

The current state of the credit market of the Republic of Kazakhstan

El estado actual del mercado crediticio de la República de Kazajstán

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ABSTRACT:

In the state of the national address "Kazakhstan in a New Global Reality: Growth. Reforms. Development" delivered on November 30, 2015, the President Nursultan Nazarbayev defined one of the five directions of anti-crisis and structural reforms - stabilization of the financial sector. The research shows the growing dynamics of loans provided by banks to customers. There were also calculated volumes of long-term and short-term loans, the volume of loans to legal entities and credit activity of the banks.

Key words credit market, the Republic of Kazakhstan, financial system, banking sector, loans

RESUMEN:

En "Kazajstán en una Nueva Realidad Global: Crecimiento, Reformas y Desarrollo", presentado el 30 de noviembre de 2015, por el presidente Nursultan Nazarbayev éste definió que una de las cinco direcciones de las reformas anti-crisis y estructurales era la estabilización de la economía financiera y la reforma del sector. La investigación muestra la creciente dinámica de los préstamos otorgados por los bancos a los clientes. También se han calculado volúmenes de préstamos a largo y corto plazo, volumen de préstamos a entidades jurídicas y actividad crediticia de los bancos.

Palabras claves Mercado crediticio, República de Kazajstán, sistema financiero, sector bancario, préstamos

The President of the Republic of Kazakhstan Nursultan Nazarbayev defined the direction of reforms: "Our most important task is to quickly stabilize the financial system, bring it in line with the new global reality. First, it is necessary to ensure the effective functioning of the financial sector in conditions of a floating exchange rate of tenge. The principal point is that there will not be a return to the practice of the endless maintenance of the national currency at the expense of the National Fund. The National Bank needs to conduct stress testing of all subjects of the banking sector for non-performing loans. According to its results, it is necessary to take measures to recognize them and write-off them. Banks that failed to solve the problem of capitalization must "leave" the financial system. Kazakhstan banks must comply with all international standards, including the Basel Committee and the International Monetary Fund. It is important to build confidence in the national currency through the expansion of instruments of "de-dollarization" (State of the Nation Address by President of Kazakhstan Nursultan

Nazarbayev., 2015).

- Quickly stabilize the financial system, bring it into line with the new global reality;
- It is necessary to ensure the effective functioning of the financial sector in conditions of a floating exchange rate of tenge. The principal point is that there will not be a return to the practice of maintaining the national currency rate at the expense of the National Fund;
- The National Bank should reduce the level of inflation to 4% in the medium term;
- The National Bank needs to conduct stress testing of all subjects of the banking sector for non-performing loans. Based on its results, measures should be taken to recognize them and write-off them;
- The National Bank should regularly provide the society and financial institutions with comprehensive information on its activities;
- Banks that failed to solve the problem of capitalization must leave the financial system. Kazakhstani banks must comply with all international standards, including the Basel Committee of the International Monetary Fund;
- The Unified Pension Fund, the Problem Loan Fund and other financial institutions should be removed from the control of the National Bank;
- The use of the National Fund for current expenses should be discontinued. The only mechanism for the National Fund's participation is an annual fixed transfer to the national budget.

In general, 7.5 trillion tenge is allocated for the implementation of projects of the state of the national address (State of the Nation Address by President of Kazakhstan Nursultan Nazarbayev., 2015).

One of the main functions of banks is lending to the economy. Bank credit is the most common form of credit relations in the economy. Currently, the main risk factors for banks associated with lending to the population are general economic shocks that could lead to a decrease in the solvency of the population, a decline in property prices and the instability of exchange rates. As for the corporate sector, the risks here are primarily due to the high proportion of loans directed to the economy, whose businesses, in the event of a decline in business activity, are more mobile, which could lead to increased bankruptcies and a deterioration in the quality of the loan portfolio. Because a slowdown in the growth of the economy may lead to a decrease in the ability of borrowers to repay loans, it is necessary for banks to reorient lending from the branches of trade and real estate in the manufacturing, transport, and agricultural industries.

In the current situation, one of the most successful opportunities for reaching a fundamentally new level of business and gaining competitive advantages for banks is the creation of a balanced analytical system for managing financial flows (Money, credit, banks, 2006).

In the structure of aggregate assets of the banking sector of the Republic of Kazakhstan (Table 1), overall, the positive dynamics of development is observed: the assets of credit organizations increased by 30.4% to KZT 23,784.4 billion as of January 1, 2016, by 18.0% - up to KZT18,239.00 billion as of 01.01.2015. In the structure of assets, the largest share (60.6%) is occupied by the loan portfolio (principal debt) in the amount of KZT15,553.7 billion (at the beginning of 2015 - 14 184,4 billion tenge), increase for 2015 is 9,7%.

In general, the banking sector of Kazakhstan functions in equal competitive conditions. The share of the loan portfolio in assets of 60-70% is most likely to be optimal for maintaining normal banking activity in Kazakhstan.

Table 1. Structure of total assets of the banking sector of the Republic of Kazakhstan
Billion tenge

Indicator / date	2013	2014	Growth,	2015	Growth,

	billion tenge	In % of total	billion tenge	In % of total	in% to 2013	billion tenge	In % of total	in% to 2014
Cash, refined precious metals and correspondent accounts	1 953,6	9,5%	2 446,7	10,9%	25,2%	3 969,2	15,5%	62,2%
Deposits placed with other banks	465,0	2,3%	382,3	1,7%	-0,8%	692,0	2,7%	81,0%
Securities	1 916,6	9,3%	2 075,4	9,3%	8,3%	56,3	0,2%	-97,3%
Bank loans and reverse repurchase transactions	13 348,2	64,6%	14 184,4	63,4%	6,3%	15 553,7	60,6%	9,7%
Investments in capital	351,7	1,7%	486,9	2,2%	38,4%	479,3	1,9%	-1,6%
Other assets	2 623,8	12,7%	2794,0	12,5%	0,6%	4 908,2	19,1%	75,7%
Total assets (excluding provisions (provisions))	20 659,0	100,0%	22 369,7	100,0%	8,3%	25 658,7	100,0%	14,7%
Provisions (provisions) in accordance with IFRS, including:	-5 197,3	-25,2%	-4 130,7	-18,5%	-20,5%	-1 874,3	-7,3%	-54,6%
Provisions (provisions) for correspondent accounts and deposits with other banks	-3,6	0,0%	-1,9	0,0%	-0,5%	-0,1	0,0%	-94,6%
Provisions (provisions) for securities	-54,9	-0,3%	-63,8	-0,3%	-83,8%	-10,3	0,0%	-83,9%
Provisions (provisions) for bank loans	-4 643,9	-22,5%	-3 569,8	-16,0%	-23,1%	-1 642,4	-6,4%	-54,0%

and operations "Reverse REPO"								
Provisions (provisions) for covering losses on investments in subsidiaries and associates	-116,0	-0,6%	-123,1	-0,6%	0,6%	-175,8	-0,7%	42,8%
Provisions (provisions) for other banking activities and receivables	-378,9	-1,8%	-372,2	-1,7%	-0,2%	-45,8	-0,2%	-87,7%
Total assets	15 461,7		18 239,0		18,0%	23 784,4		30,4%
Note: Compiled from the National Bank of the Republic of Kazakhstan (The official website of the National Bank of the Republic of Kazakhstan)								

Consider the dynamics of assets and loan portfolio of the banking sector of the Republic of Kazakhstan for the period from 2013 to 2015. The dynamics of assets and loan portfolio of the banking sector of the Republic of Kazakhstan as of 01.01.2016 (figure) are as follows:

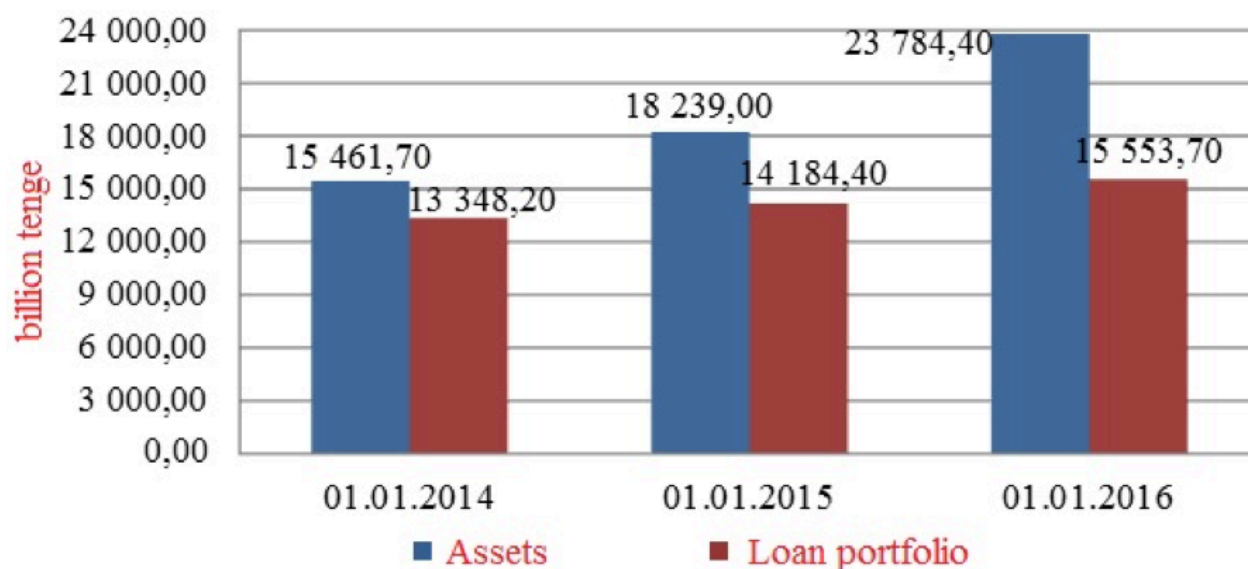


Figure 1. Dynamics of assets and loan portfolio of the banking sector of the Republic of Kazakhstan

In accordance with Figure 1, a slight increase in the loan portfolio in banks' assets can be noted, as on 01.01.2014 the share of the loan portfolio in assets was 86.3%, as of 01.01.2015 - 77.8%, as of 01.01.2016 - 65.4%. In 2015, a relatively large increase in assets was due to other items: cash, refined precious metals and correspondent accounts (an increase of 62.2%); Deposits placed with other banks (an increase of 81.0%). Thus, for the period 2013 – 2014 there was a change in the structure of assets of the banking sector of the Republic of Kazakhstan, not in favor of the loan portfolio.

The content of the loan portfolio depends on the liquidity and profitability of banks, and their

very existence. In 2015, lending was quite stable, even with a certain growth, so the growth in the loan portfolio in 2015 was 9.7% versus 2014.

Table 2. Structure of the loan portfolio of the banking sector of the RK for the period 2013-2015.
Billion tenge

Indicator / date	2013		2014		Growth,% to 2013	2015		Growth,% to 2014
	billion tenge	In % of total	billion tenge	In % of total		billion tenge	In % of total	
Carrying amount of loans including:	14 582,5	100,0%	15 357,7	100,0%	5,4%	16 711,3	100,0%	8,8%
Main debt	13 348,2	91,5%	14 184,4	92,4%	6,3%	15 553,7	93,1%	9,7%
Discount, premium	-47,7	-0,3%	-37,0	-0,2%	-22,4%	-14,0	-0,1%	-62,0%
Accrued compensation	1 282,0	8,8%	1 212,3	7,9%	-5,4%	1 174,6	7,0%	-3,1%
Positive / Negative Adjustment	0,1	0,0%	-2,0	0,0%	-20%	-2,9	0,0%	45%
IFRS Provisions	4 643,9	31,8%	3 569,8	23,2%	-23,1%	1 642,4	9,8%	-54,0%
The carrying amount of loans, net of provisions (net value of loans)	9 938,6	68,2%	11 787,9	76,8%	18,6%	15 069,0	90,2%	27,8%
Loan portfolio (main debt), including:	13 348,2	100,0%	14184,4	100,0%	6,3%	15 553,7	100,0%	9,7%
Loans to banks and organizations engaged in certain types of banking operations	121,1	0,9%	102,1	0,7%	-15,7	62,2	0,3%	-39,1%
Loans to legal entities	7 666,0	57,5%	8 091,0	57,1%	5,5%	8 511,0	54,8%	5,2%

Loans to individuals	3 626,0	27,1%	4 015,0	28,2%	10,7%	4 163,0	26,8%	3,7%
Loans to small and medium-sized enterprises (residents of the Republic of Kazakhstan)	1 283,0	9,7%	1 788,0	12,6%	39,4%	2 060,0	13,3%	15,2%
Other loans	537,8	3,9%	78,8	0,6%	-85,3%	688,2	4,4%	873,3%
Reverse repo transactions	114,3	0,9%	109,5	0,8%	-4,2%	69,3	0,4%	-36,7%

Note: Compiled from the National Bank of the Republic of Kazakhstan (The official website of the National Bank of the Republic of Kazakhstan)

According to Table 2, the volume of the loan portfolio of borrowers in the Republic of Kazakhstan is equal to KZT15,553.7 billion, which exceeds the volumes of 2013 by 16.5% (KZT845.0 billion), in 2014 by 9.7% (420, 0 billion KZT).

Crediting of legal entities in the amount of 54.8% in 2015 continues to lead in the total volume of the loan portfolio of the Republic of Kazakhstan. Loans to legal entities in 2015 increased by 5.2% and amounted to KZT 8,511.0 billion (in 2013 - KZT 7,666.0 billion or 57.5% of the loan portfolio, in 2014 - 8,091 , 0 billion tenge or 57.1% of the loan portfolio).

Loans to individuals amount to KZT4,163.0 billion with a 26.8% share of the loan portfolio (at the beginning of 2015 - KZT4,015.0 billion or 28.2% of the loan portfolio). The growth of loans to individuals in 2015 was 3.7%, less than in 2014 - 10.7%.

By the subjects of small and medium-sized businesses, there was a tendency for an annual increase in the volume of issued loans. For the needs of the subjects of this direction, about KZT 2,060 billion was granted in 2015, which is 15.2% higher than the previous year's figure (KZT1,788.0 billion). By volume of crediting, small and medium-sized business occupies 13.3% of the loan portfolio of the banking sector of the Republic of Kazakhstan. A very large increase is observed in 2014 - 39.4%.

In connection with the concern over the quality of the loan portfolio, Kazakh banks tightened their credit policy in 2015. Restraint of banks in lending is explained by low availability of liquidity and high credit risk. According to the estimates of banks, the additional factors that contributed to the tightening of the credit policy are the economic uncertainty in the country, the risk of deterioration in the cost of collateral, and fears of deterioration in the risk profile of borrowers.



Figure 2. Dynamics of the loan portfolio of the banking sector of the Republic of Kazakhstan for 2013-2015
(The official website of the National Bank of the Republic of Kazakhstan)

From 2013 to 2015, the prevailing type of active operations in commercial banks is the lending of legal entities from 57.5% to 54.8% in the loan portfolio. Also in the loan portfolio of the banking sector as of 01.01.2016, a high proportion of loans accounted for loans to individuals - 26.8%. There is a tendency to increase the demand for consumer lending. Consumer lending permits the needs of the population in necessary items and equipment in installments.

Table 2. Credits of second-tier banks of Kazakhstan for 2011-2015.
billion tenge

	Credits to the economy of Kazakhstan, including						
	Total	by currency type		by date		on subjects of crediting	
		In national currency	In foreign currency	Short-term	Long-term	Non-bank legal entities	Individuals
2012	11 623	8 393	3 230	2 486	9 137	8 448	3 175
2013	13 348	9 633	3 715	3 102	10 246	9 398	3 950
Growth,%	14,8%	14,8%	15,0%	24,8%	12,1%	11,2%	24,4%
2014	14 184	10 124	4 060	3 179	11 005	9 860	4 324
Growth,%	6,3%	5,1%	9,3%	2,5%	7,4%	4,9%	9,5%
2015	15 554	10 608	4 946	3 365	12 189	11 108	4 446
Growth,%	9,7%	4,8%	21,8%	5,8%	10,8%	12,7%	2,8%

Note: Compiled from the National Bank of the Republic of Kazakhstan (The official website of the National Bank of the Republic of Kazakhstan)

As of January 2016, the following situation was observed in the credit market of Kazakhstan. As a result of 2015, the volume of loans reached KZT15,554 billion, having increased by 9.7% compared to 2014, and by 16.5% since 2013. In general, the data in Table 3 confirm that the credit activity of Kazakhstan's economy is growing. The loan portfolio as of the end of 2013 amounted to KZT13,348 billion, having increased by KZT1,725 billion or by 14.8% compared to the beginning of the year. The growth in 2014 was insignificant - 6.3%, decreased by 8.5% compared to 2013. In 2015 - 9.7% there is an increase in comparison with 2014, but this indicator is lower than the increase in 2013 (14.8%) by 5.1% (Table 2).

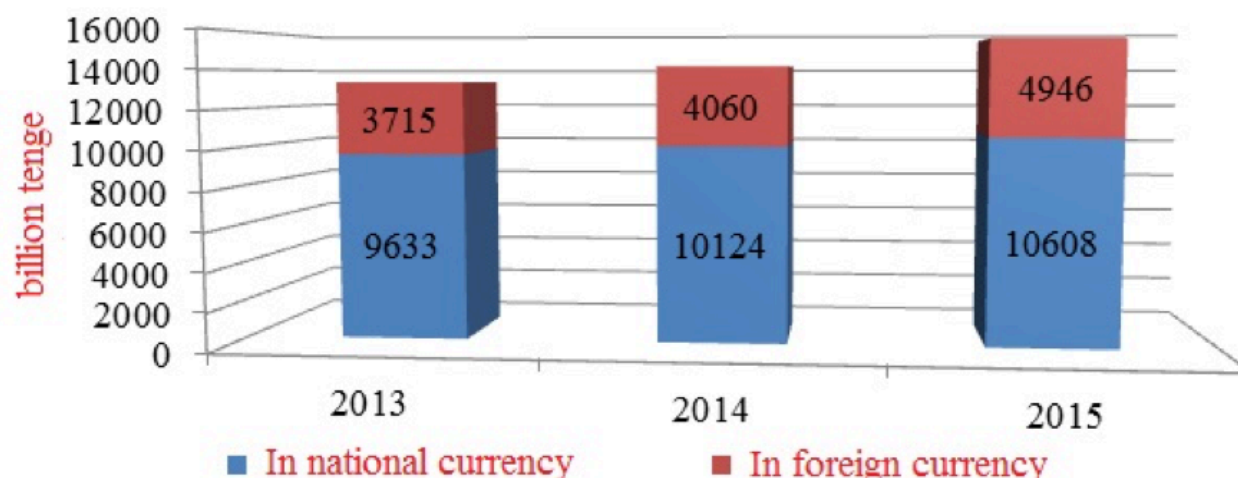


Figure 3. Credits to the economy of Kazakhstan (by types of currencies)

Loans in national currency from 2013 to 2015 tend to increase in nominal terms (Table 2), but in terms of growth there is a decrease from 14.8% (9 633 billion tenge) in 2013 to 4.8% (10 608 billion KZT) in 2015. But for the same period there is an outstripping growth in loans in foreign currency. Increased from 15.0% (KZT3,715 billion) to 21.8% (KZT4,946 billion) in 2015 (Table 2, Figure 3).

In the total volume of loans for 2013, the share of loans in the national currency - 9 633 billion tenge was - 72.2%, in foreign currency - 3,715 billion tenge - 27.8%; For the year 2014 the share of loans in the national currency - KZT10,124 billion was - 71.4%, in foreign currency - KZT4,060 billion - 28.6%; For 2015, the share of loans in the national currency amounted to 10 608 billion tenge - 68.2%, in foreign currency 4 946 billion tenge - 31.8%. As a result, the share of loans in national currency decreased from 72.2% in 2013 to 68.2% by the end of 2015, while in foreign currency it increased from 27.8% in 2013 to 31.8% in 2015 (Figure 3). The transition to a freely floating exchange rate led to a weakening of the tenge. The devaluation is predetermined by the decision of the National Bank of Kazakhstan to stop supporting the exchange rate of the tenge, the country is unable to maintain its currency, that is, to keep the tenge rate at the expense of state subsidies. This measure also became a reaction to the reduction of the cost of oil on the world market. The floating exchange rate should correspond to the economic situation in the world. This will allow the state budget not just to save money on keeping its own currency, but also to replenish the state budget. In connection with the current economic situation in 2015, Kazakhstan banks tightened their credit policy, which is dictated by low liquidity availability and high credit risk.

As we see, the issuance of loans in tenge is not entirely beneficial to second-tier banks. But this trend is influenced by state support for lending, which is implemented through state programs of industrial and innovative development of the state, programs for supporting small and medium-sized businesses, agricultural development programs, etc. Lending to the economy through state-owned resources through second-tier banks is made in national currency.

Analysis of the country's credit market by types of currencies is indicative of the upward trend in the share of loans in the national currency, however, the decline in the share of loans in foreign currency is not observed, which is more closely related to the resource base of

commercial banks, which is more formed from deposits in foreign currency, as well as the growth of the exchange rate on the market.

The growth in the share of loans in foreign currency is associated with an increase in the share of liabilities in the structure of the resource base, expressed in foreign currency. In the conditions of inflow of deposits mainly in foreign currency, banks, in order to minimize currency risks, are also forced to issue loans mainly in foreign currency (Table 2, figure 3).

The observed growth of the dollar to the tenge became the main factor influencing the changing situation in the financial and money market. On the other hand, the growth of the dollar will affect the rise in price of imports, which, naturally, will affect the price increase.

The second-tier banks are practical to ensure their profit on short-term loans due to turnover within one year. In general, short-term loans are directed to the trade sector, as the turnover and profitability of trade operations are much higher than in the manufacturing sector. Also, the outstripping growth of long-term loans is mainly due to the increase in the volume of term deposits and the gradual extension of their terms of attraction.

The banking system of Kazakhstan retains a significant number of banks that do not have sufficient funds for long-term lending. The banks' investments in long-term projects are increasing, but not at the expense of the banks' own funds. As practice shows, the main source of financing for the real sector of the economy, the state itself becomes the source of long-term loans necessary to stimulate the growth of the country's economy.

In order to analyze the credit market of the Republic of Kazakhstan, we will consider the structure of loans issued by second-tier banks in terms of credit terms, which was reflected in Table 2, in Figure 4.

As it can be seen from Table 10, from 2013 to 2015, the volume of issued long-term loans is more than short-term. So in the total volume of loans for 2013, the share of long-term loans - 10,246 billion tenge - 76.8%, short-term - 3,102 billion tenge - 23.2%; In 2014, the share of long-term loans - 11,005 billion tenge of components - 77.6%, short-term loans - KZT 3,179 billion - 22.4%; In 2015, the share of long-term loans.

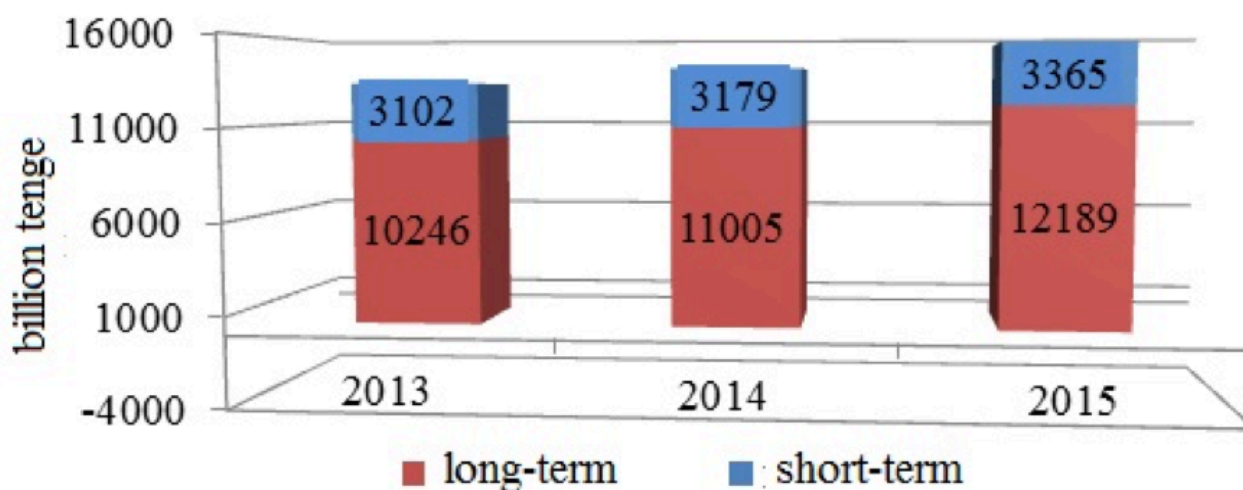


Figure 4. Credits of the peoples of the world (by maturity)
(The official website of the National Bank of the Republic of Kazakhstan)

- 12 189 billion tenge was equal to 78.4%, short-term - 3,365 billion tenge - 21.6%, the growth trend of long-term loans (Figure 4) continues in comparison with the short-term ones, as a result of which the share of the first until 2015 increased by 10.7% to KZT12,189 billion compared to 2014 - KZT11,005 billion. The growth of short-term loans for the same period amounted to 5.8% from KZT3,179 billion in 2014 to KZT3,365 billion in 2015 (Figure 4).

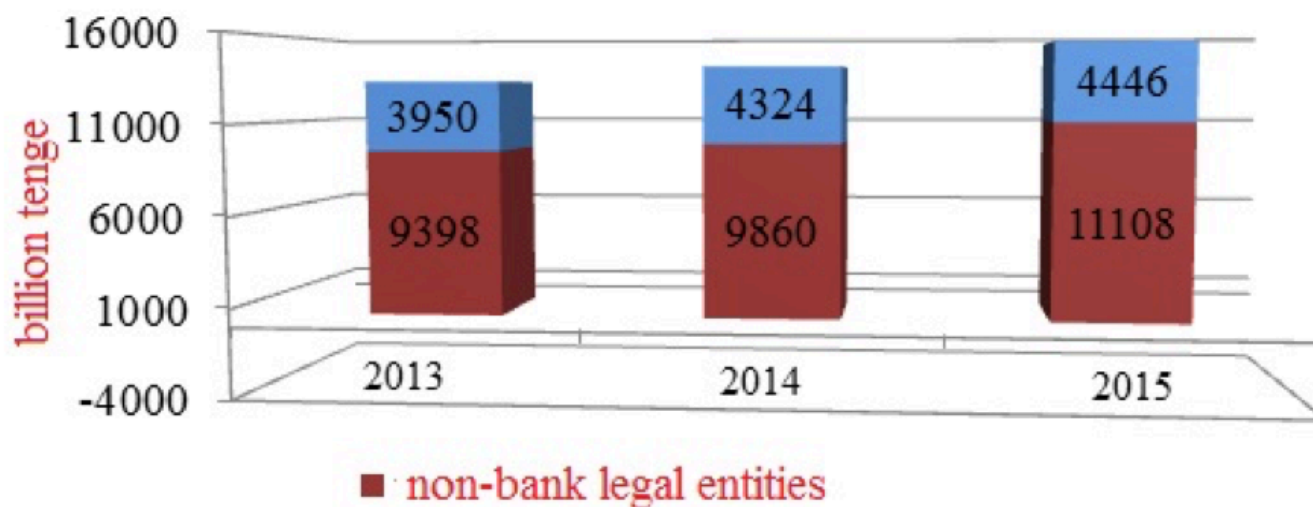


Figure 5. Credits in the euro area (by lending entities)
(The official website of the National Bank of the Republic of Kazakhstan)

If we pay attention to the fact that loans are provided for bank loans (Figure 5), then we see that most of the bank loans are used by non-bank legal entities. In the total volume of loans for 2013, the ratio of loans to non-bank legal entities and individuals is: in 2013, 70.4% - 29.6%; In 2014, 69.5% - 30.5%; In 2015, 71.4% - 28.6%. For the period from 2013 to 2014, the volume of lending to legal entities is increasing. According to Table 3 in 2014, for non-bank legal entities, the growth was 4.9%, which is 6.3% less than the increase in 2013. Only in 2015 crediting of legal entities has significantly increased to 11,108 billion tenge, an increase was 12.7%. In the period from 2013 to 2015, in nominal terms, the volume of loans issued grows from KZT 3,950 billion to KZT 4,446 billion, but the growth rate steadily decreases from 24.4% in 2013 to 9.5% in 2014 and to 2.8% in 2015.

Currently, according to banks, the current level of credit risk on the retail portfolio is high, which is explained by the instability of the country's economy, the decrease in the solvency of borrowers and the decrease in consumer demand of the population.

According to comparable data on the maturity of loans in 2013-2015, we can conclude that a significant increase in the volume of long-term loans in comparison with the short-term. This is a positive factor. Corrective impact on the market, as a rule, affects the increase in the volume of investments directed to production purposes.

When considering the credit activity of banks, loan interest plays an important role. It is the main source of profit for banks.

In the theory of J.M. Keynes, interest is an autonomous factor, its level is determined by the interaction of supply and demand for money balances, i.e. Not on all savings, but only on their monetary part. In his opinion, interest is a purely monetary phenomenon reflecting the game of market forces in the money market (Tavasiev, 2008).

In A. Marshall's theory, the interest rate is regarded as a factor that leads to a balance in the desire to invest and save. According to A. Marshall, interest, being the price paid in any market for the use of capital, tends to an equilibrium level at which the aggregate demand for capital in this market at a given rate of interest equals the total capital flowing into the market at the same rate of interest (Tavasiev, 2008).

The policy of the state is important, which manifests itself in regulating the rate of loan interest through the discount rate, as well as the provision of credit funds through second-tier banks to regulate the financial market.

The main regulator in approving interest rates for second-tier banks, both on deposits and on loans granted, is the discount rate set by the NBRK. The higher the official discount rate, the higher the cost of loans of second-tier banks and, accordingly, the loans for the ultimate borrower are also more expensive. At the same time, with an increase in the refinancing rate, the rates on deposits of both the population and enterprises also increase.

With a decrease in the official discount rate, the credit resources of the National Bank of the Republic of Kazakhstan become cheaper, respectively, the second-tier banks reduce the interest rate on loans, which increases the supply in the credit market. There is also a reduction in deposit rates, and the money market may lose some of its funds, which will go to other markets in case of more favorable conditions offered on them. Thus, through the policy of changing the discount rate, the NBRK regulates the money market and the cost of bank loans.

The interest rate depends on the size of the loan. This is because the issuance of large loans increases the risk of loss of the lender due to the possibility of insolvency of the borrower. At the same time, issuing loans to several borrowers reduces price, because excludes the simultaneous bankruptcy of several borrowers. In this regard, in banks, the interest rate is differentiated for small and large loans, depending on the size of the loan.

Also, the value of the interest rate depends on the security of the loan. As a rule, rates on unsecured loans are high, since the risk is high. For loans with security, the interest rate is lower.

Depending on the purpose of using the loan, the interest rate will also be different. Increased risk is available to loans issued for the elimination of financial difficulties for the implementation of investment projects.

As a market value, the interest rate depends on the demand and supply of money, the development of the money market, the sources of free money, borrowers of funds (their creditworthiness, reliability in repayment of borrowed funds) and other factors.

Table 12 shows that the interest on loans depends on the timeframe for which the economy is ready to take out a loan, so that the demand for credit is divided into short, medium and long-term. The loan interest rate is related to the term of the loans. As we can see, in 2015, not only the requirements for the financial position of the borrower, but also interest rates on loans were raised.

The market rate of loan interest is determined by the interaction of supply and demand in the credit market. With a high interest rate, the capital productivity of the enterprise is relatively low, the demand decreases accordingly, and the loan offer increases. When the interest rate decreases, the profitability for the enterprise grows, it makes sense to borrow money. And the population makes a choice in favor of using a loan in order to meet their needs at the expense of borrowed funds. A decrease in interest rates on loans leads to an increase in demand for credit. In this connection, the process of changing interest rates on loans will be constantly on the move.

Within the framework of the thesis, we will examine the interest rates of second-tier banks (Table 3) in Kazakhstan for 2011-2015.

Table 3. Average interest rates of banks on loans granted (by years, by maturities and currencies).

	2011	2012	2013	2014	2015
Loans to non-bank legal entities, KZT	11,9	11,0	10,6	10,8	15,7
From 3 months to 1 year, KZT	12,4	11,5	11,0	11,3	14,0
From 1 year to 5 years, KZT	11,6	11,7	11,2	11,1	13,2
Over 5 years, KZT	10,8	10,0	11,2	10,3	10,8
Loans to non-bank legal entities, hard currency	8,8	8,3	7,9	7,8	7,3

From 3 months to 1 year, hard currency	10,2	9,0	7,9	8,1	7,6
From 1 year to 5 years, hard currency	8,0	9,7	10,0	9,6	8,6
Over 5 years, hard currency	8,8	10,0	10,2	8,8	9,0
Loans to individuals, KZT	20,4	20,9	20,4	19,1	20,0
From 3 months to 1 year, KZT	24,4	21,9	19,9	18,8	18,6
From 1 year to 5 years, KZT	22,5	23,3	22,4	20,9	19,0
Over 5 years, KZT	12,9	13,3	14,1	13,7	13,0
Loans to individuals, hard currency	13,6	13,1	12,2	9,0	12,0
From 3 months to 1 year, hard currency	13,5	15,3	12,2	9,0	10,6
From 1 year to 5 years, hard currency	13,4	12,4	11,8	11,0	10,3
Over 5 years, hard currency	13,5	12,5	13,3	12,7	12,2

Note: Compiled from the National Bank of the Republic of Kazakhstan (The official website of the National Bank of the Republic of Kazakhstan)

In the period that is shown under review, the minimum loan interest is observed in 2013 - 10.6%. In 2013, there is a relative rise in the country's economy. The increase in loans granted reached a maximum size of 14.8% (Table 3). Accordingly, a decrease in loan interest contributed to an increase in the volume of loans issued. According to figure 6, the interest rate on loans in tenge to non-bank legal entities reached a maximum in 2015 - 15.7%. The increase in demand for loans in tenge by non-bank legal entities enables banks to raise interest rates. Also, the unstable economic situation in the country, the drop in the price of oil and the unstable situation in the world as a whole (the conflict in Ukraine, the depreciation of the Russian ruble, the imposition of sanctions, etc.) led to a significant decrease in the supply of loans from banks.

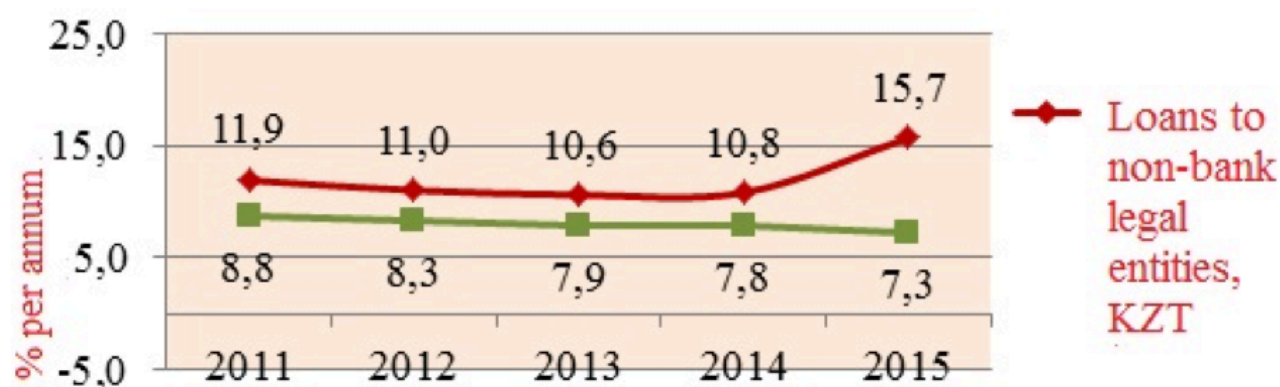


Figure 6. Average interest rates of banks on loans extended to KZT and SLE to non-bank legal entities (The official website of the National Bank of the Republic of Kazakhstan)

For loans in foreign currency, the maximum level was in 2011 - 8.8%. From 2011 to 2015, there is a tendency to decrease the loan interest, so the loan interest on loans granted to non-bank legal entities in 2015 amounted to 7.3%.

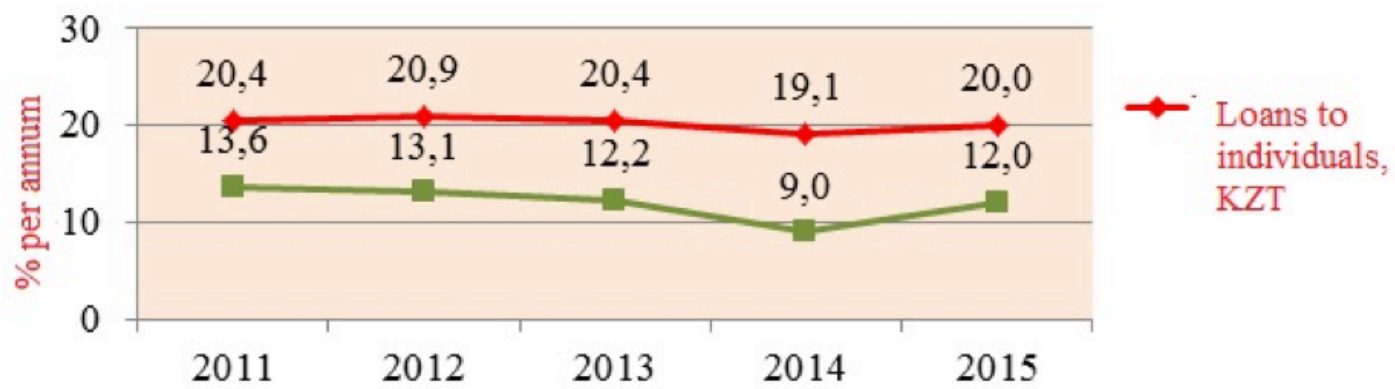


Figure 7. Average interest rates of banks on loans granted in KZT and SLE to individuals
(The official website of the National Bank of the Republic of Kazakhstan)

According to figure 7, the interest rate on loans to individuals reached the maximum value for loans in tenge in 2012 - 20.9%, in 2015 - 20.0%. Only in 2014 there was a decrease in loan interest to 19.1%. For loans in foreign currency, the maximum level was in 2011 - 13.6%, in 2015 - 12.0%, this is significantly higher than in 2014 - 9.0%.

Loan interest is affected not only by microeconomic factors - goals, loan size, term of use, risk level, but also macroeconomic factors - demand and supply, stability of the money market in the country, NBRK rate.

The interest rate on the micro level:

- purpose of the loan. Loans that are provided to trade and intermediary firms that build their business on the principle of buying and selling should be expensive, since the profit from this type of activity is speculative, and loans granted to manufacturing enterprises should be cheap;
- the size of the loan. Large loans are provided to reliable borrowers, whose probability of bankruptcy is, as a rule, lower;
- the period of use of the loan. The longer the period, the higher the interest rate for a loan, since there is a greater risk of loss from a loan default or a depreciation of funds due to the inflation always inherent in a market economy;
- the level of risk. By providing loans, commercial banks deal with two main types of risk - credit and interest. Credit risk is associated with losses from default of principal due to possible bankruptcy of the borrower, and interest - with losses from non-payment of interest for using the loan. Loans with a high level of risk are granted at a higher rate.

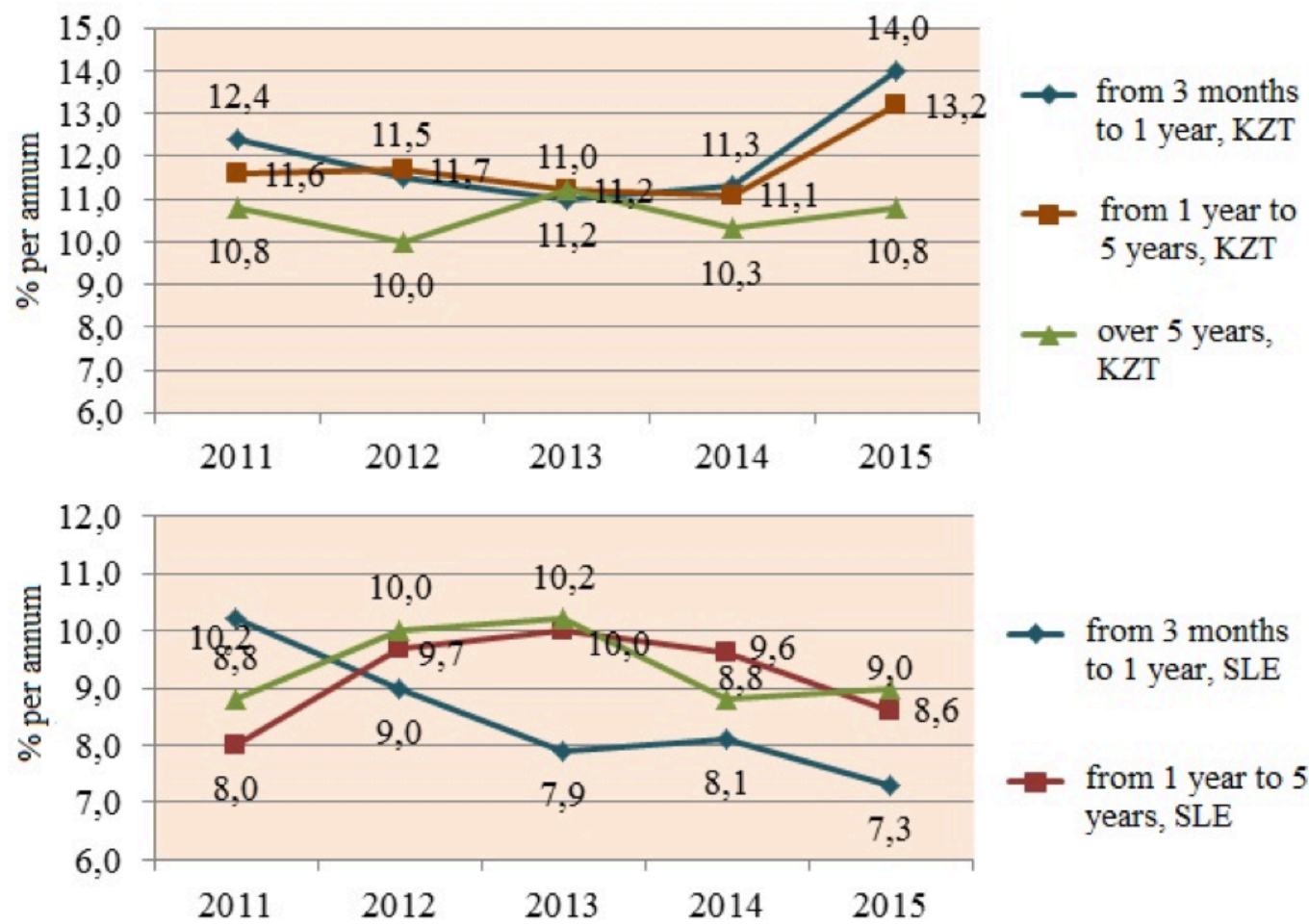


Figure 8. Average interest rates of banks on loans extended to KZT and SLE to non-bank legal entities (The official website of the National Bank of the Republic of Kazakhstan)

Consider the loan interest in terms of currencies for the period from 2011 to 2015 on non-bank legal entities (Figure 8). Interest rates on loans to non-bank legal and natural persons are not stable. In 2011, the weighted average interest rate on short-term loans extended to non-bank legal entities in tenge decreased to 11.0% in 2013.

But already in 2015, it reached the maximum size of 14.0%. The loan interest rate of medium-term loans up to 2015 was relatively stable in the range of 11.6-11.1%, in 2015 it increased to 13.2%, and demand decreased accordingly. Loan percent of long-term loans for this period is stable. In 2013 interest rates on short-term, medium-term and long-term loans were practically leveled to 11.0%, 11.2%.

On interest rates for loans in foreign currency, we see a relatively moderate growth in medium-term loans from 8.0% in 2011 to 8.6% in 2015. Interest on long-term loans, respectively, is from 8.8% to 9.0%. Rates on short-term loans decreased from 10.2% to 7.3%.

As the analysis of figures in Figure 5 shows, there are proposals from banks, but there is no demand for foreign currency loans, although interest on loans in the national currency is higher. The slowdown in the growth of the segment of foreign currency lending is due to a decrease in interest in this type of loans. Borrowers do not want to take on the risks of exchange rate fluctuations during the period of uncertainty in the rates of world currencies.

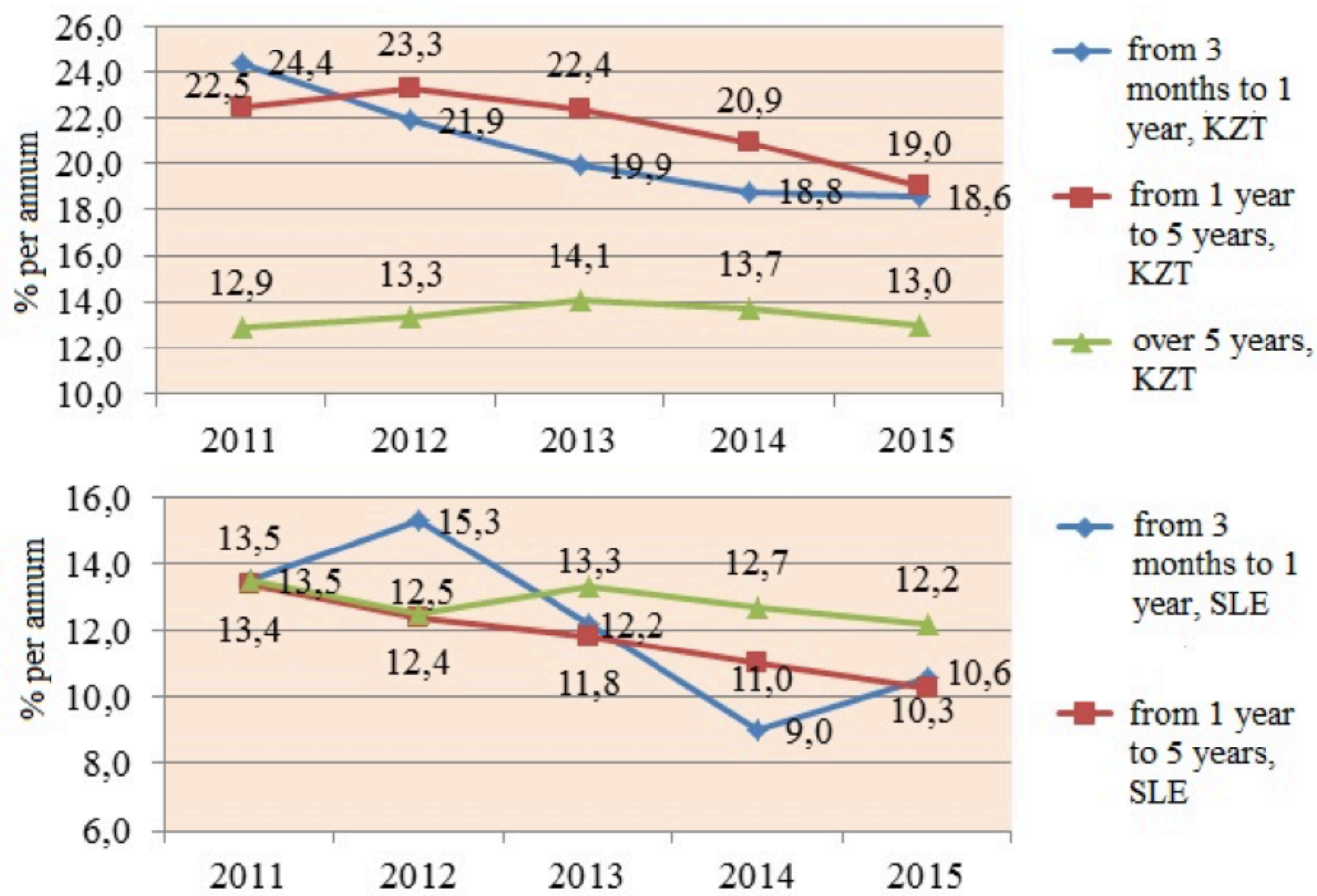


Figure 9. Average interest rates of banks on issued loans in KZT and SLE to individuals (The official website of the National Bank of the Republic of Kazakhstan)

Interest on loans to individuals, both in national currency and in foreign currency is higher than for non-bank legal entities (Figure 9). Stable economic situation in previous years contributed to the development of consumer and mortgage lending, which in turn led to changes in the retail lending market.

From 2011 to 2015 Loans issued to individuals increased in nominal terms, but the increase compared to previous years is low starting in 2013. In 2015, the loan interest rate on loans in the national currency decreased from 24.4% to 18.6%, on medium-term loans from 22, 5% to 19.0%. For long-term loans, a slight increase from 12.9% in 2014 to 13% in 2015.

The same situation in foreign currency, the interest rate on short-term loans varies within the limits of 13.5-10.6%, on medium-term loans from 13.4% to 10.3%, on long-term loans from 13.5% in 2011 to 12, 2% in 2015.

Formation of the loan interest of the bank for all the independence of the financial and credit institution depends not only on the interests of the owners of the second-tier banks and the competitive situation, but also on state regulation, and to a greater extent than other types of commercial organizations. This is due to the impact on banks of monetary policy of the NBRK, regulating the exchange rate, the terms of bank refinancing, the interest policy on operations, the amount of minimum reserve requirements and the regulation of operations on the open market. The change in interest rates of the NBRK directly affects the prices of the money market, the upper limit of their fluctuations is established, and their increase reduces the demand for monetary resources from STB.

The interest policy of the National Bank of the Republic of Kazakhstan is designed to create conditions for ensuring internal and external stability of the official monetary unit. To this end, the issuing bank regulates the base refinancing rate. Due to unfavorable external conditions that have a long-term nature, such as a low price for oil and other commodities, the weakening of the national currencies of the countries-main trade partners of Kazakhstan, as well as in the implementation of measures to implement the inflation targeting regime envisaged by the Monetary Policy Republic of Kazakhstan until 2020, on August 20, 2015, the regime of the currency corridor was abolished and a transition to a freely floating exchange rate was

implemented. As a result, at the end of August 2015, there was a short-term jump in the money market rates.

The transition to the free floating exchange rate of the tenge allowed the National Bank to take measures to strengthen the percentage channel. On September 2, 2015, the National Bank announced the introduction of a basic rate for continuous access operations to provide and withdraw liquidity, which form the upper and lower limits of fluctuations in money market rates, were set at 17% and 7%, respectively. In order to reduce the volatility of money market interest rates, on September 22, 2015, the lower interest rate corridor was increased to 12%. In conditions of increased pressure on the exchange rate caused by speculative demand for US dollars, from October 2, 2015, the National Bank raised the base rate to 16% and narrowed the interest rate corridor. The increase in the base rate was taken in order to reduce inflationary expectations. The decision to narrow the corridor was also aimed at ensuring greater manageability of interest rates and increasing their role for achieving the inflation target.

Many enterprises-borrowers can not return loans on time. Poorly calculated the market, did not take into account the full extent of competition, not enough work is being done to increase profitability of production, increase labor productivity, and efficient use of fixed assets.

At present, the banks of Kazakhstan are characterized by a stable increase in the issuance of loans, while at the same time there is an increase in overdue loans.

A high proportion of problem loans pull down the indicators of almost all banks. The situation continued to worsen, and in 2012, according to the calculations of the World Bank, in terms of non-performing loans (NPL) in 31% Kazakhstan ranked first in the world. At the same time, this figure was 18.7% in Ireland, 18% in Lithuania, 17.2% in Greece, 16.9% in Bulgaria, 16.8% in Romania, 15.8% in Hungary, Moldova - 15.2%, Ukraine - 14.1% (Alshanov, 2014).

Only for 8 banks the amount of non-performing loans at the beginning of 2013 was KZT3, 890.9 billion. At the same time, the share of non-performing loans in JSC Nurbank is 50%, Temirbank - 46.76%, JSC Kazkommertsbank - 40.43%.

Starting from 2014, banks began active work to reduce the number of non-performing loans in their loan portfolios. Banks conduct operations to reduce bad debts through write-offs to off-balance accounts and the implementation of loan restructuring (table 5).

In 2014, the National Bank of the Republic of Kazakhstan in order to intensify the process of reducing the level of non-performing loans, active work was carried out to strengthen supervisory measures and initiatives to introduce the necessary changes in the legislative framework. In particular, a special emphasis was placed on creating favorable conditions for banks to use with regard to affordable instruments to reduce non-performing loans.

For the analyzed period, the maximum amount of overdue debts in 2013 is 34.5% (KZT 4 602.3 billion), in 2014 - 27.7% (KZT 3,925.2 billion) , In 2015 - 13.6% (KZT2,117.0 billion).

In general, for the period from 2013 to 2015, there is a tendency to normalize the situation with overdue debt, its share in the total volume of loans issued is decreasing, which is shown in table 5. As of January 1, 2016, the share of overdue loans in the loan portfolio was 13.6%, whereas as of 01.01.2013, it was equal to 34.5%.

Table 4. Quality of the loan portfolio of the banking sector of the Republic of Kazakhstan billion tenge

Indicator / date	01.01.2014		01.01.2015		01.01.2016	
	billion tenge	In % of total	billion tenge	billion tenge	In % of total	billion tenge
Bank loans, including:	13 348,2	100,0%	14 184,4	13 348,2	100,0%	14 184,4

Loans for which there is no overdue debt on principal and / or accrued interest	8 745,9	65,5%	10 259,2	8 745,9	65,5%	10 259,2
Loans with overdue debts from 1 to 30 days	209,90	1,6%	357,2	209,90	1,6%	357,2
Loans with overdue debts from 31 to 60 days	91,5	0,7%	158,4	91,5	0,7%	158,4
Loans with overdue debts from 61 to 90 days	142,7	1,1%	69,4	142,7	1,1%	69,4
Loans with overdue debts of more than 90 days	4 158,2	31,2%	3 340,2	4 158,2	31,2%	3 340,2
IFRS Provisions	4 643,9	34,8%	3 569,8	4 643,9	34,8%	3 569,8
Coefficient of covering by provisions under IFRS of loans with overdue debts over 90 days	111,7%		106,9%	111,7%		106,9%

Note: Based on the materials of the National Bank of the Republic of Kazakhstan (The official website of the National Bank of the Republic of Kazakhstan)

It should be noted that the debt on loans for the period under review is growing (Table 4). So, as of 01.01.2015, arrears on loans increased by 6.3%, and the growth of overdue loans amounted to 17.3%; As of 01.01.2016, arrears on loans increased by 9.7%, and the growth of overdue loans amounted to 31.0%. Average annual increase on overdue loans as of 01.01.2016 amounted to 13.7% compared to 17.3% as of 01.01.2015 with the growth of debt on loans by 3.4%.

Consequently, the improvement in the situation with arrears is mainly due to the growth in the portfolio of loans issued.

Consider the dynamics of the loan portfolio and loans with overdue debts of the banking sector of the Republic of Kazakhstan for the period from 2013 to 2015 (Figure 10).

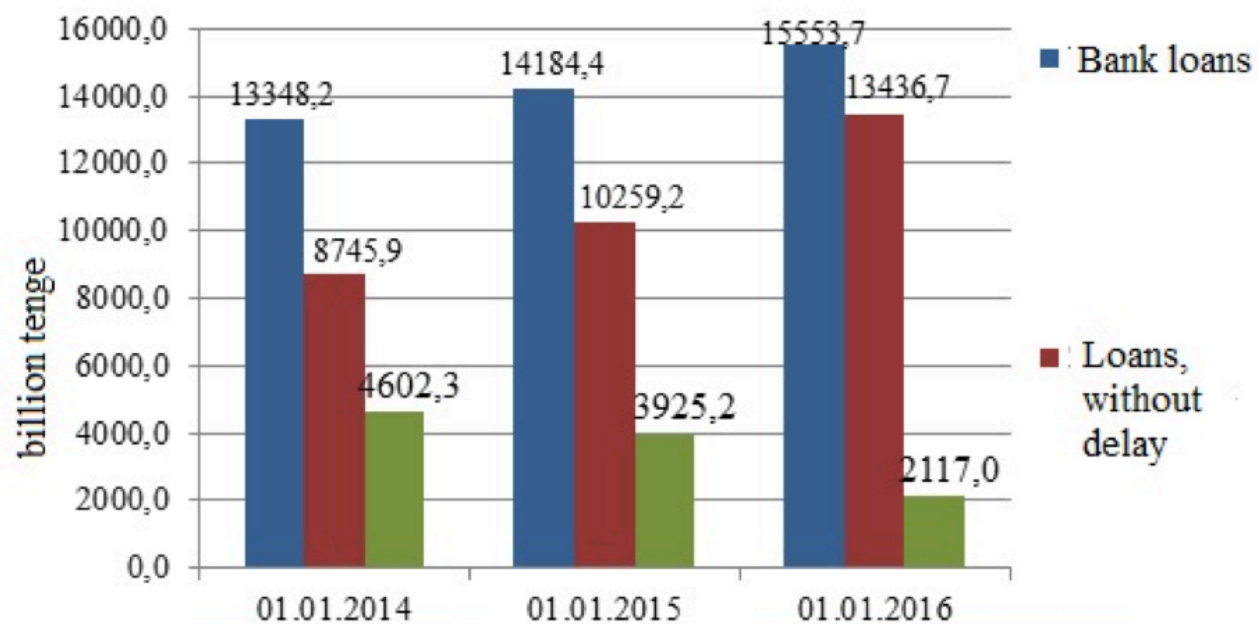


Figure 10. The share of overdue loans in the total volume of loans extended to the banking sector of the Republic of Kazakhstan
(The official website of the National Bank of the Republic of Kazakhstan)

As a result, the share of overdue loans decreased significantly and amounted to 2 117 billion tenge as of January 1, 2015 against 4,602.3 billion tenge as of 01.01.2014 and 3 925.2 billion tenge as of 01.01.2015 (figure 10). With a slowdown in the growth of the loan portfolio, the share of overdue debt is likely to start rising after three years of decline. In this case, most likely, the situation will not be of a critical nature.

In May 2014, the Commission for Evaluation and Control over Activities to Reduce Overdue Loans was established by National Bank of the Republic of Kazakhstan, which individually monitors the effectiveness of the measures taken by banks to improve the loan portfolio. The basic principles, instruments and measures necessary to manage overdue loans have been defined in the adopted Unified Policy on reducing overdue loans in second-tier banks (Akkozov, 2016).

In order to effectively reduce non-performing loans and stimulate the solution of the NBRK problem, certain work has been done to optimize tax legislation and reduce administrative barriers for banks in the following areas:

- extension until 2016. Tax benefits for forgiving bad debts (in the amount of not more than 10% of the loan portfolio);
- recognition in the tax accounting of losses from writing off from the balance of banks of bad loans;
- recognition in the tax accounting of losses from the transfer with a discount of problem assets in the WSE, which has a temporary preferential tax treatment (tax privilege is effective from January 1, 2012 to January 1, 2018);
- exemption from taxation of income of individuals when writing off bad debts for the balance sheet, as well as forgiving the debt in a number of cases;
- granting tax benefits to banks that have undergone restructuring, in order to facilitate the resolution of the problem of non-performing loans;
- expansion of the powers of the OASA to conduct all activities to improve the quality of distressed assets.
- optimization of the criteria for forgiving bad debts.

In addition, from January 1, 2016, it provides for the introduction of a prudential standard for the maximum share of non-performing loans in the loan portfolio of the bank at a level of not more than 10%.

To activate the activity of JSC "Fund for Problem Loans", a new Concept of functioning of the "Problem Loan Fund" was adopted, aimed at a more active and diversified interaction of the Fund with banks through mechanisms for equitable distribution of risks when buying out bad loans. "Implementation of the measures envisaged by this Concept is expected to increase the effectiveness of the Fund, in particular:

- considering the increase in the Fund's resources, the availability of a list of flexible mechanisms for working with banks, a significant contribution will be made to the target level of "non-performing" loans (no more than 10%) both by individual banks and the banking system as a whole;

- assistance in improving the practice of determining the value of distressed assets;

3) assistance in forming a benchmark in the pricing of financial instruments in the securitization of the asset portfolio;

- assistance in the formation of the circulation market for "non-performing" loans (State program of industrial and innovative development of the Republic of Kazakhstan for 2015 – 2019).

In conditions of increasing consumer activity, growth of incomes of the population and slowing of industrial production, banks have become more preferable to give short-term consumer loans. The current level of credit risks associated with this is insignificant.

The economic environment in which the financial sector functions continues to be characterized by high credit risks of borrowers. The share of "non-performing" loans of banks is gradually decreasing, thanks to measures taken by the State and the National Bank of the Republic of Kazakhstan. The active write-off of non-performing loans by banks resulted in a significant decrease in their level to a minimum of 23.5% over the past five years.

As a whole for 2015, the credit activity of banks in the issue of issuing new loans has moderately increased. At the same time, growth was ensured by almost all groups of banks, who received support from the state, so they independently attracted the necessary resources.

Adjusting the exchange rate of the national currency, reducing world oil prices, depreciating the Russian ruble, the difficult geopolitical situation in the world and the slowdown in world economic growth since the second half of 2014 have had an impact on the financial stability of the banking sector. The result was a decrease in the lending activity of banks and a reduction in the growth rate of the loan portfolio. The loan portfolio growth slowed not only due to a decrease in overall lending activity, but also due to active write-off by banks of non-performing loans primarily in the corporate sector.

An analysis of Kazakhstan's credit market shows the growing dynamics of loans provided by banks to customers. The volume of banks lending to the economy at the end of 2015 was 15,554 billion tenge, an increase of 9.7% over the year. The volume of loans in national currency amounted to 10,608 billion tenge (since the beginning of the year the increase was 4.8%), in foreign currency - 4,946 billion tenge (since the beginning of the year growth by 21.8%). The share of loans in tenge was 68.2%.

The volume of long-term loans at the end of 2015 amounted to KZT12,189 billion, an increase of 10.7% over the year, and a short-term level of KZT3,365 billion (an increase of 5.8% over the year).

The volume of loans to legal entities at the end of 2015 increased by 12.7% to KZT 11,108 billion, individuals increased by 2.8% to KZT4,446 billion. The share of loans to individuals was 28.6%.

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