

The Impact of the Financial Crisis on the Banking System of Kazakhstan

Valeriya Anichshenko

Kazakh – British Technical University, Kazakhstan

miss_dior_cherie@list.ru

Abstract

Nowadays economy of Kazakhstan faces the problems concerning to the world financial crisis. Particularly it has a pernicious effect on banking system of the country. Almost all banks in Kazakhstan have to pay off a big debt to foreign financial institutions. Due to the crisis the burden of the debt became more complicated because of devaluation of the national currency, the problem of rising unemployment and inability of population to repay their loans and mortgages. Moreover a possibility of banks' default to date is very high. Thus the current situation of banking system therefore the whole economy of Kazakhstan are unfavorable, so because of it the international rating agency Fitch Ratings decreased the investment grade of Kazakhstan and now it is only BBB. According to this grade an attractiveness of the country for foreign investment is low so the investment flow into the country will decline and again it will banefully influence on the economic situation. Thereby for stabilization of the whole economy it's necessary to normalize the banking system within the country.

This project attempts to research the consequences of the banking crisis and resolutions of it. It identifies the reasons of financial crisis, the impact of it on banking system, includes the solutions of current problems, strategy and actions which will be undertaken in order to stabilize the economy, stave off defaults of banks and resume their normal and stable performance.

Keywords: *banking system, financial crisis, devaluation, default, debt, refinancing, mortgage, external funding.*

1. Introduction

The economy of Kazakhstan implies close political and trade relations with other countries. Because of it difficulties which arise in economy of foreign countries provoke the same problems in our country. Thereby the world financial crisis has influenced on the economy of Kazakhstan. Particularly it has a fatal effect on banking system. From my point of view crisis it is a consequence of mistakes and defects of the whole economy, and current financial crisis showed us that Kazakh banking system is imperfect. And due to it we should reform all weak parts and improve an effectiveness of banks' strategies.

This research provides the detailed coverage of the impact of the financial crisis on banking system and shows resolutions. It uncovers the reasons of financial crisis, the impact of it on banking system and economy of Kazakhstan. Also research paper includes the solutions of current problems, strategy and actions which will be undertaken by the government of Kazakhstan in order to stabilize the economy, stave off defaults of banks and resume their normal and stable performance. The paper concludes with relevant recommendations concerning to the avoidance of such situations in the future.

2. The impact of financial crisis on banking system

The financial crisis in Kazakhstan appeared in 2007 and there were a lot of reasons of it. One of them is that banks of the country borrowed a big sum of money from foreign countries such as Netherlands, Great Britain, USA and others in order to repay their other loans. In September, 2007 the size of debt was approximately 50 million of dollars. Moreover the financial sector of Kazakhstan was the biggest borrower in structure of the government external debt. The growth strategy of most Kazakh banks in that time was simple: they raised cheap short-term debt on European capital markets denominated in Euro and dollars, and used the funds to provide credit to the growing customer base in Kazakhstan at a much higher

interest rate. Almost all banks of Kazakhstan carried on an aggressive policy. It included the high interest rate on deposits, which attracted a lot of customers. In addition to this a procedure of issuance of loans was very easy: it required a minimum of documents and little time, so the problem of adverse selection and moral hazard was very actual because not all clients had the possibility to pay off a loan. And nowadays unfortunately this debt is increasing. On 17 September, 2008 the head of State Agency for Financial Control of the Republic of Kazakhstan E. Bahmutova informed that Kazakh banks have to pay out \$12 billion of foreign credits by 1 September 2009 (*Financial crisis makes the state bankruptcy of Kazakhstan just a matter of time, 2009*)

2.1 The current situation of banking system

Considering the previous events and the current situation of Kazakhstan's economy 2009 year is very difficult for almost all banks of Kazakhstan. And from my point of view the market will reach "a bottom". A possibility of banks' default to date is very high because nowadays some banks have problems with the current payment service and execution of the liabilities.

The main reason is debt of banks to foreign financial institutions. And due to the crisis the burden of the debt became more complicated. First of all recent devaluation of the national currency tenge in February has inauspiciously influenced on this foreign obligation. According to the estimation of the rating agency "Moody's" devaluation provoked a growth of assets' riskiness by 54% and increase of debt in fact by 25-30% (*Devaluation of tenge will have a negative impact on economy of Kazakhstan, 2009*). Really repayment of external owing became more expensive as most of operations with customers in banks are conducted in tenge. Thus banks had to pay off \$12 billion - 1440 billion of tenge (120 KZT/USD) and now due to devaluation banks must to repay 1800 billion of tenge (150 KZT/USD).

Secondly this situation became aggravated owing to difficulties of clients' payment of loans. As most of people in Kazakhstan earn their salaries in national currency so it's hard for them to pay off a loan in foreign currency because heretofore they have to convert their money. In addition to this nowadays the economy faces an increasing unemployment rate. The reduction of production in companies or partial suspension of it entailed the dismissal on grounds of redundancy and incomplete or late wage payment. For example according to the data of Interfax arrears of wages in Almaty in January, 2009 was 800 million of tenge. Thus not all customers who borrowed money from banks have possibility to pay off the loans.

Thus the current situation of Kazakh banks is unfavorable. But concerning to the subsidiaries of foreign banks in Kazakhstan situation is much better. There are several daughter companies of west-European banks such as UniCredit Group "ATF Bank", "RBS" (Kazakhstan), "HSBC Bank Kazakhstan". Like in the Kazakh banks a necessity of subsidiaries asset's optimization and reduction of expenditure is also essential but their financial position is more auspicious than in Kazakhstani banks because of external funding from parent banks. For example UniCredit Group provides to "ATF Bank" approximately 1.2 billion of euro therewith capital will be increased by 150 million of euro. Unlikely RBS is in a difficulty therefore it's important to optimize their assets especially in daughter bank in Kazakhstan. Contrary to the world financial crisis "HSBC Bank Kazakhstan" succeeded in achieving good financial performance. The chairman of the board of HSBC Mr. Myunhen stated that HSBC is not one of the biggest banks in Kazakhstan and bank's interest rate on deposits isn't so high like in other Kazakh banks, but due to the individual approach, reliability and security this authoritative bank anyway attracts their customers, conservative policy and risk management are the strongest features of HSBC (*Investing in the reliability, 2009*). Thereby subsidiaries of foreign banks in Kazakhstan have more conducive position than our Kazakh banks.

2.2 Ways of resolutions

The current situation of banking system therefore the whole economy of Kazakhstan are unfavorable, so because of it the international rating agency Fitch Ratings decreased the investment grade of Kazakhstan and now it is only BBB (*The government of Kazakhstan will own only National Bank*, 2009). According to this grade an attractiveness of the country for foreign investment is low so the investment flow into the country will decline and again it will banefully influence on the economic situation. Thereby for stabilization of the whole economy it's necessary to normalize banking system within the country. For this purpose several solutions were undertaken:

- The restructuring of banks' strategies and reorientation by themselves.
- The support of the government.

First of all banks carry out a reorientation on short-term loans in order to ensure the quick assets turnover and maintain the liquidity for external debt repayment. Also because of borrowers' insolvency most of banks have to sell their collateral, cut down expenses: reduce the number of staff, shut down or merge branches.

The second way is a support of the government. According to the crisis management program the government of Kazakhstan supports the banking system, small and medium enterprises, and agricultural sector of the country by allocation the appointed sum of money.

Firstly the government of Kazakhstan attempts to support the banking system by nationalization and entering in capital of banks. In October 2008 the government appealed to shareholders of the biggest banks – BTA, Halyk, Kazkommerts and Alliance banks with offer of pouring of additional money in their capital. From my point of view these banks were chosen exactly because they are too big to fall therefore the government attempts to save them and prevent their default. Banks accepted this offer and according to the memorandum of mutual understanding gave 25% of shares to the government. Also the government through the “Samruk-Kazyna” fund purchased control packet of shares of BTA bank (78.14%) and of Alliance bank (76%) by the compulsory issuance and purchase of common shares. This action was explained by state authority that BTA bank couldn't discharge its obligations any more, it had too low liquidity ratio and owned capital ratio (*The nationalization of BTA bank*, 2009). Moreover National bank used to give to BTA short-term loans, therefore a possibility of default was low. Although there is another view that BTA discharged their external commitments in 2008 (nearly \$1.2 bln) without any support of government and it has all opportunities to repay them in 2009 and 2010 (\$1.7 bln and \$1.9 bln).

The government of Kazakhstan transferred \$1,7 bln to BTA bank and \$200 mln to Alliance bank. So there is much to gain from it because due to these money banks can support the liquidity and repay foreign debt. Also from my point of view the government entering in capital of banks is an additional guarantee for depositors that banks will meet all obligations without fail. And according to K.Kelimbetov, the head of government fund, after stabilization Samruk-Kazyna in 5 years will drop out of banks' capital (*Salvation or confiscation*, 2009).

The next solution of current problems is refinancing. The prime minister of Kazakhstan K.Masimov informed that the government of Kazakhstan and “Samruk-Kazyna” fund started a program concerning to a refinancing of mortgage credit. For realization of this program 120 billion of tenge were allocated in order to support the borrowers and banks (*Billion for the nation*, 2009). This program implies the refinancing of previous mortgage loans through the reduction of interest rate on them. According to the terms of program a person who has a mortgage credit on accommodation (no more than 120 square meters of living space), it's his/her the only habitation and there is no an expiration of loan so this person can come to a bank with the request about transfer dollar loans into national currency and reduction of

interest rate on it. Reduced interest rates are 9 and 11% while market interest rates are nearly 16-18%. This program includes only 4 big banks: Halyk bank, Kazkommerts bank, BTA bank and Alliance because most of all mortgage loans were issued in these banks. Again we have an application of the “too big to fall” policy. The government attempts to increase payment of a loan from customers, consequently the biggest banks’ circulating capital. Mortgage loans which do not qualify to requirements of government program can be refinanced by “HSBC Bank Kazakhstan” at the expense of they own capital with interest rate of 12.99%. As competition in banking sector of Kazakhstan is decreased so HSBC can attract more reliable customers and occupy the niche on Kazakhstani market.

Also through the “Samruk-Kazyna” and “Damu” funds 12 commercial banks get the same sum of money (120 billion of tenge) on financing small and medium enterprises in order to support enterprises and banks in Kazakhstan.

3. Conclusion

In spite of negative tendency in banking sector of Kazakhstan and close relation with world capital market financial performance of many Kazakhstani banks is satisfactory and there is almost low possibility of default. Thus the situation in banking system is manageable and nearly can be controlled by the government.

As I said before crisis it is a consequence of mistakes and shortcoming of the whole economy and current financial crisis showed us that Kazakh banking system is imperfect. And due to it we should reform all weak parts and improve an effectiveness of banks’ strategies. So the banks will be forced to get their balance sheets in order. They will need to orient themselves increasingly towards domestic depositors in order to attract financing because nowadays there is almost no possibility of external funding from foreign countries. And they will have to convince international lenders and rating agencies that they will be reliable partners in the future. Also banks should comply with the currency position i.e. loan which is involved in dollar has to be issued by bank in dollar loan too. Nowadays this rule is significant because of cases of devaluation in the country.

Concerning to the government performance there is need of oversight intensification. Financial oversight Agency of Kazakhstan should supervise the risk management policy of banks more toughly. And in case of inadequacy it should punish the bank management. And also it’s necessary to establish more strict requirements for capital reserves portion, banks have to keep a certain portion of cash in reserve and increase it in order to avoid defaults.

As people (depositors) are integral component of any bank it’s important to give a recommendation about keeping the money in banks. In case of world financial crisis, instability of dollar and devaluation of tenge nowadays it’s preferably to keep money in dollar. Although the interest rate on tenge deposits - 12% is higher than on dollar 8% but there is possibility of second wave of devaluation of national currency in summer 2009 so tenge would be devaluated by nearly 15-20%, thus anyway amount of money on tenge deposits will be decreased. Moreover depositors can keep their money in yuan. Economy of China is one of the strongest in world and there is forecast that this country will be the first who will drop out of crisis. Furthermore yuan can be one of the reserve currency but it is moot point.

Despite the financial crisis has negative consequences on economy of Kazakhstan it uncovered all weaknesses and defects of banking system, thus after overcoming the crisis our banking sector will be more staunch and stronger. Hereby crisis will strengthen immunity of banking system of Kazakhstan.

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