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## On the KASE


The Almaty-based Kazakhstan Stock Exchange (KASE) benefited last year from the government's "People's IPO" programme and exchange rate volatility. But there remains a big question mark over the bourse's future, as the government intends to set up an international financial centre (IFC) in Astana with a rival exchange.

Having failed to turn the commercial capital of Almaty into a "regional financial centre", in 2015 the Kazakh government decided to make the desolate, wind-swept capital of Astana into an "international financial centre" (IFC) modelled on the Dubai financial centre, with a wide range of incentives and perks for foreign investors. In addition to tax breaks and visa-free travel, the Kazakh government is touting the English legal system as a major selling point for the centre.

The IFC's establishment by 2018 initially envisaged the relocation to Astana of the National Bank of Kazakhstan and the KASE, in which the bank holds a 50.1% stake, but in February those plans appeared on hold due to the economic crisis that's gripping the region.

Then, on March 19, came a bombshell from Kairat Kelimbetov, a former central bank governor who has been appointed to oversee the plan: the Astana international financial centre will now be developed independently of KASE, with a new stock exchange, court of arbitration and independent regulator. "By January 1, 2018, an independent judiciary will be created on the basis of the English law with an international court of arbitration, a new stock exchange that will become a platform for developing capital markets and an independent regulator to set the rules within the international financial centre," Kelimbetov told Russian journalists on March 19. "The main aspects of the work of this centre is, above all, the development of capital markets within a large-scale privatisation programme planned in Kazakhstan by the government and Samruk-Kazyna sovereign wealth fund."

The decision by the government to discontinue the "People's IPO" programme – a flagship policy to give ordinary Kazakh citizens the opportunity to own shares in major companies and boost the dormant stock market – is also linked to the plans to set up the financial centre in Astana: national companies will now be expected to float their shares on the new stock exchange to attract international investors.

All this has created uncertainty for the existing stock market in Almaty. While hailing the establishment of a new stock exchange to help develop the Kazakh capital market, KASE CEO Alina Aldambergen warns that Kazakh blue chips will most likely choose the Astana centre for raising finance via IPOs and bonds. "It will first of all impact the development of the stock market by increasing liquidity [but] more promising issuers could go to the Astana international financial market," she says.

However, she stresses that, “not all Kazakh issuers will be able to work in Astana because new conditions and new requirements are being created there and compliance with foreign legislation is costly.”

Because the Astana stock exchange is still a work in progress, Aldambergen says the lack of details makes it difficult to assess whether it will be in direct competition to KASE or will supplement it. “We don’t yet know about the format of the work of the Astana international financial centre and its regulations should first be adopted. A team is now working on its vision for the financial centre in Astana and it has two years to launch the centre,” she says.

“From the point of view of positioning, it should be a Kazakh stock market, be it two stock exchanges or one, but we should clearly understand who occupies which niche and try to increase liquidity on certain instruments on either exchange, so liquidity is not eroded,” she adds.

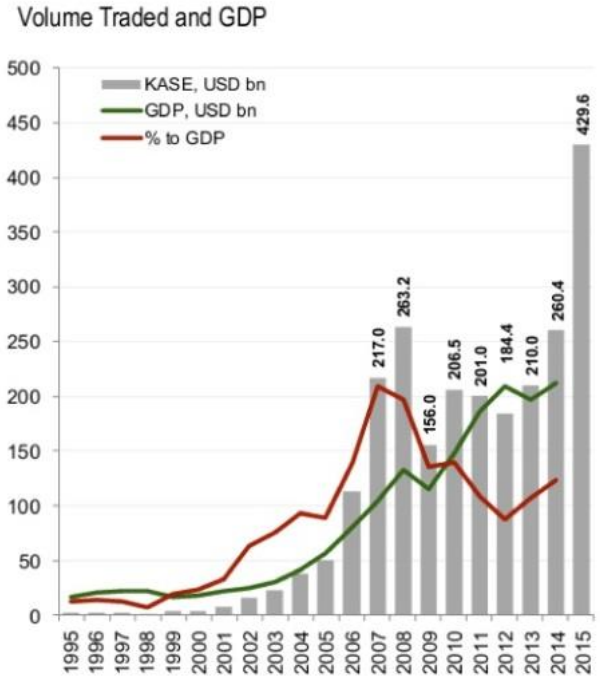
According to law, Kazakh issuers have to first float a certain share of their stocks or bonds on KASE before carrying out a listing on foreign stock exchanges. It is not clear whether this rule would apply to a future Astana stock exchange: with its new regulation and English law, it could technically be considered “foreign”; if so, KASE would still stand to benefit from Kazakh blue chips’ listings in Astana.

Bumper year for KASE

The irony is that KASE's business has started to look up after years of performing poorly. Trade on KASE skyrocketed in the past year on the back of foreign currency-related operations, as well as from a spate of recent IPOs by state-run and private companies.

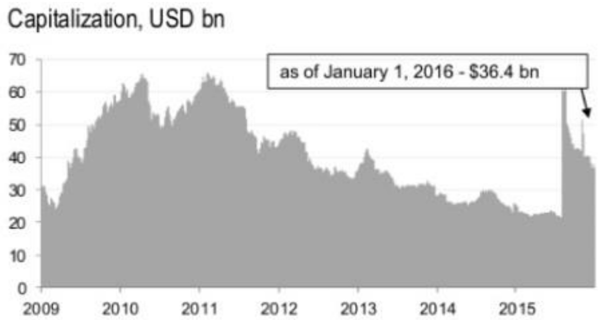
Total trade on KASE reached $429.6bn in 2015, up from $260.4bn in 2014. With the Kazakh economy sharply falling in dollar terms due to a slowdown in economic growth and a 46% depreciation of the tenge, the ratio of total trade on KASE to GDP is expected to increase from about 1.2 times in 2014 to 3.6 times in 2015.

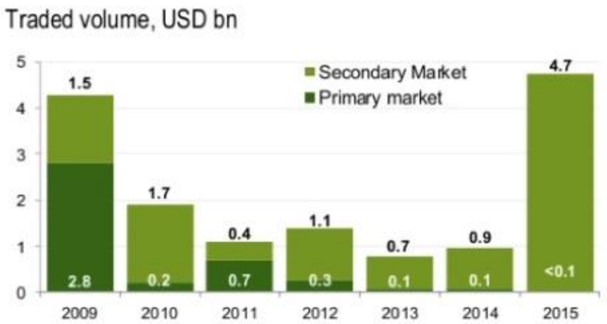
However, Aldambergen explains that the sharp increase in total trade mostly came from a 160% jump in foreign currency swap operations to $256.6bn in 2015. In contrast, the spot foreign exchange market fell to $56.2bn in 2015 from $89.4bn. That market players (mostly commercial banks) turned to foreign currency swap operations is explained by devaluation expectations in the first half of 2015 and volatility in the foreign exchange market following a switch to a free-floating exchange regime for the tenge in August of that year. The devaluation expectations led to the high levels of dollarisation of deposits in Kazakh commercial banks, which in turn squeezed tenge liquidity in the market.

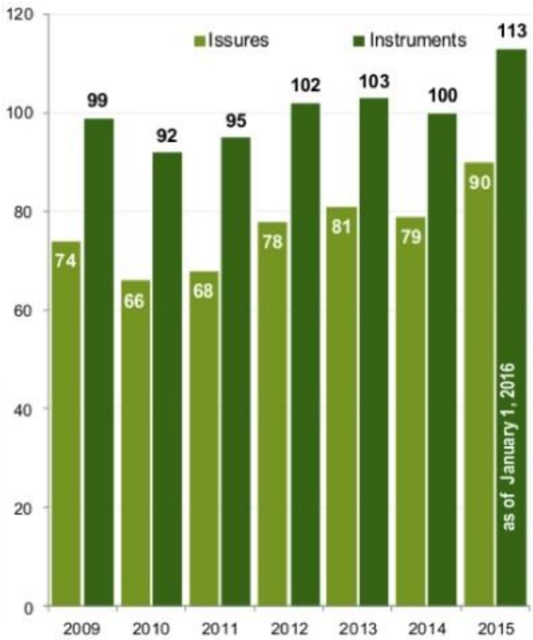



"Because of uncertainty surrounding the exchange rate last year, the volume of swap operations involving government securities or foreign currency was significant," Aldambergen tells bne IntelliNews in an interview, noting that the forex swap market accounted for 58% of the total trade, foreign exchange operations for 13.5% and repo operations for 25.2%. "Practically 90% of the trade was related to foreign currency. But this was the specifics of last year. The swap operations increased because of shortages of tenge liquidity, which means banks mortgaged their foreign currency in return for tenge liquidity."

The devaluation of the tenge caused a fall in interest in tenge-denominated assets such as the shares of Kazakh companies listed on KASE, says Aldambergen, but this interest is now recovering with the stabilisation seen on the forex market and decreased in the volatility of the exchange rate. "It's clear that the situation was complicated by the change of the exchange rate of the tenge last year and interest went down at some point because share prices are in tenge. And with the stabilisation of the exchange rate since the beginning of the year, we can see heightened interest in shares that make up the KASE index."



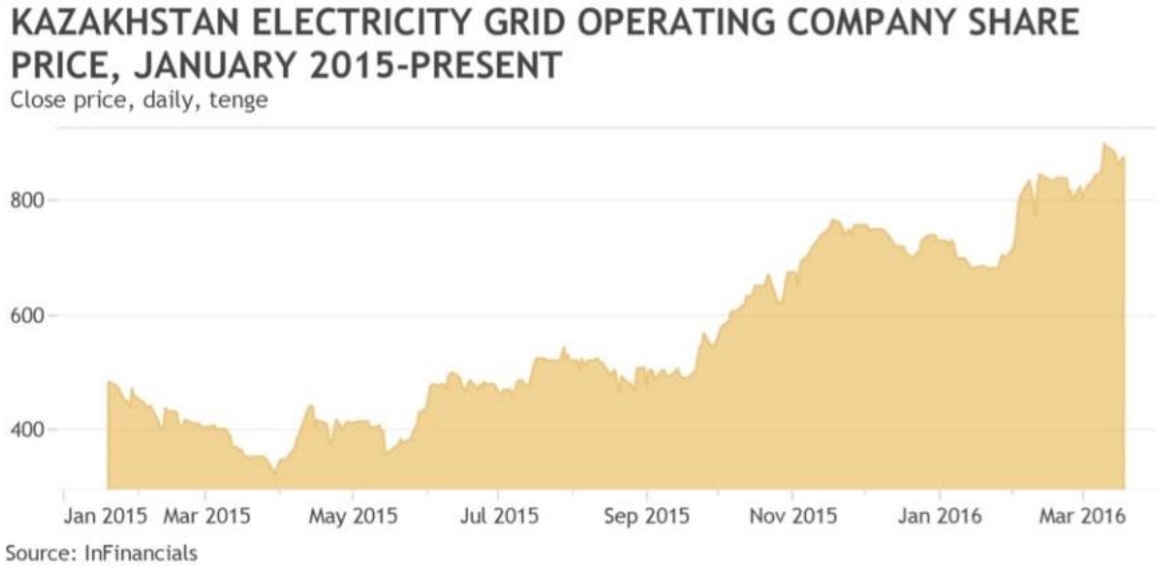




Despite share trading jumping by 370% y/y to $4.7bn in 2015, the KASE index fell by 9% to 858.79. The index, made up of eight most-traded stocks of power grid company KEGOC, oil-transporting company KazTransOil, national telecom giant Kazakhtelecom, oil producing company KazMunaiGas Exploration Production (KMG EP), copper giant KAZ Minerals, leading banks Halyk and CenterCredit, and the country's largest mobile operator Kcell, has been on the upward trend this year so far, jumping to 1,023.33 as of March 18.

"KEGOC is now the best performer, which is very attractive now because KEGOC paid good dividends last year and it has a good market maker who maintains good pricing for these stocks," Aldambergen explains.

KEGOC is the second national company run by the sovereign wealth fund Samruk-Kazyna that offered shares to the general population at the end of 2014 as part of the government's now-defunct "People's IPO" programme. The programme, announced with great ceremony in 2011, was supposed to float shares of national companies run by Samruk-Kazyna to liven up the stock exchange by engaging retail investors. Initial plans included the floating of at least 10% stakes in other companies run by the fund, such as Samruk-Energy power generation, Air Astana, KazTransGas gas-transporting company and in railway company Kazakhstan Temir Zholy.

The authorities hyped the sale of the electricity transmission monopoly's shares to the population at what they described as the "very conservative" price of KZT505 ($2.8 at the time) per share, promising that at least 40% of its profits would be channelled into paying dividends. But investors did not share the official enthusiasm, as only 11,000 people bought 4.698mn shares worth KZT2.372bn ($13.1mn) out of 26mn shares offered. Since the floatation, the shares touched an all-time low of KZT320 in March 2015, but have since picked up to trade at KZT875 on March 18.




"Generally, the 'People's IPO' programme has had a positive impact on the development of the stock exchange and the stock market, and on the attraction of new investors to the market," the KASE CEO notes. "The work conducted by the issuers and Samruk-Kazyna as well as brokers has allowed the stock exchange to increase the number of accounts in the central securities depository from 16,000 individual clients to 100,000 clients. We can see after those IPOs these clients remain active and are taking part in other stock exchange transactions. For example, the local mining company Bast issued an IPO last year and its market maker attracted to it clients who took part in KEGOC's IPO."

In addition to KazTransOil and KEGOC, two private companies placed their IPOs on KASE in the past few years. But the general slow pace of IPOs by Kazakh companies is explained by Kazakh businesses' unpreparedness to deal with multiples of investors as opposed to one creditor like a bank that issues loans. "An issuer itself should be prepared for it because going public means accountability before several investors not one creditor. The level of information disclosure is different and the level of corporate governance is different," Aldambergen explains. "Kazakh companies have reached the point when they should start employing new methods of work, because bank funding has specifics and it cannot replace shareholder capital. And we can see Kazakh companies are undercapitalised."

## Rainy-day funds

While the "People's IPO" programme benefited the stock market, the 2014 merger of nearly a dozen pension funds into the state-owned Unified Accumulative Pension Fund has somewhat arrested the development of the market by reducing the number of active players. "The merger of pension funds has definitely had an impact on the liquidity of the stock market, but we should note that the growth rates of the stock and bond markets have been maintained because there are issuers who enter the market, and banks and national companies are continuing to place their bonds," Aldambergen explains.

She welcomes government plans to attract private, both local and foreign, management companies to manage parts of the pension fund's assets worth KZT5.8tn as of the beginning of 2016, and to transfer KZT600bn from the National Oil Fund to national banks and commercial banks. "I believe there should be more companies managing pension funds," she says.

Aldambergen says the transfer of KZT600bn from the National Oil Fund to national companies and banks “is good for the stock market”, because they will be transferred either in the form of deposits or through the issuance of bonds. “The more players there are, the better,” Aldambergen concludes.

By Naubet Bisenov in Almaty March 21, 2016