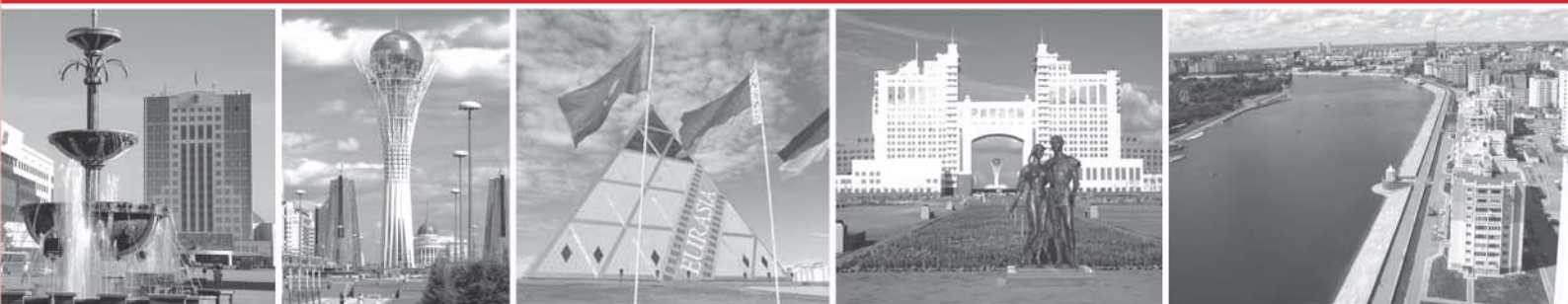


Kazakhstan

From a tough Q1 to a better H2



An analysis by ATFBank Research

From a tough Q1 to a better H2

We expect the Kazakh economy to begin to see some hesitant growth in late 2009 after a tough first half thanks to strong fiscal support and some easing of the global crisis. From mid-2010 on, the recovery will be driven mainly by exports. Efforts to stabilise systemically important banks will remain at the center of economic policy in H1/09, while in H2/09 government funds should finally reach the construction, SMEs and agriculture sectors.

Our forecasts

	2006	2007	2008	2009f	2010f	2011f
Nominal GDP, bln KZT	10214.0	12763.2	15907.0	15968.3	17895.9	20797.8
Real GDP, yoy % change	10.7	8.9	3.2	-2.0	3.0	5.5
- Personal consumption, yoy % change	12.6	10.8	-1.2	-2.3	3.0	4.2
- Investment, yoy % change	29.7	17.3	4.9	-8.8	5.7	10.4
Inflation (CPI) yoy, eop	8.4	18.8	9.5	12.6	7.1	6.9
average	8.6	10.8	17.2	10.8	8.8	7.0
Exchange rate /USD, eop	127.0	120.3	120.8	165.0	165.0	165.0
3M KazPrime, eop		12.35	10.58	15.98	8.01	8.00
Current Account/GDP (%)	-2.5	-7.0	5.3	-9.5	-4.1	-1.1
FDI/GDP (%)	7.8	9.8	11.0	8.3	10.4	10.5
Budget Balance/GDP (%)	8.4	5.2	1.2	-9.9	-4.0	-0.0

Source: NBRK, Statistical Agency, ATF Research

Main vulnerabilities: Lower than assumed oil prices, failure of bank restructuring

Lower than assumed oil prices

We expect oil prices of USD 60 per barrel Brent at end-2009. Substantially lower oil prices would result in a weaker exchange rate, a higher budget deficit and slower growth than we currently forecast. The

combined foreign exchange reserves of the central bank and the National Oil fund would fall below the USD 30bn we foresee for end-2009.

Smaller than foreseen success in bank restructuring

Efforts to stabilise banks will remain in the center of economic policy in most of 2009. The case of BTA, Kazakhstan's largest bank, is of particular interest. We believe that the authorities will be able to renegotiate some of its foreign debt while avoiding a default

in the technical sense. However, the government may drop its support in case negotiations fail or credit quality deteriorates faster than assumed. This would additionally strain the financial system and investor sentiment.

Main drivers of recovery: Stabilisation of commodity demand, flow of government funds, large investment projects

Recovery in commodities demand, fiscal loosening

We believe that demand for commodities will begin to recover in late 2009. Fiscal loosening in the magnitude of 11% of GDP should underpin consumption and investment in the second half of 2009 with

positive growth effects also in 2010. Road construction and strategic projects in the oil, gas and electricity sectors should also support growth.

Politics

In mid-February, the Nur Otan party, headed by President Nursultan Nazarbayev, addressed other political forces and public organizations to adopt a memorandum on maintaining stability during the economic crisis. Meanwhile seven political parties signed the memorandum, reflecting in

the political sphere, what also happens in the economy: additional concentration of power during the crisis. This helps manage the crisis, but bears the danger of abuse, bureaucracy and corruption if not reverted afterwards.

Stability memorandum signed by 7 parties

Economy

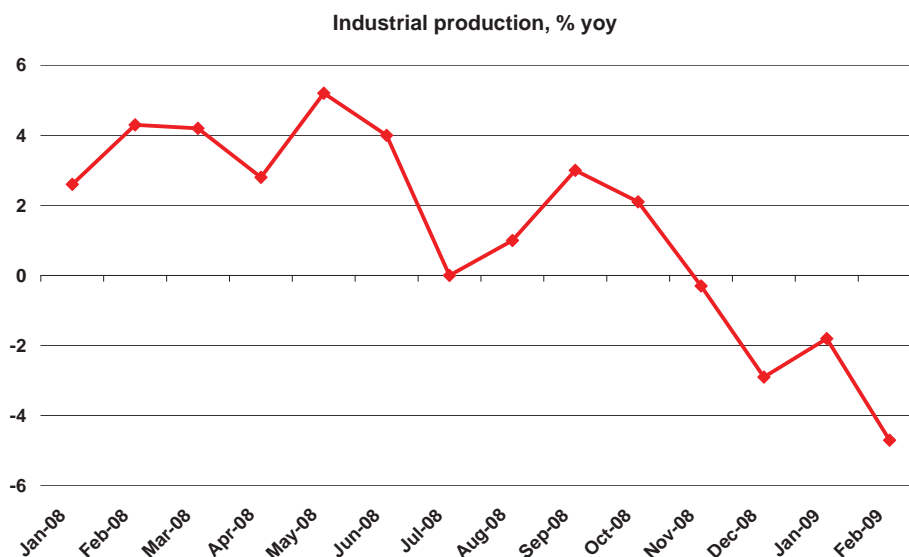
A tough Q1

In 2008, real GDP grew 3.2% yoy according to Statistical Agency data, which according to our estimates means growth of 1.3% yoy in Q4. For Q1 2009, all indicators point to a substantial output contraction: Industrial output declined 3.2% yoy in Jan-Feb 2009, with manufacturing down 11.4% yoy.

Metallurgy and engineering were particularly severely hit. Constant price retail sales decreased 2.2%, fixed capital investment 9.7% yoy. The consumer sentiment indicator computed monthly by the Statistical Agency worsened by 6pps to -4% in February, the first negative value in two years.

Real GDP growth in 2009: -2%: some revival in H2

OUTPUT SHRINKS



Source: Statistical Agency, ATFBank Research

Unemployment at 7.1%, additional 1.9% hidden

Unemployment on the rise

Unemployment is increasing despite agreements between the authorities – mostly the local governments – and companies not to lay off workers. In February, 599,000 people were unemployed or 7.1% of the workforce. This compares with 575 thousand persons or 6.9 % a year earlier. The Statistical Agency estimates that additional 1.9% of the work-force can be regarded as

hidden unemployed because of forced part-time work or unpaid vacation. The number of such cases has sharply increased since February. There is also significant growth in the unemployment of non-registered migrant workers.

Private consumption to shrink, but has some support from hikes in pensions and social spending

Incomes possibly flat, consumption lower

Real disposable income may remain flat in 2009, despite a fall in real wages of perhaps 2-3%: Students' grants and the average pension are foreseen in the budget to increase by 25% in 2009 and in 2010. Pensions and social support account for about 14% of incomes. About KZT 140 bn are ear-

marked for employment policies in 2009, KZT 14 bn for other social spending (together about 1% of GDP). Private consumption is nevertheless likely to shrink an additional 2.3% in 2009 after estimated 1.2% in 2008 as unemployment increases and lending to households stalls.

Exports slump in January by more than 50%

Sharp contraction in foreign trade

According to first data from customs statistics, Kazakhstan's foreign trade surplus narrowed to USD 0.8 bn in January 2009 from USD 2.9 bn the year before. Exports fell 50.5% yoy in USD terms, imports 21.4%. Exports of oil were 9.3% yoy lower in January in physical terms and 66.1% in

USD terms; iron ore exports fell 54.5% in physical and 35.5% in USD terms respectively. The most significant decline on the import side was caused by the slump in the demand for cars. Car imports were down 54% yoy in physical and 55% yoy in USD terms in January.

With oil prices one-half that of 2008, the C/A deficit could amount to 9-10% of GDP in 2009

Current account deficit set to widen drastically

We see oil prices recovering to about USD 60 per barrel Brent at end-2009. This nevertheless implies that they will be on average 47% lower in 2009 than in 2008. Global demand for metals will also remain weak because of the difficult situation in the au-

tomotive and construction industries. We therefore expect the current account deficit to widen to as much as of 9.5% of GDP, even though weak domestic demand, the February tenge devaluation and "buy Kazakhstan" policies will also keep imports low.

Record high FDI inflows in 2008

FDI resilient

Net inward FDI inflows amounted USD 14.5 bn in 2008, up from USD 10.2 bn in 2007. We believe that projects in the oil/gas and electricity sectors could keep FDI inflows

at USD 8.7 bn in 2009 despite investor restraint because of the difficult global environment.

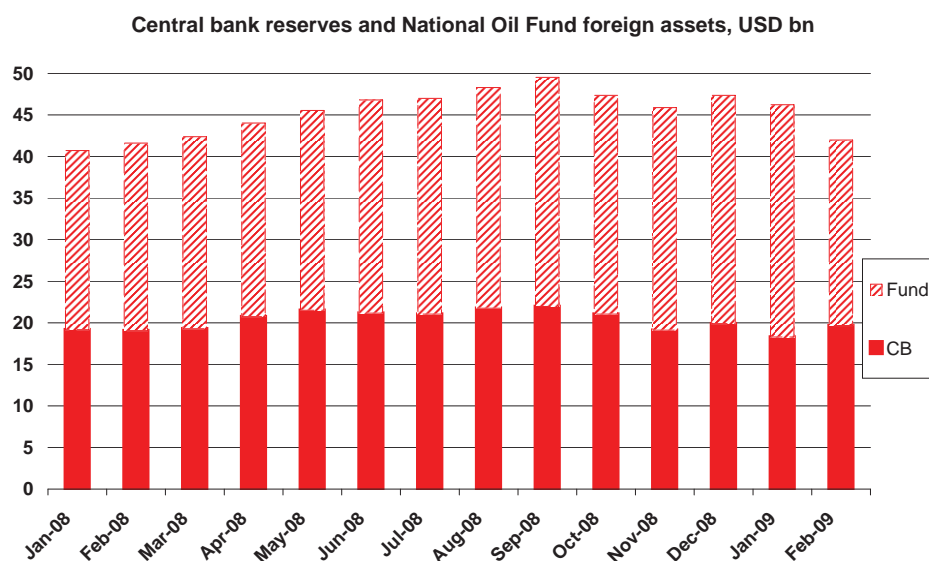
Reserves to fall another USD 11 bn

Central bank reserves stood at USD 18.9 bn as of 31 March 2008, we see them to fall to USD 12.4 bn at end-2009. This would mean a reduction in the import cover from 3.6 months at the end of 2008 to 2.4 months at end-2009. We assume that the Oil Fund will wind down its foreign assets by another USD 5 bn in the remainder of 2009 after a decline of already almost USD 6bn between end-January and end-March 2009 from USD 27.96bn to USD 22.00bn, used for tenge support and purchasing bonds of the Samruk-Kazyna state holding. Thus the combined NBK reserves and

Oil fund assets would decrease further by about USD 11 bn from the March amount to USD 30 bn. A larger decrease is likely to be avoided by resilient FDI, tightened capital controls and possibly by the restructuring of some foreign bank debt. Principal repayments due amount to USD 14 bn in 2009, of which USD 9 bn from banks. Parliament approved in early March in first reading a law giving the president the right to impose mandatory forex sales by exporters and introduce a ban on forex transfers and holdings abroad.

Reserves to decrease another USD 11 bn, after already USD 6 bn in Jan-March

RESERVES DECREASE SINCE SEPTEMBER



Source: NBRK, ATFBank Research

Inflation: moderate in early 2009, but more to come

Inflation in December 2009: 12.6% yoy

On 4 February 2009, the National Bank of the Republic of Kazakhstan announced that it would no longer hold the tenge in the previous implicit corridor of 199-120 to the dollar. Consequently discussions have begun about how severe the impact on inflation will be. In our view, actions taken by the authorities should combine with subdued credit growth and weak money supply to leave the pass-through to inflation on the lower side of what other Central and

Eastern European countries have experienced in the past at about 0.32, meaning that the roughly 20% devaluation should increase the consumer price level by about 6% over a couple of months. The February data came in at only 0.8% mom and 8.7% yoy, March at 0.8% and 8.9% yoy. Some price hikes were probably only postponed however. We forecast an inflation rate of 12.6% yoy for December 2009.

Policy response

Revised budget, further transfers from the Oil Fund

Government cuts forecasts

In response to the difficult global economic situation the Ministry of Economy and Budget Planning cut its 2009 real GDP growth forecast to 1.0% in late March, citing lower export prices for oil and metals. Growth should accelerate to 3.0% in 2010 according to the ministry, and then to average 4.3% until 2013. Inflation is seen at 11% yoy at end-2009, with a consequent

decline to 5.5%-7.5% until 2013. The 3 year Republican budget, adopted on 4 December 2008, was based on real GDP growth of average 2.7-4.1% for 2009-11, down from 5-7% in the previous draft; the projection of the oil price has been lowered from USD 60 per barrel to USD 40 in 2009 and USD 50 in 2010-11.

Budget revenues lower, expenditures higher

In the now revised budget law, revenues of the Republican Budget are projected to amount to 2837.4 bn (or 17.7% of GDP) in 2009, down from KZT 2,845 bn in the December budget because of the lower growth forecast. Expenditures, by contrast,

increased to KZT 3411 bn (or 21.3% of GDP according to our calculations) from KZT 3175 bn. The December budget set a deficit target (revenue-expenditure-net lending+net asset sales) of KZT 571.4 bn, now changed to KZT 573.6 bn (3.6% of GDP).

Additional money from the Oil fund

The revenues include extra transfers from the National Oil Fund in the amount of KZT 347.9 bn. KZT 320.6 bn were shifted from other purposes to social and employment programmes. In his speech on 6 March 2009, President Nazarbayev advocated the re-channelling of KZT 600 bn (USD 4bn) from the National Oil Fund to the budget and to direct KZT 140 bn out of this sum towards employment policies and the con-

struction and repair of local road networks and community services. Large projects in the fields of school and hospital construction, and also motorway and railway projects are to be finalised, but new projects postponed, he reportedly said. Means should be re-directed to the electricity sector, the construction of gas pipelines, the "Europe - West China Magistrale" and the agro-food sector.

Fiscal deficit of almost 10% of GDP in 2009

The consolidated deficit of central and local governments widened to 2.1% of GDP in 2008 from 1.7% in 2007. Including the National Oil Fund, which gives a more accurate figure of overall budget developments, the fiscal surplus narrowed from 5.2% of GDP in 2007 to 1.2% of GDP in 2008. For 2009,

we expect a deficit of as much as 9.9% of GDP after the latest spending plans were announced. A part of the deficit widening is only nominal due to lower oil prices and a part is used for acquiring (bank) assets, but even at constant prices the fiscal stimulus should amount to about 5-6% of GDP.

Flow of funds has begun

Most of the effect of the fiscal loosening will be felt in the second half of 2009. Flows in the magnitude of 4.5% of (KZT 716 bn) GDP have been disbursed by the Samruk-Kazyna Welfare Fund to banks (see tables). Another KZT 364 bn or 2.3% of GDP are in the pipeline. Of the KZT 716 bn, KZT 308 bn were used for acquiring bank shares, the rest for liquidity support and for SME and Mortgage lending pro-

grammes. However, as of 20 March 2009 only KZT 24.4 bn in SME support and KZT 4 bn of the mortgage programme reached the intended clients. The larger part of the money will reach the economy only in H2. (For an overview of the government programmes and their timing see also pages 3, 4 and 5 of the February 2009 issue of our Kazakhstan Economic development report).

Samruk-Kazyna:
USD 4.8 bn disbursed,
USD 0.2 bn at clients

Transfers from the National Oli Fund in autumn 2008: ca USD10 bn at the fx-rate of 120 per USD

to	USD bn	KZT bn
Kazagro (Agriculture)	1	120
Samruk-Kazyna*	9	1080
	10	1200

* On 6 March, Samruk-Kazyna additionally announced the issue of KZT 750 bn in local bonds

Samruk-Kazyna funds disbursed as of 27 February 2009

KZT billion

to	Financial sector*	SME**	Mortgages***	Total
KKB	120	16	24	160
Halyk	120	12	24	156
BTA	212	22	40	274
Alliance	24	18	14	56
Other banks		52	18	70
Sum	476	120	120	716

Samruk-Kazyna funds still to be disbursed

KZT billion

Construction, new mortgages, apartments	240
Infrastructure	120
Extra for financial sector stabilisation	4
Sum	364

Total disbursed + non-disbursed

1080

* KKB: KZT36 bn prepayment for 25% stake, KZT84bn for lending
 Halyk: KZT60 bn prepayment for 25% stake, KZT60bn for lending

BTA: total sum for the purchase of 75.1% of ordinary shares

** ATF, BCC - KZT20 bn each, Kaspi, Sberbank Russia (KZ subsidiary) - KZT12 bn each,
 Nur - KZT8 bn, Tsesna - KZT3.3 bn, Eurasian, Astana Finance, Damu (SME fund) - KZT 3bn each

*** ATF, BCC, Kaspi, Eurasian, Temir, Tsesna, KZT3bn each
 Source: Samruk-Kazyna Welfare Fund, ATFBank Research

Further monetary easing

Minimum reserve requirements further reduced

The National Bank of the Republic of Kazakhstan (NRBK) reduced the minimum reserve requirements for commercial banks from 3.0% to 2.5% for foreign liabilities and from 2.0% to 1.5% for domestic liabilities at the beginning of March, as pre-announced at the occasion of the 20% devaluation of

the tenge on 4 February 2009. The move should free up approximately KZT 50 bn (USD350 mn) of liquidity into the banking system. The requirements have fallen since January 2008, when they stood at 10% for foreign liabilities and 5% for domestic liabilities.

KazPrime temporarily decreased

The 3M KazPrime interbank rate slightly decreased to 14.5% in late March from 15.0% in late February. We forecast the 3M KazPrime to increase to 16% by end-2009 report as re-acceleration of inflation might combine with scarce tenge funding and

devaluation fears. Chances have improved that the rate might come in a bit lower, but until we have more certainty about banking sector developments and the exchange rate, we keep the fore-cast.

Lending, deposit rates hardly reflect monetary easing

The picture on banks' lending and deposit rates is mixed but does overall not reflect the monetary easing: Average tenge lending rates for legal persons peaked at 16.5% in January 2009, according to central bank data, and declined consequently to 15.7% in February, but interest rates on loans to individuals increased further from 18.4% to 19.2% in February. Deposit rates for legal persons rose from 6.1% in January to 6.2% in February and for individuals from 6.9% to 8.4%.

The authorities attempt to lower rates by using ceilings in their mortgage and other pro-grams (e.g. maximum effective interest rate of 14%). This is intended to help debtors and support growth. However, the ceilings combine with detailed documentation requirements for qualifying to the programs to make banks and clients less eager to participate. This adds to further slowing the crediting process.

Credit growth nevertheless to remain weak

Some growth in corporate loans, decline in retail loans

The total volume of outstanding loans was 4.7% higher in January 2009 than a year earlier, with corporate loans growing 11.1%, retail loans contracting however by 8.1%. In February, these figures improved to 16.0%,

23.2% and -0.4% respectively. However roughly 10 percentage points reflect the February devaluation, with about 50% of loans in foreign currency. Tenge loans decreased 2.2% mom, fx-loans increased 25.1% mom.

Growth in corporate deposits, shift to foreign exchange

Total deposits grew 22.5% yoy in January, among them corporate deposits 38.8% and retail deposits a meagre 3.9%. In February the analogues figures were, 38.9%, 65.2% and 10.3%. Retail tenge deposits fell 12.7% mom, while corporate tenge deposits increased by 8.7% thanks to the place-

ment of Samruk-Kazyna funds in banks. In foreign currency, retail deposits increased 25.5% mom, corporate deposits 35.2%. The strong growth in fx-deposits, but also in fx-loans, shows that the devaluation triggered a shift from the tenge to foreign currency.

The government programmes make some credit growth likely in 2009, a moderate one however. Funding by deposits will remain weak as household incomes and savings will grow at modest rates, and corporate finances deteriorate. Some companies might however increase deposits as they

cut back on investment. Foreign funding will remain particularly scarce, given the global risk-aversion. A significant part of liquidity will be used for repayments, bond buy back programmes and provisioning rather than for the extending of new loans.

Funding to remain scarce and probably only a fraction will be used for new loans

The aggregate pre-tax loss of banks amounted to KZT 264 bn in Jan-Feb 2008 according to local accounting standards. KZT 366 bn in provisions were set aside, 70% of the amount in 2008 as a whole, and significantly more than the KZT 247 bn in all of 2007. Non-performing assets (Cat 4, 5, and loss) increased from 2.3% of total

assets at end-2007 and 10.5% at end-2008 to 11.3% as of 1 March 2009. More is to come as extending loan durations and capitalizing interests becomes less feasible as a practice to avoid overdue debt, and as the economy deteriorates. This will leave lending very restrictive.

Sharp increase in bad assets and in provisioning

A lot will depend on how successful the government's bank restructuring efforts will be. The case of Kazakhstan's largest bank by assets, BTA, is of particular interest. We believe that the Bank will - with the support of the authorities - be able to renegotiate some of its foreign debt while avoiding a default in the technical sense.

However, the government may drop its support if any of its creditors ask for early debt repayment citing the change of ownership clause, the bank's chairman Arman Dunayev said on 24 March, according to media reports. This would further increase CDS spreads and the cost of foreign funding for Kazakhstan.

The case of BTA

Capital controls

The Majilis (the lower house of parliament) approved in early March in first reading a law streamlining the introduction of currency controls. The new law gives the president the right to impose mandatory forex sales by exporters and introduce a ban on forex transfers and holdings abroad by both firms and individuals. Such provisions have been part of the current law but the

amendments will facilitate the introduction. Judging from Kazakhstan's own experience in the 90ies and from Ukraine in late 2004 (other than in 2008-2009) the measures could be quite effective to prevent fx-speculation, given shallow capital markets and only moderately developed external economy links, as is the case in Kazakhstan.

Introduction of mandatory forex sales and ban on accounts abroad simplified

Risk of further devaluation in 2009 diminished

The drain on fx-reserves will be substantial in 2009, therefore a further devaluation of the tenge in 2009 cannot be ruled out. We keep our forecast of 165 to the USD at end-2009. However, there are factors which make further devaluation less likely than before. Among them are: diminished pres-

ures on competitiveness because of likely rouble bottoming out, reduced import elasticity because of "buy Kazakh" campaigns, tightened fx-control legislation. And the state meanwhile is majority or at least 25% owner of the major banks, which enables a better control of speculative flows.

Diminished devaluation risk

Outlook

Higher commodity prices, government programs should allow recovery in H2

A better H2

Thanks to some recovery in global commodity demand and the effects of fiscal loosening in the magnitude of 11% of GDP (KZT 1800 bn, USD 12 bn), made possible by ample reserves and low public debt, the economy should begin to grow slightly again in seasonally adjusted quarter on quarter terms in late 2009. Beside bank

stabilisation, most of the additional money will go to construction and higher social spending. Support for public sector incomes should allow real disposable income to remain flat despite a likely fall in real wages. Bank restructuring should have advanced to a degree that moderate credit growth will be possible.

State sponsored road construction, strategic projects to support investment

Investment underpinned by roads, oil, power stations

Companies, particularly in metallurgy, have begun to cut back investment due to lack of demand. Construction companies and SME's suffer from scarce financing. As a result, investment will sharply decline in 2009, by perhaps 9% in real terms. The decline will be mitigated by KZT 80 bn in government money earmarked for construction works on major roads and another KZT 95 bn for infrastructure upgrading in Astana and Almaty. KZT 120 bn each for SME and mortgage support have been disbursed via Samruk-Kazyna to banks. These funds add

up to 2.6% of GDP. In the oil-gas sector several projects begin. One example is the "Caspian Energy Hub", not far from the city of Aktau. In a first stage, beginning in May and lasting 18 months, USD 400 mn will be spent. Total investment is to amount to USD 15 bn over 7-8 years. Another investment focus is electricity. On 25 March, Samruk-Energo and Kepko and Samsung of Korea agreed on the construction of the Balkhash Electro Station, with an estimated investment volume of USD 4.5 bn until 2016. Several other projects are also under way.

3% growth in 2010, 5.5% growth in 2011.

Return to more significant growth in 2010, 2011

Real GDP year on year growth rates will likely remain negative in all of 2009, but turn positive again in 2010. There is some risk that developments will be less favourable than we predict in case the global crisis continues well into 2010. However, we

expect real GDP to recover to +3% growth in 2010 and +5.5% in 2011 from -2% in 2009. From mid-2010 on, the recovery will be driven by mainly exports as fiscal reserves will have been spent.

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