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**February 21, 2023**

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*In 2022, Kazakhstan's economy experienced the same challenges as the global economy as a whole – record consumer inflation, rapid and widespread tightening of monetary conditions, reduced household consumption, deteriorating residential real estate market, as well as negative consequences of the military conflict in Ukraine. In addition, due to the accident at Kashagan, oil production at the field decreased by more than 10%, and the total production in the republic fell to the lowest level since 2017 (84.1 million tons). A further slowdown in growth in 2022 was held back by a fiscal impulse, external demand and high hydrocarbon prices, as well as a record grain harvest. Thanks to this, the economy showed growth by 3.2% yoy in 2022. Against the backdrop of high inflation rates in October (18.8% yoy) and December (20.3% yoy) last year, the NBK raised the base rate first to 16.0% and then to 16.75%. Taking into account the persistence of pro-inflationary risks, the NBK expressed the need to maintain the base rate at the current level for an extended period of time.*

*Growth in prices for oil and gas condensate by 51% yoy, with a decrease in the physical volume of exports by 0.7% yoy, contributed to the growth of the trade account surplus by 2 times to \$35.1 billion, which led to an expansion of the current account surplus to \$6.3 billion. However, the record current account surplus over the past 11 years was leveled by an outflow from the financial account in the amount of \$7 billion. The exchange rate of the national currency depreciated by 7.2% yoy in 2022 (weakening by 2.6% yoy in 2021) and amounted to 462.7 tenge per US dollar.*

*The macroeconomic picture in the country in 2023, according to our forecasts, will be as follows: GDP growth rate will amount to 3.5% yoy, inflation rates will slow down to 11.5% yoy, and the exchange rate will be at the level of 480 tenge per 1 US dollar as of the end of the year.*

**An increase in oil production, along with lift up in business activity in the non-primary sector, with maintaining a pro-cyclical budget policy in 2023, will ensure the growth of GDP at the level of 3.5%.** In 4Q2022, there was an improvement in agriculture, construction and investment activity, which somewhat "gloomed" oil prices, which corrected by 11% qoq to an average of \$88.6 per barrel. For the year as a whole, the average price of Brent oil stood at \$99.8 per barrel and was 41.7% higher than in 2021. This contributed to the expansion of Kazakhstani exports by about 41% in 2022, while imports of goods increased at more subdued rate (+19.4 yoy). Against the backdrop of internal social and external geopolitical tensions, as well as record growth in consumer prices, government support for the national economy has noticeably increased. Fiscal momentum expanded significantly with a 19.9% yoy increase in state budget spending in 2022 to T21.5 trillion (+7.3% yoy to T18 trillion in 2021). A record grain harvest in a decade contributed to the growth of gross agricultural output by almost double digits. Sharp recovery in oil production was reflected in the acceleration of economic growth from 2.5% yoy in 10M2022 to 3.2% yoy<sup>1</sup> in 12M2022.

According to official forecasts, the volume of oil production in Kazakhstan in 2023 will be about 90.5 million tons compared to 84.1 million tons last year. Growth in oil and gas condensate production in the republic will compensate for the projected decline in oil prices on global markets in 2023. At the same time, the expansion of state budget spending at a double-digit pace in 2023 will continue to support the economy from the aggregate demand side.

**Gradual easing of monetary conditions amid slowing inflation.** In 4Q2022, the NBK tightened the monetary policy in October and December, raising the base rate first to 16% and then to 16.75%. At the same time, consumer inflation accelerated from 17.7% yoy in September to 18.8% yoy in October and from 19.6% yoy in November to 20.3% yoy in December. The NBK assessed the level of the base rate in the republic as quite high and emphasized the need to maintain it at the current level for a long time, and also pointed to the end of the cycle of its increase. The main contributor to consumer inflation continued to be food prices, which reached a record high of 25.3% yoy at the end of 2022 (+26.6% yoy in 2007), as well as paid services 14.1% yoy (+15.4% yoy in 2007). The growth rate of prices for non-food products accelerated to 19.4% yoy by the end of the year, which is comparable to the price level in 2015 of 22.6% yoy. In 2022, pro-inflationary pressure on price growth in the republic was exerted by the expansion of government spending (19.9% yoy), the growth in investment in fixed assets (7.9% yoy), as well as the expansion of net exports (99.3% yoy). The pass-through of external inflation (24% yoy increase in the cost of imports from the CIS countries) through the foreign trade channel (an increase in imports by 19.4% yoy in 2022),

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<sup>1</sup>Preliminary data

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as well as an immigration shock from the RF, created additional pro-inflationary pressure on the economy of the republic.

In 2023, consumer inflation rates will peak in the first quarter of 2023 and will gradually slow down to 11.5% yoy by the end of the year. The base rate against the backdrop of a slowdown in consumer inflation, in our opinion, will be reduced to 14%, while the real interest rate will be 2.5%. A greater reduction in the base rate will be hindered by the persistence of significant external and internal pro-inflationary risks.

**Exchange rate - weakening will continue.** As of the end of 2022, tenge depreciated by 7.2% yoy (depreciation by 2.6% yoy in 2021) and amounted to 462.7 tenge per US dollar. At the same time, in 4Q2022 tenge exchange rate strengthened against the US dollar by 3.0% qoq. Such dynamics of the national currency exchange rate in 4Q2022 was accompanied by a decrease in oil prices by 2.3% qoq to \$85.9 per barrel (+10.5% yoy), an increase in nominal ownership of government securities of the republic by non-residents by 0.6% qoq (-35.9% yoy) and expansion of NBK foreign exchange operations for the National Fund by 30.5% qoq (-55.4% yoy). The value of the DXY index (USD exchange rate) decreased over 4Q2022 by 7.7% qoq (+8.2% yoy) to 103.5 p, which was reflected in the appreciation of the tenge by 3.0% qoq. Favorable foreign trade conditions contributed to the growth of the trading account surplus by 2 times to \$35.1 billion, which led to the expansion of the current account surplus to \$6.3 billion. However, the record current account surplus over the past 11 years was offset by an outflow from the financial account in the amount of \$7 billion.

Taking into account the expected reduction in NBK foreign exchange operations for the NF, the decline in oil prices to \$80 per barrel, moderate economic growth at the level of 3.5% and restrained household consumption, as well as further tightening of monetary policy of the leading countries of the world against the backdrop of a slowdown in the forecast global economic growth to 2.9% yoy (3.4% yoy in 2022), the national currency exchange rate will experience some pressure and by the end of the current year will be 480 tenge per US dollar.

Main macroeconomic indicators	2021	2022	Base		Worse case		Best case	
			2023	2024	2023	2024	2023	2024
Oil Brent, average, USD/bbl.	70.4	99.8	80.0	80.0	60.0	60.0	100.0	100.0
Real GDP, % yoy	4.3	3.2	3.5	4.5	2.0	2.5	4.0	4.8
Exchange rate USDKZT, eop	431.7	462.7	480.0	500.0	500.0	520.0	465.0	480.0
Exchange rate USDKZT, average	426.0	460.5	465.0	490.0	480.0	510.0	463.0	473.0
CPI, % change yoy	8.4	20.3	11.5	7.5	15.0	10.0	10.5	6.5
Base rate, %	9.8	16.8	14.0	9.8	15.0	11.0	13.0	9.0
Budget balance consolidated, % GDP	-3.0	-2.1	-2.8	-2.7	-3.0	-3.0	-2.5	-2.4
Current account, % of GDP	-1.3	3.9	2.1	2.8	1.5	1.9	2.8	3.5

### Difficult year for the economy of Kazakhstan

The fourth quarter of 2022 was marked by an improvement in economic indicators in the republic against the backdrop of an acceleration in economic growth rates from 2.5% yoy in 10M2022 to 3.2% yoy in 12M2022. Quite a significant “drawdown” in the dynamics of economic growth compared to 4.3% yoy in 2021 was mainly due to the oil sector, which saw a decline in oil production due to repair work at three of the country's largest oil fields at once. In addition, in the autumn, the countries participating in the OPEC+ agreement decided to limit oil production, which also affected the quota of Kazakhstan. The fall in economic growth in 2022 was also affected by the aftermath of the January events, which had a negative impact on business activity and on domestic household consumption. The ensuing conflict in Ukraine affected the economy of the country's main trading partners and provoked disruptions in the well-established logistics of supplies between countries, which indirectly contributed to the acceleration of consumer inflation in the republic to record levels since the 1990s.

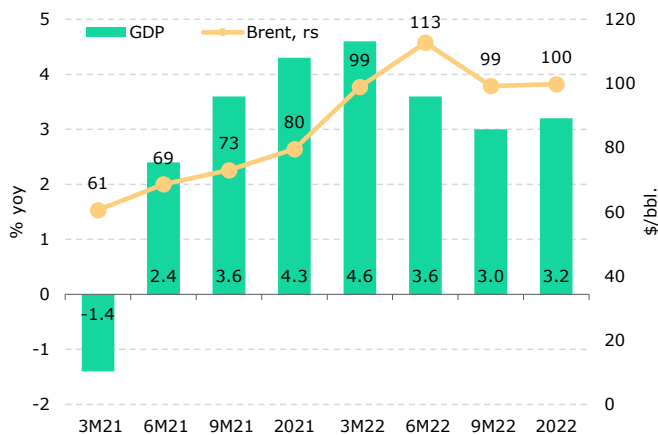
In the context of the slowdown of GDP growth, it is also worth mentioning the residential real estate market, which, after the boom of previous years, has transited into a phase of gradual “cooling”. Moreover, high activity in the market was still maintained in 1Q2022, but after the reduction in the inflow of pension savings, it began to noticeably subside. The cooling of the housing market was facilitated by the curtailment of preferential mortgage programs, an increase in the base rate of the NBK and a significant elevation in the cost of real estate, which over the past two years in the primary market has increased by more than a third.

The weakening of the national currency, combined with sharply increased inflationary pressure on the economy, had a depressing effect on the domestic demand of households. At the same time, there was even a decrease in the volume of sales of food products, while the consumption of non-food products supported the expansion of consumer lending (+25.2% yoy) in the republic.

Against an overall negative background, favorable climatic conditions in 2022 contributed to the record grain harvest in a decade, as a result of which the dynamics of gross agricultural output approached double-digit growth (+9.1% yoy).

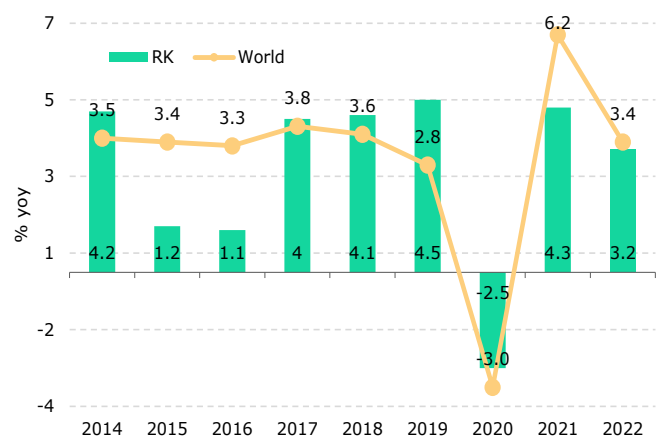
Against the backdrop of internal social and external geopolitical tensions in the world, as well as record growth in consumer prices, government support for the economy has increased significantly. Fiscal momentum was boosted significantly by a 19.9% yoy increase in government spending in 2022 to T21.5 trillion (+7.3% yoy T18 trillion in 2021).

Fig. 1. GDP of RK and oil prices



Source: BNS, \* GDP cumulatively

Fig. 2. Dynamics of global GDP and RK



Source: BNS

According to the IMF, global GDP growth in 2022 slowed to 3.4% from 6.2% in 2021. Numerous difficulties that engulfed the global economy last year in the form of a military conflict in Ukraine, high consumer inflation, and widespread tightening of monetary conditions acted as major obstacles to economic growth and their negative impact will also be felt in the short term. In 2023, according to the Fund's forecasts, many countries will experience economic difficulties, and global growth will slow down to 2.9%. At the same time, China's economic growth estimate in 2023 was raised by 0.8 pp to 5.2%, which will certainly have a positive impact on the economy of Kazakhstan, given the significant share of Kazakhstan's exports to China (16%) and double-digit growth of bilateral trade between the countries.

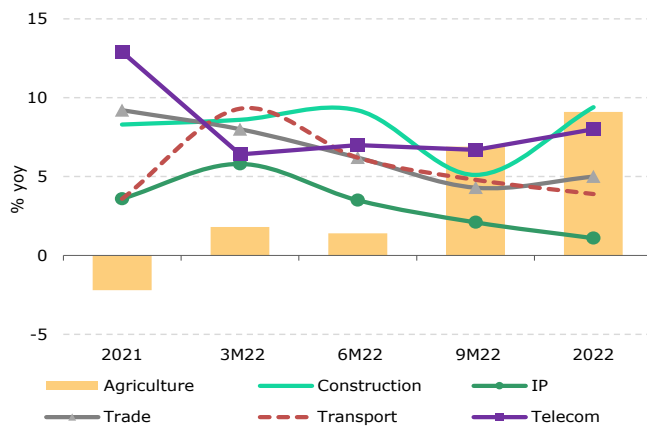
### Slowdown in industry and strong growth in construction and agriculture

In January-December, growth rates of industrial production slowed down to 1.1% yoy from 2.1% yoy in 9M2022, while in 1Q2022, industrial production dynamics was at the level of 5.8% yoy. It should be noted that in recent years, the dynamics of industrial production growth corresponded to the growth rates of the country's GDP (~4%), and such low growth rates in the sector have developed for the first time since 2017, not counting the crisis year of 2020.

The main impact on the slowdown in the dynamics of output in the industry was driven by the mining sector (-1.0% yoy). Thus, in 2022 decreased not only oil production (-1.9% yoy), but also gas (-1.0% yoy), coal (-0.7% yoy) and ores (from -3% yoy to -16% yoy). The reduction in oil production was affected by repair work at the three largest oil fields of the republic, where about 60% of all oil in the country is produced, as well as interruptions in the operation of the main channel for the supply of Kazakhstani hydrocarbons to foreign markets – the CPC oil pipeline. As a result, oil production in the republic in 2022 amounted to 84.1 million tons, which was the lowest since 2017. Recall that the maximum level of production was recorded in 2019 and amounted to 90.6 million tons. However, due to the maintenance of stable external demand in the countries of the main trading partners, the conditions for foreign trade have developed favorably for Kazakhstan. For example, the export price index for 2022 increased by 31.9% yoy. Although oil quotes corrected by about 11% qoq to \$88.4 per barrel in the last quarter, they were still at a very comfortable levels for the republic. For the year as a whole, the average cost of Brent oil was \$99.8 per barrel and was 41.7% higher than in 2021 and at the highest level since 2014. Steady external demand and relatively high energy costs led to an increase in Kazakhstani exports by about 41% in 2022.

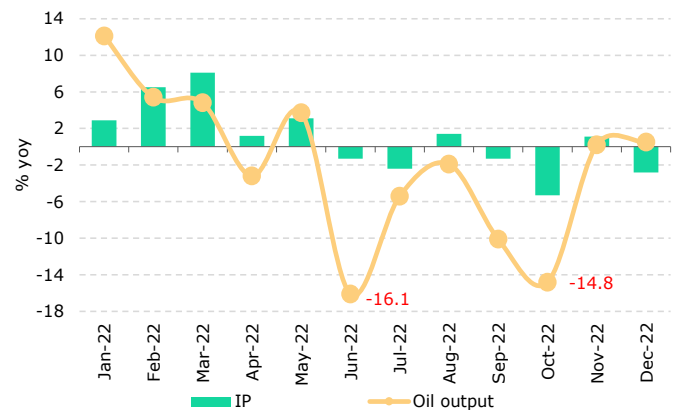
Growth rates in the manufacturing industry (+3.4% yoy) last year also turned out to be the lowest since 2017. The slowdown in the dynamics of gross output was reflected in the decline in the production of pharmaceutical products (-10.3% yoy), ferrous metallurgy (-3.2% yoy), as well as a slowdown in output rates in the oil refining industry (from 6.5% yoy to 1.8% yoy), in engineering (from 20.4% yoy to 9.4% yoy) and in a number of other industries.

Fig. 3. Output by industry



Source: BNS

Fig. 4. IP and oil output



Source: BNS

Agriculture in 2022 became the second fastest growing industry after the construction sector. Output growth amounted to 9.1% yoy (-2.2% yoy in 2021) due to an increase in gross crop production (+15% yoy). According to the statement of the relevant department, last year the harvest of grains and legumes increased by 39% yoy to 22.8 million tons. The gross harvest of wheat increased by 44% and amounted to 17 million tons. This allowed to export more than 13.2 million tons of grain and flour in grain equivalent (9.1 million tons in 2021) in 2022, which was an absolute record in the history of the republic. It should be noted that the share of agriculture is more than 5% in the structure of the country's GDP and, according to experts, has good potential for further growth.

In addition to industry, a slowdown was also observed in the telecommunications sector, however, the dynamics remained at a fairly high level of 8.0% yoy (+12.9% yoy in 2021). In domestic trade (wholesale and retail), the dynamics slowed down to 5.0% yoy (+9.2% yoy in 2021). The growth rate of the construction industry, despite mixed intra-year dynamics, accelerated to 9.4% yoy in 2022 from 8.3% yoy in 2021. The main growth driver in the industry was the construction of non-residential buildings (+21.7% yoy), and residential real estate construction volumes increased by 13.7% yoy.

As a result, despite high growth rates in agriculture, construction and telecommunications, their small weight in the structure of GDP could not compensate for the decline in industrial output, which ultimately affected the restrained growth of the republic's economy.

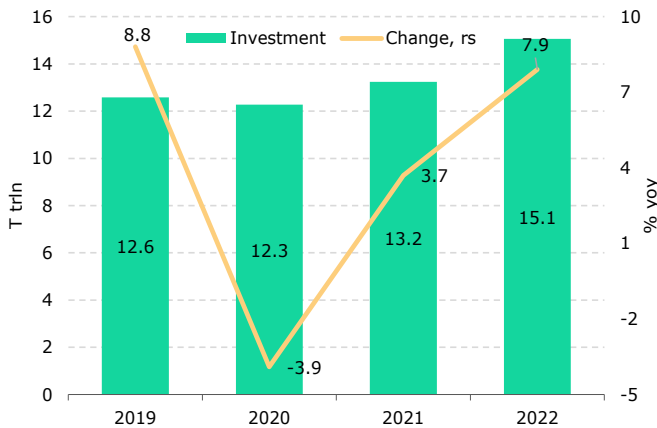
### Massive investment growth in 2022

Despite the tightening of monetary policy and the global increase in interest rates, investment activity increased significantly, supporting economic growth from the side of aggregate consumption in 2022. The volume of investments in fixed assets increased by 7.9% yoy compared to 3.7% yoy in 2021. In nominal terms, the volume of investments amounted to T15.1 trillion, an increase from T13.2 trillion in 2021. In dollar terms, the sum of investments amounted to \$32.6 billion, exceeding the figures for the previous 2 years and slightly falling short of \$32.9 billion in 2019. Note that the maximum investment in fixed assets was recorded in 2013 and amounted to about \$40 billion, and the smallest level of \$22.7 billion in 2016. Thus, investment activity in the country's economy in 2022 has recovered to the pre-pandemic level.

The acceleration of investment growth was facilitated by their dynamics in the oil production sector, where they increased immediately by 22.5% yoy and amounted to T3.4 trillion. Given this growth in volume, the share of investments in the mining industry in 2022 approached 30% of all investments in the country's economy. The dynamics of investments in fixed assets in the manufacturing industry in 2022, on the contrary, turned out to be in the negative zone, declining by 5.6% yoy to T1.5 trillion (10% of the total). The slump of investments in the manufacturing industry was explained by their decline in the oil refining and chemical industries. At the same time, for example, in metallurgy, their volume, on the contrary, increased by 28% yoy, in food production – by 15.7% yoy and by 14.5% yoy in the production of other non-metallic mineral products.

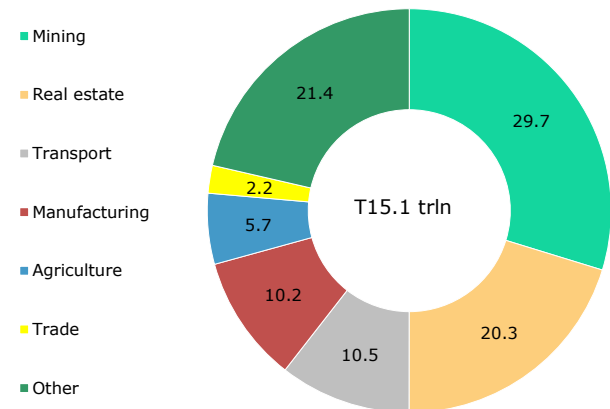
A notable increase in investment occurred in real estate (+15.2% yoy), construction (+65.9% yoy), domestic trade (+17.3% yoy) and telecommunications (+18.4% yoy).

Fig. 5. Investment in fixed assets 2019-2022



Source: BNS

Fig. 6. Structure of investment, %



Source: BNS

### Reduction of consumer activity of the population

Wage growth in the fourth quarter of last year, after declining in the third quarter, showed positive growth again and amounted to 7.9% qoq. The size of nominal wages, according to the preliminary estimate, came in at the level of KZT338.7 th. (\$724).

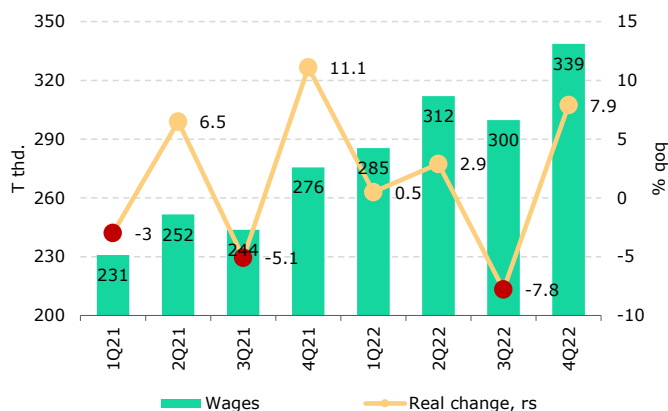
The entire year of 2022 was marked by large-scale social and economic upheavals, the most significant of which were the January unrest, the military conflict in Ukraine and a record acceleration in inflation. Such socio-economic dynamics could not but have a depressing effect on household consumption. As a result, the retail trade turnover increased by only 2.1% yoy (+15.0% yoy in nominal terms). In nominal terms, retail sales amounted to T15.8 trillion compared to T13.7 trillion in 2021, of which food sales accounted for 35.6% (37.2% in 2021), and non-food sales 64.4% (62.8 % in 2021).

Sales of food products for 2022 decreased by 5.4% yoy, while a decline in sales was noted in about half of the regions of the republic. Given the increase in the turnover of food sales in nominal terms by 12.8% yoy, it turns out that in 2022 the population spent significantly more in monetary terms, but at the same time, actually bought much less food. This was affected by record inflation rates for food products in the republic, which accelerated to 25.3% yoy in December 2022.

In turn, sales of non-food products increased by 6.6% yoy in real terms and by 21.0% yoy in nominal terms. Higher rates of consumption of non-food products, apparently, the population was able to afford through consumer loans, the volume of which increased by 25.2% yoy in 2022 (+40% yoy in 2021)

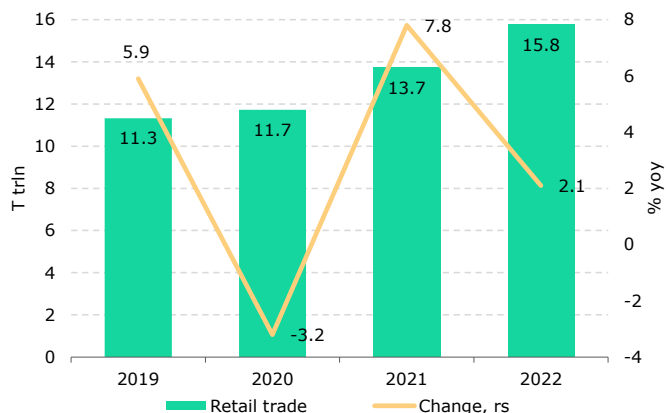
The tightening of the monetary policy of the NBK affected the consumer spending of households, which manifested itself in an increase in their savings due to an increase in interest rates in the market. In 2022, retail deposits at second-tier banks increased by 18% yoy to T15.6 trillion (+22.9% yoy in 2021 due to retirement savings withdrawals). An additional incentive for the growth of savings of the population was the Government program, which provided a premium of 10%, accrued on deposits in tenge.

Fig. 7. Wages growth



Source: BNS

Fig. 8. Retail trade



Source: BNS

### Inflation accelerated to record levels

Consumer inflation rates in December continued to slow down for the third consecutive month and amounted to 1.2% mom. The average annual inflation rate was at the level of 14.9% (8.0% in 2021). At the same time, the rate of consumer inflation in annual terms accelerated to 20.3% from 19.6% in November and 18.8% in October. Thus, the growth of consumer prices in annual terms was noted throughout the year, while the inflation rate accelerated to record levels since 1996 (28.7%). The highest growth rates in 2022 were demonstrated by food prices, which rose by 25.3% yoy from 9.9% yoy in 2021 and approached the maximum level of 26.6% yoy in 2007. Dynamics of price growth for non-food products accelerated from 8.5% yoy in 2021 to 19.4% yoy in 2022, narrowly missing the peak of 22.6% yoy recorded in 2015. Prices for paid services increased from 6.5% yoy to 14.1% yoy over the same period and also approached the maximum value of 15.4% yoy in 2007. Approximately 50% of the growth dynamics of the consumer price index was provided by food products.

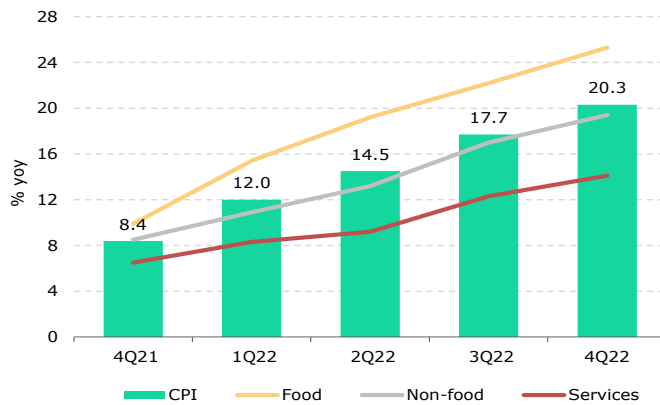
At the same time, external inflationary pressure on food products continued to decline. Thus, according to the World Food Organization (FAO), the food price index showed a decrease in December 2022 for the past 9 months in a row. The food price index in December decreased by 1% yoy to 132.4 p, which was due to a significant decrease in oil prices by 19.1% yoy. Prices for other components of the index were higher than in the previous year: dairy products (+7.9% yoy), cereals (+4.8% yoy), meat (+2.5% yoy) and sugar (+0.6% yoy).

The consequences of the pandemic and government measures to support the economy, along with the military confrontation in Ukraine, provoked a significant increase in prices in 2022. State budget expenditures in 2022 increased by 20% and almost doubled compared to 2018. The increase in public spending was reflected in an increase in the minimum and average wages in the republic, and also contributed to an increase in investment in housing construction, the expansion of which was accompanied by an increase in housing prices. Together with extra-budgetary funds, the budgetary impulse exerted significant pro-inflationary pressure on the republic's economy.

The external negative background in 2022 also affected the weakening of the national currency, the exchange rate of which depreciated against the US dollar by 8.1% from T426 to T460.5 (average annual rate). At the moment, the rate of Kazakhstani tenge reached T512.2 per US dollar. At the same time, the tenge depreciated against the Russian ruble by 20%, which, taking into account the prevailing volume of imports from Russia, further increased inflationary pressure in the economy.

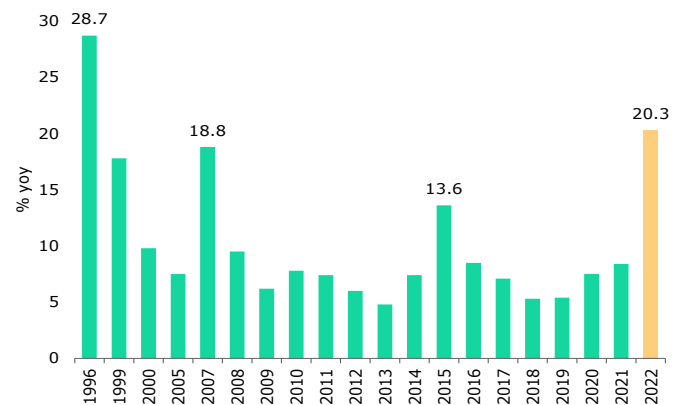


Fig. 9. Consumer inflation in RK



Source: BNS

Fig. 10. Inflation in 1996-2022



Source: BNS

In 4Q2022, there were signs of a slowdown in inflation on a monthly basis, and this trend will continue in 2023. However, annual consumer inflation will accelerate slightly in the first quarter of 2023. A more tangible deceleration of inflation since the second quarter will be facilitated by a relatively moderate increase in the level of wages, a reduction in demand for retail loans and a moderate growth of the republic's economy. In addition, the effect of last year's high base will affect inflation rates. Against this background, disinflationary processes will be more pronounced, as a result of which consumer inflation rates will slow down to 11.5% yoy by the end of 2023.

### Interest rate policy – real rate remains negative

During 4Q2022, the NBK raised the base rate twice from 14.50% to 16% in October and to 16.75% in December. In both cases, the liquidity management band remained symmetrical at +/-1%. The increase in the base rate took place against the backdrop of a record acceleration in annual inflation rates from 17.7% yoy in September to 18.8% yoy in October and from 19.6% yoy in November to 20.3% yoy in December. At the same time, monthly rates of consumer inflation since September last year showed a steady decline of 20 bp from 1.8% mom to 1.2% mom by the end of the year.

All components of aggregate demand showed steady growth. Thus, retail trade volumes increased by 15.0% in nominal terms in 2022 (16.9% yoy in 2021). At the same time, the portfolio of loans for consumer purposes of households increased by 25.2% yoy in 2022 (40% yoy in 2021). The volume of investment in fixed assets in real terms increased from 3.5% yoy in 2021 to 7.9% yoy in 2022, approaching 8.5% in 2019. In addition to an increase in investment activity, there was also expansion in state budget expenditures, which went up by 19.9% yoy in 2022. On the part of the external sector of the republic, an increase in net exports was observed (+99.3% yoy). Growth in budget expenditures and the transfer of external inflation through the foreign trade channel (import growth by 19.6% yoy in 2022), as well as immigration shock due to large-scale migration of Russian citizens, created significant pro-inflationary pressure on the economy.

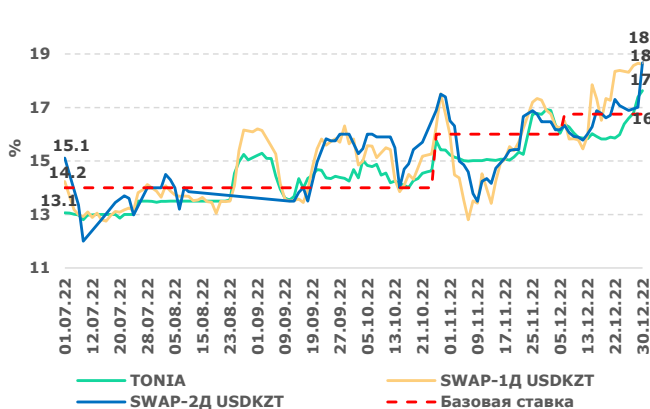
On the supply side, inflationary pressure on the economy was fueled by relatively high prices for energy, metals, fertilizers, as well as reorganization of supply logistics. High geopolitical tensions and the sanctions war of Kazakhstan's partner countries in foreign trade played an important role in the rise in prices on the supply side. Thus, the dynamics of price growth for imported goods coming from the CIS trading partner countries amounted to 23.9% yoy in 2022 (23.3% yoy in 2021).

Against the backdrop of such external and internal macroeconomic dynamics, the depreciation of the national currency against the Russian ruble by 11.4% yoy and against the US dollar by 7.2% yoy was observed. Moreover, the depreciation of the tenge in the moment for these pairs reached 57.7% and 18.7%, respectively. In 4Q2022, on the contrary, the tenge appreciated against the Russian ruble by 22.6% and against the US dollar by 3.0%. Significant volatility of the tenge exchange rate against the ruble was due to the strengthening of the Russian ruble against the US dollar, which, as of the end of 3Q2022, appreciated by 22.7% YTD and depreciated by 22.5% qoq by the end of 2022. The observed volatility of the national currency exchange rate is including inflation expectations of the population, which increased over the 12-month horizon from 16.5% in September to 24% in December 2022.

In December 2022, at a regular meeting of the monetary policy committee, the NBK made a statement that the agency was nearing the end of the base rate increase cycle. The agency said that consumer inflation, having peaked in 1Q2023, will begin to slow to 11%-13% by the end of 2023.

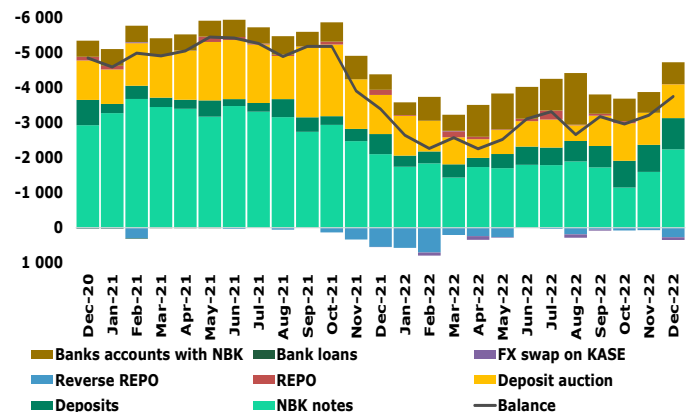
We believe that while the NBK's real rate remains negative on the back of accelerating consumer inflation, a further increase in the base rate is unlikely. The current level of the base rate is near its historical maximum (17% in 1Q2016). The NBK assesses the level of the base rate as quite high and, taking into account pro-inflationary risks, will keep it at current values for an extended period of time. In mid-January 2023, at a meeting of the monetary policy committee, it was decided to keep the base rate at 16.75%.

Fig. 11. Money market rates



Source: NBK, Halyk Finance

Fig. 12. Excess liquidity absorption



Source: NBK, Halyk Finance

We believe that the rate of consumer inflation in the republic, while maintaining the current external and internal macro dynamics, will reach a peak in 1Q2023 and will slow down further. The pass-through of consumer inflation via the foreign trade channel will be limited, because inflation rates in the countries of trading partners are slowing down and are lower than inflation in the republic. Thus, the inflation rate in the RF (34.7% of imports in 2022) slowed down from 17.8% yoy in April to 11.9% yoy in December 2022. In China (22% of imports in 2022), the pace of inflation also slowed down from 2.8% yoy in September to 1.8% yoy in December 2022. Food inflation (food price index), according to FAO data, decreased from 159.7 p in March to 132.4 p in December last year (133.7 in December 2021). Such dynamics of food prices in global markets will be translated into prices within the republic, reducing their contribution to the overall dynamics of consumer inflation. Based on such external macro dynamics and measures to control it within the country, consumer inflation will slow down to 11.5% yoy by the end of the year, and the base rate, in our opinion, will be 14% by the end of 2023.

### Money market - expanding the volume of transactions

The rate on automatic REPO operations (TONIA) at the end of December 2022 was at the level of 17.6% (10.56% at the end of December 2021 and 14.7% at the end of September 2022) with an average value of 15.5% (13.8% in 3Q2022). The volume of transactions on automatic repo in 4Q2022 increased by 2.2% qoq (-18% yoy) and amounted to KZT32,081 bn, while the average value of daily transactions for the period amounted to KZT509.2 bn (KZT490.3 bn in 3Q2022). The maximum daily volume of transactions on automatic REPO operations fell on the first ten days of December and amounted to KZT784.2 bn (KZT980.1 bn in 3Q2022).

The volume of transactions on overnight swaps on the USDKZT pair in 4Q2022 increased by 24.0% qoq to KZT5,654.6 bn rates at 15.8% (14.1% in 3Q2022). The maximum volume of transactions on overnight swaps occurred at the end of December 2022 and amounted to KZT268.1 bn with an average quarterly value of KZT97.5 bn (average quarterly value of the nominal volume of transactions is T74.8 bn in 3Q2022). The volume of transactions on two-day swaps on the USDKZT pair in 4Q2022 increased by 6.7 times to KZT2 279.1 billion at 15.9% (14.2% in 3Q2022). The maximum volume on two-day swaps fell in the first ten days of December and amounted to KZT92.2 bn, with an average quarterly value of KZT42.2 bn (an average quarterly value of the nominal volume of transactions was KZT10.2 bn in 3Q2022).

In general, for 2022, the volume of the money market of the Republic of Kazakhstan increased by 51.9% yoy and amounted to T231.8 trillion. About 94% of the money market or KZT189.5 trln accounted for auto-REPO with government securities of the Republic of Kazakhstan.

In 4Q2022 there was an increase in the amount of withdrawn liquidity using NBK notes (59.7% in the structure of withdrawal instruments) by 29.8% qoq (+6.4% yoy) to KZT2,236 bn. December 2022 was at the level of 18.1% (9.96% in December 2021 and 15.5% in September 2022). The effective initial placement rate of NBK notes in December 2022 was 16.72% against the rate of 14.48% in September 2022. In general, the volume of withdrawn



liquidity in the system increased by 18.1% qoq (+10.5% yoy) and at the end of December amounted to KZT3 748.5 bn.

The increase in money market transactions in 4Q2022 was accompanied by an increase in the money supply (M3) by 5.6% qoq and by 13.9% yoy to T34.3 trln. The dynamics of the money supply slowed down compared to 20.8% yoy in 2021 and 16.9% yoy in 2020, but remains relatively high compared to 7.0% yoy in 2018 and 2.4% yoy in 2019. The growth of the money supply ensures the monetization of the economy of Kazakhstan at the level of 35%-36%, while the velocity of money in the economy has stabilized at the level of 3.0X per year (average value of 2.8 times per year from 2015-2022).

In 4Q2022, the money market rate (15.5% TONIA average for 4Q2022) formed at the lower boundary of the NBK's liquidity management interest rate band of 15.75%, while the FX swap rate averaged 15.9%. The acceleration of economic growth rates in 4Q2022 against the backdrop of intermittent weakening and strengthening of the national currency and tightening monetary conditions led to an expansion in demand for liquidity in the money market of the republic.

### **The exchange rate is a weakening course**

As of the end of 2022, the tenge depreciated by 7.2% yoy (depreciation by 2.6% yoy in December 2021) and amounted to 462.7 tenge per US dollar. At the same time, in 4Q2022, the tenge exchange rate strengthened against the US dollar by 3.0% qoq. In 4Q2022, at the moment, the tenge exchange rate reached 479.3 tenge per US dollar, which is slightly less than the maximum value of 484.2 tenge per US dollar in 3Q2022.

The weakening of the national currency took place against the backdrop of a quarterly adjustment in the cost of oil and the US dollar on the global market. Thus, oil prices decreased by 2.3% qoq and amounted to \$85.9 per barrel, with an average value of \$89.1 per barrel (\$112.7 per barrel in 2Q2022, \$101.3 per barrel in 3Q2022). At the same time, over the year the average oil price increased by 41.7% yoy to \$99.8 per barrel, ensuring the growth of Kazakhstani exports (foreign currency inflow) by 40.7% yoy in 2022.

The US dollar index (DXY) corrected for 4Q2022 by 7.7% qoq (+8.2% yoy) to 103.5 p, when the US dollar index reached a local maximum of 114.1 p. The quarterly weakening of the US dollar exchange rate on global markets by 7.7% led to the strengthening of the tenge by 3.0%. The value of the US dollar index in 2023, according to Bloomberg's forecast, will gradually correct from 103.1 p in 1Q2023 to 99 p in 4Q2023. Considering such dynamics of the US dollar exchange rate, the USDKZT pair should strengthen slightly and remain relatively stable in over the course of the year, however, high geopolitical uncertainty and a reduction in the current account surplus that we predict will still put some pressure on the tenge.

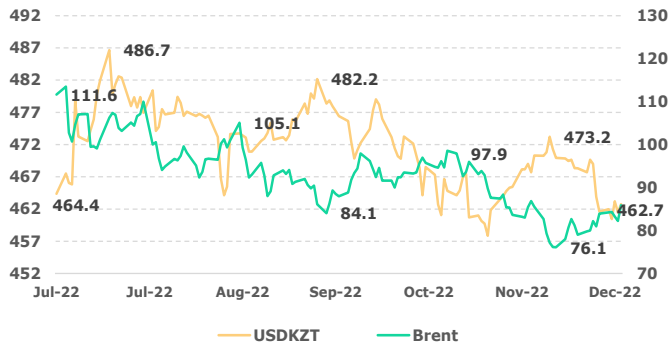
The volume of NBK foreign exchange transactions for the NF in 4Q2022 increased by 30.5% qoq to \$893 million (-63.5% yoy). Over the entire past year, the NBK exchanged currency for the National Fund in the amount of \$4.3 billion, which is 55.4% yoy less than the volume of the previous year. Thus, despite the increase in the volume of foreign exchange transactions in 4Q2022, the annual reduction in the volume of NF transactions by more than 2 times did not support the exchange rate of the national currency, as it was in 2021.

In the foreign exchange market, in the segment of exchange trading for the USDKZT pair in 4Q2022, there was an increase in foreign exchange transactions by 26.7% qoq to \$8,270 million (-22.2% yoy). The minimum volume of foreign exchange transactions on KASE fell in October and amounted to \$2,411 million. Over the past year, the volume of transactions in the foreign exchange market for the USDKZT pair decreased by 14.1% yoy and amounted to \$29,705 million.

The volume of purchases of US dollars in exchange offices in 4Q2022 decreased by 29.9% yoy (+75.9% qoq) to T604.6 billion (\$1,292 million at an average exchange rate of 467.9 tenge per US dollar). In 2022, the volume of purchases of US dollars decreased by 10.1% yoy and amounted to KZT1,830.9 billion (\$3,976 million).

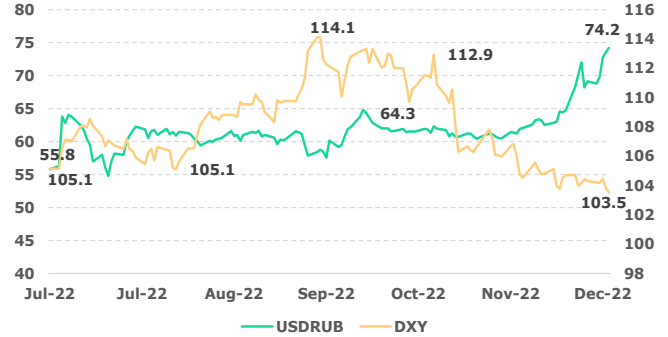
Against the backdrop of tightening monetary policy by the US Federal Reserve and the ECB, as well as growing geopolitical tensions around the conflict in Ukraine and the risks of secondary sanctions, in 4Q2022, there was an outflow of foreign capital from emerging markets. Thus, the volume of government securities of Kazakhstan owned by non-residents increased slightly compared to 3Q2022 by 0.6% qoq to T381.4 bn (-35.9% yoy). The expected increase in the discount rate in the US to the level of 5.0%-5.25% in 2023 will allow non-residents to receive risk-free returns in the markets of developed countries, which will result in an outflow or an extremely restrained inflow of foreign capital into the GS market of the Republic of Kazakhstan. Thus, support for the tenge exchange rate from the movement of foreign capital through this channel will be limited.

Fig. 13. USDKZT vs Brent



Source: NBK Bloomberg, Halyk Finance

Fig. 14. USDRUB vs USD



Source: Bloomberg, Halyk Finance

As of the end of December, the exchange rate of the Russian ruble, according to the Central Bank of Russia, appreciated by 5.3% yoy and amounted to 70.3 rubles per US dollar. At the same time, in 4Q2022, the depreciation of the USDRUB pair amounted to 22.5% qoq, and the minimum value at the level of 55.3 rubles per US dollar was formed at the very beginning of the 4th quarter. The strengthening of the Russian ruble in 2022 was facilitated by the expansion of the current account surplus to \$227.4 billion (\$122.3 billion in 2021) due to the growth of the goods and services account surplus by 66% yoy to \$282.3 billion. Current account surplus was formed due to the growth of export volumes by 14.2% yoy to \$628.1 bn, while the volume of imports decreased by 9.0% yoy to \$345.8 bn. However, the quarterly foreign trade dynamics did not support the Russian ruble exchange rate as the current account balance decreased by 34.6% qoq, while the goods and services account balance decreased by 30% qoq. This was facilitated by a 4.8% decrease in exports, while at the same time expanding imports by 14.3% in Q4 2022. Such a quarterly dynamics of exports was formed due to the embargo imposed by the EU countries on the supply of Russian oil by sea from December 5 last year, and the growth in imports was supported by the expansion of imports of "gray" imported products. The financial account, including the reserve assets of the Central Bank of Russia, saw a capital outflow of \$223.2 bn (+82.5% yoy), while in 4Q2022 there was a decrease in capital outflow by 34.4% qoq to \$29.6 bn.

In 2023, the Russian ruble will be under pressure. Recall that in February 2023, an embargo will be introduced on the purchase of Russian oil products in the EU. In addition, at the end of 2022, a price ceiling was introduced for the purchase of oil from the RF, which will continue to operate throughout 2023. The weakening of the Russian ruble in 2023 will also be facilitated by the "restart" of the budget rule, which provides for the purchase of foreign currency by the Central Bank of Russia for the FNB of the RF in yuan. Thus, the annual basic oil income of the RF for 2023 is planned at the level of 8 trillion rubles, everything above will be sent to the National Welfare Fund.

The current Bloomberg consensus forecast for the Russian currency at the end of 2023 is 73.40 (median) rubles per US dollar. At the same time, the weakening of the Russian currency will be smoothed out and is projected from 2Q2023, when the ruble exchange rate reaches 72.7 rubles and strengthens to 72.0 rubles per US dollar in 3Q2023.

Thus, the exchange rate of the national currency of the Republic of Kazakhstan in 2023 will experience some pressure from the ongoing geopolitical uncertainty around the military conflict in Ukraine, due to the ongoing global tightening of monetary policy by central banks and the predicted slowdown in global economic growth. The weakening of the US dollar, the reduction in the volume of NBK foreign exchange operations for the NF due to the reduction in the size of the guaranteed transfer from T4.6 trillion to T3.2 trillion, as well as the forecasted decrease in the average oil price for 2023 to \$80 per barrel will also put pressure on the tenge exchange rate, which at the end of 2023 will be at the level of 480 tenge per US dollar.

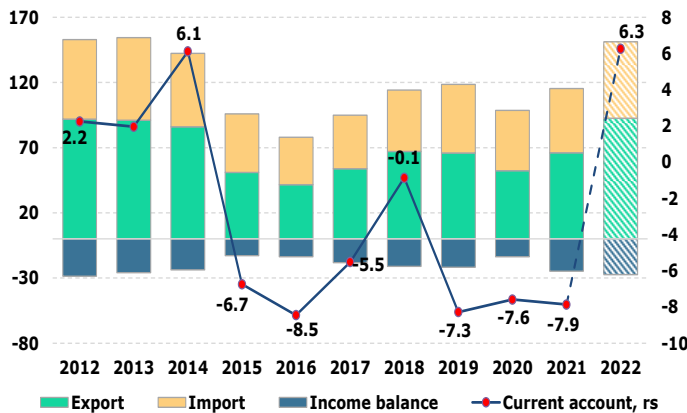
### In 2022 current account posted record surplus

According to preliminary NBK data, the current account of the Republic of Kazakhstan in 2022 developed with a surplus of \$6.3 billion (deficit of \$7.9 billion in 2021). Over the past 11 years, the current account surplus has been at an all-time high (\$6.1 billion in 2014). The current account surplus in 2022 was driven by a 1.9-fold expansion in the trade account surplus to \$35.1 bn and a reduction in the services account deficit by 24.8% yoy to \$1.4 bn. At the same time, the expansion of the deficit in the primary income account by 10.3% yoy to \$26.7 bn and in the secondary income account by 33.7% yoy to \$814.4 mln had a restraining effect on further expansion of the current account surplus.

The increase in the trade account surplus (\$35.1 billion) was driven by the outstripping dynamics of exports (+40.7% yoy to \$84.8 billion) over imports, which volume in 2022 increased by 19.6% yoy to \$49.7 billion. The expansion of

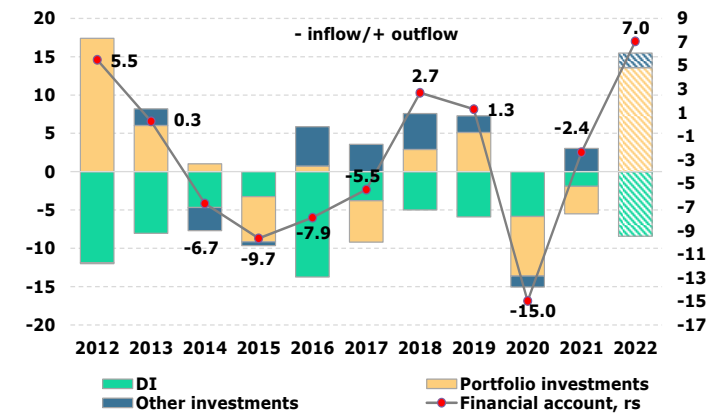
the surplus on the trading account was facilitated by an increase in the cost of oil and gas condensate by 51% yoy against the backdrop of a reduction in the physical volumes of their exports by 0.7% yoy to 65.2 million tons. Recall that the average value of the cost of Brent crude in 2022 was \$99.8 against \$70.4 per barrel in 2021, while quotes at the moment reached \$128 per barrel.

Fig. 15. Current account surplus, \$ bn



Source: NBK, Halyk Finance

Fig. 16. Capital account outflow, \$ bn



Source: NBK, Halyk Finance

A deepening deficit of primary income received by non-residents from direct investment (FDI) in 2022 by 12.8% yoy to \$25.1 billion (net) led to an expansion of the deficit in the balance of primary income by 10.3% yoy to \$26.7 billion. Remuneration on reserves and NF assets in the period increased by 23.8% yoy to \$1.2 billion. The reduction in the deficit in the services account to \$1.4 billion was due to the outpacing growth in exports of services by 31.4% yoy to \$7.6 billion compared to the growth rate of imports of services by 18.0 % yoy to \$9.0 bn.

The relative current account surplus ratio to GDP for 2022 was 2.9% (\$6.3 billion), down from a deficit of -4.0% (\$7.9 billion) in 2021.

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

The financial account for 2022 saw a capital outflow of \$7.0 billion (an inflow of \$2.4 billion in 2021). Capital outflow in 2022 was observed in portfolio investments in the amount of \$13.6 billion (inflow of \$3.6 billion in 2021). Under other short-term capital flows, there was a decrease in capital outflow from \$6.0 billion in 2021 to \$2.7 billion in 2022. Under medium-term and long-term investments, an inflow of \$773.8 million was recorded, compared with an inflow of \$2.9 billion last year. A significant capital inflow was observed in the direct investment account in the amount of \$8.4 billion (an increase of 3.4 times).

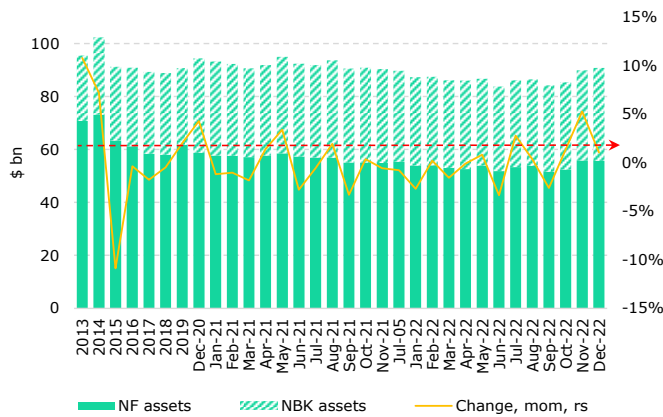
The relative ratio of capital movement in the financial account to GDP decreased from an inflow of 1.2% (\$2.4 billion) in 2021 to an outflow of 3.2% (\$7.0 billion) in 2022.

**Consolidated international reserves - growth for the first time in the last three years**

By the end of last year, consolidated international reserves (CIR) increased by 1.2% yoy and amounted to \$90.8 billion (the highest value in the last 14 months). The increase in CIR was largely due to the growth of the NBK's gross gold reserves by 2.0% yoy to \$35.1 bn, while the assets of the National Fund increased by only 0.7% yoy and amounted to \$55.7 bn. Quarterly dynamics was positive for both components of the CIR. Thus, the NBK's gold reserves increased by 7.5% qoq, while the assets of the National Fund of the Republic of Kazakhstan showed an increase of 8.1% qoq.

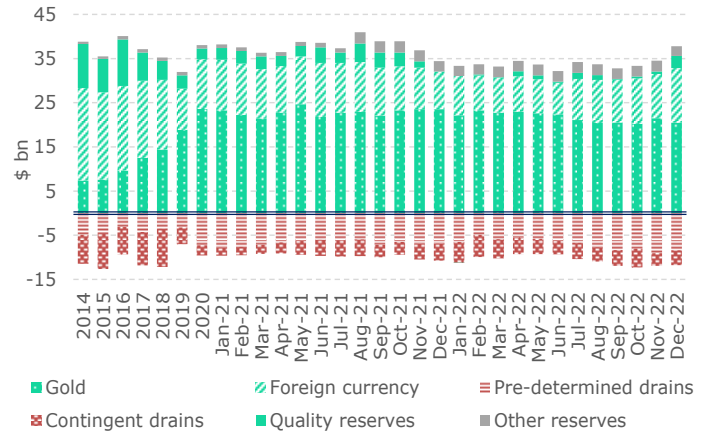
In the structure of the NBK's gross reserves, assets in hard currency grew by 20.3% qoq to \$14.6 bn (+34.6% yoy). The share of assets in hard currency for the first time since May 2019 (44.9%) reached 41.6% of the NBK's gold reserves.

Fig. 17. Consolidated reserves



Source: NBK, Halyk Finance

Fig. 18. Intl. NBK reserves



Source: IMF, Halyk Finance

The NBK's gold assets decreased by 0.1% qoq (-13.0% yoy) and amounted to \$20.5 bn. The reduction in the NBK's gold reserves was facilitated by a decrease in its physical volume. The NBK reduced its gold holdings by 12.6% last year from 12.94 million (402.5 tons) to 11.31 million troy ounces (351.8 tons). This is the minimum value of the NBK's reserves in gold since November 2018, when its volume was 11.11 million troy ounces (345.6 tons). The price of gold changed insignificantly over the past year (-0.3% yoy), while in 4Q2022 gold quotes grew by 9.8% to \$1,824 per troy ounce against the backdrop of a depreciation of the American currency (DXY) from 112.1 p to 103.5 p and correction of Brent oil prices from \$87.9 to \$85.9 per barrel. For the first time since May 2019 (55.1%), the share of assets in gold in the structure of the NBK's gold reserves reached 58.4%.

According to the NBK, in December 2022, the structure of gold reserves saw an increase in assets in securities by 46.4% qoq to \$7.9 bn (53.7% yoy). Hard currency and deposits decreased by 3.2% qoq (+32.6% yoy) and amounted to \$4.4 bn.

As of the end of 2022, the ratio of the NBK's gold reserves to the external trade turnover (\$134.6 billion<sup>2</sup>) of the republic was 26.1% (33.7% in 2021), while the size of the NF assets to GDP decreased to 25.3%<sup>3</sup> (28.1% in 2021).

<sup>2</sup> NBK preliminary data for 2022

<sup>3</sup> Based on preliminary data on GDP for 2022 at \$220.5 bn

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