ERI

Kazakhstan: through the time of financial turbulence

Economic Research Institute
Republic of Kazakhstan

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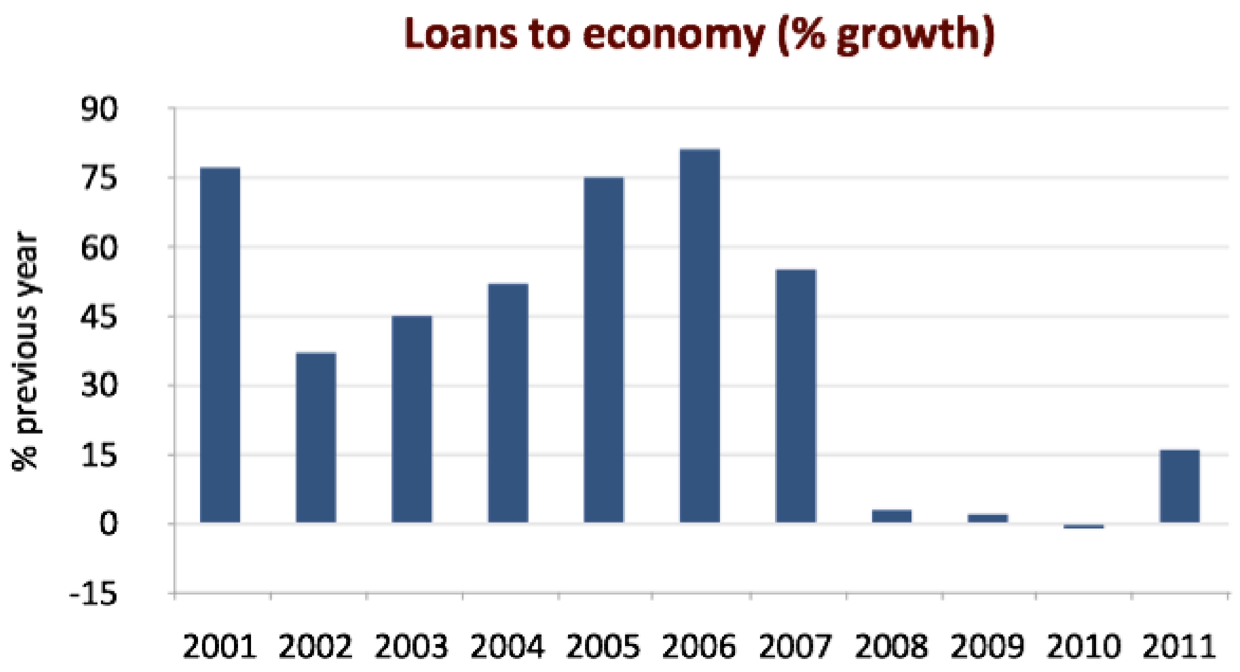
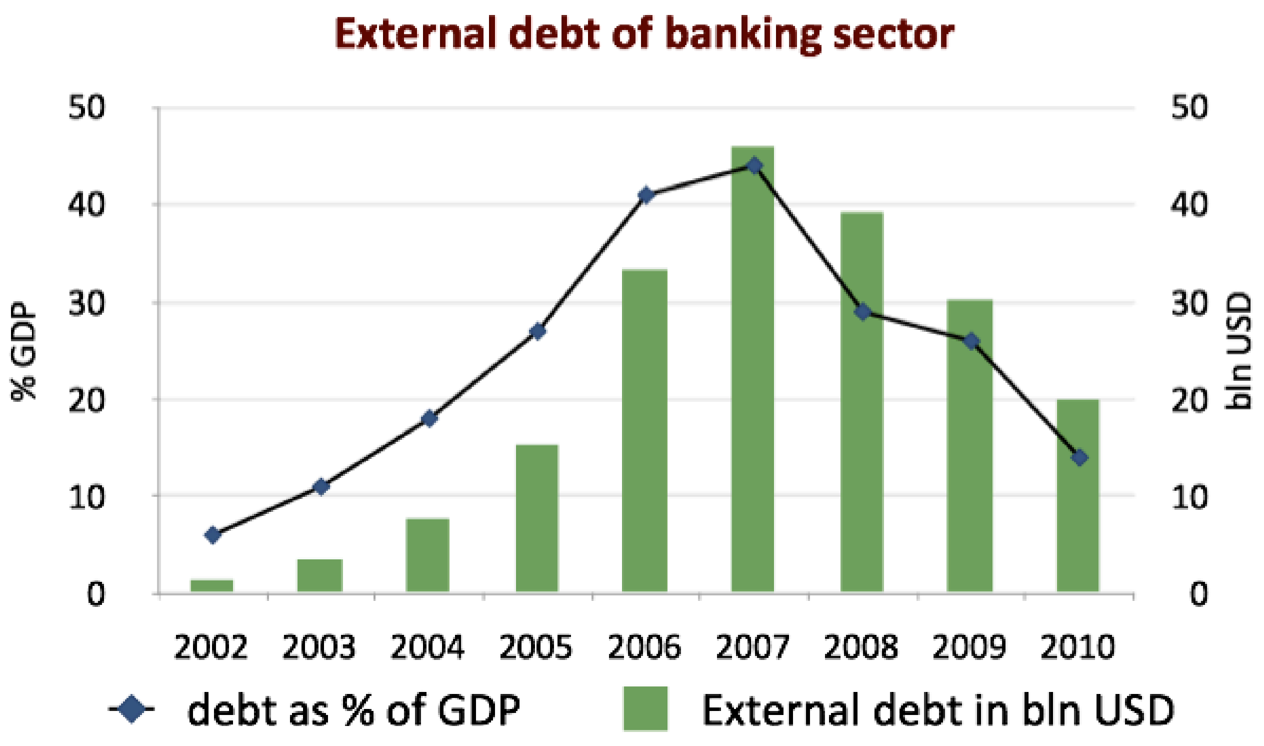
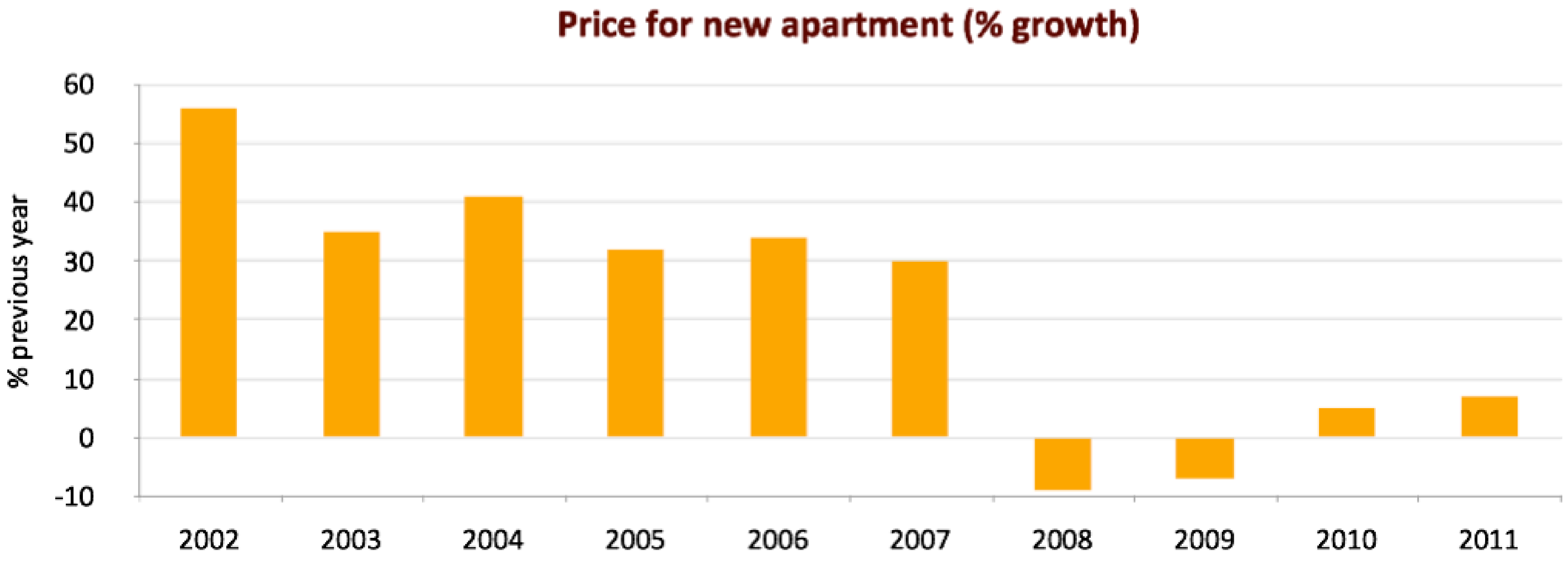
Economic situation before the crisis

- "Overheating", external borrowing, and a housing bubble.
- Kazakhstan experience the crisis already in the second half of 2007

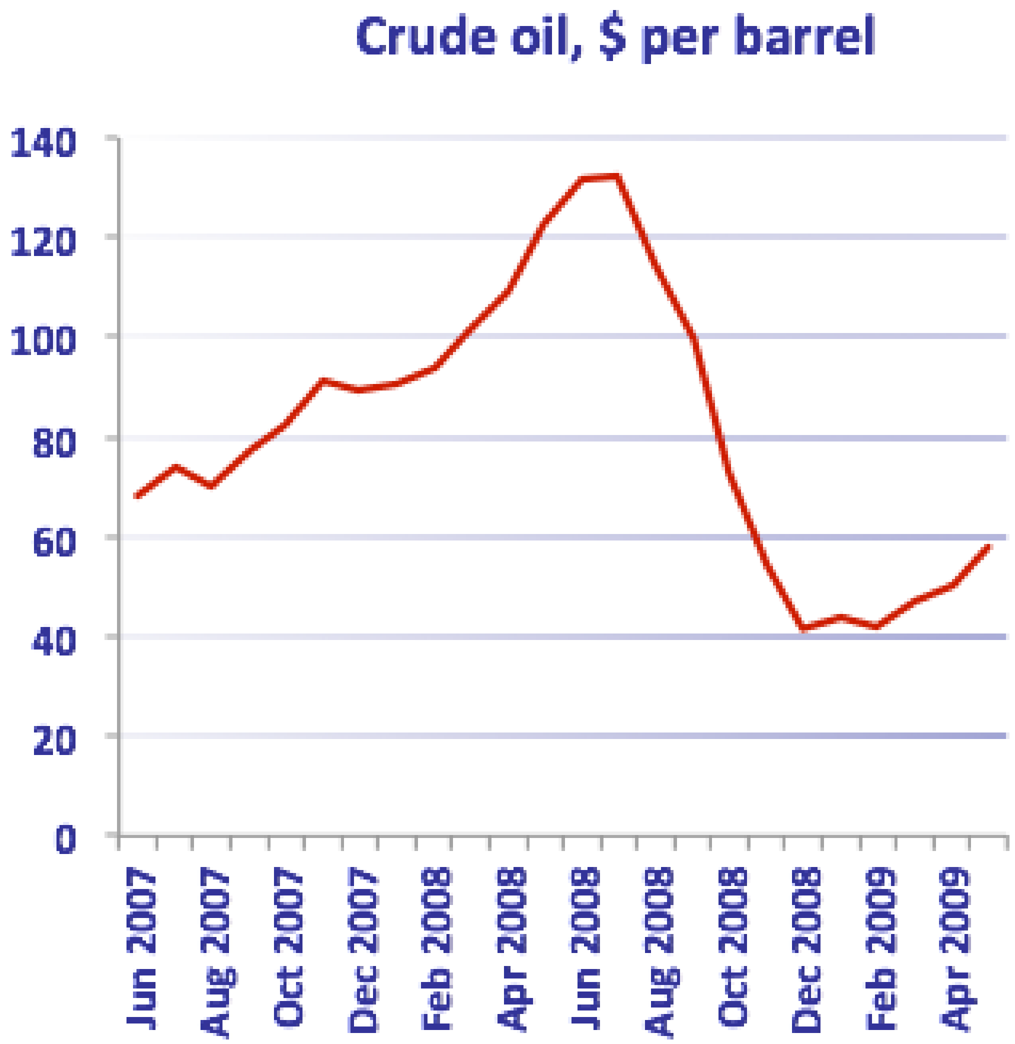






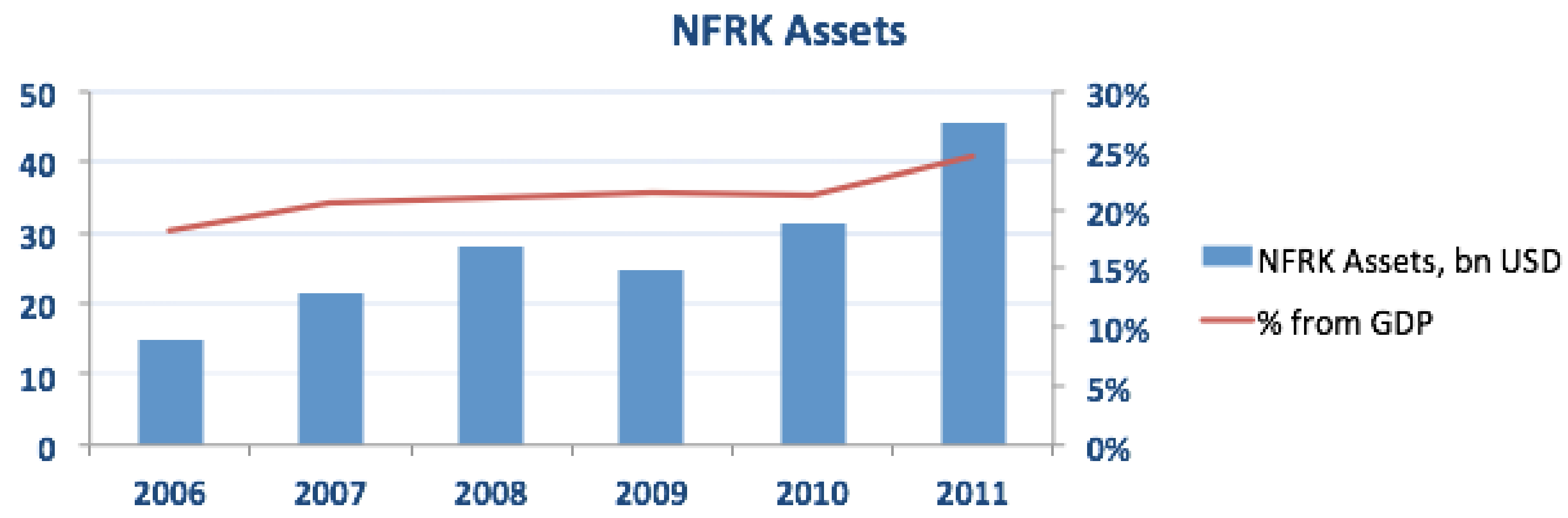
Situation in 2008

- Bankruptcy of financial institutions
- Oil prices go down
- Devaluation of Russian ruble (main trade partner of Kazakhstan)
- Capital outflows



Government reaction to the crisis

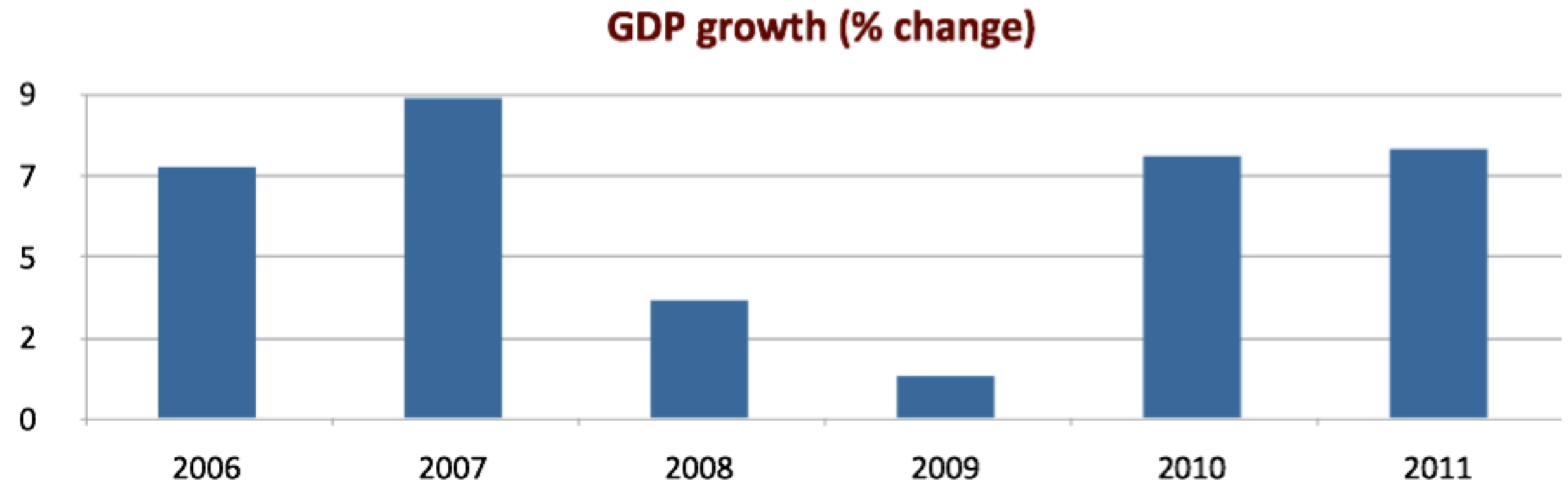
- Creation of SWF “Samruk-Kazyna”
- Merger of State Assets Management Holding “Samruk” and Sustainable Development Fund “Kazyna” (both established in 2006)
  - Mission: increasing the long-term value of the Fund’s companies
  - Primary anti-crisis authority
- Anti-crisis program worth $19bn, including transfer from the Oil Fund



Government reaction to the crisis

During the crisis	Post-crisis period
The SWF was the main operator of Government's stabilization program	The SWF intends to complete all tasks related to the stabilization program of the Government and concentrate on its core activities
Government issued to the SWF 1087.5 bln tenge for anti-crisis measures	The SWF will put efforts to return attracted resources to the National Fund.
Stabilization of Banking and Financial Sectors	
Recapitalization of main banks and debt restructuring of financial organizations under Fund's control (BTA-Bank, Alliance Bank, Astana Finance)	Completing restructuring and rehabilitation of commercial banks, search for strategic investors.
Housing Construction Support and Development of Rental Properties Market	
Financing of construction via commercial banks, completing constructions via Real Estate Fund Samruk Kazyna, mortgage refinancing.	Completing construction of "problematic" objects
SME Support	
SME Support of 120 bln. tenge	Continue to implement government program on SME Support via Damu Fund
Infrastructure projects	
SWF is implementing industrial and infrastructure projects	Further continuation of these projects

- The government implemented a set of measures:
  - Restructuring of external liabilities of 3 banks (BTA, Alliance Bank, Temirbank) helped reduce the external debt of the banking sector from $30 bn (at the end of 2009) to $20 bn (at the end of 2010)
  - Recapitalization of 4 systemic banks (BTA, Alliace, Halyk and Kazkom)
  - Replacement of external borrowing by domestic funding
  - Deposit insurance coverage increased from 700K to 5M tenge
  - Credit activity is sustained by government programs of support for priority sectors of the economy
  - In 2009, minimal reserve requirements were decreased from 2% to 1.5% on domestic liabilities and from 3% to 2.5% on other liabilities.
  - To keep the on-going liquidity in banks under re-structuring, special minimal reserve requirements norms of 0% on all liabilities, were applied.
- As a result of anti-crisis program, the economy bounced back: GDP growth was positive and in 2010 was as high as 7%.



Financial Services: Overview

- Good banking sector performance before the financial crisis:
  - Large branches chain of BTA Bank: then-largest bank in Kazakhstan
  - Offices/branches in Russia, Ukraine, and other CIS countries
  - Real estate purchased in Russia
- Great vulnerability:
  - high external debt (still remains high);
  - systematic banks hit by the crisis: "too big to fail";
- State intervention:
  - four largest banks "saved" by the government;
  - debt restructuring: both state intervention and debt haircut in expense of lenders;
  - as a result, great share of the government in the banking and pension savings system (32%).
- Still a problem:
  - Large share of non-performing loans
  - Stagnation: banks are reluctant to give new loans
- Share of the foreign owners in banking sector: about one third by the end of 2011;
- UniCredit, Sberbank, and VTB -- strengthening players;

Industrialization program

- In 2009, Government launched a program aimed to improve current infrastructure and industry.
- The program consists of large projects with total cost of about $40 bn;
- Government developed a Industrialization road map with detailed project outlines and goals.

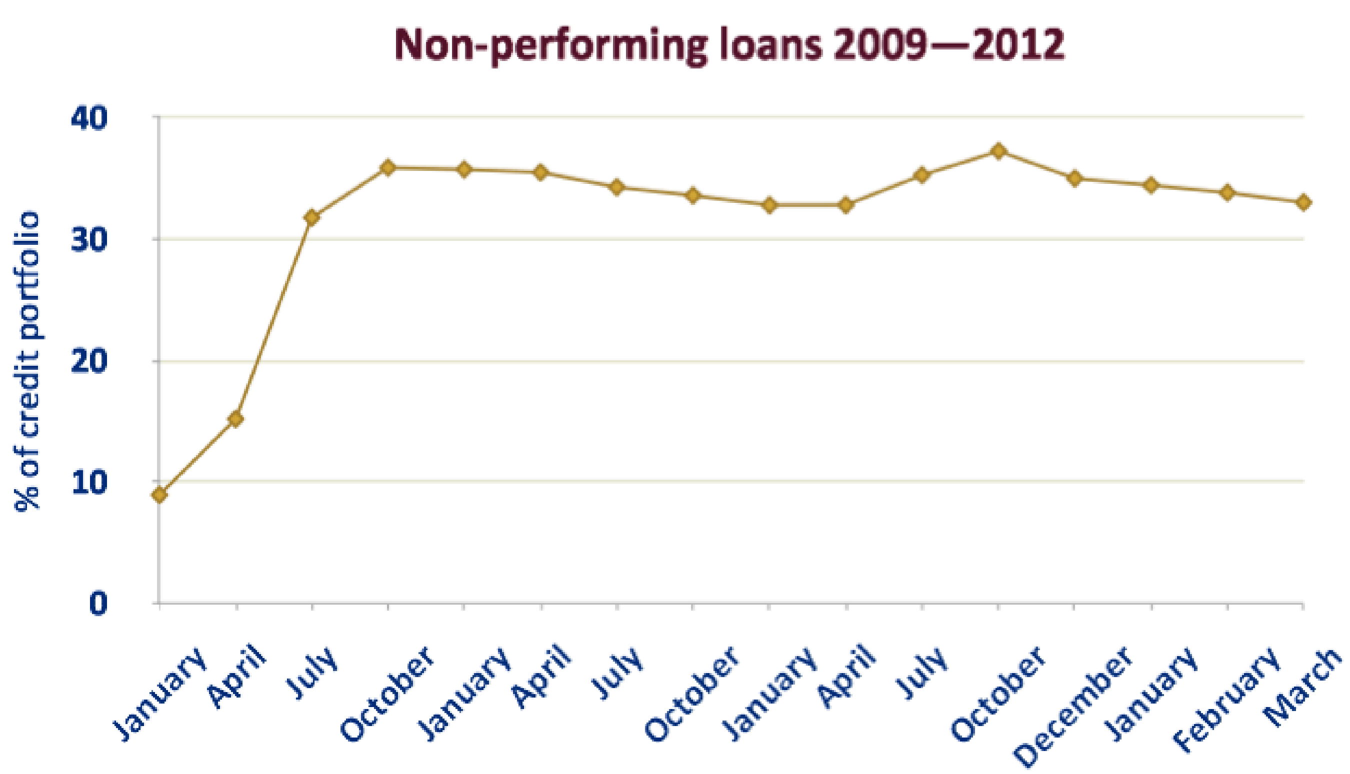
•Similarities between South Korea and Kazakhstan:Small open economies; Big diversified corporations with strong government support;Pre-crisis large amount of external borrowing, mostly by banks;Devaluation of the national currency due to the crisis;Vulnerability of the system to capital outflows;Both countries survived the crisis without significant damage, and recovery followed relatively quickly.

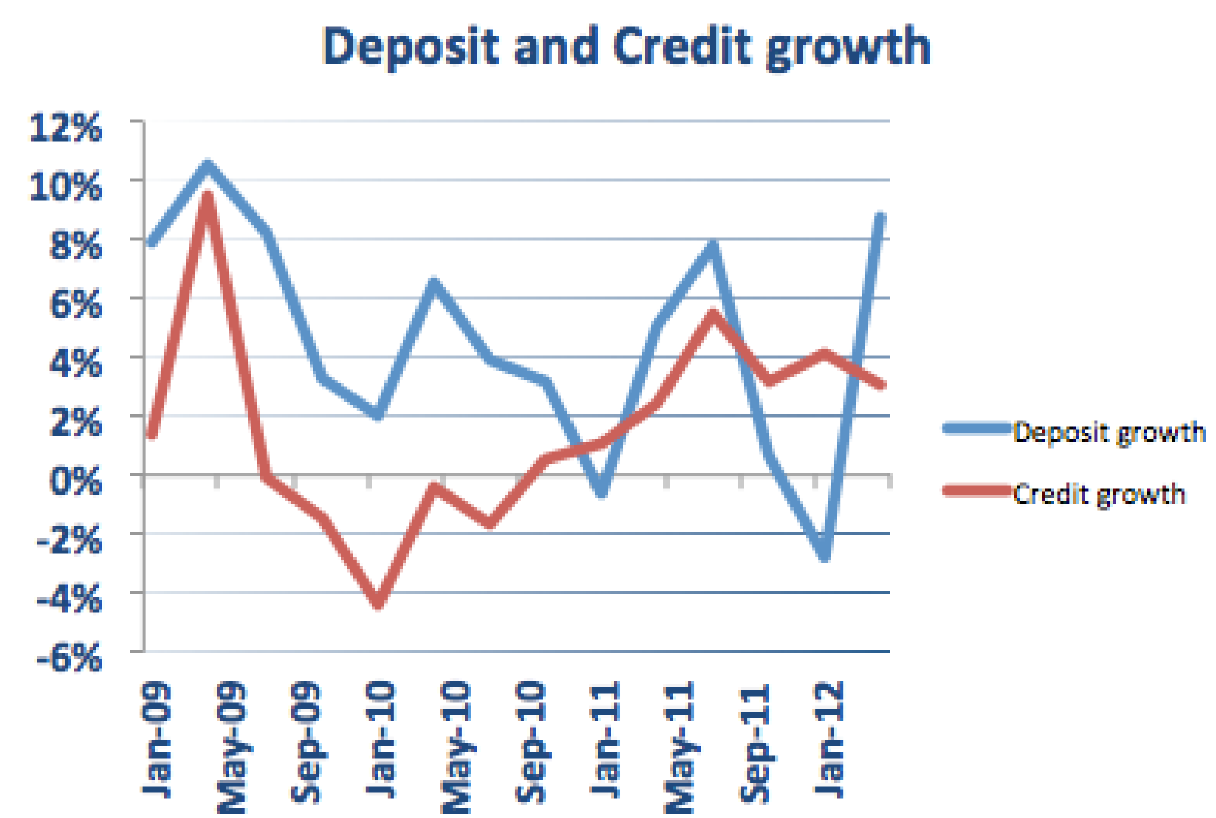
New wave of crisis: Eurozone

- Transformation of private bank debt into public liabilities;
- Persistent current account and budget deficits led sovereign debt to boiled over;
- Complex links between financial institutions, and between financial institutions and public entities;
- Numerous mechanisms of vulnerability;
- High speed of the financial contagion;
- Insufficient speed of crisis-prevention measures;
- High commodity prices (oil, metals, etc) hinder the recovery.

Necessity of complex macro-prudential measures, capable of protecting the system as a whole

- Korea 1998:
  - Korea Asset Management Corporation (KAMCO)
- Kazakhstan 2010:
  - A plan to remove NPLs with a face value of $6 billion (about 37% of the total) from banks' balance sheets in order to facilitate a resumption of lending. Two vehicles:
    - A distressed asset fund, owned by the National Bank, capitalized with $1bn raised through a debt placement
    - Private asset management companies (AMC), owned by banks. These AMC will deal with problem real estate and land assets
- In 2011 changes to the tax law excluded profits from the restoration of reserves from the taxable income, making it easier for banks to write-off bad debts.





Financial sector reform

- Getting ready for Basel III
  - «Safety cushion» of capital
  - Counter-cyclical capital requirements for systemic banks
- Better oversight
  - Increase in institutional capabilities and power of the regulator
  - Merger of the national regulator into the Central Bank, following a similar measure taken by the British authorities, lowering the cost-effectiveness of regulation
- Macro-prudential regulation
  - Loan-to-value (LTV) and debt-to-income (DTI) ratios, liquidity req., etc. proved effective in preventing bubbles and are being discussed by regulators
- «Too big to fail»
  - No moral hazard and excessive risk-taking by big banks
  - Orderly resolution framework for failed financial institutions
- Centralized clearing houses for derivatives
  - Decreasing counter-party risk
  - Increasing transparency of over-the-counter (OTC) trading

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