

August 12, 2022

During the first 5 months of this year, the economy of Kazakhstan evinced high growth rate of 4.6% yoy amidst a favorable commodity price environment in the global markets. However, due to the planned shutdown of production at the Kashagan field in June, economy slowed a bit down that month and it reflected in the 6-month GDP growth rate which decelerated to 3.4% yoy (4.6% yoy in 1Q2022). Economic growth and a strong increase in the foreign trade surplus contributed to the improvement of budget parameters and the growth in state support for the economy, which mitigated the negative impact of external factors. External pro-inflationary pressure on the economy as a consequence of the conflict between the Russian Federation and Ukraine contributed to the acceleration of consumer price inflation in June to its maximum level since 2016 – 14.5% yoy. The expansion of fiscal impulse and credit to the economy led to an acceleration in inflation, both on aggregate demand side and the aggregate supply side of the economy as well. Amidst accelerating inflation, the NBK hiked the base rate in 2Q2022 by 50 bp to 14.5%. Since the prices went up on the major setup of the Kazakh exports in 1H2022, trade account surplus at \$21.6 billion (the highest in the last 8-year) led to the widening of the current account surplus to \$6.6 billion. Despite the contraction of demand for foreign currency and a significant surplus of external balances the tenge weakened by 7.7% YTD and stood at 465.1 per US dollar at the end of 2Q2022 (1.5% qoq).

Geopolitical tensions, global acceleration of consumer price inflation and monetary tightening in the second half of this year will affect the economy of Kazakhstan. We forecast GDP growth this year at the level of 3.3%, CPI rate at 15.0%-16.0% and the FX rate of 475 tenge per 1 US dollar as of the end of 2022.

High energy prices and a spike in oil output coupled with fiscal impulse will ensure GDP growth by 3.3% in 2022. Resource orientation of the Kazakh economy amidst the geopolitical tension that drives commodity prices up gives a competitive advantage and stimulates economic growth due to the external demand. Consequent of the sanctions against the Russian Federation, Kazakhstan's access to new markets for its products is expanding. Amidst the high commodity prices the export earnings of the republic for 6M2022 went up by 57% yoy, while the foreign trade surplus increased by 2.4 times. Decline in oil output in June due to the planned shutdown of Kashagan oilfield will be offset by higher oil output in 2H2022. Under a favorable commodity price environment, the country has enough room to implement an expansionary fiscal policy to mitigate the effects of external geopolitical shocks and support domestic demand.

Monetary tightening amidst accelerating consumer price inflation. Inflation rates were growing dynamically and as of the end of 2Q2022 reached the highest since 2016 at 14.5% yoy. Food (+19.2% yoy) and non-food inflation (+13.2% yoy) contributed significantly to the acceleration of consumer inflation in Kazakhstan. Paid services inflation in 1H2022 has not yet stepped over the double-digit threshold (+9.2%). The acceleration of consumer inflation rates for these key components amounted to 60%-90% of annual growth. Against the backdrop of such dynamics in consumer prices, the NBK raised the base rate to 14% in April and to 14.5% in July. However, the tightening of the monetary policy has not yet had an impact on inflation rates either in Kazakhstan or in the world due to the fact that the reasons for its acceleration arise not only from the demand side (budget impulse, credit growth, export expansion), but also from the supply side (growth in the cost of energy, metals, overhead and logistics costs, etc.). The persistence of geopolitical tensions in the world is also creating pro-inflationary pressures in the global economy, disrupting supply chains and creating shortages in food markets. We believe that price growth will continue in 2H2022, while consumer price dynamics will be within the range of 15.0%-16.0%.

Tenge - weakening amidst reduced demand. As of the end of June, FX rate of the national currency weakened by 7.7% since the beginning of the year and reached 465.1 per US dollar (1.5% qoq). Despite a significant inflow of foreign currency within the external accounts (current account surplus widened from \$2.2 bn to \$4.1 bn) in 2Q2022, the drop in the demand of the households for foreign currency (-0.1% qoq) and corporates (-28.1% qoq FX trade on stock market) was observed and accompanied by a decrease in FX transactions of the NBK for the NF in 2Q2022 (-70.9% qoq). In addition, in May, the NBK made a net buy of \$100.5 million at the FX market. Taking into account the current dynamics, the tenge FX rate at the end of 2022 will stand at 475 per US dollar.

Main macroeconomic indicators	2020	2021	2022		
			Base	Worse case	Best case
Oil Brent, average, USD/bbl.	42.3	70.4	100.0	90.0	110.0
Real GDP, % yoy	-2.5	4.1	3.3	1.9	4.2
Exchange rate USDKZT, eop	420.7	431.7	475.0	505.0	445.0
Exchange rate USDKZT, average	413.0	426.0	464.0	479.0	449.0
CPI, % change yoy	7.5	8.4	15-16	16.5-17.5	13.5-15.5
Base rate, %	9.0	9.8	15-16	16.5-17.5	13.5-15.5
Budget balance consolidated, % GDP	-4.0	-3.1	-3.1	-3.6	-2.8
Current account, % of GDP	-3.7	-3.0	4.4	1.7	5.2

Economy slowdown due to planned shutdown at Kashagan oilfield

The economy of Kazakhstan evinced high growth rates of 4.6% yoy in 5M2022 that due to the planned shutdown of production at the Kashagan oilfield in June resulted in slowing of GDP growth rate to 3.4% yoy in 6M2022. According to the Ministry of National Economy, GDP growth rate in January-May peaked at 4.6% yoy.

The Kazakhstan's economy is gradually adapting to function under the global geopolitical tension that produces multidirectional effects on the economy. Thus, high prices for Kazakhstan's commodities spurs the export earnings. At the same time, the acceleration of consumer price inflation amidst its import from outside and a significant expansion of budget expenditures resulted in a monetary tightening. In addition, consequent to sanctions between the West and the Russian Federation, there are economic risks associated with interruptions or decrease in oil supplies to the global market.

For Kazakhstan, which has no access to the sea, the oil delivery to the global markets is a serious challenge. Nowadays deliveries from Kazakhstan are directed through three main pipelines: the Caspian Pipeline Consortium (CPC) - about 51 million tons, the Atyrau-Samara pipeline - 14 million tons and the Kazakh-Chinese pipeline (KCP), which now mainly transports oil from the Russian Federation (10 million tons), with a potential capacity of up to 20 million tons with the current transportation of 3.6 million tons (2021) of Kazakh oil. In addition, the port of Aktau has a throughput capacity of 5.2 million tons per year.

Other transportation routes are significantly more expensive and will require a lot of time to set them in work. For example, 4 years were needed to expand the transportation capacity of the CPC. It will take at least 3 years to expand KCP capacity to redirect CPC flows. This includes expanding the existing KCP capacity, which is 20 million tons per year, as well as expanding the Atyrau-Kenkiyak oil pipeline, which has a capacity of only 6 million tons per year. In addition, there is still no understanding as to whether China is ready to buy such volumes of oil from Kazakhstan, because large oil deposits of China are located in the border areas with Kazakhstan. The Baku-Tbilisi-Ceyhan (BTC) oil pipeline with a capacity of about 50 million tons per year works only 45-50% of its full capacity. The disadvantages of this direction are the need to invest in oil pipelines to Aktau, modernize and expand the port of Aktau (current capacity is about 5 million tons per year), invest in the construction of the tanker fleet and the infrastructure of Baku port terminals. Thus, it is still extremely difficult to quickly and fully diversify the routes of supply to the global markets the staple product of the Kazakh economy. There are risks of suspension of transportation of Kazakh oil through the CPC (80% of oil exports) for the Kazakh economy, however, we do not expect those risks to materialize in our base case scenario.

In the wake of the unfolding global energy crisis, due to the growth of external demand for Kazakhstan commodities, business activity in the economy reached a relatively high level. Brent prices in 2Q2022 increased by 14% qoq and by 64% yoy to almost \$112.7 per barrel (quarter average), approaching 2014 levels.

Fig. 1. GDP RK and oil prices

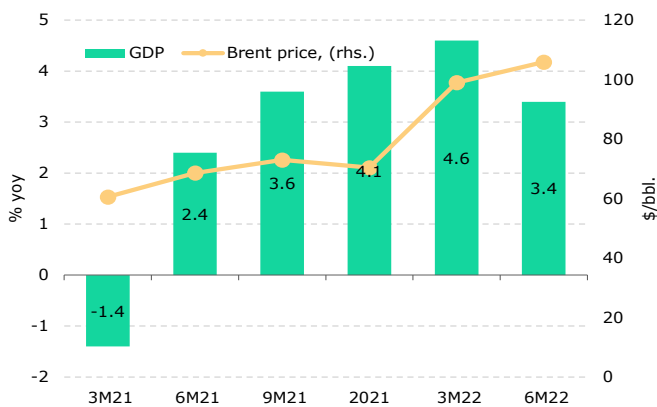
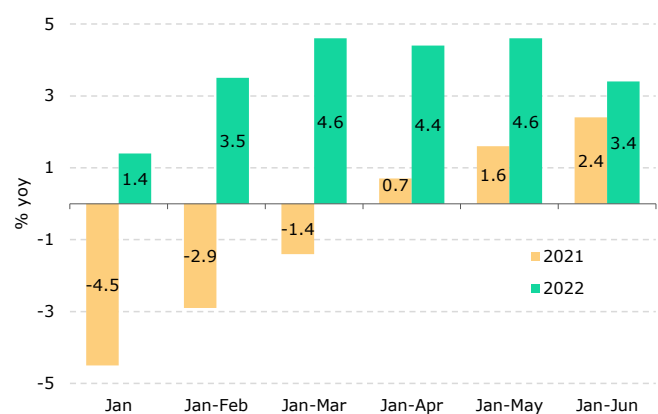


Fig. 2. GDP dynamics



* GDP accumulated Source: BNS

Source: BNS

In addition, fiscal stimulation of domestic demand contributed a lot to the economic growth. Thus, in 5M2022 state budget expenditures increased by 18.9% yoy to T7.8 trillion (T6.6 trillion in 5M2021).

The military conflict in Ukraine has been going on for about 6 months already and becoming a protracted one negatively affects the global economy. In its updated July forecast, the IMF lowered global economic growth from 3.6% to 3.2% in 2022. This is the second downward revision of the global GDP growth forecast this year. Thus, in April, the IMF revised its previous forecast, which assumed the growth of the global economy in 2022 by 4.4%. In contrast, Kazakhstan's GDP growth was revised upward from 2.3% (forecast April 2022) to 2.9%. The forecast of

economic recession in the Russian Federation was softened from -8.5% to -6%. IMF experts explained the mitigation of the recession in the Russian economy by the growth of export earnings. Considering that the Russian federation is the largest trading partner of Kazakhstan, the reduction in the rate of decline of the Russian economy due to sanctions will have a positive impact on the Kazakh economy as well. In addition, Kazakhstan can even benefit from relocation of companies from the Russian Federation to Kazakhstan as well as from attracting personnel from there. A softer monetary policy of the Bank of Russia amidst monetary tightening in Kazakhstan will make attractive capital flows from the Russian Federation to the republic.

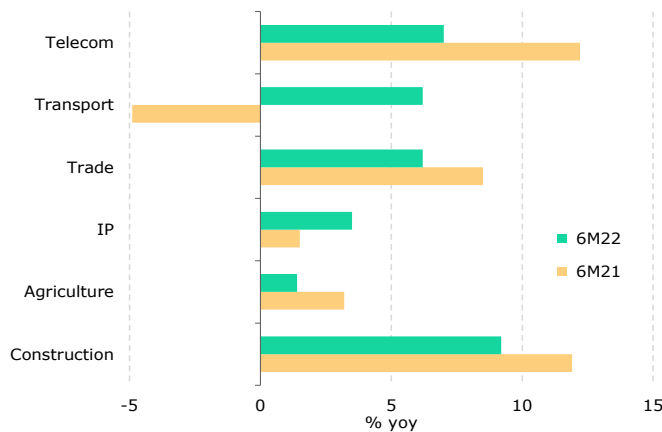
Real sector temporary slowdown

High external demand and rising prices in the global commodity markets had a positive impact on the economy in the 2nd quarter. However, purely technically, there was some slowdown of certain indicators due to the high base effect of last year.

In January-June, the growth of industrial production slowed down to 3.5% yoy, compared to 5.8% yoy in the 1st quarter of this year, while in June the decline in it amounted to 1.3% yoy. The contraction of activity was due to the planned shutdown of output at the Kashagan field, which produces almost 20% of all oil in the country. The repair at the field was completed ahead of schedule, and in early July, oil output at the field had already resumed. In general, for 2022, according to the forecast of the Ministry of Energy of the Republic of Kazakhstan, production at Kashagan should increase by 7% yoy. Therefore, the decline in volumes in June will be "more than" offset by an increase in output in 2H2022.

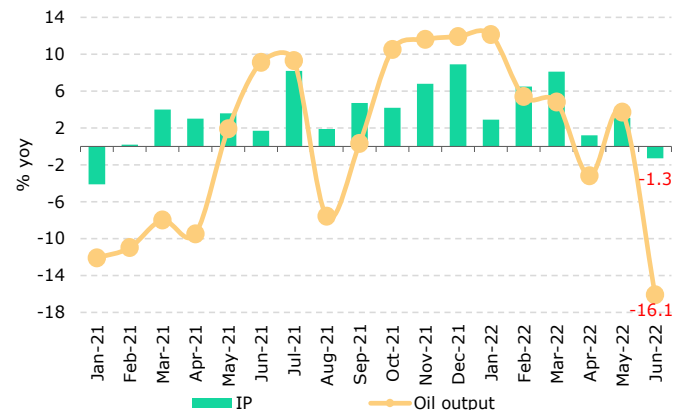
High growth rates continued in the manufacturing (+5.8% yoy) in 1H2022. However, the dynamics in 1Q2022 in it was higher (+6.5% yoy). This dynamics of growth in the manufacturing was supported by: oil products output (+8.1% yoy), chemical industry (+10.1% yoy), metal products (+5.1% yoy) and machine building (+9.6% yoy). Vehicles output in 6M2022 amounted to 47 thousand units (+35.8% yoy). It should be noted that this year the state allocated T100 billion for subsidized car loans for domestically produced cars, which additionally provided support to manufacturers. The decline in output took place in the ferrous metallurgy sector due to overstocking of the neighboring market in the Russian Federation.

Fig. 3. Output by industry



Source: BNS

Fig. 4. IP and oil output



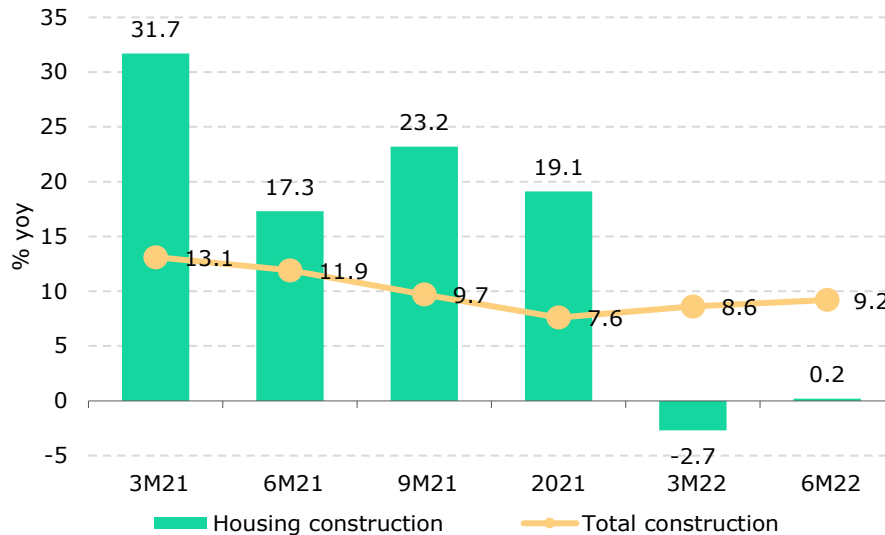
Source: BNS

It should be noted that this year the performance of the sectors of the Kazakhstani economy will still be affected by the effect of the high base of last year, which will be expressed in more moderate growth rates. However, the growth in the output of economic sectors will be relatively more stable compared to the recovery dynamics of the previous year. Thus, the volume of domestic retail trade in January-June increased by 6.2% yoy, which corresponded to pre-COVID indicators. The growth rates of transport services also formed at the level of 6.2% yoy. In the telecommunications sector growth accelerated to 7% yoy in 6M2022 from 6.4% yoy in 1Q2022. Output of agricultural products and services slowed to 1.4% yoy in January-June 2022 from 1.8% yoy. The situation in agriculture, according to statistics, this year is not typical. Thus, for 5M2022, there were no official statistics in the crop raising at the regional level. In turn, in the livestock breeding sector in most regions there was a synchronous slowdown in growth rates, which was also not observed in the previous years. The dynamics in the construction remained at a fairly high level. Thus, in 6M2022 the volume of construction works increased by 9.2% yoy to T2.1 trln. At the same time, the construction of non-residential buildings increased by 29.2% yoy (40% of the total volume), construction of infrastructure up by 1.8% yoy (43% of the total volume), and residential construction increased by only 0.2% yoy. Atyrau region contributed the most to the growth of construction, where a project is being implemented to

expand oil production capacities. Thus, according to Tengizchevroil, according to the results of 1H2022, the expansion project was complete by 91%. The total cost of this project is \$45.2 billion.

In the residential construction there was a noticeable slowdown in activity – the volume of construction of residential buildings increased by only 0.2% yoy in 1H2022, while the number of apartments built decreased by 2% yoy. As a result, the commissioning of new housing in the republic decreased by 0.5% yoy to 6.6 mln sq.m. However, there has not yet been a sharp decline of investment in residential construction that has increased by 18.8% yoy, which will provide some support to the construction industry this year. At the same time, the construction industry is facing a set of challenges that will negatively affect the future dynamics of the industry. In particular, there has been an excessive increase in housing prices under the influence of government stimulus measures, which, although they began to partially phase out in 2H2021, price dynamics remain strong so far. Rising prices for building materials and increasing overall costs amidst of higher interest rates will also provide support for higher prices in the industry. This, in turn will have a negative impact on the demand for residential real estate.

Fig. 5. Construction activity



Source: BNS

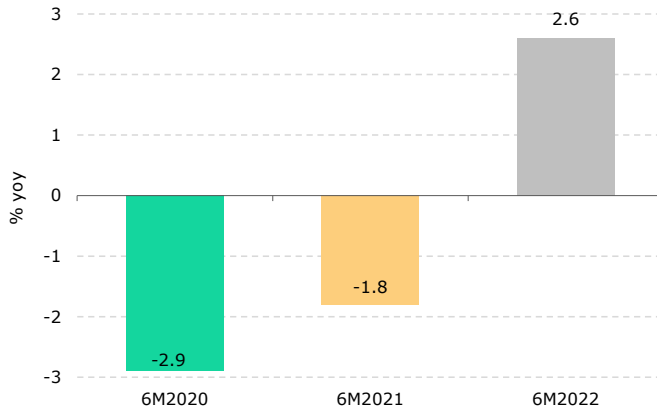
Gradual increase of investment

Investment in fixed assets gradually began to increase amidst economic growth. Thus, in the 1st quarter of this year, investments increased by 1.5% yoy, and by the end of 1H2022 were already up by 2.6% yoy. The investments amounted to T5.7 trillion, having increased from T5.2 trillion in 1H2021.

In the second quarter of this year, small business investments continued to predominate and amounted to T1.9 trillion (T1.1 trillion in 1Q2022). Investments of large enterprises amounted to T1.4 trillion (T1 trillion in 1Q2022), while investments of medium enterprises hardly reached T160 billion. In general, for the first half of 2022, investments of small enterprises showed an increase of 5.8% yoy, and for large enterprises - by 8.9% yoy. The main increase in investments was due to construction costs which went up by 10.2% yoy for small enterprises and by 34.5% yoy for large enterprises.

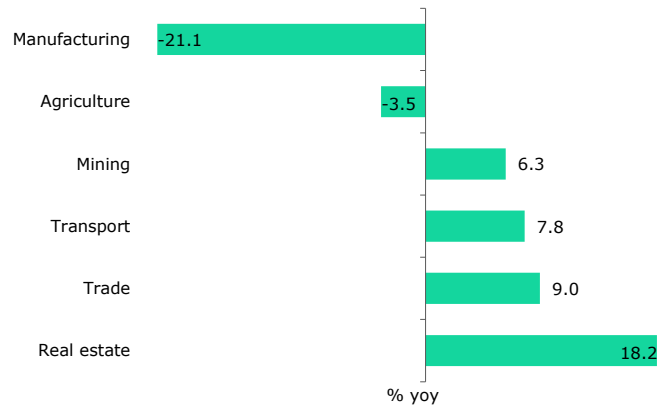
In terms of industries, investment activity showed a generally positive trend, with the main growth coming from the real estate sector (+18.2% yoy), with investments of T1.3 trillion or 22% of the total. The growth rate of investment in fixed assets in the extractive industry in 1H2022 increased by 6.3% yoy to T1.9 trillion (33% of the total). Investments in the manufacturing industry showed a decline of 21.1% yoy due to the high base of last year, when growth reached 88.3% yoy. Positive dynamics of investment growth was also noted in construction (+12.2% yoy), trade (+9% yoy) and transport (+7.8% yoy). Along with this, there was a decrease in investments in the telecommunications sector (-24.6% yoy) and in agriculture (-3.5% yoy).

Fig. 6. Investment – from slump to growth



Source: BNS

Fig. 7. Investment by sector



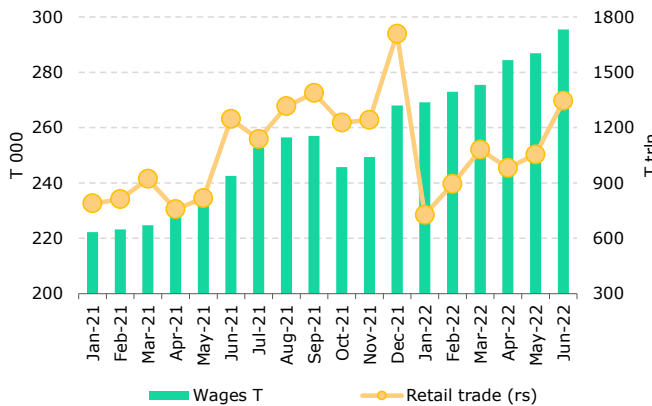
Source: BNS

Consumption growth is subdued, and inflation has outpaced wage growth

Since the beginning of the year the average salary in June increased by 10% and reached KZT295 thousand (\$635). However, the average inflation rate for the same period accelerated by 11.8% yoy. Thus, despite the significant dynamics of wage growth, which has been growing continuously in real terms since 2018, it has begun to lag behind the dynamics of inflation, which accelerated drastically this year. As a result, the increase in wages of state employees this year is more compensatory, mitigating the consequences of rising prices in the consumer market.

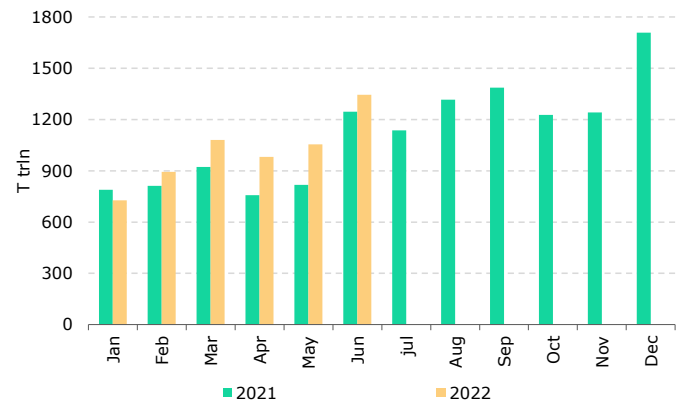
Outstripping inflation growth rates, among other factors, restrained consumer activity of the population, which was already limited. Thus, due to the January unrest and weakening of the tenge, the retail trade turnover decreased by 3.3% yoy in January-March. In the second quarter, the situation improved so far, and by the end of 6M2022, the retail trade turnover turned positive (+1.2% yoy).

Fig. 8. Wages and trade dynamics



Source: BNS

Fig. 9. Retail trade



Source: BNS

Due to a significant increase in food prices (+19.2% yoy in June), the reduction in household consumption is noted primarily in the group of food products, where the sales volume decreased by 6.3% yoy. Non-food products sales, on the contrary, increased by 5.4% yoy, which was driven by the growth of consumer loans by 21.8% yoy to T3.6 trillion in the same period.

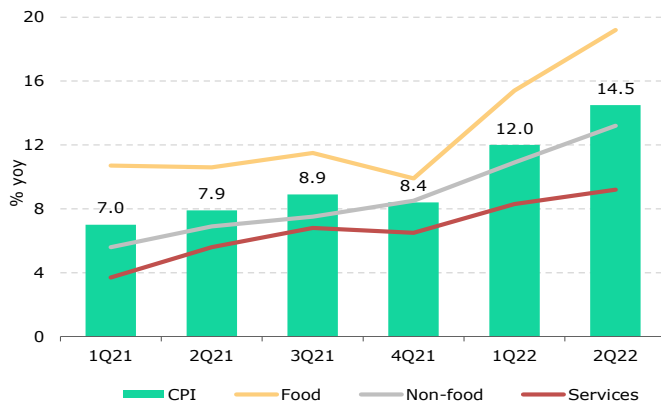
Retail sales in May and June increased by 12.9% and 25.3% in monthly terms, which may indirectly indicate the recovery of consumer activity at present. At the same time, the weakening of the national currency traditionally affects the retail sales. Since there are no grounds for strengthening yet, subdued growth in retail sales will continue. The weakening of the tenge coupled with an increase in the base rate and, as a result, an increase in the attractiveness of deposits, will constrain household consumption in the near term and stimulate savings.

Consumer price inflation remains high

Consumer price inflation (CPI) accelerated to 1.6% mom in June from 1.4% mom in May. In annual terms, CPI rate accelerated to 14.5% yoy (14.0% yoy in May). CPI index has been rising in annual terms for six months in a row experiencing the effect of last year's low base. Prices grew across all components of CPI – food prices rose by 19.2% yoy (+19.0% yoy in May), non-food prices – by 13.2% yoy (+11.9% yoy in May) and paid services – by 9.2% yoy (+9.1% yoy in May).

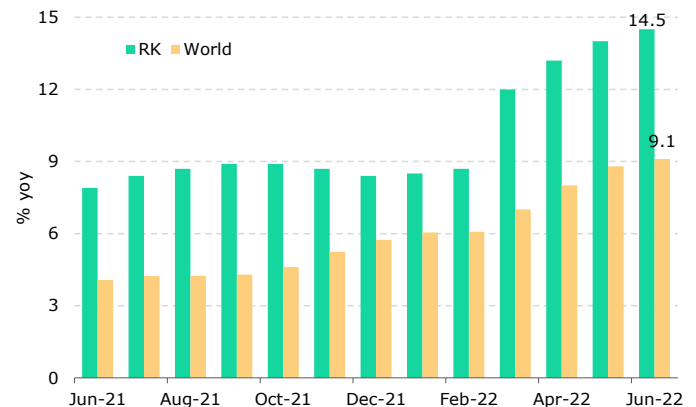
Turbulence in the FX market contributed to consumer prices growth in the country. Thus, in 1H2022, the national currency weakened to 449 per 1 US dollar (average value) against 424 per 1 dollar in 1H2021. In addition, tenge also weakened against the ruble in the same period by more than 6% yoy. Considering that almost 40% of Kazakhstan's imports come from the Russian Federation, weakening of the Kazakhstan tenge against the Russian ruble added to consumer imports inflation.

Fig. 10. CPI in Kazakhstan



Source: BNS

Fig. 11. CPI RK and World



Source: BNS, Bloomberg

At the end of 6M2022, Kazakhstan's GDP grew by 3.4% yoy, which, among other things, was influenced by economic stimulus resulting from the budget spending increase (+18.9% yoy in 5M2022). Thus, the republic's economy is experiencing inflationary pressure, both from the demand as well as from supply side. The military conflict in Ukraine and sanctions against the Russian Federation further increase the pro-inflationary pressure on the country's economy, both directly and indirectly.

Prices surge in the second quarter was slightly lower than in the first quarter (5.2%) and amounted to 5%. Despite some slowdown and a downward trajectory of inflation, price growth has the potential to accelerate further. In particular, in June the term of the moratorium on maintaining marginal prices for fuel and energy (in certain regions of the republic) and utility tariffs expired. Also worth noting is the slowdown in the growth of agricultural output, which is reflected in the supply of agricultural products within the country. As a result, inflationary pressure on the economy in the second half of this year will remain at a high level. While the external inflationary background is also getting firmer.

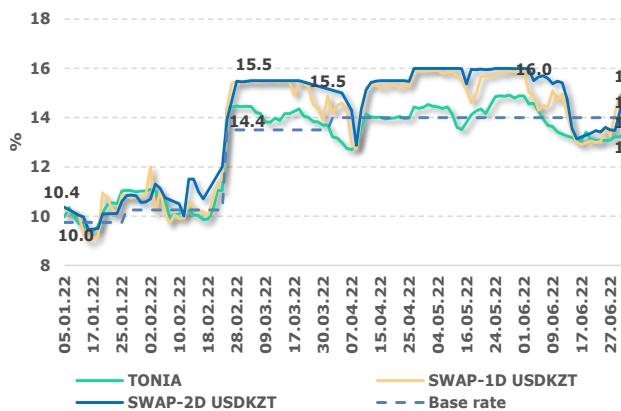
Interest rate policy – monetary tightening goes on

Since the beginning of the year, the NBK has consistently increased the base rate from 9.75% at the beginning of the year to 13.50% in March. At the end of April, the NBK raised its base rate by 50bp up to 14%. The liquidity management band was kept symmetrical within +/-1%. The acceleration of consumer price inflation on the part of aggregate demand was facilitated by the pro-cyclical fiscal policy. Along with the implementation of a positive budgetary impulse and anti-crisis measures within the support programs in the republic, there was observed a high rate of credit expansion to the economy by 24.8% yoy in June this year (the volume of consumer loans increased by 32.5% yoy in 6M2022). External conditions also contributed to the acceleration of consumer price inflation through foreign trade channels, especially from major trading partner countries. In addition to importing consumer price inflation, rising geopolitical tensions over the military conflict in Ukraine have also contributed to higher inflationary pressure. At the end of July, the NBK expectedly increased the rate by 50bp to 14.5%. For the first time since the autumn of 2016, the base rate began to match the consumer price inflation metrics in the country. There was also some inflationary pressure on the aggregate supply side. Thus, in 5M2022 the economy showed high growth rates of 4.6% slowing down to 3.4% in 6M2022.

We believe that the main stance of the monetary policy of the Republic of Kazakhstan this year will be aimed at monetary tightening. Inflation processes in non-CIS countries are picking up (EU-8.6% yoy, USA 9.1% yoy, worldwide – 9.1%) amidst a slowdown in global economic growth. Global monetary tightening could lead to a further slowdown in global growth, as well as provoke a public debt crisis in some countries. Under such conditions, the government of the Republic of Kazakhstan will be forced to maintain a high level of fiscal impulse by increasing public spending. In addition, the high cost of energy and the end of the moratorium on rising prices for utilities will contribute to the increase in costs of production and thus cost pushing inflation on the part of the aggregate supply. The weakening of the national currency amidst of high prices for export goods will contribute to the transmission of inflation through the FX channel.

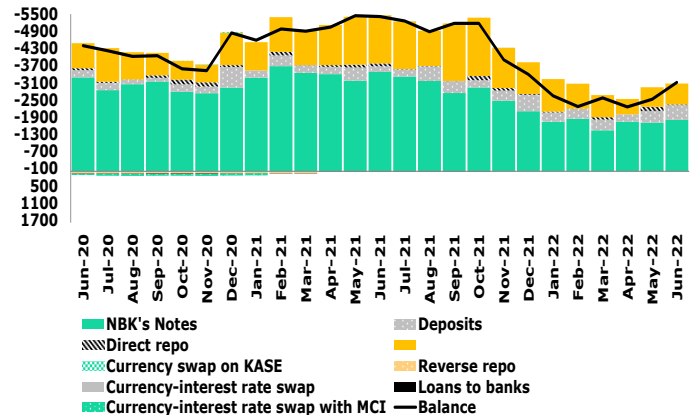
Despite the monetary tightening lending in Kazakhstan remains at a high level, supporting household spending and therefore stimulates inflation through the credit channel. Thus, the conditions that accelerated inflation in 1H2022 will continue in 2H2022. According to our current forecast, consumer price inflation dynamics for the year will fall within the range of 15%-16% yoy, while the base rate of NBK at the end of the year will also be 15%-16%.

Fig. 12. Money rates, eop



Source: NBK, Halyk Finance

Fig. 13. Excess liquidity withdrawal



Source: NBK, Halyk Finance

Money market reacts to monetary tightening and FX rate fluctuations

Interest rate on automatic REPO operations (TONIA) at the end of June 2022 was at the level of 13.4% (10.56% at the end of December 2021 and 13.9% at the end of March 2022) with an average value of 13.9% (11.8% in 1Q2022). REPO transactions in 2Q2022 increased by 17.7% qoq (an increase of 2.2 times yoy) and amounted to KZT44,600 bn, while the average value of daily transactions for the period amounted to KZT719.4 bn (KZT676.7 bn in 1Q2022). The maximum daily volume of deals on automatic REPO operations fell on the first ten days of April 2022 and amounted to KZT1,141 bn (KZT1,026 bn at the end of January 2022). The quarterly growth in money market transactions was accompanied in 2Q2022 by an increase in the money supply (MS) by 3.1% qoq and by 1.1% ytd. The correlation between the market rate and transactions in the money market increased from 17.5% in 1Q2022 to 66.0% indicating that the money market is adapting to the monetary tightening (an increase in the base rate from 10.25% at the beginning of the year to 14% at the end of 1H2022).

Overnight swaps transactions with USDKZT pair in 2Q2022 increased by 82.2% qoq to KZT7 367.8 bn with the average rate of 14.9% (12.4% in 1Q2022). The maximum volume of transactions for USDKZT overnight swaps fell on May 4, 2022 and amounted to KZT200.5 bn with an average quarterly value of KZT122.8 bn (average quarterly value of the nominal volume of transactions was KZT79.3 bn in 1Q2022). Transactions on two-day swaps with USDKZT pair in 2Q2022 increased 8 times to KZT3 114 billion. As of the end of 2Q2022, USDKZT two-day swap rate stood at 15.7% (15.5% at the end of 1Q2022) with a quarterly average at 15.3% (11.9% in 1Q2022). The maximum volume on two-day swaps fell on May 5 and amounted to T93.1 bn, with an average quarterly value of T54.6 bn (an average quarterly value of the nominal volume of transactions was T9.9 bn in 1Q2022).

In 2Q2022, there was a noticeable increase in the amount of withdrawn liquidity via NBK notes (57.7% in the structure of withdrawal instruments) by 25.4% qoq (-48.3% yoy) to KZT1.796 bn. At the same time, the effective yield on NBK notes in circulation in June 2022 was at 13.67% (9.96% in December 2021 and 11.57% in March 2022). The effective rate of the NBK notes issued in June 2022 was 14.92% with the volume of placement of KZT1,711 bn versus the rate of 10.21% and the volume of issuance of KZT879.5 bn in January of this year. The yield on placement of NBK notes for a period of 91-182 days was 14.0997% and 13.7693% in June 2022, respectively. In general, the volume of excess liquidity in the system increased by 23.3% qoq (-42.6% yoy) and at the end of June amounted to KZT3,111 bn.

In 2Q2022, the money market rate was formed closer to the upper limit of the NBK interest rate band (13.9% average) for liquidity management. Growth in volumes and rates in the FX swap market reflected the dynamics of the exchange rate and demand for tenge liquidity in the money market amidst of adaptation to the NBK's monetary tightening.

FX rate weakening amidst shrinking FX demand

As of the end of June, the national currency weakened by 7.7% since the beginning of the year and amounted to 465.1 tenge per US dollar (weakening by 8.7% yoy, 1.5% qoq). In 2Q2022, the FX rate of the national currency peaked 472.8 tenge per US dollar. The weakening of the FX rate was largely due to geopolitical factors rather than economic ones. Thus, oil prices had increased by 47.6% since the beginning of the year and amounted to \$114.8 per barrel hitting the long-term highs (\$128 per barrel). The average oil price for 2Q2022 reached \$112 per barrel (\$97.9 per barrel in 1Q2022).

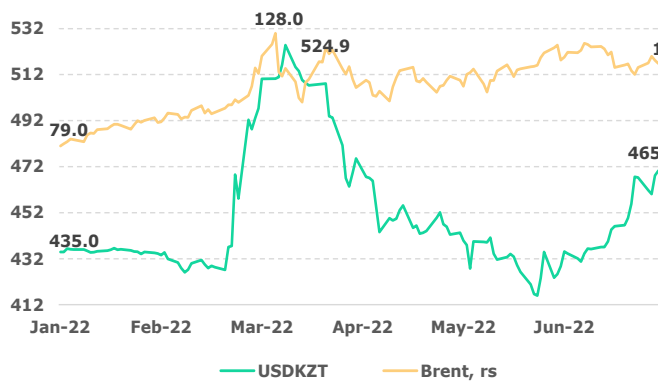
The volume of NBK FX exchange operations for the National Fund in 2Q2022 decreased by 70.9% qoq to \$611 million. And in May of this year, the decrease in FX operations was by 97.6% mom to \$4 million. In addition, in May the NBK entered the foreign exchange market and bought \$100.5 million (net buy). The decrease in the NBK's FX operations for the National Fund was primarily due to high budget revenues and a surplus of T358 billion thus the transfers to the state budget was at the level of 40.7% of the plan. Taking into account the leading role of the NBK in the FX market of the republic, such "currency maneuvers" could not but affect the weakening of the national currency.

In the FX market in USDKZT segment in 2Q2022, there was a decrease in foreign exchange operations by 28.1% qoq to \$6.2 billion (-2.6% yoy). The volume of purchases of US dollars in exchange offices in 1Q2022 decreased by 0.1% qoq to T441 billion (\$996 million at an average exchange rate of 442.5 tenge per US dollar). The largest contraction was observed in June by 79.7% mom to T42.4 bn (\$95.8 mn). In general, this indicates a decline in domestic demand of households and business for US dollars in the republic.

The weakening of the tenge in 2Q2022 was conditioned by the withdrawal of non-residents from the government securities of the Republic of Kazakhstan. Thus, the volume of government securities held in nominal ownership by non-residents decreased from the beginning of the year by 19.8% to KZT477.5 billion, while the growth of foreign capital in government securities of the Republic of Kazakhstan in the second quarter by 12.5% qoq provided insignificant support to the national currency due to limited amount of non-residents' ownership of the state debt of the Republic of Kazakhstan. Given the tightening of the US Federal Reserve's monetary policy and the expansion of sanctions against the Russian Federation and the growth of geopolitical risks, we do not expect a significant inflow of foreign capital into the government securities of the Republic of Kazakhstan in the second half of this year.

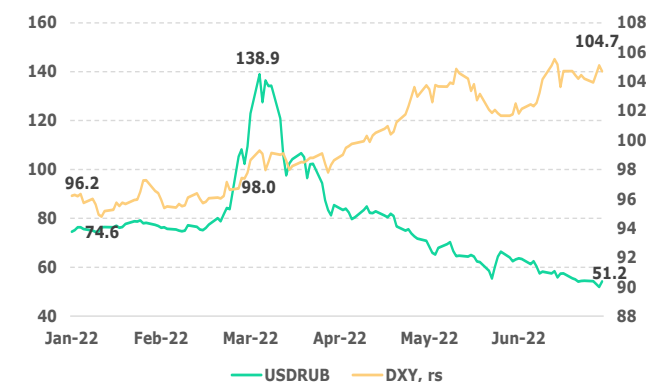
The weakening of the tenge occurred amidst of the strengthening of the US dollar. Thus, the US dollar FX rate (DXY index) has increased since the end of 1Q2022 by 6.5% qoq (9.4% since the beginning of the year and 13.3% yoy) to 104.7. In the middle of June of the current year, the US dollar FX rate reached the maximum local level of 105.5 (the maximum value since September 2002 - 106.9). The outflow of capital from Europe and from emerging markets amidst of the Fed's monetary tightening and the ongoing conflict on the territory of Ukraine contributed to the strengthening of the US dollar. At the same time, according to the consensus forecast of Bloomberg agency, the FX rate for the EURUSD in 2022 will be 1.06 US dollars (the minimum value since 2016 is 1.05 US dollars per 1 EURO).

Fig. 14. USDKZT vs Brent



Source: Bloomberg, NBK, Halyk Finance

Fig. 15. USDRUB vs DXY



Source: NBK, Bloomberg, CBR, Halyk Finance

As of the end of June, the Russian ruble strengthened by 31.1% since the beginning of the year and amounted to 51.2 rub per US dollar. This is the minimum for the USD on the Moscow Exchange since May 2015 (51.02 rub per USD). The strengthening of the Russian ruble occurred amidst of increased sanctions pressure on the RF (6 packages of sanctions), an increase in energy prices (+6.4% qoq oil, +9.5% qoq natural gas) and, as a result, an increase in export earnings (balance of goods and services for the year increased 2.3 times in 2Q2022) and the outflow of capital from the country (outflow is expected to increase from \$151 bn to \$246 bn in 2022, CB of RF estimate).

During the conflict in Ukraine, the implementation of the budget rule was temporarily suspended, which, amidst a significant inflow of FX currency through foreign trade channels, led to the strengthening of the ruble. Despite the reduction in the obligatory sale of FX currency from 80% to 50%, the ruble strengthened by 39.2% qoq. The Russian Ministry of Finance proposed changing the parameters of the budget rule, setting the cut-off point at \$60 per barrel at an output level of 9.5 mn barrels per day. It is assumed that the implementation of the budget rule will begin in 2H2022 and will allow the ruble to weaken against the US dollar by 10-20 rub. However, given the sale of Urals oil from Brent levels at a \$30 discount, the impact of the fiscal rule will have a limited effect on ruble weakening. The consensus forecast for the ruble at the end of 2022 is 63.50 (median) with an average of 67 in 4Q2022.

FX rate of the Kazakh tenge will be supported by high oil prices (\$106.43 per barrel, Bloomberg's consensus forecast) due to the growth of export earnings. In addition, the NBK will have to convert the NF's FX assets for the needs of the budget in the amount of KZT2,136.50 bn (the amount of the transfer to the budget is set at KZT4.6 trln for 2022), which will support the FX rate of tenge. However, the trends of the global economy verging on recession, the persistence of geopolitical tension amidst strengthening of the US dollar (DXY) due to the deterioration of the EU economy and, as a result, the weakening of the EURO (Bloomberg consensus forecast for DXY 103.7) will put downward pressure on the tenge. Thus, based on the predicted macroeconomic and geopolitical dynamics of the events, we believe that FX rate of the tenge will be at the level of 475 tenge per US dollar by the end of this year.

Current account surplus in 1H2022

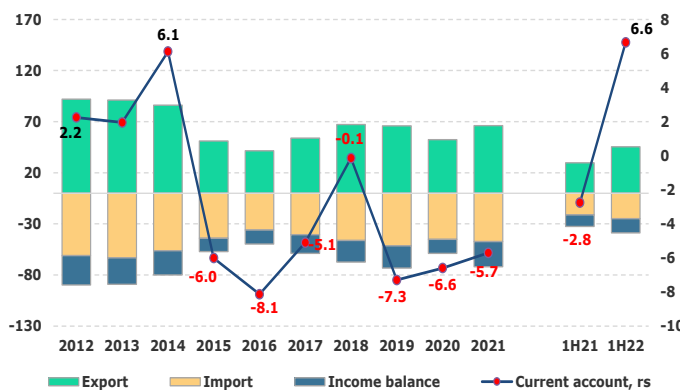
According to the NBK estimation, the current account of the Republic of Kazakhstan in 1H2022 recorded a surplus of \$6.6 billion (deficit of \$2.8 billion in 1H2021). Despite the widening of the balance of services deficit in 1H2022 by 50.2% yoy to \$1,058 million, the widening of the primary income balance deficit by 26.0% yoy to \$13.9 billion and maintaining the secondary income balance deficit at \$32.1 million, trade balance surplus, having increased by 2.4 times to \$21.6 billion, completely offset the deficit of \$15.0 billion under those account items.

Kazakhstan's record 8-year trade account surplus of \$21.6 bn (\$23.2 bn in 1H2014) was driven by outpacing growth in exports by 56.8% yoy to \$42.4 bn over imports, which grew by 15.9% yoy and amounted to \$20.7 billion. Such export dynamics resulted from oil prices spike for 1H2022 by 47.6% YTD to \$114.81 per barrel of Brent. There were the moments when Brent price peaked \$127.98 per barrel. The expansion of primary income deficit due to the returns received by non-residents from direct investment in 1H2022 by 28.9% yoy to \$13.2 bn (net) led to widening deficit in the balance of primary income by 26.0% to \$13.9 bn.

Financial account (excluding reserve assets of the NBK)

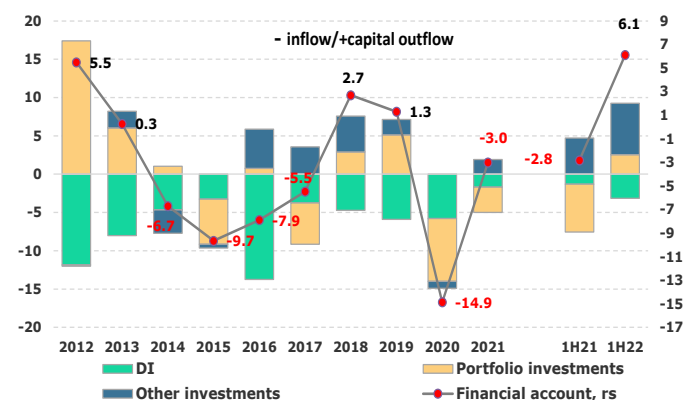
Financial account evidenced a capital outflow of \$6.1 bn in 1H2022 (inflow of \$2.8 bn in 1H2021). Capital outflow in 1H2022 was recorded for portfolio investments in the amount of \$2.6 bn (\$6.2 bn inflow in 1H2021). Other short-term capital flows saw an outflow of \$8.5 bn (outflow of \$6.3 bn in 1H2021). Only direct investments had the inflow in the amount of \$3.1 bn (inflow of \$1.3 bn in 1H2021).

Fig. 16. Current account, \$bn



Source: NBK, Halyk Finance

Fig. 17. Capital outflow and financial acc., \$bn



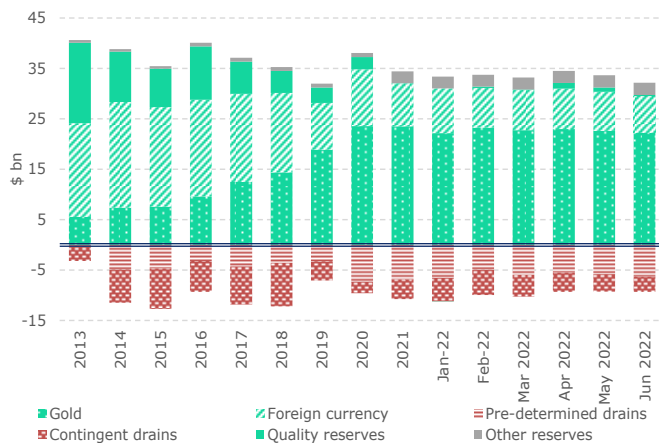
Source: NBK, Halyk Finance

Within portfolio investment, there is an increase in net asset acquisition by the Government of the Republic of Kazakhstan and the NBK in the amount of \$3.6 bn in 1H2022, while there is a decrease in the net incurrence of liabilities in the amount of \$782 mn. In total, the outflow of capital from the Government and the NBK in 1H2022 amounted to \$4.4 bn.

Consolidated International Reserves (IRs)- reduction

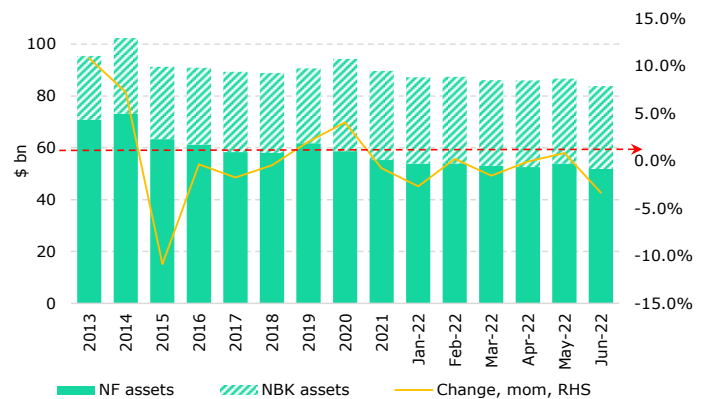
Consolidated international reserves at the end of the first half of 2022 amounted to \$83.8 billion. Consolidated reserves decreased by 2.6% qoq (-9.3% yoy) due to a decrease in the nominal volume of the NBK’s gross gold reserves by 3.5% qoq to \$32.0 billion (-8.8% yoy) and due to a reduction in the assets of the National Fund by 2.1% qoq to \$51.9 bn (-9.5% yoy).

Fig. 18. NBK IRs



Source: NBK, IMF, Halyk Finance

Fig. 19. Consolidated reserves



Source: NBK, Halyk Finance

As part of the NBK’s reserves, assets in hard currency decreased by 7.5% qoq to \$9.6 bn (-27.7% yoy). Over the past 28 months, this is the minimum amount of FX currency (\$9.6 billion in February 2020). According to the IMF, in 2Q2022, there occurred a decrease of the reserves in securities by 4.2% qoq to \$4.8 bn (-14.9% yoy in the FX reserve’s structure. Assets and deposits in hard currency decreased by 20.5% qoq (-64.8% yoy) and amounted to \$2.3 bn.

The NBK’s gold holdings shrank by 1.7% qoq (-4.9% YTD), growing 2.6% yoy to \$22.4 bn. Since the beginning of the year, the value of gold (XAU) has grown by 0.6% and reached \$1 807.3 per troy ounce as of the end of June. Given slight change in the value of gold, the observed decrease was due to the physical decline of the holdings in gold reserves. The share of assets in gold at the end of June of this year amounted to a record 70.0%, having increased from 68.5% since the beginning of the year due to the slump of assets in hard FX currency. Thus, in December 2021, the physical volume of NBK gold amounted to 12.94 million troy ounces (402.5 tons), and as of June, the volume decreased by 4.6% since the beginning of the year to 12.34 million troy ounces (383.8 tons).

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Contacts:

Research department mail to: research@halykfinance.kz

Sales department mail to: sales@halykfinance.kz

Address:

Halyk Finance
Abay av., 109 «B», 5th fl
A05A1B4, Almaty, Kazakhstan
Contact. +7 727 357 59 77
www.halykfinance.kz

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