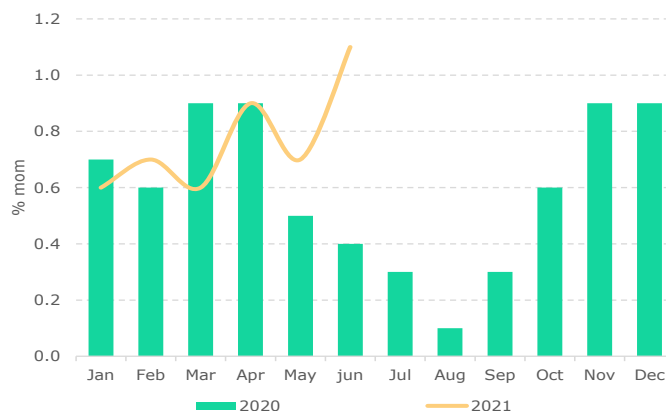
Domestic prices remain quite sensitive to changes in the cost of fuel and electricity. Since the beginning of this year, the cost of gasoline has increased by 14%, while the cost of diesel fuel has increased by 2.9%. Over the past six months, gas has risen in price by 4.8%, and electricity – by 1.9%. Due to the increase in energy costs, the prices of manufacturers of industrial products have significantly increased. So, if the dynamics of prices of manufacturers of industrial products in February of this year amounted to 3.9% yoy, then in June it accelerated to 50.2% yoy. Such rates of price growth in the industry are a record in Kazakhstan over the past 10 years (33.4% yoy in August 2011).

A noticeable increase in prices is observed for most components of the consumer basket. At the same time, external price shocks play a significant role in this process. So, since the beginning of this year, the price of oil has increased by 45% to \$75 per barrel. In addition, the increase in the price of agricultural products in foreign markets continues. According to the World Food Organization (FAO), the food price index in June of this year was 33.9% yoy higher than a year earlier and is at peak levels since 2011. Prices for such components included in the index as dairy products +22% yoy, cereals +33.8% yoy, sugar +43.8% yoy, and butter products +81.8% yoy showed a significant increase.

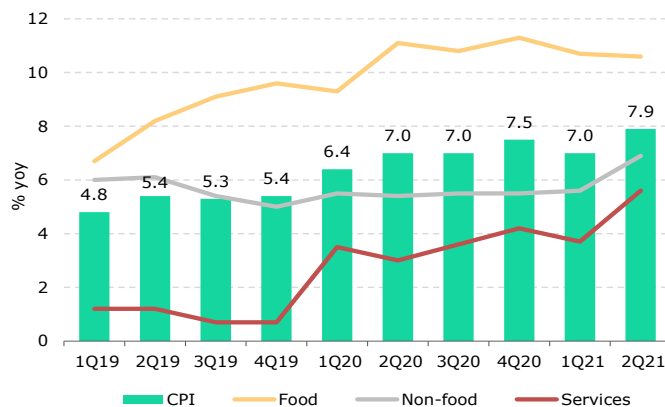
The situation with rising prices is also acute in other countries. Thus, in the Russian Federation, inflation for the year almost doubled to 6.5% yoy in June (3.2% yoy in June 2020), in Kyrgyzstan and Uzbekistan, prices are at a double-digit level of 14.2% yoy (5.8% yoy June 2020) and 10.2% yoy (14.2% yoy June 2020). In the United States, the inflation rate accelerated to 5.4% yoy in June, which is the highest value in more than a decade.

Thus, the dynamics of consumer price growth show a significant acceleration in the first half of this year, as a result of which the consumer inflation index reached its maximum since the beginning of 2017. The ongoing external and internal fiscal and monetary incentives are the main drivers of the increasing pro-inflationary pressure in the republic.



**Fig. 8. Acceleration of inflation rates**


Source: BNS

**Fig. 9. Dynamics of inflation rates by components**


Source: BNS

### Interest rate policy – tightening of monetary conditions is inevitable

During the second quarter of 2021, the NBK maintained its monetary conditions, without changing either the base rate level or the liquidity management corridor. The emerging disinflationary processes in the first quarter of 2021, when the rate of consumer inflation slowed from 7.4% yoy in January to 7.0% yoy in March, continued in April and May, when the inflation rate was 7.0% yoy and 7.2% yoy against 7.5% in December last year. However, everything changed when in June the inflation rate accelerated sharply to 7.9% yoy amid rising prices for food (10.6% yoy), non-food products (6.9% yoy), and paid services (5.6% yoy). But even despite such a sharp acceleration in the rate of inflation, the NBK kept the base rate unchanged, although it changed its rhetoric, emphasizing that if the rate of disinflation does not meet its forecast, it will have to tighten monetary conditions in the country.

The observed inflationary processes in the economy of Kazakhstan are quite comparable with the dynamics of prices for all components of inflation in the Russian Federation. The Central Bank of Russia began to react to the acceleration of inflation in the Russian Federation in March, raised the key rate from 4.25% to 4.5%, and then twice by 50 bps to 5.5% in June. However, due to the inflation rate accelerated to 6.5% in June, the Board of directors of the Central Bank of Russia decided in July increased the key rate to the inflation rate by 100 bps. The NBK also decided to tighten monetary conditions on July 26, increasing the base rate by 25 bps. up to 9.25% (+/-1%) to prevent the risks of an inflationary spiral unwinding and return of inflation to the target corridor of 4%-6% in 2022. At the same time, the regulator stressed that the increase in the base rate will have a limited impact on price inflation on the supply side and aims to affect the risks of rising inflation expectations on the demand side.

Inflation in the two largest economies of the region is largely dictated by rising production costs due to rising energy prices both inside and outside the country, as well as its imports from trading partner countries. Thus, the price inflation of manufacturers of industrial products in February of this year amounted to 3.9% yoy, while in June, producer inflation accelerated to 50.2% yoy.

Taking into account the fact that the Russian Federation is one of the largest trading partners of Kazakhstan, the import of consumer inflation through foreign trade channels (35% - 40% of imports) will exert pro-inflationary pressure on the economy of Kazakhstan until the end of this year.

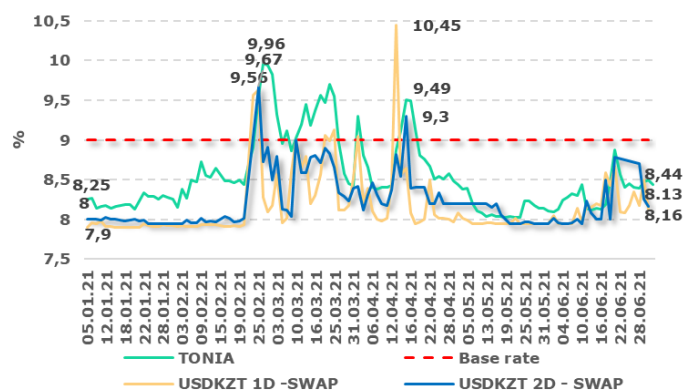
Pro-inflationary pressure on the economy in the second half of this year will also be exerted by the post-crisis recovery of business and consumer activity in the country, against the background of the implementation of the budget impulse due to the expansion of budget expenditures and maintaining the size of transfers to the budget at only slightly lower than last year's level of T4.5 trln (T4.8 trln in 2020).

Taking into account the above, we expect that the inflation rate in Kazakhstan will accelerate to 8.5-8.7% yoy by the end of this year, which, in our opinion, will lead to another or even two rounds of tightening of monetary conditions in the country. At the end of this year, the base rate will reach the level of 9.50%-9.75%. A more significant increase in the base rate may negatively affect investment activity within the country, as well as negatively affect the efficiency of the budget transmission and cause a slowdown in the growth rate of the economic recovery.

The rate on automatic REPO operations (TONIA) in 2Q2021 decreased by 86 bps to 8.44% qoq (8.25% in 2Q2020) with an average quarterly value of 8.40% (8.76% in 2Q2020). The rate on one-day USDKZT swaps in 2Q2021 decreased from 8.52% in 1Q2021 to 8.13% (7.59% at the end of 2Q2020) with an average rate value of 8.16%

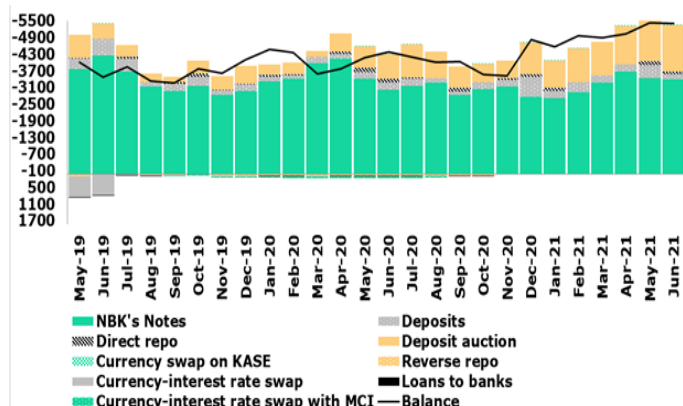
(8.87% in 2Q2020). At the end of 2Q2021, the rate on two-day USDKZT swaps decreased from 8.39% in 1Q2021 to 8.16% (8.45% at the end of 2Q2020) with a quarterly average of 8.21% (9.02% in 2Q2020).

Fig. 11. Money market rates



Source: NBK, Halyk Finance

Fig. 12. Withdrawal of excess liquidity



Source: NBK, Halyk Finance

The dynamics of money market rates during the 2nd quarter of this year were relatively uniform, and the rates themselves were formed near the lower limit of the NBK's liquidity management corridor. The volatility of rates on the money market in early April due to the weakening of the national currency against the US dollar to 433.55 tenge was replaced by relatively uniform dynamics, which acquired slight volatility in mid-June due to the strengthening of the national currency against the dollar to 425.63 tenge, followed by a weakening to 427.8 tenge per US dollar.

The effective rate of initial placement of short-term notes of the NBK increased from 9.33% at the end of last year to 9.41% in June 2021. At the same time, the volume of initial placement increased from T1 735 bn in January to T2 391 bn in June. For 2Q2021, the volume of withdrawn liquidity with the help of NBK notes increased by 0.8% to T3 475 bn. At the same time, the effective yield on NBK notes in circulation decreased from 10.21% in December 2020 to 9.34% in June this year (10.40% in June 2020).

Thus, against the background of gradual economic recovery and the preservation of monetary conditions, money market rates in Kazakhstan were formed at the lower border of the NBK's liquidity management corridor, reacting to both the weakening and strengthening of the national currency.

### Kazakhstan tenge - the rate weakening

As of the end of 2Q2021, the national currency has weakened by 1.7% since the beginning of the year to 427.79 tenge per US dollar, while the tenge has lost 5.9% of its value over the year. The average value of the national currency exchange rate increased from 419.70 tenge in 1Q2021 to 428.36 tenge per US dollar in 2Q2021.

In 2Q2021, the exchange rate of the national currency was influenced by several opposite factors. Among those that supported it, first of all, was the upward dynamics of prices for Brent crude oil, the cost of which has increased by 45% since the beginning of the year (+82.6% yoy, +18.2% qoq) and amounted to \$75.13 per barrel at the end of the quarter. The inflow of foreign capital to the State Securities of the Republic of Kazakhstan has provided relatively good support for the national currency exchange rate since the beginning of the year. Thus, the portfolio of investments of non-residents in state securities has increased by 84% since the beginning of the year to T791.4 bn (the inflow since the beginning of the year amounted to T361 bn). However, in 2Q2021, there was a slight outflow of portfolio investments of non-residents in the State Securities of the Republic of Kazakhstan in the amount of T8.4 bn (-1.0% qoq). Sales of NBK currency for the National Fund of the Republic of Kazakhstan, which increased by 30.9% qoq to \$2.4 bn, supported the exchange rate of the national currency. The outstripping quarterly dynamics of export volume growth in 2Q2021 by 35.1% (+3.4% yoy for 6M2021) against the background of import growth by 30.0% (+9.2% yoy for 6M2021) did not lead to a noticeable strengthening of the tenge against the US dollar.

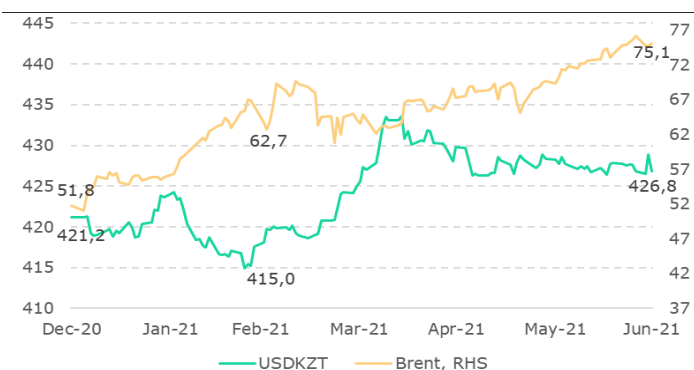
The USDRUB exchange rate had a certain restraining effect on the strengthening of the tenge exchange rate, which was supported only by high oil prices and the absence of hostile rhetoric from the US State Department.

The DXY index in the second quarter of 2021 slightly weakened to 92.44 p.p. from 93.23 p.p. (Q12021) and strengthened from 89.94 p.p. since the beginning of the year. Thus, the impact of the exchange rate of the US currency itself on the exchange rate of the Kazakhstani tenge and the Russian ruble was relatively limited. For the Russian ruble, the correlation coefficient with DXY was 47.4%, and for the Kazakh tenge 34.3%.



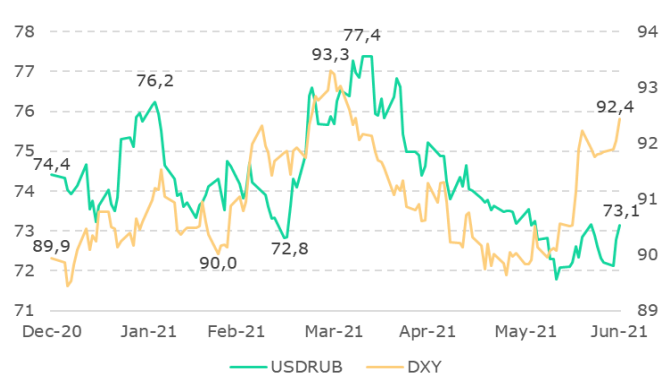
It is believed that at the current level of oil prices, the Russian ruble is undervalued by at least 18-19% due to the budget rule of the Ministry of Finance of the Russian Federation (the cut-off level under the budget rule for 2021 was increased to \$43.3 per barrel). However, despite the lack of additional support in the form of foreign capital inflows to the State Securities of the Russian Federation (the share of non-residents decreased to 19% from 22.7% at the beginning of the year) and the expansion of foreign currency purchases under the budget rule, the Russian ruble exchange rate still strengthened by 4.4% qoq (by 2% at the beginning of the year) to 72.37 rubles per US dollar. Despite the strengthening of the exchange rate of the Russian ruble to the dollar, the exchange rate of the Russian ruble to the Kazakhstani tenge in 2Q2021 was formed at the level of 5.6-5.96 tenge per Russian ruble.

Fig. 13. Dynamics of USD KZT and Brent oil



Source: Bloomberg, NBK, Halyk Finance

Fig. 14. Dynamics of the USDRUB and the USD index



Source: Bloomberg, Halyk Finance

Recall that the National Welfare Fund of the Russian Federation (NWF), where the Ministry of Finance sends currency purchased on the currency exchange, refused to store dollars in the asset structure. However, the conversion operations were completed only by the beginning of July. The share of the dollar in the asset structure was reduced from 35% to 0%, while the shares of the EURO and the Chinese yuan were increased from 35% to 40% and from 15% to 30%, respectively. The share of gold in the fund's structure was 20%. Thus, if there is no purchase of the dollar within the budget rule, we can expect a strengthening of the Russian ruble for the USDRUB pair in the second half of this year. However, in contrast to this decision, amendments to the federal law "On Currency Regulation and Currency Control" were adopted and ratified, under which the mandatory repatriation of export earnings by resident companies exporting raw materials from the Russian Federation was canceled. Taking into account the fact that the annual export of goods from the Russian Federation in recent years amounted to about \$300-400 bn, a reduction in this volume will have a significant weakening effect on the Russian ruble in the second half of 2021 (the law came into force on July 1 of this year). Some support for the Russian ruble will be provided by the tightening of monetary conditions (in July, the Central Bank of Russia raised the key rate by 100 bps to 6.5%), which is likely to continue following the accelerated rate of inflation. The forecast for the key rate at the end of this year is 7-7.25%. However, the strengthening of the Russian ruble from carry trade operations will be limited, since American financial companies are prohibited from buying government debt on the primary market. Based on the above, the exchange rate of the Russian ruble, according to our forecasts, will be 75-76 rubles per US dollar at the end of 2021.

During the 2nd half of this year, high energy prices will have a beneficial effect on the exchange rate of the Kazakh currency. On average, for the current year, Brent oil prices will be about \$65-\$67 per barrel (\$43.21 in 2019). The growth of domestic demand for imported goods, which have risen in price on foreign markets due to rising production costs (rising prices for metals, energy carriers), as well as due to current quarantine restrictions and, as a result, not fully restored production chains of international cooperation, may negatively affect the exchange rate of the Kazakhstani tenge.

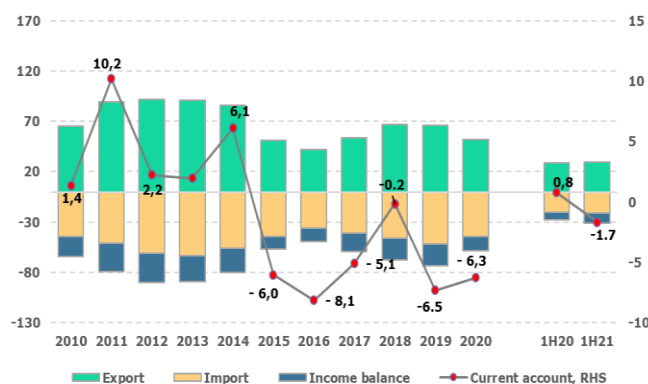
The NBK's currency exchange operations for the National Fund of the Republic of Kazakhstan will contribute to the strengthening of the national currency exchange rate. At the moment, out of T4.55 trln tenge of planned transfers, 2.1 trln has been received to the budget, i.e. the NBK has carried out currency exchange operations in the amount equivalent to \$4.3 bn. About \$5.3 - \$5.4 bn should enter the foreign exchange market in the second half of this year. Such a volume of currency inflow to the foreign exchange market will support the tenge until the end of the year.

We do not change our current forecast for the national currency exchange rate, which at the end of this year is 435 tenge per US dollar, expecting that the rate for the RUBKZT pair will be in the range of 5.75-5.80 tenge per ruble.

## The current account deficit widened in 1H2021

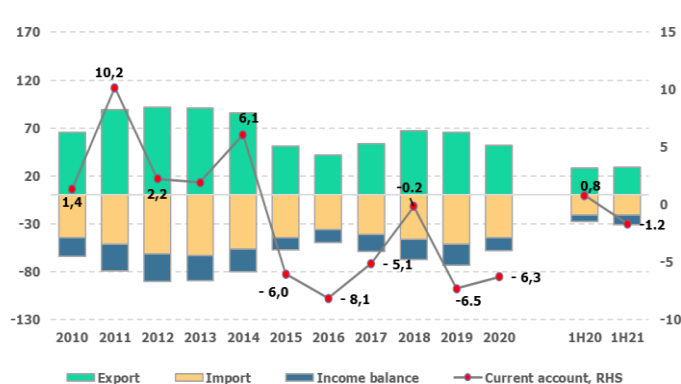
The current account of the Republic of Kazakhstan for 1H2021, according to the preliminary assessment of the NBK, developed with a deficit of \$1.7 bn compared to a surplus of \$801 mn in 1H2020. The expansion of the current account deficit was primarily facilitated by a reduction in the trade balance by 5.9% yoy to \$9.4 bn, an expansion of the primary income balance deficit by 36.1% yoy to \$10.1 bn, as well as the existing deficit of the secondary income balance at \$195.5 mn (the deficit in 1H2020 at \$32.9 mn). The current account was supported by a reduction in the deficit on the services account by 55.8% yoy to \$779 mn.

Fig. 15. Current account deficit, \$billion.



Source: NBK, Halyk Finance

Fig. 16. Reduction of inflows on the financial account, \$billion.



Source: NBK, Halyk Finance

The reduction in the trade account surplus for 1H2021 was due to an increase in exports by 3.4% yoy to \$26.9 bn (\$26.0 bn for 1H2020), while imports increased by 9.2% yoy to \$17.5 bn (\$16.0 bn for 1H2020). The increase in the primary income account deficit was facilitated by an increase in income payable from direct investments to \$9.3 bn (+42.4% yoy). As part of this account, there is a decrease in the amount of remuneration for the reserves and assets of the NFRK by 3.9% yoy to \$479 mn. According to the service account for 1H2021 there was a reduction in the deficit by 55.8% yoy due to a decrease in imports of international services by 24.1% yoy to \$3.3 bn (\$4.4 bn for 1H2020) and a decrease in exports of services by 2.7% yoy to \$2.5 bn (\$2.6 bn for 1H2020).

## Financial account (excluding NBKR reserve assets)

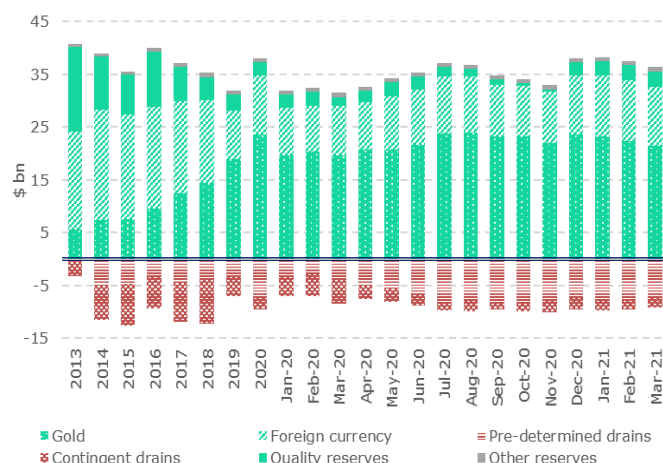
According to the NBK's assessment, the financial account saw a decrease in the volume of capital inflows from \$6.1 bn in 1H2020 to \$4.3 bn in 1H2021. The positive dynamics of capital inflows in the Republic of Kazakhstan were facilitated by the expansion of capital inflows in the portfolio investment account by 98.7% yoy to \$7.2 bn. On the contrary, the direct investment account shows a decrease in capital inflows from \$4.0 bn in 1H 2020 to \$1.4 bn in the 1st half of this year. According to the article other short-term capital flows, there are multiple increases in capital outflow from \$1.2 bn in the 1st half of last year to \$5.6 bn in 1H2021.

As part of the balance of payments, the NBK records a significant reduction in the number of errors and omissions from \$6.5 bn in the 1st half of last year to \$2.1 bn in the 1st half of this year. Such a significant reduction in the article is due to a decrease in the movement of unaccounted capital within the financial and current accounts due to the normalization of the economic situation.

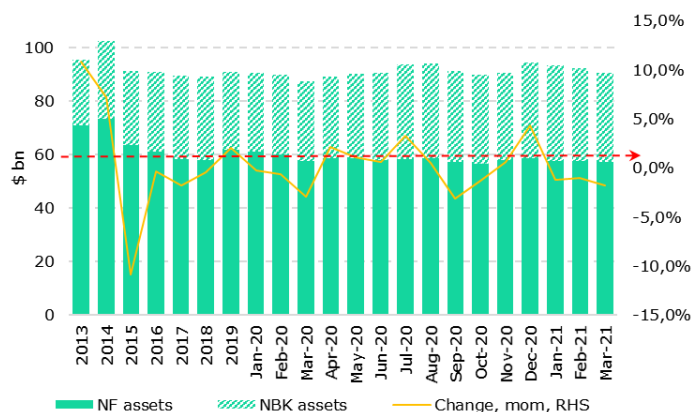
## Consolidated international reserves are declining

Consolidated reserves for 1H2021 decreased by 2.1% (+1.9% yoy) to \$92.4 bn due to a 1.7% reduction in the volume of the NBK's gross gold reserves to \$35.0 bn (+6.6% yoy) and a 2.4% reduction in the volume of the National Fund's assets from the beginning of the year to \$57.3 bn (-0.7% yoy).

In the structure of the NBK's assets, there is a decrease in assets in gold by 7.5% since the beginning of the year to \$21.8 bn (+1.2% yoy). The reduction of the NBK's assets in gold is primarily due to the decline in the value of gold on global markets. Thus, the price of gold at the end of June was from \$1,770 per troy ounce, having fallen in price by 6.8% since the beginning of the year. According to the IMF, in January-June, the physical volume of NBK gold decreased by 0.5% from the beginning of the year and amounted to 12.41 mn troy ounces (+2.0% yoy, -2.5% qoq) or 385.9 tons. The share of assets in gold at the end of 1H 2020 amounted to 62.2% of the gold reserves, having decreased from 66.2% at the beginning of the year.

**Fig. 17. International reserves of the NBK**


Source: IMF, Halyk Finance

**Fig. 18. Consolidated reserves of Kazakhstan**


Source: NBK, Halyk Finance

Assets in SLE increased by 9.8% from the beginning of the year to \$13.2 bn (+16.7% yoy). At the same time, the share of SLE in the structure of gold reserves was 37.8% compared to 33.8% at the beginning of the year. According to the IMF, in January-June 2021, the structure of gold reserves saw a reduction in assets in securities to \$5.7 bn (-11.1% yoy, -4.2% qoq). Assets and deposits in SLE in June 2021 increased by 24.1% yoy and amounted to \$6.6 bn (56.5% yoy).

Receipts of funds to the National Fund in January-June of this year, according to the Ministry of Finance of the Republic of Kazakhstan, decreased by 69.4% yoy to 1.1 trln (\$2.6 bn). The decrease in revenues to the National Fund was caused by a decrease in direct tax revenues by 11.7% yoy to T921.5 bn. Receipts for CPN decreased by 15.7% yoy to T314 bn, for rental income for export by 6.7% yoy to T110. 2 bn. The share of Kazakhstan in the division of products under concluded contracts increased by 5.2% to 278.6 bn rubles. The tax on excess profits for 1H2021 decreased by 66.8% yoy and amounted to T32 bn.

For 1H2021, the fund's expenses decreased by 32.2% yoy and amounted to 2.1 trln or \$5.0 bn. For 6 months of the current year, the size of the guaranteed transfer to the state budget decreased by 49.4% yoy and amounted to T1.6 trln or \$3.7 bn. The amount of the target transfer for 6 months of this year amounted to T540 bn (last year it was absent, in 2019 it amounted to T370 bn). For 1H2021, the balance of receipts to the Fund was negative at the level of T1.0 trln (\$2.4 bn).

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