

FINANCIAL SYSTEM OF THE REPUBLIC OF KAZAKHSTAN: INSTITUTIONAL CONDITIONS AND DEVELOPMENT TRENDS

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Annotation

In modern conditions, the importance of the financial system in ensuring the distribution of material and other resources of society is difficult to overestimate. It should also be noted that the main world-class economic crises are primarily associated with problems in the development of the financial sector.

Key words: *financial sector, lending, investments, national economy, stock technologies*

J. Stiglitz, a Nobel laureate in economics, compared the financial system to the brain of society. This comparison is based on the fact that the financial system distributes scarce capital between competing ways of using it, trying to direct it most effectively to where it gives the greatest return” [1]. It has a significant impact on all sectors of the economy, permeating all aspects of society. And in many ways, the efficiency of the functioning of the national economy as a whole depends on the effectiveness of its activities. In this regard, this article discusses the financial aspects of the development of the Kazakh economy.

Taking into account the time frame, the main regulatory document for the financial sector of the economy of the country of finance is the “Concept for the development of the financial sector of the Republic of Kazakhstan until 2030”, approved by the government back in 2014.

According to the Concept, the development of the country’s financial sector depends on determining its place and role in the country’s economy, taking into account the needs of society and the state [2]. It highlights the State’s expectation that the financial sector will be able to provide sufficient resourc-

es at an affordable price to finance priority sectors of the economy within the framework of economic development programs.

And the common goal for both society and the state, as well as for financial organizations, is the formation of a financial sector that performs its function of a financial intermediary as efficiently as possible. Taking into account the dynamic situation in the global economy, it was noted that, against the background of strengthening integration processes, coordinated unified approaches to regulating national financial markets (Basel standards) are being developed. It is important to further actively implement the best international practices and regulatory standards.

The subsequent increase in competition in the financial market, on the one hand, should entail an increase in the quality and expansion of the range of services provided. On the other hand, the degree of vulnerability of the financial sector of the Republic of Kazakhstan will increase, external risks will increase, which, in an unfavorable development scenario, may lead to an outflow of capital and funds of creditors and depositors from the banking system. And thus to credit compression.

The financial system should not create new risks or increase the scale of existing risks in the economy. This, in turn, it requires the development of an optimal regulatory mechanism, when the possible consequences of the implementation of risks are minimized, and the requirements are not excessive and do not suppress the activity of the financial sector.

In this Concept, the key problems of the financial system of Kazakhstan are correctly noted. Among them, in our opinion, the following can be distinguished [2]:

- a) The priorities of lending by banks reflect the disproportions in the structure of economic growth based on consumer demand, and not on investments to the real sector of the national economy.
- b) A limited set of services provided to large enterprises. And the main thing is the inability of banks to accumulate independently a significant amount of resources needed to finance large-scale investment projects.

Table 1. Indicators of lending to the real sector of the economy of the Republic of Kazakhstan [3]

	2016 year	2017 year	2018 year	2019 year	2020 year
The share of enterprises that received a loan	14,7%	17,3%	17,97%	17,27%	15,8%
The level of refusals in lending	7,4%	4,8%	-	13,6%	5,4%
Average interest rate on loans, tenge	14,2%	14,3%	13,4%	12,6%	12,0%
Acceptable interest rates in tenge	9,3%	8,0%	-	7,1%	5,5%

The above determines the dependence of financing of priority areas of development of the domestic economy, including small and medium-sized businesses, largely on the resources allocated by the state. Under these conditions, domestic banks, as part of the implementation of strategic programs for the development of the national economy, are assigned the auxiliary role of intermediate operators between the financial resources allocated by the state and the business entities to which these resources are intended.

c) Shortage of supply and unattractiveness of securities market instruments relative to bank deposits and the real estate market for retail investors.

The following problem is closely related to this. The absence of a decent financial center in the republic at the level of many existing world financial centers. In 2006, a Regional Financial Center of Almaty was established in Kazakhstan on the basis of a legislative act [4]. It was endowed with a special legal regime regulating the relationship between the participants of the financial center and interested parties. In general, it was aimed at the development of the financial market of the Republic of Kazakhstan.

The main tasks of JSC “RFCA” were as follows:

- ensuring the integration of the Kazakh securities market with international capital markets;
- creation of conditions for attracting foreign investors and issuers to work in the financial center;
- development and introduction of new financial instruments and stock technologies;
- improving the investment culture and financial literacy of the population.

The structure of JSC «RFCA» also included the rating agency RA RFCA, which became the first national rating agency in the republic. His tasks included providing services in the field of independent evaluation of Kazakhstani companies with the assignment of corporate credit ratings and corporate governance ratings.

But, unfortunately, JSC «RFCA» has not achieved its goals in solving a number of international financial goals. It has not become competitive in comparison with global financial centers. As a result, the current problems of the development of the country's securities market and other problems of a systemic nature remained unresolved. These include: infrastructure, economic, investment, business and others.

- d) A bias towards retail funding of the banking system with the actual absence of a liquidity redistribution market and underdeveloped refinancing mechanisms.
- e) A high level of non-performing loans, which reduces the ability of the banking sector to flexibly respond to changes in the macroeconomic environment, the situation in individual markets.

But, as the subsequent activity in general and the current practice of the unfavorable development scenario in particular have shown, the financial sector of the domestic economy remains one of its weakest links.

In 2015 President of the Republic of Kazakhstan Nursultan Nazarbayev, in the aspect of implementing this Concept in order to improve the activities of the National Bank as a domestic financial regulator, instructed its new leadership to conduct stress testing of all subjects of the banking sector for non-performing loans. In the future, based on its results, take measures to recognize them and write them off. Also, that banks that failed to solve the capitalization problem should «leave» the financial system. Kazakh banks must comply with all international standards, including the Basel Committee and the International Monetary Fund.

In 2016, according to the management of the National Bank, as part of its countercyclical regulation, the requirement to increase the equity capital of banks from 10 to 100 billion tenge, as well as the prudential standard limiting the annual growth of unsecured consumer loans was canceled [5]. But at the same time, these requirements, taking into account the risks of globalization and WTO conditions for the banking system, were contained in the “Concept of development of the financial sector of the Republic of Kazakhstan until 2030” under consideration, taking into account the recommendations of the Basel Committee on Banking Supervision. It was planned that the gradual introduction of new capital adequacy requirements and capital buffers would

begin in 2015 and, according to the plan, be completed by the end of 2018 simultaneously with many countries and within the deadline specified by the Basel Committee.

Later, the issue of the state and stability of the financial sector of Kazakhstan is raised again [6]. About the need for a “reset” of the country’s financial sector. In this regard, the regulator, i.e. the National Bank of the country, is tasked with developing a set of measures to improve the banking sector. Among the important ones, there is a need to accelerate the work on clearing banks’ balance sheets from “bad loans”, as well as ensuring their recapitalization by the shareholders of the banks themselves. In this direction, the possibility of granting the regulator more rights for operational control over the state of the banking sector is noted. And the National Bank should move from a formalized approach to a risk-oriented one. Its task should be to take measures to influence banks without waiting for a formal violation on their part.”

During this and subsequent periods, the republic’s banking sector continues to provide significant financial and other assistance to banks with problems, primarily large ones. There are processes of absorption and merger of some of them. But the policy of the banks themselves practically does not change. The main task - providing the subjects of the national economy with the necessary credit resources at an affordable price to ensure the conditions for their development - does not find its solution in the activities of banks.

The country’s leadership once again calls on the regulator to solve the problems that have accumulated in the banking sector, that it is necessary to complete the cleaning of the bank portfolio from “bad” loans. The owners of banks should bear economic responsibility, recognizing losses. And the National Bank should not be a spectator of such acts [7].

Over the period 2015-2018, the volume of deposits in the banking system of Kazakhstan amounted to about 17 trillion tenge. But the structure of the deposits themselves has a pronounced tendency: an increase in the share of deposits of individuals in comparison with legal entities. During this period, the share of deposits of individuals increased from 39% to 51% [8]. On average, the volume of deposits of legal entities is reduced by 6% annually.

Problematic loans and a high degree of affiliation of banks with borrowers remain a significant problem. A high degree of affiliation of banks with representatives of public authorities and quasi-governmental structures. This is most typical for large banks in the country.

In the aggregate indicators of the country’s banking sector, the main share is accounted for by the 10 largest banks (Table 2).

Table 2. The share of the TOP 10 second-tier banks (STB) in the aggregate indicators of the banking sector of the Republic of Kazakhstan, % [9]

	2015 year	2019 year	2020 year
Share in STB assets	82,0	85,3	85,6
Share in STB loans	85,0	85,5	89,3
Доля в кредитной просрочке	14,5	10,5	0,9
Доля в депозитах физических лиц	89,3	92,0	94,0
Доля в депозитах юридических лиц	78,6	82,5	77,5

The next trend is a change in the currency content of deposits. The share of deposits of individuals in the national currency decreased from 79% to 48%. The currency content of deposits of legal entities is less pronounced, but also changes.

As the main measure to solve this problem, the financial regulator has dramatically changed the policy of recommended interest rates on foreign currency deposits, reducing the rate to 1.0%. On tenge deposits, the rates are at the same or increased level. Such an administrative measure practically deprived depositors of interest in foreign currency deposits, except for the safety of deposits. For existing foreign currency deposits, it was recommended to transfer to tenge.

Single-resource specialization, inefficiency in the implementation of state economic development programs, a high degree of dependence on fluctuations in the world market, the manifestation of corruption in the public administration system could not but affect the considered sector of the domestic economy.

The international rating agency Moody's has changed the forecast for the banking system of Kazakhstan from stable to negative as of March 2020 [10]. According to the agency, the revision of the assessment reflects the growing risks of deterioration in the quality of assets of Kazakhstani financial institutions and a decrease in their profitability in a deteriorating operating environment. According to analysts, less favorable monetary conditions and a slowdown in economic growth will continue to reduce demand for loans and lead to a deterioration in the ability of borrowers to service their loans. It is for these reasons that the agency changed the forecast from stable to negative.

Moody's notes the expectation of a slowdown in the growth rate of Kazakhstan's real GDP from 4.5% in 2019 to approximately 2.5% in 2020 due to lower oil prices and negative consequences for the economy caused by the coronavirus epidemic. He also expresses his opinion about the prospect

of an increase in the share of problem loans, which has been declining in recent years.

It is important to note the conclusions that the increase in credit rates and the weakening of the national currency will lead to a deterioration in the ability of borrowers to service their financial debt. The level of liquidity will remain high, but the risks associated with the volatility of the funding base and the high level of dollarization will remain.

In this direction, unlike neighboring countries such as China and Russia, our state does not have the capacity and resources to conduct a sufficient policy to protect the interests of the domestic economy.

Currently, in the context of a pandemic, the country's leadership is actively working on the development and application of measures to support both the population and economic entities. Including the financial sector of the country's economy.

But here it is necessary to take into account the complexities of the current situation for the economy of our republic. The available gold and foreign exchange reserves, the resources of the National Fund formed by deductions from the activities of enterprises of the mineral resource sector of the economy would be relatively sufficient for the previous period of the republic's life. But in the current conditions of a sharp reduction in economic activity due to the pandemic, a sharp drop in prices for domestic mineral resources, increasing financial "injections" to support the population and the economy - these reserves are actively depleted without any income to these reserve sources.

As a general consequence of the pandemic and other related factors, the slowdown in global economic activity will affect commodity prices. This, in turn, will affect local exporters. In these conditions, investments will slow down, revenues from the export of oil, gas and other raw materials will decrease. All this will have a negative impact on the financial condition of the domestic economy, reducing budget expenditures and overall domestic demand. Objectively, the share of problem loans will not only remain, but also increase. But taking into account the changing approach of the state leadership to the policy of the financial regulator and the processes taking place in the financial sector of the domestic economy, this negative trend should be leveled in the coming years.

In this regard, the following should be noted. After changes in the top leadership of the state in 2019, the National Bank of the Republic of Kazakhstan was faced with the need to develop and implement a financial recovery plan. First of all, this is reflected in the following.

The National Bank has launched a full audit of 14 major domestic banks to assess the quality of banking assets (AQR).

These banks accounted for about 87% of all assets of the banking system of Kazakhstan and 90% of the total loan portfolio of the country's banks. The process of assessing the state of the republic's banks was carried out in accordance with the methodology of the European Central Bank, with minimal adjustments to the specifics of the Kazakh market. This approach helped to ensure the comparability of the results obtained with the results of similar foreign programs.

More than 500 employees of audit and consulting companies, more than 60 employees of the National Bank and more than 70 independent appraisal companies were involved in the AQR process [11]. The reporting date for an independent asset quality assessment is April 1, 2019.

The results of the AQR, as well as measures implemented after April 1, 2019 and up to now to improve the quality of assets and maintain the capitalization of second-tier banks confirm that there is no shortage of capital both at the system level and at the level of individual banks. There are no risks for depositors of AQR participating banks, due to the fact that the level of capital adequacy according to the results of all implemented measures for all banks is higher than the requirements of the regulator.

Therefore, assets in the 3rd stage for the assessment of unrealized loss are adjusted for the degree of coverage of loans with formed provisions, collateral and other collateral.

The reduction in the value of collateral after revaluation is 23.8% of the value of the collateral valid as of April 1, 2019. The analysis showed that, on the one hand, banks also discount collateral on their own, i.e. they approach conservatively to obtain their objective value. At the same time, in order for the methodology of valuation of collateral and the valuation itself to more accurately reflect the price characteristics of the markets, it is necessary to take systematic measures to bring valuation activities in Kazakhstan to international standards.

To date, the banks have implemented and confirmed by the regulator significant measures to improve the quality of the portfolio. As a result, out of 429 billion tenge, more than 180 billion tenge of potential adjustments for AQR were settled by the banks themselves in the period from April 1, 2019 to February 2020 by completing provisions, paying off borrowers' debts, accepting additional collateral for loans.

According to the results of the AQR, taking into account the revaluation of the value of assets for all banks, in order to ensure full coverage of potential risks for banks in 2020, in accordance with prudential capital requirements, the financial regulator together with the National Bank has taken a number of measures.

The Government, the National Bank and the Agency for Regulation and Development of the Financial Market, within the framework of the ongoing Program to Improve the financial stability of the banking sector, adopted by the National Bank in June 2017, have identified an additional asset protection tool in the form of a paid guarantee of the Problem Loans Fund. The Asset Protection Tool provides banks participating in this Program, which assume obligations to recapitalize and limit risks, with the opportunity to implement all necessary measures to improve the quality of assets, taking into account the results of the AQR.

Similar asset protection tools have been used in countries such as the UK and Spain.

In accordance with the instruction of the President of the Republic of Kazakhstan, given within the framework of the expanded government meeting on January 24, 2020, potential risks will be covered by banks and shareholders without the use of budgetary funds and on a fee basis. The creation of a capital buffer for banks will be carried out by the banks themselves and shareholders within the framework of the current program to increase financial stability using an asset protection tool and setting strict requirements for banks and shareholders.

The necessary decisions on the regulation and development of the financial market have been taken, and relevant agreements with each participating bank have been signed by all parties.

The support of banks is carried out entirely on a paid and paid basis with the mandatory participation of shareholders. The financial models presented by the banks are stable and allow the necessary measures to be carried out at the expense of the bank and shareholders.

Completion of the AQR and ensuring capital adequacy for all participating banks should contribute to a significant increase in the transparency of the banking sector in Kazakhstan. This, in turn, is an essential factor for attracting international investors to the country's financial market and improving its investment attractiveness.

Currently, the strengthening of the competitive positions of the above-mentioned largest banks continues. In particular, assets increased by 16.8%, loan portfolio - 11.8%. The remaining banks collectively have the following indicators: assets increased by 13.6%, loan portfolio decreased by 21% [12].

In this regard, it can be noted that the large banks of the republic, for a number of reasons, have the opportunity to choose the most creditworthy and reliable borrowers as clients. This can be emphasized by the following data: in 2020, the delinquency of large banks on the loan portfolio was 0.9%,

while in 2019 it was 10.5%. As a result, a reduction in the level of risk and the level of redundancy (6.9%). Thanks to this, large banks have the opportunity to direct additional funds for their development.

The deposit market is characterized by the following trends. The population began to invest more free money in large banks – an increase of about 20%. And this is a corresponding minus for smaller banking entities. This was probably influenced by the closure of a number of them in recent years.

But these banks have a more pronounced tendency to attract deposits from legal entities - an increase of more than 50%. This could be influenced by a higher level of their loyalty compared to large banks.

The most important trend, as well as on a global scale, is the transformation, digitalization of all banking activities. Investment in the renewal and development of IT systems and technologies has increased dramatically. And, of course, an investment in human capital. If initially, Kaspi Bank was a pronounced leader in this direction, now it has become a priority for the rest.

In today's difficult economic conditions in the global economy, the national regulator of the financial market of the Republic - the Agency for Financial Market Development of the Republic of Kazakhstan - plans to integrate AQR and stress testing of banks into the agency's supervisory process on a regular basis using the developed templates, tools and methodology. The priority of supervision will be to conduct stress testing on all banks to assess the impact of the crisis on the banking sector and its further development.

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