Macroeconomic report Q4 2019

February 7, 2020

Large-scale budget injections, together with a significant increase in investments, brought the economy to a new level of growth of 4.5% in 2019, which turned out to be higher than the average dynamics of 4.2% over the past decade. A set of targeted incentive and administrative measures supported domestic demand, offsetting the negative impact of negative global oil market conditions, while inflation remained at a moderate level of 5.4%, which is significantly lower than the long-term trend. In the basic version of the forecast for 2020, we expect GDP growth of 4.5%, inflation of 5.5% and a weakening of the national currency by 4% by the end of the year.

There has been a record economic growth over the past six years at 4.5% in 2019. The growth of Kazakhstan's economy in 2019 significantly exceeded analysts' expectations - the consensus forecast for GDP growth was below 4%. The economy began 2019 with growth of less than 4% in the first quarter, but accelerated to almost 5% in the last quarter. The increase in government spending to 20.4% of GDP (+1.6pp per year) gave a fresh impetus to economic growth, which, in parallel with the continued increase in demand for retail loans, fueled increased consumption and increased investment. Since 2009, annual economic growth averaged 4.2% and was accompanied by injections from the National Fund at the level of 5.3% of GDP annually.

Agriculture showed the worst dynamics among all sectors of the economy. In construction, growth was almost +13%, trade +7.6%, telecommunications +5.2%, transport +5.1%, industrial production almost +4%. The outsider among the sectors is agriculture, where a weak crop has led to a slowdown in growth from 3.4% to about 1%. Oil prices last year were quite comfortable for the economy, although they dipped 10% to $64 per barrel, but were above $50 on average in 2015-2017.

Domestic consumption has maintained high growth rates - investment +8.5%, retail sales +5.8%. The primary sector, energy and housing construction were the main drivers of investment in fixed assets. Numerous fiscal and administrative incentives aimed at increasing household incomes, as well as continued growth in retail lending, had a positive effect on consumer activity. However, their effect was offset by increased demand for foreign currency by the population and weaker economic growth in some regions.

Salaries grew by 14.5% yoy in nominal terms, inflation by 5.4% yoy in 2019. Due to increased budget spending and a 50% increase in salaries in 2019, real wages increased by about 9% yoy. Such strong growth has not been observed since 2012, which, among other things, paved the way for increased inflation expectations. Last year, the main contribution to inflation was made by food products (40% in the price index) with an increase of almost 10% per year, which offset the impact of lower tariffs on services. This year, without another intervention by the state, the effect of a loose coil spring can be realized, provoking a new wave of price increases. State intervention in pricing process in 2019 had a temporary effect - the costs were shifted to state monopolies.

The current account deficit for 9M2019 expanded to $ 4.3bn from $ 1.8bn for 9M2018. According to updated NBK data, the current account negative balance of $ 1.4bn increased in the second quarter of 2019 to $ 2.8bn in the third. The expansion of the current account deficit for 9 months of 2019 was facilitated by a decrease in the trade surplus of 19.3% yoy to $ 15bn. At the same time, export volumes decreased by 2.0% yoy to $ 42.8bn, while import volumes grew by 10.8% yoy to $ 27.8bn. Within the financial account, there is a significant outflow of capital in the amount of $ 2.1bn, which is 19.5% more than the outflow of capital for the same period in 2018. Such dynamics was facilitated by an increase in capital outflow in the first quarter of 2019 in the amount of $ 3.5bn. The inflow of capital in the account for the 9 months of last year was facilitated by the inflow in the third quarter of 2019 of $ 1.4bn due to the placement of Eurobonds in September and the influx of foreign investment.

The national currency rate followed oil prices. At the end of the fourth quarter, the national currency strengthened by 0.8% yoy to 381.2 tenge per US dollar. However, this strengthening was mainly the result of the last month of the year due to the simultaneous influence of the growth of oil quotes in global markets and tax payments within the country. During the year, the national currency rate remained at levels significantly higher. This was facilitated by the negative background associated with trade disagreements between the US and China, unstable oil prices, and during the year, non-residents invested in TK financial instruments from T125.2bn at the end of January to T53.6bn at the beginning of December 2019. The national currency rate against the Russian ruble updated its minimum at 6.04 tenge per ruble at the end of June 2019, when the Russian ruble appreciated against the US dollar to 62.58 rubles. At the end of the year, the quotation for the RUBKZT pair reached its minimum at 6.17 tenge per Russian ruble, when the ruble against the dollar updated its second annual maximum, strengthening to 61.84 rubles per US dollar.

Monetary conditions, despite the absence of changes in the base rate, have become weakly restraining. After raising the base rate to 9.25% in September under pressure from inflation in food prices, expanding domestic demand and volatility in global oil markets, uncertainties due to trade disagreements between the US and China, the regulator assessed monetary conditions as neutral. At subsequent meetings in 2019, the regulator did not change the base rate, however, in a press release last year, it noted that monetary conditions are weakly constraining. At the same time, rates on money market instruments continued to move up while reducing the volume of operations. Since the summer of 2019, there has been an increase in the yield on instruments on the money market with maturities of 6-12 months, which, in our opinion, is caused by the NBK efforts to move liquidity to a longer time, on the one hand, and the withdrawal of free liquidity from the foreign exchange market in order to reduce speculative component. The upward movement of rates was also facilitated by the demand for the national currency, especially during tax payments (in August and December). The average annual currency swap rates and money market rates approximate to each other and vary in a narrow range of 10.05% -10.16%. In addition, this approximation occurs against the background of a shrinking, but still persisting excess liquidity.

The international reserves of the NBK decreased by 6.4%, while the share of gold increased to 65%. Consolidated international reserves at the end of 2019, according to updated NBK data, amounted to $ 90.9bn. Since the beginning of the year, consolidated reserves increased by 2.2% mainly due to an increase in the volume of assets of the National Fund by 6.8% to $ 61.9bn, while gross gold and foreign currency reserves of the National Bank of the Republic of Kazakhstan decreased by 6.4% and amounted to $ 29.0bn. As part of the NBK reserves, there is a decrease in the most liquid part of gold reserves, assets in hard currency, the volume of which has decreased by 39.0% since the beginning of the year (by $ 6.5bn) to $ 10.1bn. Gold in the NBK's asset structure grew by 31.2% beginning of the year and amounted to $ 18.9bn, or 65.0% of the gross volume of international reserves of the NBK. The increase in the value of gold from $ 1,464 in November to $ 1,517 at the end of December affected the nominal revaluation of this asset in December by 5.5% mom.

In the base case, according to the results of 2020, we expect GDP growth of 4.5%, inflation of 5.5% and weakening of the tenge by 4%. The global oil market remains under considerable supply of reserves and the expected increase in oil production in countries outside of OPEC, and it continues to put pressure on prices for hydrocarbons. Accordingly, our forecast for oil prices this year remained at $62 per barrel (-3.4% yoy). Thanks to numerous government measures to stimulate consumption, domestic demand in the Kazakhstan's economy largely compensates for the deterioration of the external environment and supports economic growth in the short term. As a result of accelerating economic growth within the current business cycle, it is possible that it will increase slightly this year, but further growth will come against structural constraints. The risks of accelerating consumer inflation under the influence of increasing budget expenditures, accompanied by a depreciation of tenge, will to a certain extent depend on the effectiveness of government agencies in containing prices. According to our baseline scenario, the forecast for GDP growth in 2020 is 4.5%, expectations for the tenge against the US dollar were maintained at 397 at the end of this year, which implies a weakening of 4% from the beginning of the year. We implemented the scenario forecasts of the main macroeconomic indicators for 2020 with a symmetrical deviation from the baseline scenario, which assumes an average annual oil price of $62 per barrel in 2020.

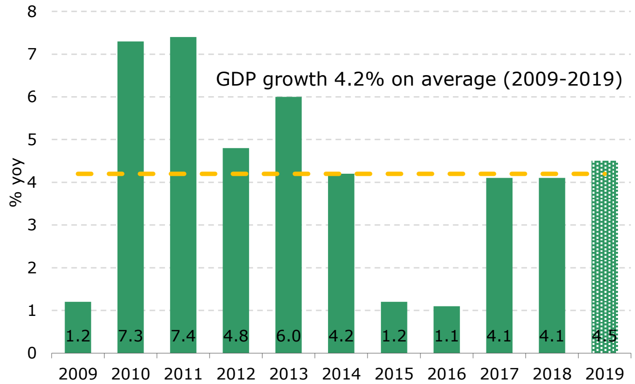
Main macroeconomic indicators	2018	2019	Base		Pessimistic		Optimistic	
	Fact	Estimate	2020	2021	2020	2021	2020	2021
Oil Brent, average, USD/bbl.	71.6	64.2	62.0	62.0	52.0	52.0	72.0	72.0
Real GDP, % yoy	4.1	4.5	4.5	4.3	3.6	3.7	4.9	4.7
Exchange rate USDKZT, eop	384.2	381.2	397.0	403.2	412	418.6	375	382.6
Exchange rate USDKZT, average	344.7	382.8	393.8	401.2	415.0	416.5	377.6	379.7
CPI, % change yoy	5.3	5.4	5.5	5.1	7.7	6.1	5.2	4.9
Government debt, KZT bn eop	15.4	16.5	18.0	19.2	18.0	19.3	17.7	18.8
Government debt, % GDP	24.9	23.9	23.6	22.9	24.1	23.7	22.5	21.9
Budget balance consolidated, % GDP	-1.3	-1.9	-2.0	-1.5	-2.1	-1.6	-1.1	-0.8
Current account, % of GDP	-0.2	-3.1	-2.1	-1.6	-4.0	-3.8	-1.5	-1.3

Economic growth increased in 2019

In 2019, economic growth markedly increased - Kazakhstan's GDP grew by 4.5% yoy, significantly higher than 4.1% yoy recorded in 2017 and 2018. Moreover, if the economic growth in 1H2019 was at the level of 4.1% yoy, then in the third quarter it accelerated sharply and exceeded 4.6% yoy, and in the fourth quarter it was close to 5% yoy. Kazakhstan's economic growth in 2019 exceeded analysts' expectations; consensus GDP growth forecast was 3.8% (Focus Economics). The positive changes in the economic situation were facilitated by significantly increased government spending and high investments. It should be noted that the GDP growth rate of 4.5% exceeds the average annual growth rate of 4.2% after 2009. However, this level is almost two times lower than 8%, recorded on average in 1999-2009. In general, a decrease in growth rates can be attributed to the fact that the past decade has experienced two severe shocks that the economy as a whole has coped with, but not overcame fully. In particular, this applies to the banking system and various development institutions, which have accumulated serious problems. The first shock is the consequences of the financial and economic crisis of 2007-2009, the second - the fall in oil prices in 2015 to about $50 per barrel. The National Fund acted as a shock absorber of these shocks, thanks to which T23.6trn ($102bn) or an average of 5.3% of GDP annually was poured into the economy since 2009.

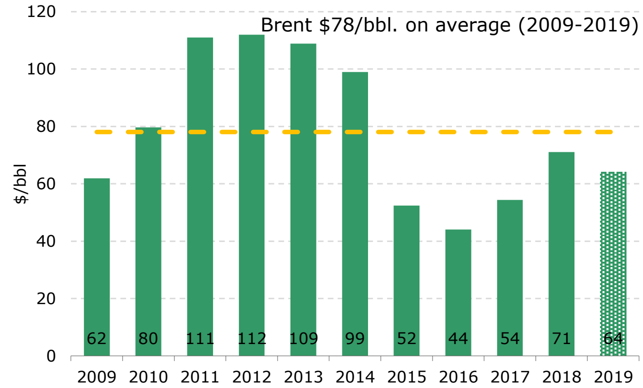
In 2019, the cost of a barrel of Brent crude oil ranged between $54 - $75 with an average for the year of $64, which was above the average of $50 2015-2017, but below $71 in 2018. Republic's export structure by 75% formed by raw materials and approximately 70% due to oil, respectively, the contribution of oil to the economy in 2019 decreased. In 11M2019, oil export revenues amounted to $34.4bn, which is 8% lower ($37.5bn) indicator for the same period of 2018.

Figure 1. Economic growth +4.5% in 2019



Source: COP MNE

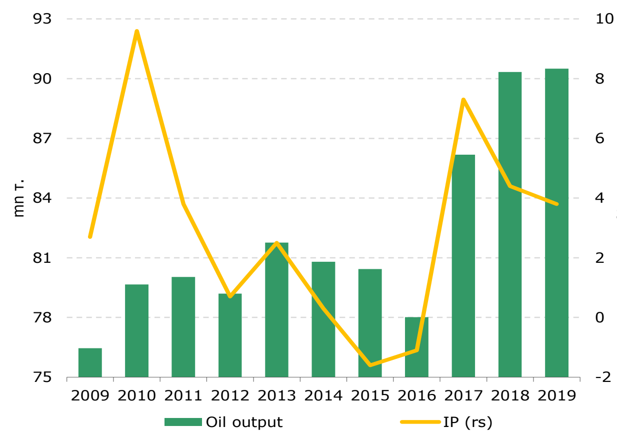
Figure 2. Oil prices below average for 10 years



Source: Bloomberg

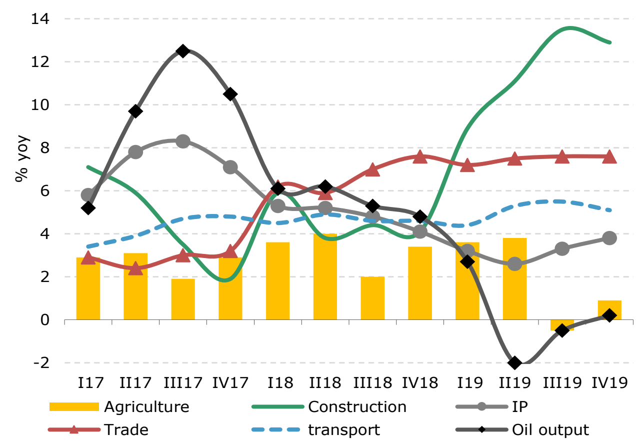
Industrial production growth in 2019 was 3.8%, slowing from 4.4% in 2018 and 7.3% in 2017. Oil production last year increased slightly by 0.2% to 90.5mn tons, mainly due to the repair work at Kashagan and Tengiz. The weak dynamics of oil production was offset by an increase in production in oil refining (+6.6%), non-ferrous metallurgy (+6.8%), and engineering (+20.9%). From a historical perspective, indicators in the industry are quite positive, and as a result of modernization of the refinery, the production of petroleum products had increased and import dependence on these products had almost disappeared.

Figure 3. Industrial production and oil production



Source: CS MNE

Figure 4. Industry dynamics



Source: CS MNE

Taken by sectors, construction activity showed significant growth, having increased by almost 13% (4.1% in 2018), where the acceleration drivers were housing construction +11.7%, non-residential buildings +18.6%, road construction +15.5%, construction of oil and gas pipelines +8.9%.

In transport, the indicators increased from +4.6% in 2018 to +5.1% in 2019, in trade +7.6% - unchanged, in the telecommunications sector +5.2%, which is better than the previous year (+2.6% in 2018).

The growth of investment and consumption

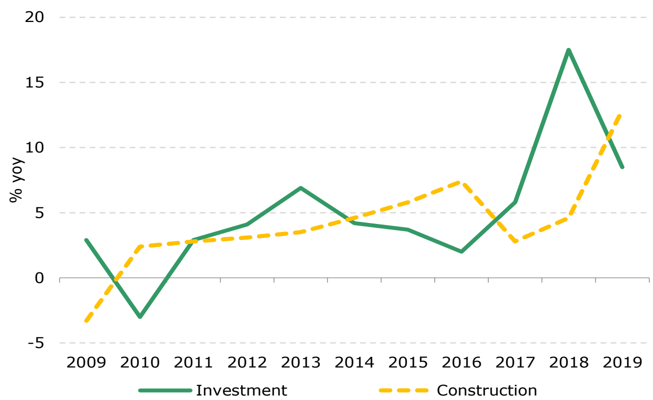
Investments in fixed assets increased by an impressive 8.5% in 2019, although the growth rate was below 17.5% in 2018. Investment growth in 2019 showed the second highest rate over the past decade and, as in previous years, was due to an increase in investment in the extractive sector by 20.5% yoy, and their total volume was equivalent to about 8% of GDP. The main contribution to investment growth was provided by the country's largest oil fields. For example, almost 80% of investments in the framework of the investment program worth $36.8bn have already been spent on Tengiz, and according to Chevron, the final amount of investments may grow to $42.5bn. Against the backdrop of increased investment in the mining industry, investment in the manufacturing industry decreased by 22.6% yoy, in the transport industry - by 21.5% yoy.

Numerous fiscal and administrative incentives aimed at increasing household incomes, as well as continued growth in consumer lending, have positively affected consumer activity. Salaries in December 2019 increased by 14.5% nominally and 8.3% in real terms, which was also helped by an increase in the minimum wage by 50% in January 2019. However, the effect of wage growth was offset by increased demand for foreign currency by the population and weaker economic growth in some regions of the country. As a result, despite the growth in the purchasing power of the population, the retail trade turnover in 2019 grew weaker than a year earlier by a modest 5.8%. The volume of retail trade turnover exceeded T11trn, which is T1.3trn higher (+12.9%) than in 2018. The turnover of food products amounted to T3.8trn, with an increase of 3.2% yoy (T3.4trn for 2018), sales of non-food goods T7.6trn with an increase of 7.1% yoy (T6.7trn for 2018).

As already noted, in 2019, the government concentrated its efforts on raising wages, using the resources of the state budget. At the same time, a whole range of measures was involved: increasing payments for social welfare of the population, tax amnesty, writing off expired consumer loans, maintaining low fuel prices in the domestic market, and reducing housing and communal services tariffs. As we noted, such measures favored the consumer activity of the population. At the same time, if it had not been for the increased devaluation expectations, in our opinion, the growth in trade turnover in 2019 could have been significantly higher. The increase in demand for foreign currency led to the fact that the volume of foreign currency buys by the population increased by about 30% yoy.

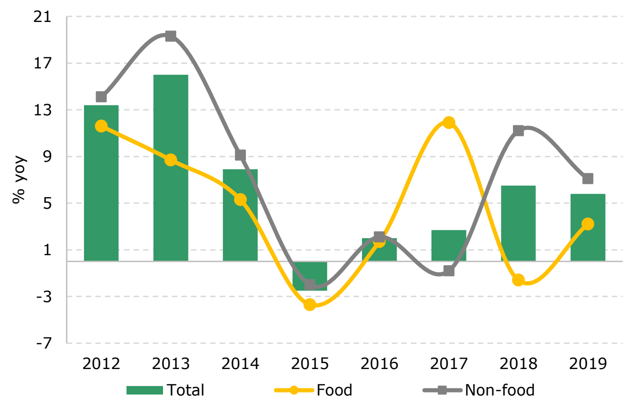
Against the general positive background of data showing improving incomes of the population, a not-so-healthy signal in 2019 came from the regions. Without taking into account the three largest cities, the growth of retail trade turnover was only 2.4% yoy for the regional average. Regional trade traditionally lagged behind cities in terms of growth, but last year we observed weaker rates of economic growth in the regions - in seven regions, representing almost half of the whole country and about 30% in gross domestic product, real GRP growth did not reach 3%, and there were even regions where there was virtually no nominal economic growth according to data for 9M2019.

Figure 5. Dynamics of investments and construction



Source: CS MNE

Figure 6. Trade growth



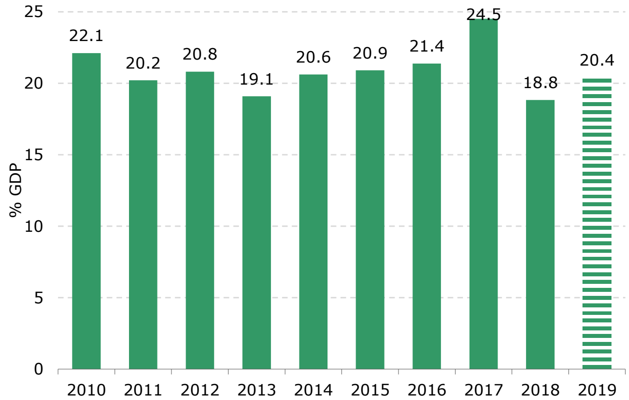
Source: CS MNE

Fiscal stimulus increased in 2019

Against the backdrop of a deteriorating external environment - a slowdown in global economic growth to 2.9% (IMF estimate) from 3.6% in 2018, accompanied by a drop in oil prices by 10% to $64 per barrel, the government proceeded with a significant increase in the injection of state funds into the economy. According to our estimates, the state budget expenditures relative to GDP in 2019 increased to 20.4% compared to 18.8% a year earlier. The decision on fiscal incentives was made in the first quarter of 2019, which was somewhat unexpected since earlier it was planned to consolidate budget expenditures with a deficit of 1.5% of GDP. In general, the past decade turned out to be difficult for the economy, which required significant government expenditures, the average level of state budget expenditures relative to GDP was 21% compared to 24.5% of GDP at its peak in 2017.

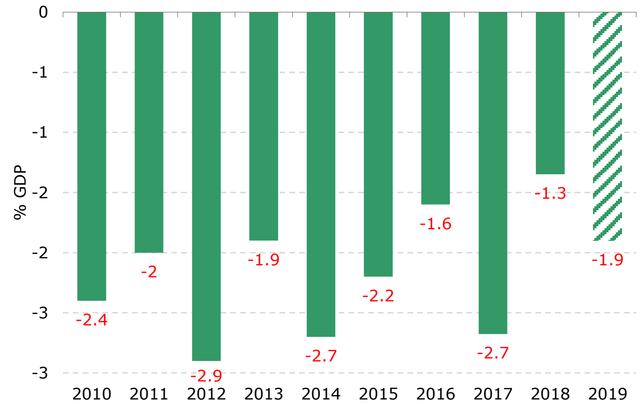
The increase in the state budget expenditures caused an increase in its deficit from 1.3% to 1.9% of GDP, remaining within the framework planned by the government. The financing of the state budget deficit was mainly covered by the placement of domestic bonds and by approximately 30% through the issuance of Eurobonds. This year, the state budget deficit is planned to be kept at 2.1% of GDP, as in the previous year, but the outlays will moderate to 20.1% of GDP, according to our estimate. At the same time, a significant part of the expenses will be directed to a further increase in salaries and expenses for social support, which will positively affect the economy.

Figure 7. The cost of the state budget



Source: CS MNE, MinFin RK

Figure 8. The budget deficit



Source: CS MNE, MinFin RK

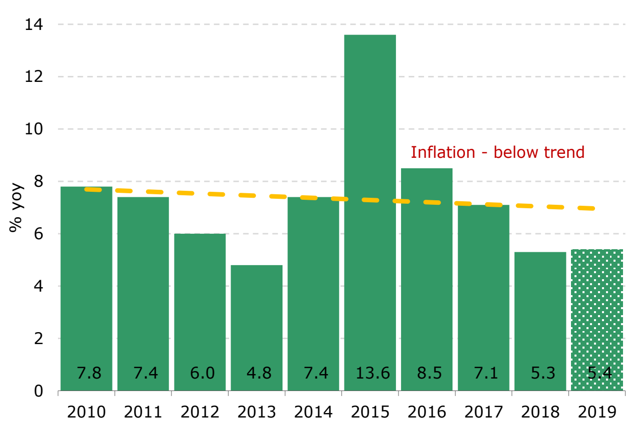
Inflation

In 2019, thanks to administrative measures, inflation was extremely moderate - the basis of a restraining effect on prices was the reduced housing and communal services tariffs and the cost of fuel. For example, paid services in December showed a slight increase of 0.7% yoy, gasoline fell by 4.6% yoy. However, food prices, which occupy almost 40% in the price index, grew throughout the year and by the end of the year grew by almost 10% yoy, which offset the influence of government measures. The contribution of food products to price growth over the 12 months of last year amounted to 3.6pp of 5.4%, being 1.8pp more than in 12M2018. Non-food products added 1.45pp, which is 0.5pp lower than the figure a year earlier, while the contribution from changes in the cost of services under the influence of state intervention decreased by 1.3pp. Thus, the main increase in prices falls on food products. In turn, the restraining effect of state regulation measures is close to exhaustion, and in 2020, without another intervention by the state, the effect of loose coil spring can be realized, provoking an acceleration in price increases.

To be fair the rise in food prices is global trend. According to the Food and Agriculture Organization of the United Nations (FAO), world food prices in November 2019 increased by 9.5% yoy. Price hike drivers were: meat +17.2% yoy, dairy products +9, 5% yoy, vegetable oil +20.2% yoy. For example, in Brazil, one of the largest meat exporters in the world, its prices increased by 8% only in November. We would like to add that the grain harvest in Kazakhstan in 2019 was lower than the previous year, which subsequently results in an increase in the cost of agricultural products that use it in their production.

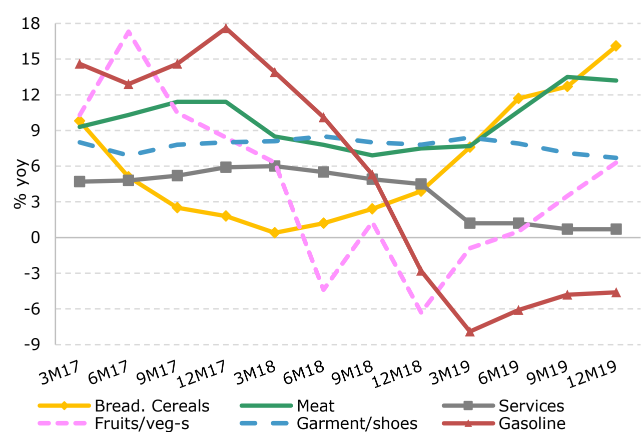
In our opinion, state interference in pricing in 2019 cannot be called unambiguously positive, since the effect is short-term, and the costs were shifted to state monopolies, which in the future will compensate them at the expense of consumers. So, for 9M2019 SamrukEnergo's profit fell by 65% yoy, KEGOK - by 7% yoy. Among other things, administrative measures of state bodies and various state programs reduce the effectiveness of the inflation targeting policy of the National Bank, forcing it to neutralize the effect of fiscal easing due to sterilization of money supply caused by increasing budget expenditures. To do this, since the fall of 2018, the regulator had to raise the base rate twice with one case of a decrease in between.

Figure 9. Inflation has stopped weakening ...



Source: CS MNE

Figure 10. ... the effect of state measures evaporates



Source: CS MNE

The interest rate policy of the NBK

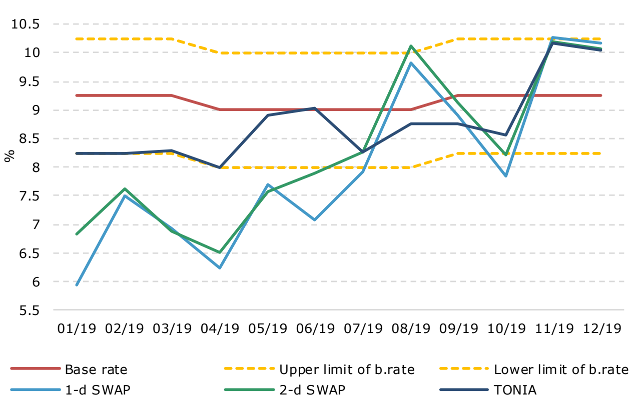
The interest rate policy of the regulator during 2019 formed a generally neutral monetary condition. In the first half of the year, the regulator reduced the base rate to 9.0%, and in September decided to raise it by 0.25%, since consumer inflation began to increase from 4.8% yoy in March to 5.5% yoy in August. With weak inflationary pressure from non-food products and payable services, there was an increase in pressure from food prices, whose inflation accelerated from 5.8% yoy at the beginning of the year to 9.7% in November.

During the year, expanding domestic demand was observed, which was supported on the one hand by an increase in real incomes of the population and growth of the economy, expansion of consumer lending (26.1% yoy in November 2019) - on the other. External conditions were under pressure from the uncertainty surrounding trade disputes between the US and China, volatility was observed in energy markets, while inflation in the trading partner countries remained below the inflation rate in Kazakhstan. From June to the end of last year, consumer price inflation ranged 5.3-5.5%, inflation expectations of the population, according to the NBK, were slightly higher than 5.8% in October 2019 and the regulator did not increase the base rate anymore last year. Although at its last meeting he stated that monetary conditions are weakly restraining.

The rate on automatic REPO deals (TONIA) as the end of 2019 amounted to 10.05% (8.26% at the end of 2018) with an average annual value of 8.43% (8.42% in 2018). The volume of automatic REPOs in 2019 decreased by 2.5% yoy and amounted to T62.458bn. The maximum volume of transactions in automatic repos was in early May 2019 and amounted to T485bn.

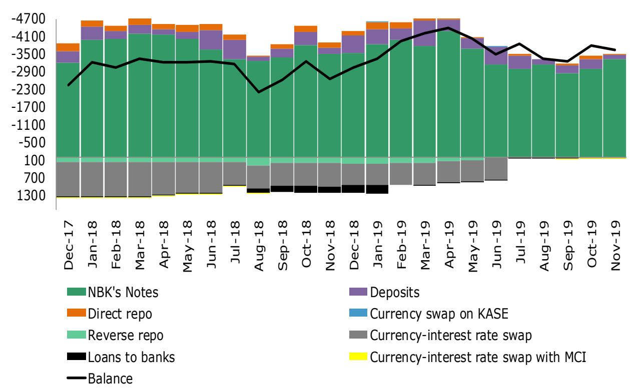
The volume of one-day swaps USDKZT in 2019 decreased by 30% yoy to T6,000bn. At the end of the year, the rate on one-day swaps USDKZT was 10.16% (7.43% at the end of 2018) with the average annual value of 7.64% (8.39% in 2018). The maximum volume of transactions for one-day USDKZT swaps fell in February last year and amounted to T173.7bn. The volume of transactions for two-day swaps USDKZT in 2019 decreased by 10.4% yoy to T22.613bn. At the end of the year, the rate for two-day USDKZT swaps formed at 10.07% (7.38% at the end of 2018) with an average annual rate of 7.75% (8.53% in 2018). The maximum volume for two-day swaps fell in mid-February and amounted to T304.2bn.

Figure 11. Money market rates at the end of the period



Source: NBK, Halyk Finance

Figure 12. Withdrawal of excess liquidity



Source: NBK, Halyk Finance

The MM composite index as of the end of 2019 was 10.07% with an average value of 8.37% (8.26% at the end of 2018 with an average value of 8.43%). Money market volume in 2019 decreased by 5.5% yoy and amounted to T68.642bn.

During 2019, there was a progressive reduction in sterilized liquidity with the help of NBK notes to T3.419bn (-3% yoy). The effective yield on NBK notes was 9.71% (8.64% in January 2019 and 8.59% in November 2018).

At the same time, rates on money market instruments continued to move up along with reduction in volume of operations. Since the summer of 2019, there had been an increase in the yield on instruments on the market with maturities of 6-12 months, which, in our opinion, is caused by a shift in liquidity for longer periods, on the one hand, and the withdrawal of free liquidity from the foreign exchange market in order to reduce speculative component. The effective rate of NBK notes on the primary market in November 2019 amounted to 10.12% with a placement of T1.234bn against a rate of 9.16% and an initial placement volume of T7.986bn at the beginning of the year. The yield on NBK notes for 182 and 364 days amounted to 10.11% and 10.20% at the end of November 2019, respectively.

The upward movement of rates was also facilitated by the demand for the national currency, especially during tax payments (in August and December). The average annual currency swap rates and money market rates approximate to each other and vary in a narrow range of 10.05% -10.16%. In addition, this approximation occurs against the background of a shrinking, but still persisting excess liquidity.

The regulator's policy in 2020 will most likely be aimed at creating weakly restraining monetary conditions due to continued inflationary pressures from rising food prices, as well as from expanding of aggregate supply. The last deficit of the current account of the republic will play a significant role in maintaining those conditions.

Currency policy

At the beginning of 2019, USDKZT FX rate was formed under the energy price quotes fluctuations within 54.91-72.80 dollars per barrel (at the end of April, oil quotes hit a record high of the year at $ 74.57 per barrel) and amounted to an average of

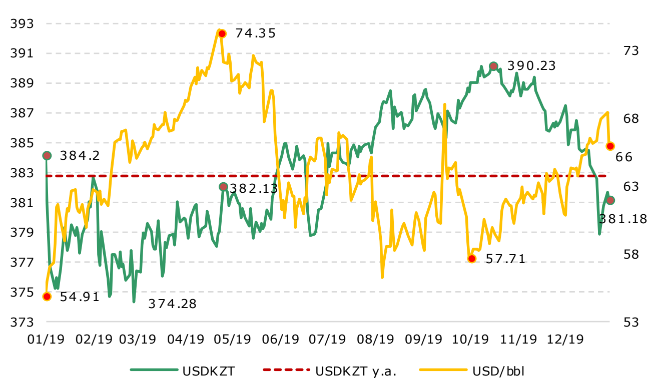
378.45 tenge per US dollar with a maximum value of the tenge against the dollar at 384.2 at the beginning of the year and 385.4 in the middle.

Compared to 2018, at the beginning of 2019, the tenge demonstrated greater stability against the US dollar and changed within the narrow range of 384.2 from the beginning of the year to 384.56 in early August with an average value of 379.98 tenge per US dollar. From August to the end of October 2019, the national currency rate ranged from 385.16 to 388.07 until mid-November with an average value of 387.84 tenge per US dollar, while quotations of prices of a barrel of Brent crude oil changed within 57.69-69.02 with an average of 61.14 dollars per barrel. In December 2019, the growth of oil quotes to $ 68.44 per barrel (the maximum value in December) coincided with the tax week, which affected the significant strengthening of the USDKZT FX rate to 378.6 (1.5% appreciation since the beginning of the year). In general, in 2019, the national currency appreciated against the US dollar by 0.8%. However, we see this strengthening according to the results of the last month of the year. During the year, the national currency rate remained at levels significantly higher. This was facilitated by the negative background amidst the trade disputes between the US and China, and unstable oil prices.

It is very difficult for us to assess the participation of the regulator on the foreign exchange market during the year, since there is no information on the direct currency supply by the regulator - all data is reduced to a net position, which in the vast majority of cases is zero. We believe that the presence of the regulator in the foreign exchange market was also dictated by the appeal of the President of the Republic of Kazakhstan on the need to restore public confidence in the national currency. The regulator also excluded from its monthly surveys the issue of devaluation of the national currency (which is an important metric of public confidence in the implemented monetary policy), and also allowed the tenge to strengthen to the levels observed at the end of the year.

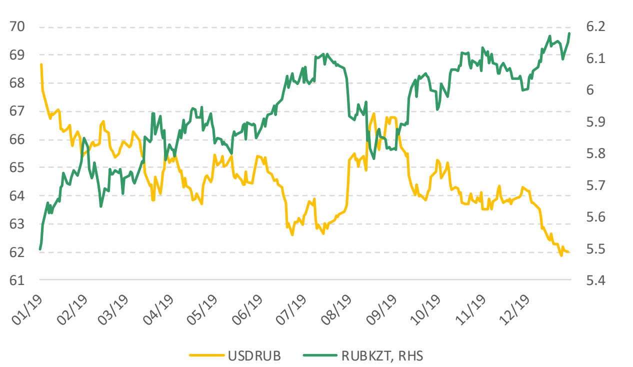
The national currency rate against the Russian ruble updated its minimum at 6.04 tenge at the end of June 2019, when the ruble appreciated against the US dollar to 62.58 rubles. At the end of the year, the quotation for the RUBKZT reached its minimum at 6.17 tenge, while the ruble against the dollar updated its second annual maximum, strengthening to 61.84 rubles. This pair movement was primarily due to the support of the Russian ruble by growing oil (from $ 58.89 in October 2019 to $ 68.44 per barrel at the end of December last year) and the inflow of foreign capital into the sovereign debt market (OFZ in 2019 placed at face value by 2.1trn rubles, which is 2 times more than in 2018). The ruble was also supported by the end of the year with optimistic news about the positive agreement between the United States and China on their trade disputes (an agreement was reached on signing the first phase trade agreement in January 2020). The strengthening of the Russian currency occurred despite the purchase by the Ministry of Finance of the Russian Federation of the domestic currency under the budget rule (at the rate of $ 40 per barrel) in the amount of about 2.8-3.1trn. rubles (estimated data for the plan for 2019 at 3.4trn rubles). In 2020, it is planned to purchase foreign currency in the domestic market under the budget rule (at the rate of 42.4 dollars per barrel - cut-off price) in the amount of 2.3trn rubles ($ 35.5bn from the calculation of quotes for a pair of USDRUB 65.7 rubles). The reduction in the volume of direct interventions (sterilization of foreign exchange earnings from the sale of oil and gas) by the financial authorities of the Russian Federation in 2020, in our opinion, will support the Russian ruble provided that the current global macroeconomic picture is maintained. However, we believe that such a movement for the USDRUB FX rate is within the forecast horizon of 6 months of 2020. In the future, we see an increase in uncertainty that will reach its maximum by November 2020, when the US presidential election is due to take place, and after the election change current US policy.

Figure 13. Change in USDKZT vs Brent quotes



Source: NBK, Halyk Finance

Figure 14. Change in USDRUB vs RUBKZT quotes



Source: NBK, Halyk Finance

We believe that the US Federal Reserve most likely will not raise its discount rate in 2020. Then the key rate of the CBRF (6.25%) and the base rate of the National Bank of the Republic of Kazakhstan (9.25%), while maintaining the current macroeconomic stance, will present good financial opportunities for interest-rate arbitrage on carry trade operations, especially considering the fact that the gold and foreign currency reserves are almost $ 542bn, and the gold and foreign currency reserves of the Republic of Kazakhstan are about $ 91bn with a government debt of $ 54.2bn (as of December 1, 2019) and $ 43.2bn (as of October 2019), respectively. Implementation of this scenario will support the tenge and the ruble, and in Kazakhstan at the beginning January 2020, the size of investments in state financial instruments by non-residents is already increased over the month from T53.6bn to T160bn. However, these investments are short-term and characterized by both a quick influx into the country, and a possible rapid outflow from it.

We believe that multidirectional signals will take place on the Kazakhstan tenge exchange rate during 2020. On the one hand, we expect that Brent quotes will be formed at $ 62 per barrel, while we expect an influx of "hot" money into the country in the form of carry trade transactions, which will support the strengthening of the national currency within trade and financial accounts. On the other hand, the current account deficit, which we forecast -1.8% of GDP, will put pressure on the national currency in the direction of its weakening. There is also a need to increase public confidence in the national currency exchange rate, which will require financial authorities to ensure its changes within a narrow band, preventing it from becoming too strong and too weak.

Based on the fact that the risks of uncertainty persist and will increase at the end of the year, we still stick to the forecast for the USDRUB FX rate at 65 Russian rubles per US dollar and 6.1 tenge per Russian ruble. The exchange rate for the USDKZT will be quoted at 397 tenge per dollar by the end of 2020.

The balance of payments for 9 months of 2019

According to the updated data of the NBK, the balance of the current account of the Republic of Kazakhstan for 9 months of 2019 was with a deficit of $ 4.3bn (deficit of $ 1.8bn for 9M2018). The negative current account balance of $ 1.4bn expanded in the second quarter of 2019 to $ 2.8bn in the third. The expansion of the current account deficit for 9 months of 2019 was facilitated by a decrease in the trade surplus of 19.3% yoy to $ 15bn. At the same time, exports decreased by 2.0% yoy to $ 42.8bn, while imports increased by 10.8% yoy to $ 27.8bn.

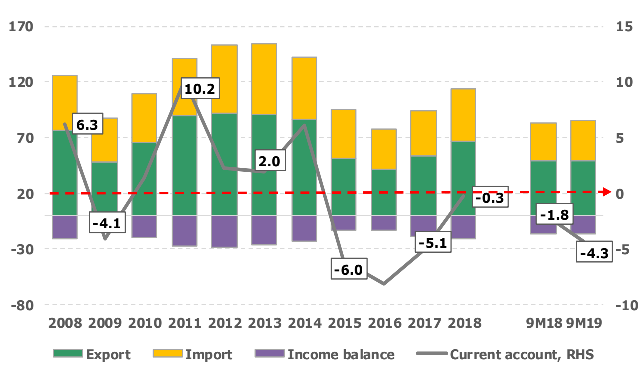
According to preliminary data of the Statistics Committee of the Republic of Kazakhstan, Kazakhstan's exports in January-November 2019 decreased by 4.7% yoy to $ 52.4bn, while imports increased by 11.5% yoy ($ 34.3bn). In January-November last year, foreign trade turnover increased by 1.1% yoy and amounted to $ 86.7bn. In the export structure by countries, a noticeable reduction is observed in Italy's share (from 19.4% in 11M2018 to 14.4% for 11M2019) and the Netherlands (from 10.4% for 11M2018 to 7.7% for 11M2019). Significant growth in exports was observed in China (from 10.4% in 11M2018 to 13.9% in 11M2019) and Korea (from 4.3% in 11M2018 to 5.5% in 11M2019). The concentration of export operations in the 5 largest trading partners decreased from 55.1% in 11M2018 to 51.9% in 11M2019.

In imports, there is a decrease in all major trading partner countries. At the same time, there is a significant increase in the share of imports to Korea from 2.8% in 11M2018 to 9.8% in 11M2019. According to the Statistics Committee for 11 months of 2019, the imports from the Russian Federation decreased from 38.7% in 11M2018 to 35.8% in 11M2019. The concentration of imports of 5 Kazakhstan's trading partner countries increased from 67.3% in 11M2018 to 70.2% in 11 months of 2019.

According to the Statistics Committee, the trade structure of exports in January-November last year represented 72.9% ($ 38.2bn) of mineral products, 13.6% ($ 7.1bn) of metals and metal products, and 5.6% ($ 2.9bn) of animal and vegetable products. The share of machinery, equipment and vehicles was 1.9% ($ 1.0bn) of Kazakhstan's export structure. Thus, the commodity concentration of exports for the two largest items amounted to 86.5% in 11M2019. In 11M2019 imports, machinery, equipment, vehicles amounted to 45.0% ($ 15.4bn). The two other major imports are chemical products 14.4% ($ 4.9bn), metals and metal products 12.1% ($ 4.2bn).

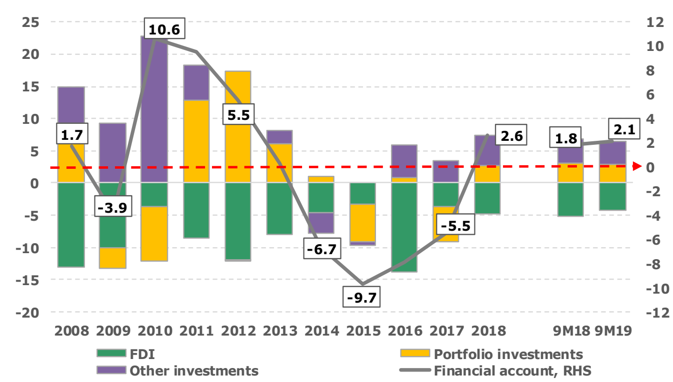
The service account had seen a decrease in the negative balance for 9 months of last year by 22.4% yoy to $ 2.6bn due to a decrease in imports of international services by 4.7% yoy to $ 8.4bn and an increase in exports by 5.9% yoy to $ 5.8bn.

Fig. 15. The expansion of the current account deficit, $ bn



Source: NBK, Halyk Finance

Fig. 16. Outflow * on financial account, $ bn



** according to the NBK methodology, the outflow of the financial account is shown as a positive number*

Source: NBK, Halyk Finance

The primary income account also saw a decrease in the negative balance, which decreased by 6.0% yoy and amounted to $ 17.0bn. The reduction in the balance of primary incomes was facilitated by a noticeable decrease in payments on direct investment income by 3.6% yoy to $ 15.8bn. According to the latest data from the NBK, FDI income for the first half of 2019 amounted to $ 10.2bn (-2.6% yoy). Most of the FDI payable income comes from the crude oil and natural gas production sector (63.0%), metal ore production (6.3%), and transportation and warehousing (6.0%). The share of FDI income payable in manufacturing was 7.3%. The largest recipient countries of FDI income were the Netherlands at $ 3.7bn, the United States at $ 3.1bn, China and the United Kingdom at $ 799mn and $ 418mn, respectively.

The balance of secondary income showed a nearly 50% yoy decrease in surplus to $ 287mn. The decrease in the surplus was facilitated by a decrease in income receivable by 17.6% yoy to $ 1.7bn, while a decrease in income payable by 5.3% yoy to $ 1.4bn. The reduction in income receivable was facilitated by a reduction in government revenues by 25.9% yoy to $ 1.2bn and also due to a reduction in personal transfers by 15.0% yoy to $ 383mn.

Thus, widening of the negative balance of the current account was facilitated by the reduction of the surplus of the trade balance and the secondary income balance, while shortening of the negative balance in the service account and primary income account.

The current account deficit relative to GDP ratio for the 9 months of last year was -2.5% ($ 4.3bn) and increasing from a deficit of -1.0% ($ 1.8bn) for the same period in 2018.

Financial account (excluding reserve assets of the NBK)

According to the NBK statistics for 9 months of 2019, a significant outflow is observed within the financial account $ 2.1bn of capital, which is 19.5% yoy more than the outflow of capital for the same period of 2018. Such a dynamics was facilitated by the growth of capital outflow in the first quarter of 2019 in the amount of $ 3.5bn, which is 3.5 times more outflow observed in the first quarter of 2018. The inflow in the third quarter of 2019 of $ 1.4bn ($ 377.4mn outflow in 3Q2018) contributed to the reduction of capital outflows in the account for the 9 months of last year. This happened primarily due to the incurrence of obligations to non-residents of the Republic of Kazakhstan in connection with the placement in September of Eurobonds of 500mn and 650mn euros.

According to the account of direct investments for 9M2019, there is an inflow of financial resources in the amount of $ 4.3bn against an inflow of $ 5.1bn in the same period in 2018. At the same time, the net incurrence of obligations amounted to $ 2.2bn ($ 1.5bn for 9M2018), and the net acquisition of financial assets amounted to $ 2.1bn ($ 3.6bn for 9M2018).

The outflow of financial resources for portfolio investments over the 9 months of last year decreased by 3.9% yoy and amounted to $ 2.9bn. The outflow was facilitated by an increase in the net acquisition of financial assets in the amount of $ 3.1bn for 9M2019 against the observed inflow of this article in the amount of $ 1.9bn for 9M2018. Net incurrence of residents' liabilities to non-residents as part of portfolio investments decreased from - $ 5.0bn for 9M2018 up to $ 198mn in the analyzed period. According to the updated NBK data on the balance of payments for the first half of 2019, there is an outflow under other investments in the amount of $ 3.5bn (-5.3% yoy).

Thus, on the financial account, net capital inflows were observed only in the direct investments account in the amount of $ 4.3bn, while in the portfolio and other investments accounts there was a net outflow of $ 6.5bn.

The outflow of financial resources on the financial account relative to GDP, according to our estimate, increased from 1.0% ($ 1.8bn) for 9 months of 2018 to 1.2% ($ 2.1bn) for 9 months of 2019.

Within the analyzed period, the widening of assets acquisition by residents on the financial account over their incurrence of obligations to non-residents continues, which contributes to the observed outflow of capital in the account.

Consolidated International Reserves

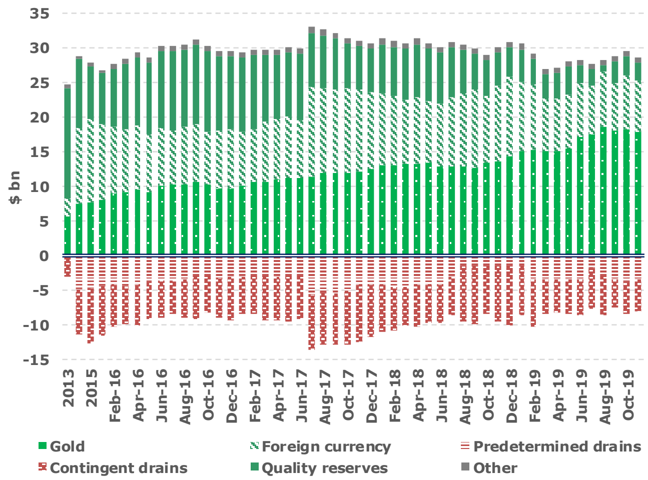
Consolidated international reserves as of the end of 2019, according to the updated NBK data, amounted to $ 90.9bn. Since the beginning of the year, consolidated reserve holdings increased by 2.2% mainly due to an increase in the assets of the National Fund by 6.8% to $ 61.9bn while the gross international reserves of the NBK decreased by 6.4% and amounted to $ 29.0bn.

As a part of the NBK's reserves, there is a decrease in the most liquid part of the reserves, fully convertible currency assets, the volume of which since the beginning of the year decreased by 39% (by $ 6.5bn) to $ 10.1bn. At the same time, the share of assets in foreign currency decreased in December to 34.8% from 37.5% in November. The decrease in assets was due to a reduction in the size of funds of commercial banks on corresponding accounts of the regulator, as well as due to the repayment of the external debt of the government (KazAgro's external obligations).

The volume of gold holdings within the NBK's assets had grown by 31.2% since the beginning of the year and amounted to $ 18.9bn, or 65.2% of the gross volume of the reserves of the NBK. According to the IMF, the volume of gold holdings of the NBK in December 2019 amounted to 12.39mn troy ounces or 385.4 tons (+10.0% from the beginning of the year). The nominal growth in the share of gold in the total gross reserves was facilitated not only by the growth of this asset in physical terms, but also by the positive dynamics of prices in global markets from $ 1.282 at the beginning of the year to $ 1.517 at the end of last year. The increase in the value of gold from $ 1.464 in November to $ 1.517 at the end of December affected the nominal revaluation of this asset in December by 5.5% mom. According to the updated NBK data for December 2019, net international reserves decreased by 6.5% since the beginning of the year and amounted to $ 28.5bn.

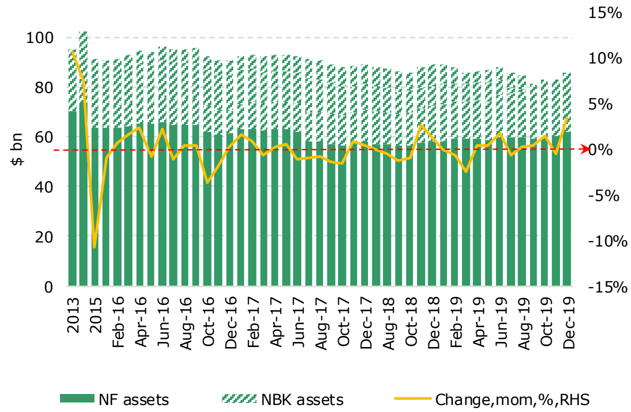
As a part of the contingent short-term net drains of the NBK in foreign currency, in December 2019, the drains continued to decrease by 56% yoy to $ 3.8bn. As of the end of December 2019, the structure of the predetermined short-term drains showed an increase in the amount of the principal debt under foreign currency loans, securities and deposits to $ 2.8bn (-5.6% mom) from $ 932mn from the beginning of the year, while interest payments are reduced from $ 587mn to $ 543mn.

Figure 17. International Reserves of the NBK



Source: IMF, Halyk Finance

Figure 18. Consolidated Reserves of Kazakhstan



Source: NBK, Halyk Finance

The assets of the National Fund (NF), according to the Ministry of Finance of the Republic of Kazakhstan, for 12 months of last year increased by 13.7% yoy and amounted to T26.062bn ($68.1bn). Income from the NF in January-December, according to the Ministry of Finance of the Republic of Kazakhstan, decreased by 20% in annual terms and amounted to T4.062bn ($ 10.6bn). Direct tax revenues from enterprises in the oil sector decreased by 11.4% yoy to T2.837bn. In January-December 2019, the NF recorded investment income in the amount of T1.179bn, which is 36.2% yoy less than the investment income from managing the Fund in the same period of 2018.

Over the 12 months of 2019, the fund’s expenses increased by 17.8% yoy and amounted to T3.084bn or $ 8.1bn (+10.2% mom). In January-December 2019, the size of the guaranteed transfer to the state budget increased by 3.8% yoy and amounted to T2.700bn or $ 7.0bn. The size of the target transfer sent to the budget for 12 months of last year amounted to T370bn or $ 967mn. In January-December 2019, the balance of revenues to the Fund was positive and amounted to T978.5bn ($ 2.6bn). Over 12 months, the balance of revenues decreased to T978bn ($ 2.5bn).

The reduction in the NF assets occurred due to a decrease in corporate tax revenues by 9.5% yoy, a decrease in rental tax revenues by 11.5% yoy, as well as due to a decrease in revenues for the share of Kazakhstan in the production section of concluded contracts for 11.2% yoy.

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