

SECTOR ASSESSMENT (SUMMARY): FINANCE

A. The Economy

1. Kazakhstan's economy significantly depends on hydrocarbons, which represented 25% of its gross domestic product (GDP) in 2015 and more than 70% of export revenues. Services (60% of GDP), industry¹ (10%), and agriculture (5%) are important non-oil segments. The economy rebounded from the 2008 financial crisis with an average GDP growth of 6.5% (2010–2013) before declining to 4.1% (2014) and falling to 1.2% in 2015. GDP growth will remain subdued at 0.4% in 2016.² The decline is a result of a sharp drop in hydrocarbon revenues, the recession in the Russian Federation, and weakening demand from Kazakhstan's main trading partners. The sharply declining foreign exchange income triggered a substantial drop in foreign currency inflows, prompting the central bank to move to a floating exchange rate regime. From 2014 to mid-2016, the tenge lost over 55% of its value against the United States dollar³ and, despite price controls and a restrictive monetary policy, inflation almost doubled to 13.6% in December 2015, from 7.4% in December 2014. Although the growth of the non-oil economy exceeded that of hydrocarbons, the government recognizes that further substantial efforts are needed to boost its non-oil economy for domestic value addition and job creation.⁴ Such efforts are particularly critical during the current economic downturn.

Table 1: Economic Structure and Growth

Value Added (T billion, current prices)	2010	2011	2012	2013	2014	2015	CAGR 2010–2015
Agriculture	984	1,409	1,330	1,621	1,718	1,913	14%
Services	11,274	13,808	15,939	19,144	21,758	23,594	16%
Industry	7,177	8,708	9,344	9,986	10,818	10,159	7%
Of which manufacturing	2,470	3,131	3,437	3,828	4,094	4,120	11%
Total	21,116	25,742	28,528	32,897	36,652	38,200	13%

CAGR = compound annual growth rate.

Source: Kazakhstan's National Statistics Office.

2. While the cities of Astana and Almaty and the Atyrau region generated 42% of value addition in 2015, 86% of Kazakhstan's 17.5 million residents live in rural districts and regional towns. Agriculture represents 24% of employment. In 2014, the rural poverty headcount of 4.7% exceeded the urban poverty headcount of 1.3%, indicating that the rural population is primarily engaged in low-productivity agriculture and trapped in low-wage jobs. Support of the rural economy is essential to generate income for low-income families and create demand for goods and services provided by farmers as well as micro, small, and medium-sized enterprises (MSMEs). However, agricultural productivity is hampered by low standards of quality, small land plots, and inadequate infrastructure. Rural financial inclusion is also limited—only 48% of rural adults have a bank account.⁵

3. A World Economic Forum business survey identified corruption, inadequate skills, and

¹ Net of hydrocarbons.

² Asian Development Bank (ADB). 2016. *Asian Development Outlook, 2016*. Manila.

³ From T188 = \$1 to T337 = \$1.

⁴ ADB. 2013. Report to the Government of Kazakhstan. *Policies for industrial and Service Diversification in Asia in the 21st Century*. Manila.

⁵ World Bank. Financial Inclusion Data / Global Findex.

<http://datatopics.worldbank.org/financialinclusion/country/kazakhstan> (accessed 30 March 2016).

poor access to finance as major obstacles to competitiveness.⁶ The performance of institutions and financial markets is undermined by corruption, bureaucracy, related-party transactions, poor performance of boards, and the dearth of experienced professionals, as seen in the banks' high rates of nonperforming loans (NPLs) resulting from poor underwriting standards.

B. The Micro- to Medium-Sized Enterprise Subsector

4. In 2015, 1.1 million MSMEs were active, of which 930,000 were sole proprietorships, 176,000 small enterprises, and 2,900 medium-sized enterprises.⁷ Sole proprietors employed 49% of MSME labor in 2015, followed by small (39%) and medium-sized (12%) enterprises. MSMEs contributed 26% of GDP and 32% to employment in 2015. While sole proprietorships display low productivity with an annual output per worker of \$3,170 equivalent in 2015, their significance in providing subsistence income, especially in rural areas, highlights their importance as a social protection for households. With an annual output per worker of \$27,000, small and medium-sized enterprises (SMEs) are the drivers of growth and employment.

5. MSMEs focus on meeting domestic demand in trade (37%), services (30%), agriculture (23%), transport (8%), and manufacturing (3%). Firms are concentrated in the cities of Almaty (25%) and Astana (10%), where about half of the SME output originates. West Kazakhstan and Astana City were the most dynamic: their compound annual growth rates (CAGRs) of output exceeded 50% (2012–2015), which is more than double the national average of 23%.

6. Women's labor force participation (68%) is below that of men (78%). Women also represent a higher share of the unemployed (57%, 2015).⁸ A survey by the Asian Development Bank (ADB) carried out in 2015 found that 58% of women-owned businesses had annual sales of up to \$10,000 and focused on services (34%), trade (33%), and manufacturing (20%), which highlights the significance of microfinance for women entrepreneurs.

7. While MSMEs contributed 26% to GDP in 2015, loans to MSMEs represented only 9.8% of GDP in 2015; banks typically prioritize corporate and state-owned enterprises. Also, given collateral requirements of up to 250% of the loan value, most MSMEs cannot meet the standard criteria for bank credit.⁹ MSMEs do not have enough financial documentation, credit histories, and property titles to satisfy collateral requirements. Credit underwriting does not focus enough on estimated business cash flows. The high cost of originating loans and perceived risk in lending to small businesses result in high lending rates that may be unattractive for MSMEs.¹⁰ Only 19% of MSMEs have received a bank loan.¹¹

C. The Finance Sector

8. The finance sector comprises 105 lenders: 35 banks and 70 nonbank financial

⁶ World Economic Forum. 2015. *Global Competitiveness Report, 2015–2016*. Geneva.

⁷ Data from the National Statistical Office. The government classifies enterprises by the number of workers and by income. In 2016, micro enterprises are those with annual turnover of up to \$184,000 equivalent, or up to 15 employees; small enterprises: less than 100 employees or up to \$1.8 million annual turnover; and medium-sized enterprises: less than 250 employees or up to \$18.4 million annual turnover.

⁸ Kazakhstan ranks 47th out of 145 countries in the Gender Gap Index 2015 (World Economic Forum, 2015).

⁹ World Bank. Enterprise Surveys. Kazakhstan.

¹⁰ Bank interest rates for tenge loans range from 14% to 25% and those in foreign currency range from 5% to 12%.

¹¹ World Bank. Financial Inclusion Databank / Global Findex.

<http://datatopics.worldbank.org/financialinclusion/country/kazakhstan> (accessed March 2016).

institutions (NBFIs). Banks represent 75% of sector assets.¹² The five largest banks held 60% of the T23.8 trillion (\$70.4 billion) banking assets.¹³ Despite their modest asset size, MFOs' service outreach is significant (300,000 clients). Bank services are concentrated in the cities of Astana and Almaty, where 70% of loans are provided and 71% of deposits sourced.

9. The performance of the Kazakhstan finance sector mirrors that of the economy. Since its independence, macroeconomic shocks such as the 2009 crisis, associated with currency devaluations, have hurt the performance and stability of the banking system as well as public confidence. From 2011 to 2013, the loan book (expressed in \$) grew by a CAGR of 10.9%, medium-sized loans by 119%, and deposits by 7.7%. Profitability improved from a negative return on assets to a positive one of 1.8%, and the capital adequacy improved to 18.7%. However, asset quality remained poor with NPLs exceeding 30% of total loans. Banks have since continued their efforts to reduce the level of NPLs through write-offs and transfers to special purpose vehicles, reducing the reported NPL ratio to 8% (2015). However, this largely overstates the improvement of asset quality since 2014.¹⁴

Table 2: Kazakhstan Banking System Indicators, 2011–2015

Item	2011	2012	2013	2014	2015	CAGR 2011- 2015	CAGR 2013- 2015
Assets (\$ billion)	86.5	92.3	100.6	99.8	70.1	7.9%	-16.5%
Loans (\$ billion)	70.7	77.5	86.9	77.6	45.9	10.9%	-27.3%
– of which to medium-sized enterprises	1.4	3.1	6.9	8.0	5.7	119.0%	-8.9%
– of which to small and micro enterprises	9.1	9.4	8.3	9.8	6.1	-4.0%	-14.7%
Customer deposits (\$ billion)	56.6	59.8	65.6	64.0	47.1	7.7%	-15.3%
SME loans/total loans (%)	14.8	16.1	17.5	22.9	25.7		
Return on assets (%)	-0.1	1.9	1.8	1.6	1.2		
Loan–deposit ratio (%)	120.0	130.0	130.0	120.0	99.7		
Capital adequacy ratio (%)	17.4	18.1	18.7	17.3	15.9		
Nonperforming loans to gross loans (%)	30.6	29.7	31.3	23.5	8.0		

() = negative, CAGR = compound annual growth rate, SMEs = small and medium-sized enterprises.

Source: National Bank of Kazakhstan (statistical bulletins and banking reports).

10. In light of declining external demand and declining foreign currency inflows, the tenge depreciated sharply and lost 55.8% of its value against the United States dollar between end-2013 to mid-2016 (footnote 3). This lowered the banking system's solvency and profitability, as presented in Table 2. Expressed in dollar terms, bank loans contracted by 27.3%, and especially loans to micro and small enterprises declined by 14.7% during 2013–2015, illustrating the adverse impact of the tenge's devaluation. As a result, the banking system's depth, expressed as the ratio of private sector credit to GDP, remained low in 2015, at only 38%.

¹² The Single Accumulative Pension Fund, microfinance organizations (MFOs, 0.15%), and other NBFIs hold the remaining 25%.

¹³ Kazkommertsbank (KKB), Halyk Bank, Tsesnabank, Sberbank, and Bank CenterCredit

¹⁴ NPLs should be interpreted with caution because rescheduled loans are not included. Also, KKB and BTA Bank held 70% of system NPLs in June 2015. While a transfer of both banks' NPLs to BTA Bank and the subsequent bank de-licensing of BTA improved the presentation of banking system NPLs, KKB remains exposed to a loan of \$6.7 billion equivalent to BTA due in 2025, which is not classified.

11. In 2015, banks were moderately capitalized; their total capital adequacy ratio of 15.9% (2015) is above the regulatory minimum of 7.5%. The continued significant size of problem loans will require write-offs and loan loss provisions over an extended period, and lowering net margins will limit their ability to generate additional capital through retained earnings. High exchange rate volatility resulted in a surge of deposit dollarization from 35% in 2010 to 70% in 2015, while the local-currency loan book represented 66% in 2015. Given that loans and deposits represented about the same value in 2015, it seems that the banks will need to manage substantial open foreign-currency positions. Bank lending in local currency was constrained by the monetary policy of the National Bank of Kazakhstan (NBK) and its measures to counter currency speculation. In 2014 and 2015, the NBK provided cross-currency swaps up to 12 months. In 2016, the government has provided T200 billion from the pension fund and the national wealth fund to support SME lending. Tenge funding is essential to counter open foreign-currency positions and related risks of financial institutions and their borrowers.

12. The NBK is mandated to regulate and supervise banks and MFOs.¹⁵ It introduced Basel III capital adequacy principles for banks in 2015, for full enforcement by 2019. Basel III will require banks to undertake internal capital adequacy assessments and stress-testing of their business models to estimate capital requirements for credit, market, and operational risks. Cyclical capital buffers for market volatility will be introduced in 2019, and additional structural buffers for systemically important banks were introduced in 2016. To mitigate risks associated with dollarization, the NBK requires additional capital for foreign currency deposits and has increased the risk weights on long-term loans denominated in foreign currency to 200% of the nominal value in 2016, which will overall increase capital requirements for banks.

13. **Government's strategy.** The government supports the MSME subsector, recognizing its significance for employment, innovation, and non-oil economic growth. The national development strategy, Kazakhstan 2050, targets to increase SMEs' contribution to GDP to 50% by 2020. The Roadmap for Business 2020, the Employment Roadmap 2020, and the State Program of Industrial and Innovative Development (2015–2019) contain measures for MSME support.¹⁶ The government has in place programs with development partners to improve access to finance to help MSME growth.¹⁷ Damu Entrepreneurship Development Fund is a government-owned agency mandated to provide loans and guarantees to MSMEs via financial intermediaries on commercial and concessional terms.

14. **ADB sector experience and assistance program.** Prior to the 2008 crisis, ADB provided nonsovereign loans and partial credit guarantees to four banks.¹⁸ Since 2010, it has provided sovereign loans through a multitranche financing facility for SMEs through banks in an aggregate amount of \$500 million equivalent.¹⁹ The facility is expected to close by mid-2017.

¹⁵ MFOs must have minimum capital of T30 million, a capital adequacy ratio of 10%, and a debt–equity ratio below 10:1. MFOs are not licensed to receive deposits from the public.

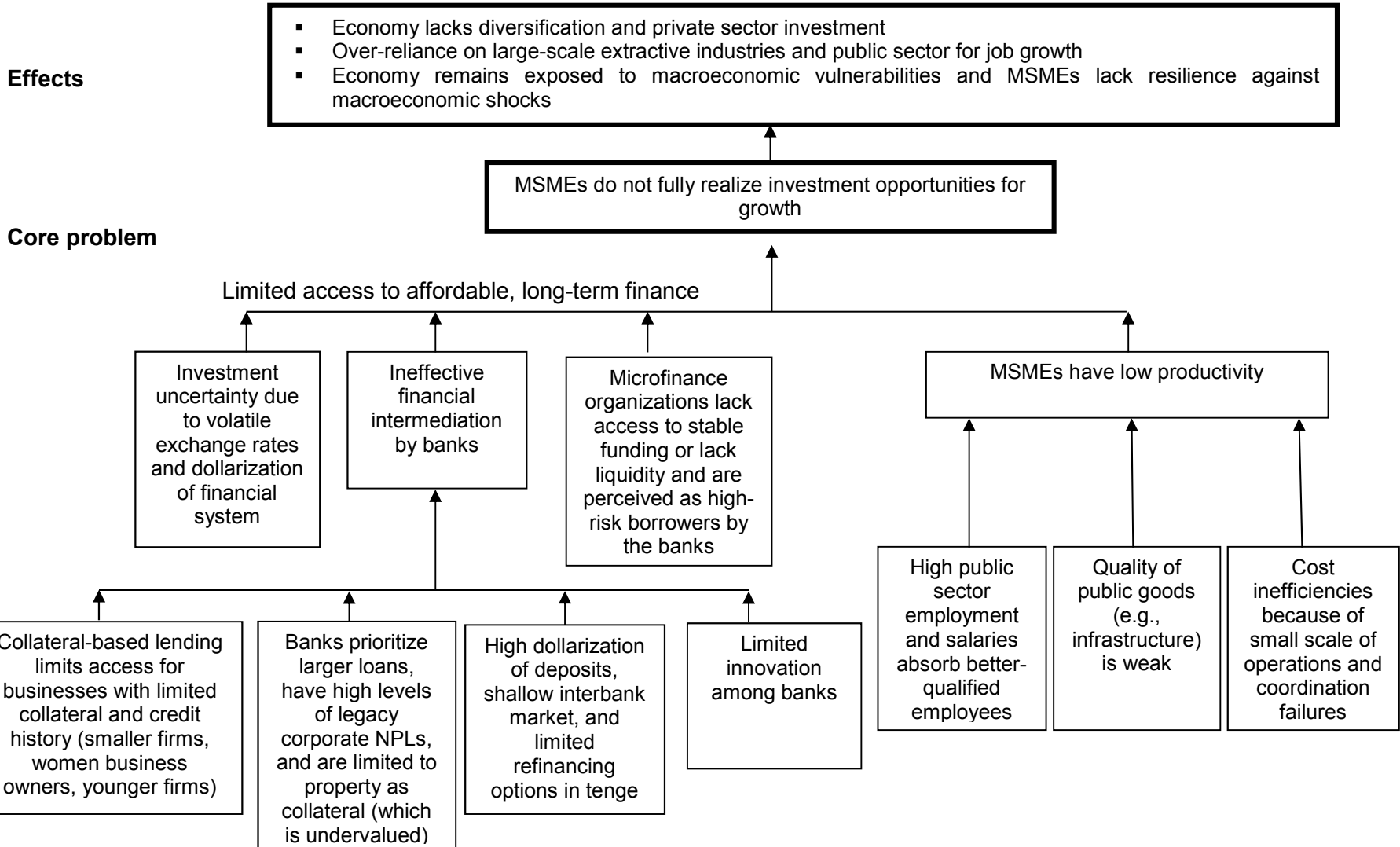
¹⁶ Government of Kazakhstan. 2012. *Kazakhstan – 2050 Strategy*. Astana; Government of Kazakhstan. 2015. *Roadmap for Business–2020*. Astana; Government of Kazakhstan. 2014. *State Program of Industrial and Innovative Development of the Republic of Kazakhstan 2015–2019*. Astana. A revision of the Business Roadmap is expected to be approved in the second half of 2016.

¹⁷ Development Coordination (accessible from the list of linked documents in Appendix 2).

¹⁸ Alliance Bank (2006, \$100 million partial credit guarantee and \$50 million loan); Bank CenterCredit (2007, T6 billion loan); BTA Bank (2006, \$75 million loan); and KKB (2007, \$100 million partial credit guarantee). The loans to BTA Bank and Alliance were restructured and partly written off.

¹⁹ ADB. 2010. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to the Republic of Kazakhstan for the Small and Medium Enterprise Investment Program*. Manila.

Problem Tree for Micro, Small, and Medium-Sized Enterprise Subsector



MSME = micro, small, and medium-sized enterprise, NPL = nonperforming loan.
 Source: ADB staff.