

Measuring and Forecasting Financial Stability

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Speech

Oleg Smolyakov

National Bank of the Republic of Kazakhstan

„Current risks to financial stability“



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НАЦИОНАЛЬНЫЙ БАНК РЕСПУБЛИКИ КАЗАХСТАН



Current risks to financial stability



Oleg Smolyakov
Financial Stability Unit
National Bank of Kazakhstan
2009 год



1. Definition of FS (cont.)

Financial Stability - the absence of disproportions in the economy, which may cause:

- the consequent adverse corrections in financial markets,
- emergence of the systemic crisis,
- failure of banks to conduct their role as financial intermediary and
- inability of banking system to support business activity of real sector



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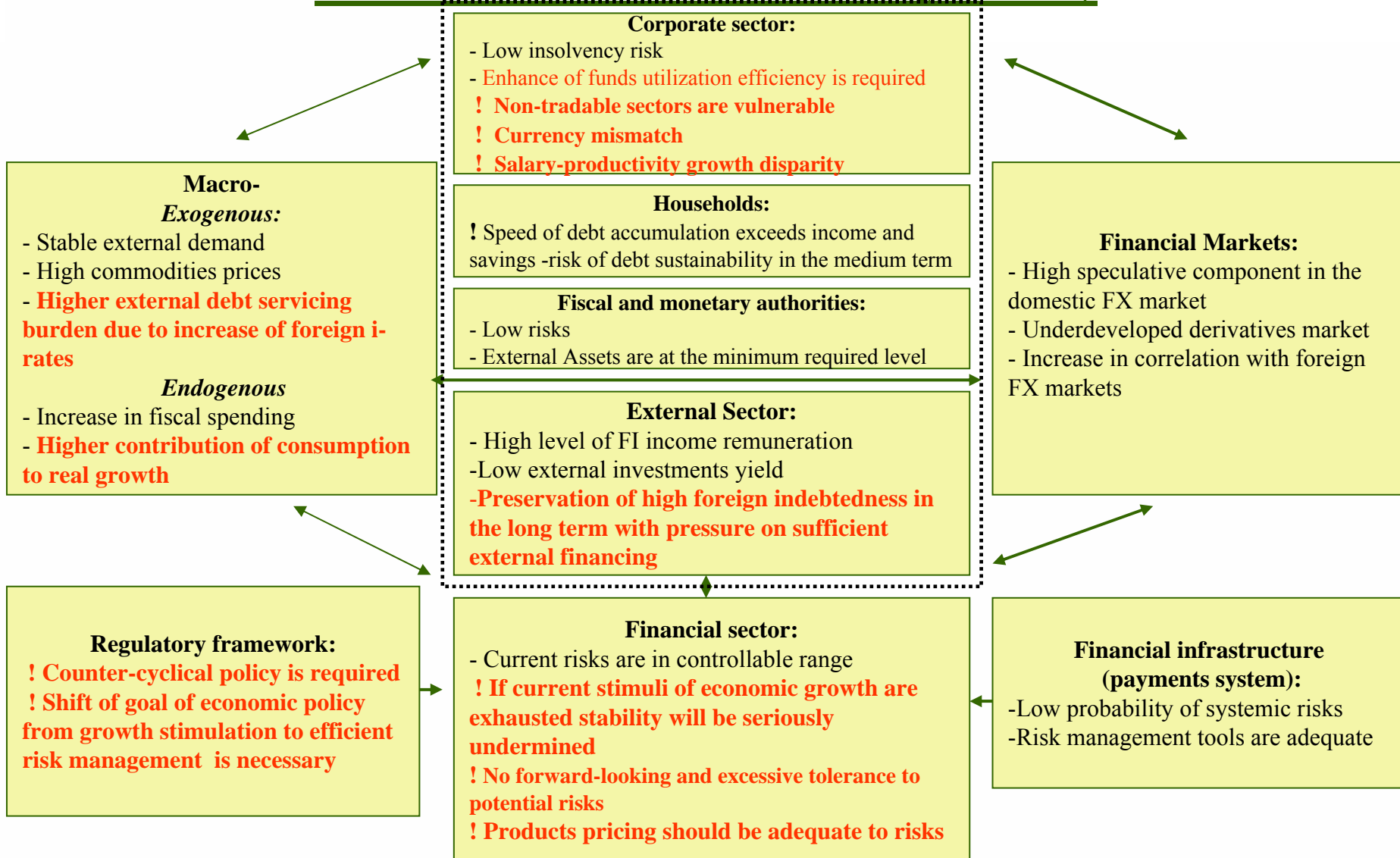


2. Vulnerabilities



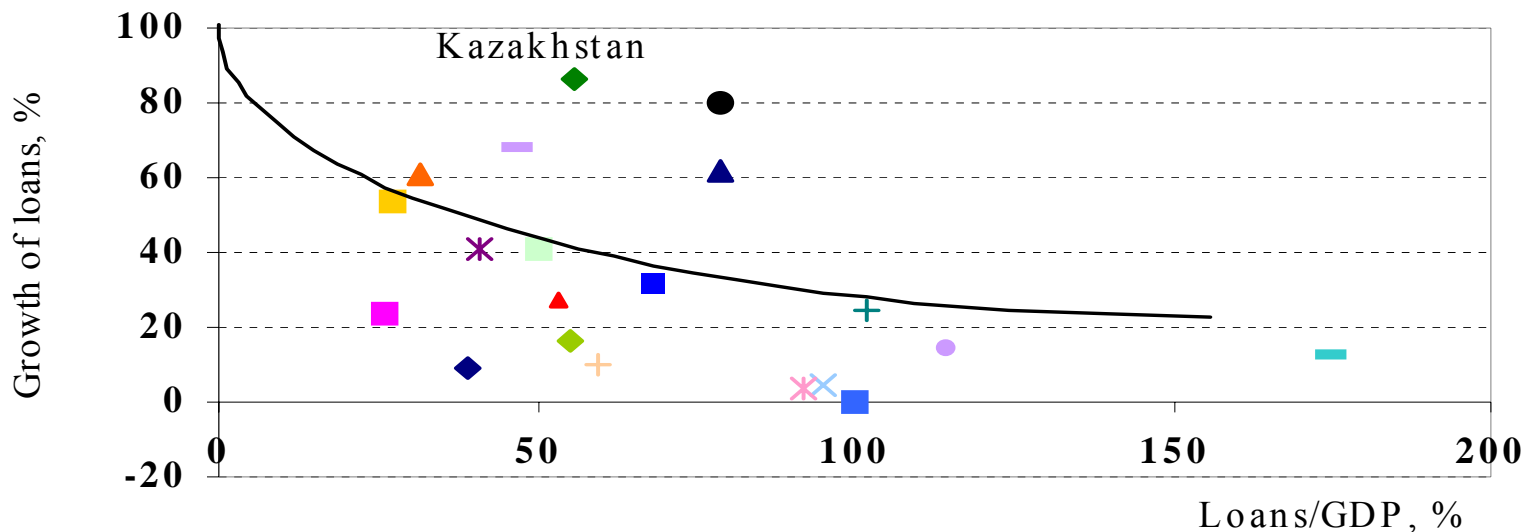


Factors of financial stability (2006)





Credit boom or catching-up process



- | | | | | |
|----------------|-------------|-----------------|-----------------|------------------|
| ◆ Saudi Arabia | ■ Indonesia | ▲ Kuwait | ■ Arab Emirates | ✱ Czech Republic |
| ● Latvia | + Korea | ▲ Russia | ■ Ukraine | ◆ Kazakhstan |
| ■ Lithuania | ▲ Estonia | × Singapore | ✱ Thailand | ● China |
| + USA | ■ Japan | — Great Britain | ◆ Hungary | ■ Romania |

**Analysis is based on data of 20 countries for 2006, Kazakhstan – data at the end of September 2007, change in annual terms*



Risks reassessment under external liquidity constraints (2H2007):

- **External debt is at the level of GDP**
- **50% of external debt was in the banks balance sheet**
- **Liabilities to non-residents were about 50% of total banks liabilities**
- **Current account deficit amounted around 5% to GDP in 1H2007**
- **Foreign Exchange Reserves of the National Bank covered 60% of short-term debt**

Risks implication:

- 1. Increase in external debt refinancing risks**
- 2. Skepticism in liquidity and reserves adequacy of central bank**
- 3. Expectations of banks assets quality worsening under credit growth slowing with further effect on banks stability**
- 4. “Flight to quality”**



Economic agents reaction (2H2007):

- **Tightening of banks lending policy in riskier spheres (mortgage, consumer lending and construction)**
- **Increase in interbank lending i-rates**
- **Deposits withdrawal by households**
- **Assets currency transformation**
- **Cash FX market pressure**
- **Banks FX Supply and demand disparity**
- **Decrease of National Banks reserves as a result of FX market interventions**



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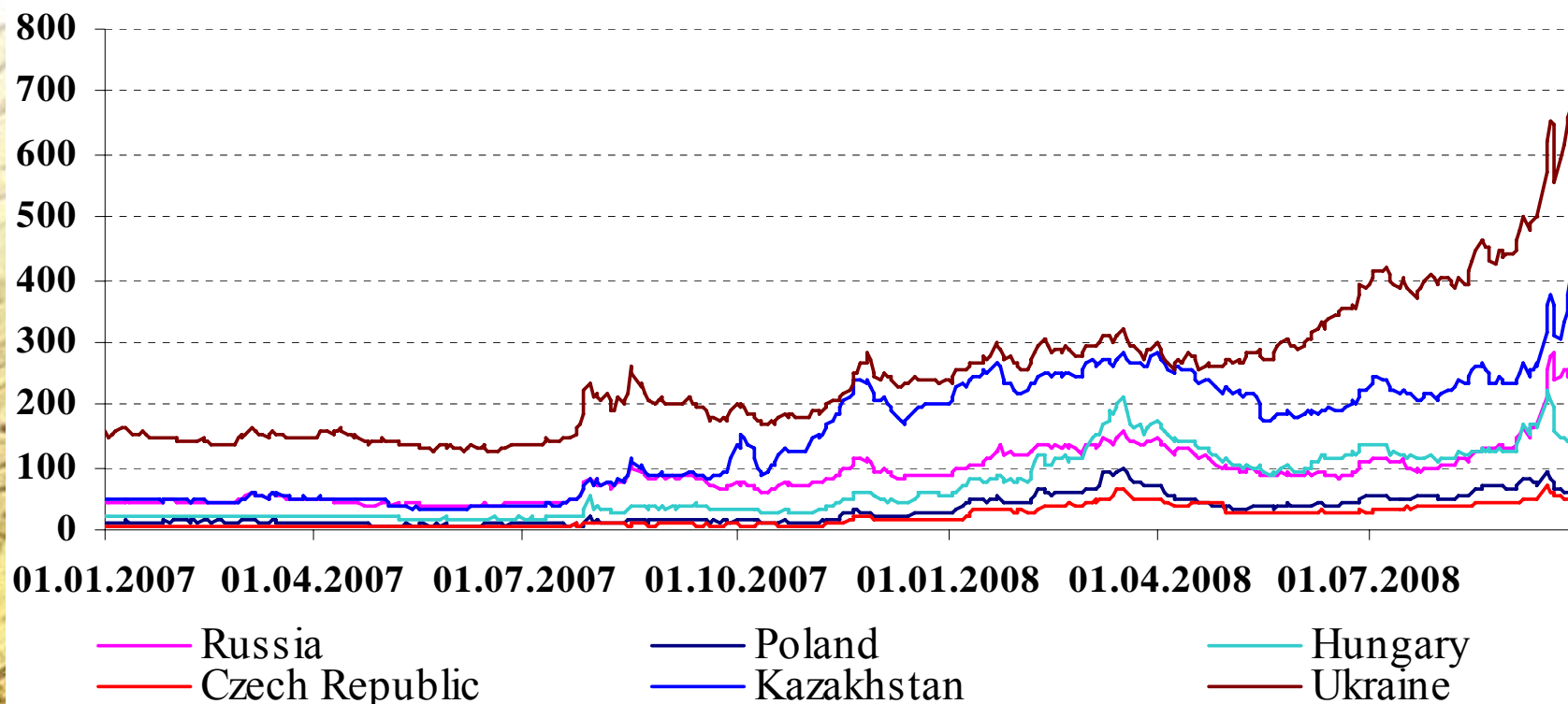
3. Risk assessments





Risk assessments in the markets

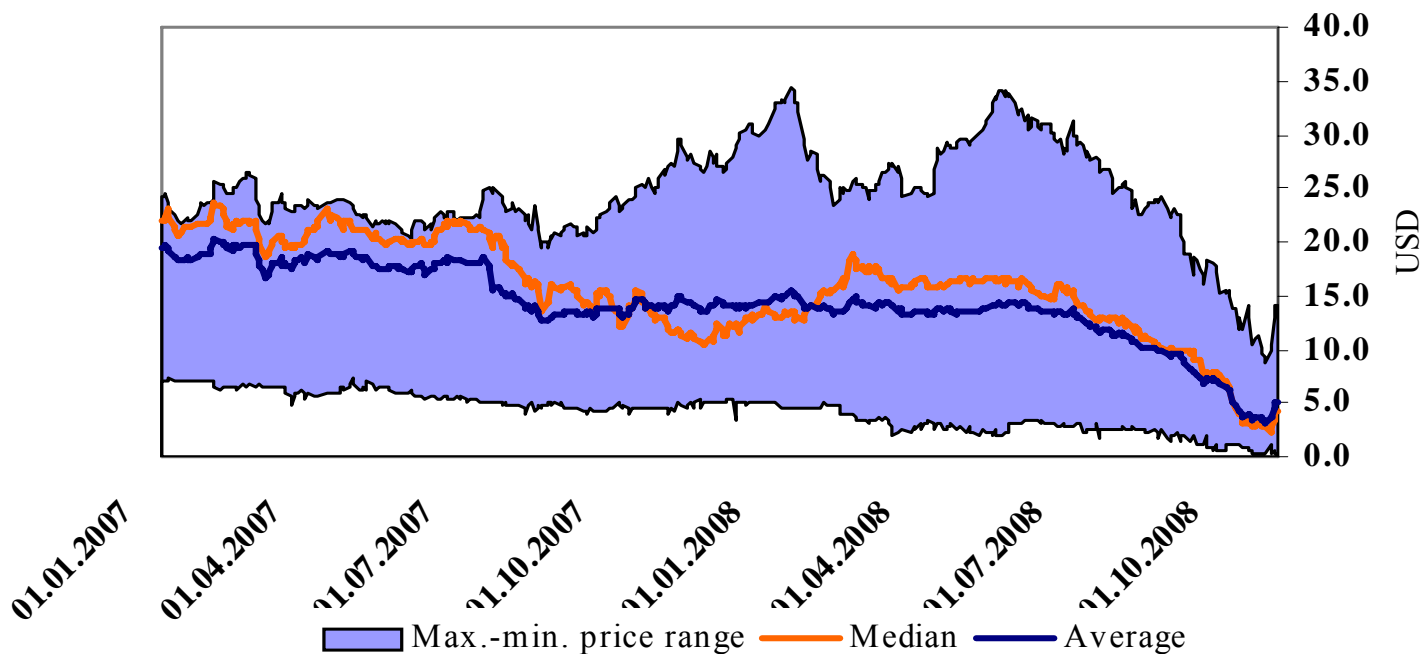
Spreads on sovereign 5-year credit default swaps of developing countries





Pricing of risks in the market

Equity prices of Kazakhstan's issuers at the London Stock Exchange



Issuers' list formed by Alliance Bank, Halyk Savings Bank of Kazakhstan, Kazkommertsbank, Kazakhgold, Kazakhstan Kagazy Plc, Kazmunaigaz, ShalkiaZinc



Comparative rating position

Ratings of Countries on Long-term Liabilities in Foreign Currency

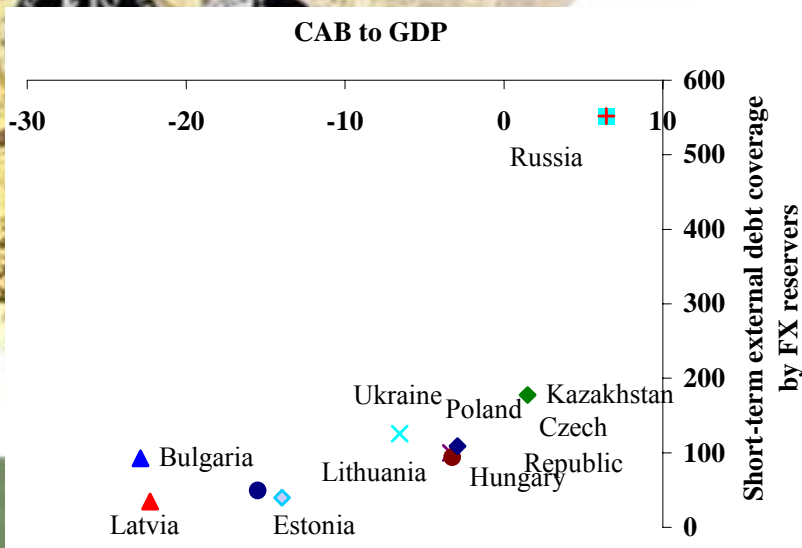
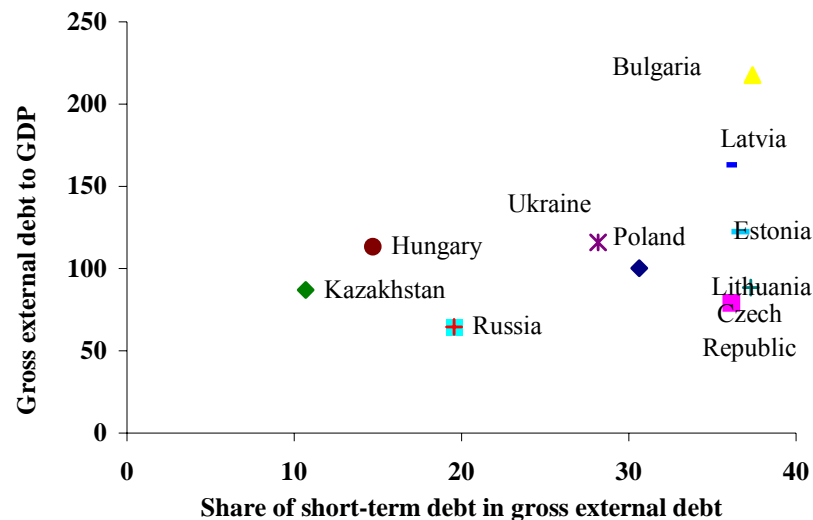
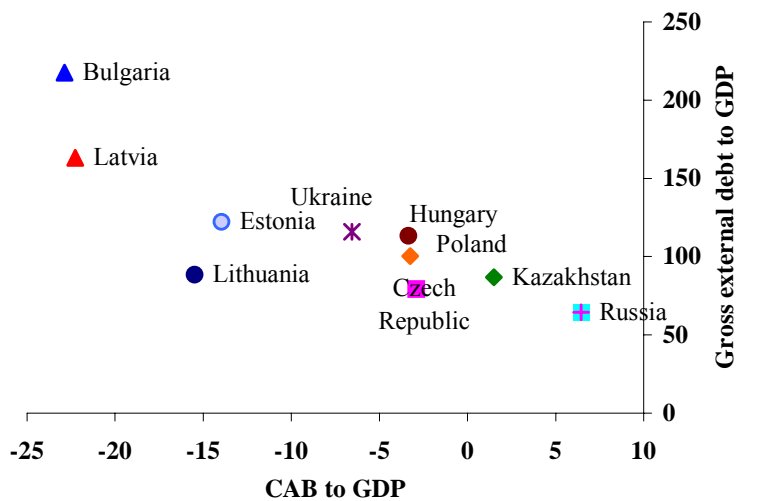
Country	As of October 31, 2008		
Rating agencies	Moody's	S&P	Fitch
Poland	A2/Stable	A-/Stable	A-/Stable
Czech Republic	A1/Positive	A/Stable	A+/Stable
Hungary	A2/Stable	BBB+/Negative	BBB+/Negative
Bulgaria	Baa3/Stable	BBB/Negative	BBB/Negative
Russia	Baa1/Positive	BBB+/Negative	BBB+
Ukraine	B1/Stable	B/Negative	B+/Negative
Kazakhstan	Baa2/Stable	BBB-/Negative	BBB/Negative

Rating increased	Rating increased/forecast improved	No changes
Rating decreased	Rating decreased/forecast worsened	Rating decreased/forecast Stable
Rating unchanged	Rating unchanged /forecast worsened	Rating unchanged/forecast improved
Rating unchanged /forecast Stable		

Source: Bloomberg



External Vulnerability (comparative analysis)





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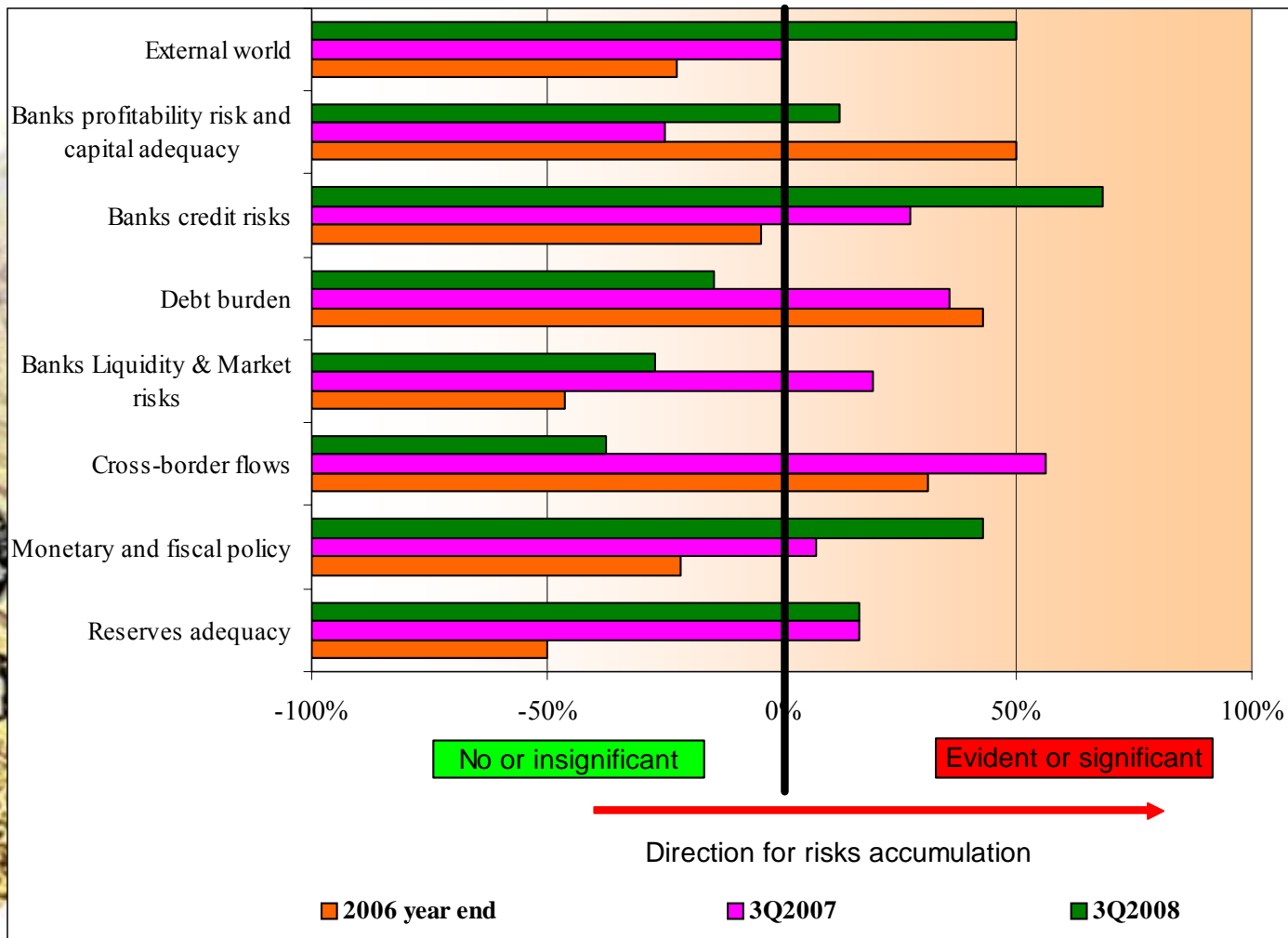


4. Current risks profile





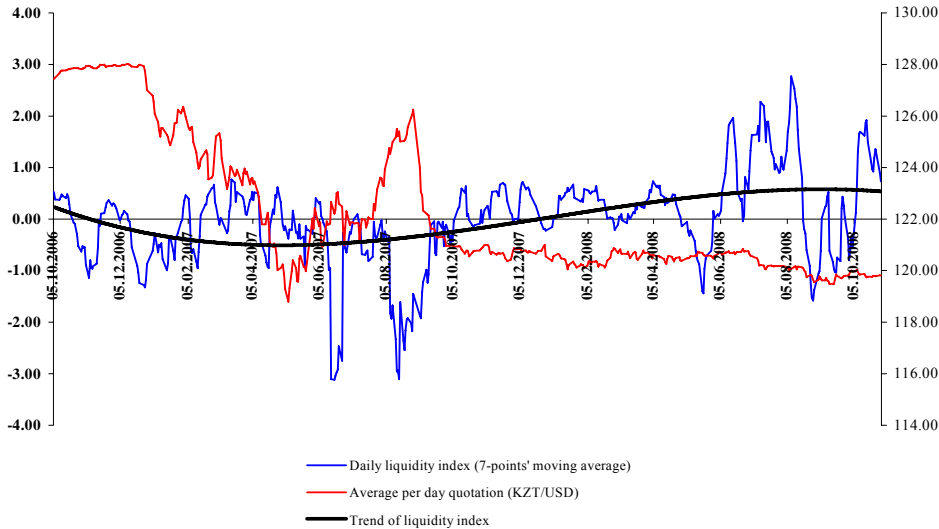
Risk map (2008)



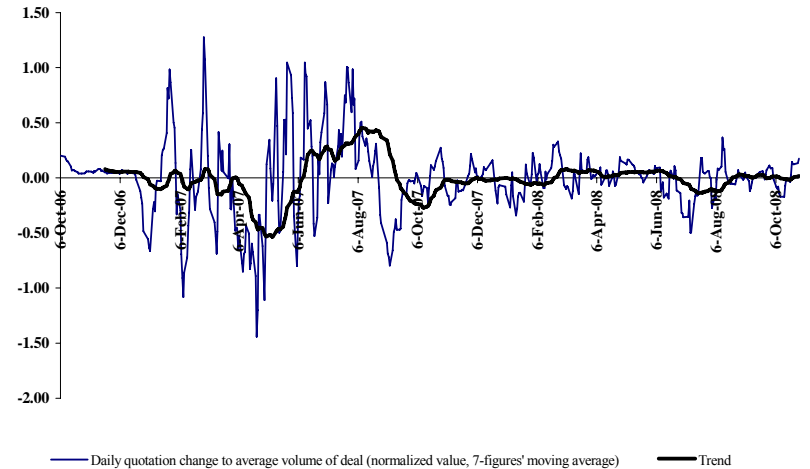


FX and money market

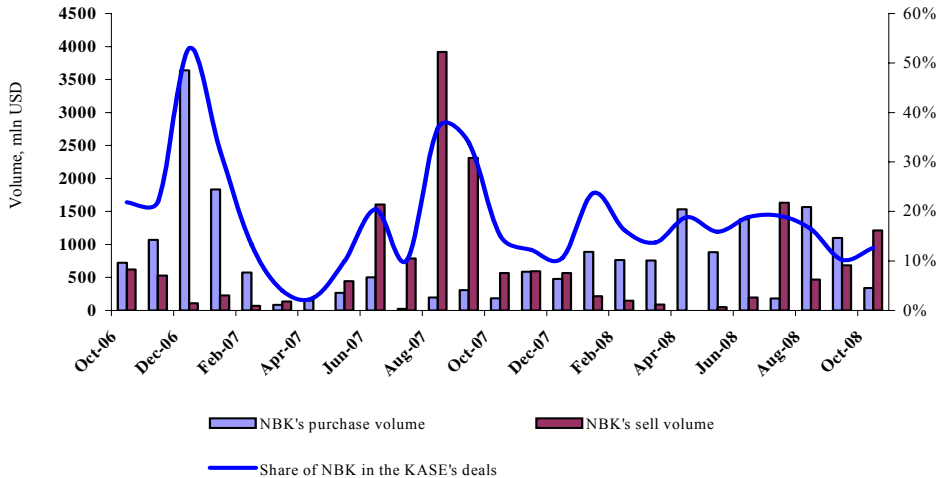
KASE FX-market liquidity



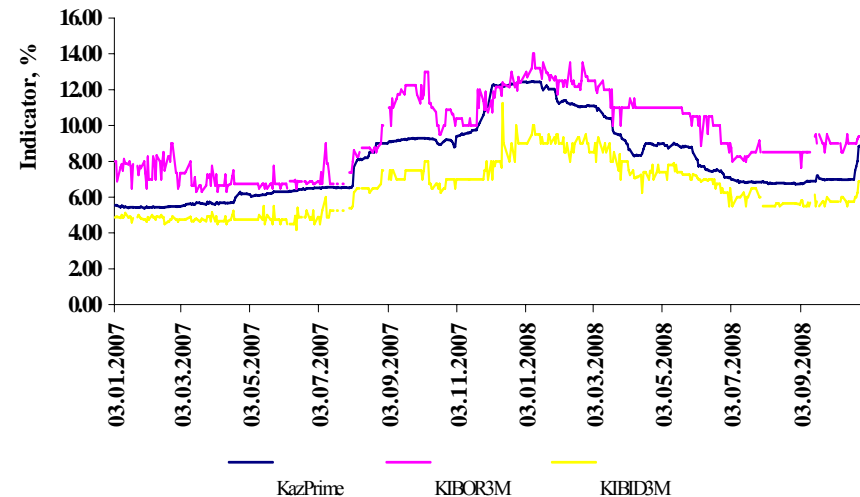
KASE's FX-market resiliency evaluation



FX-market operations on KASE, volumes and operations



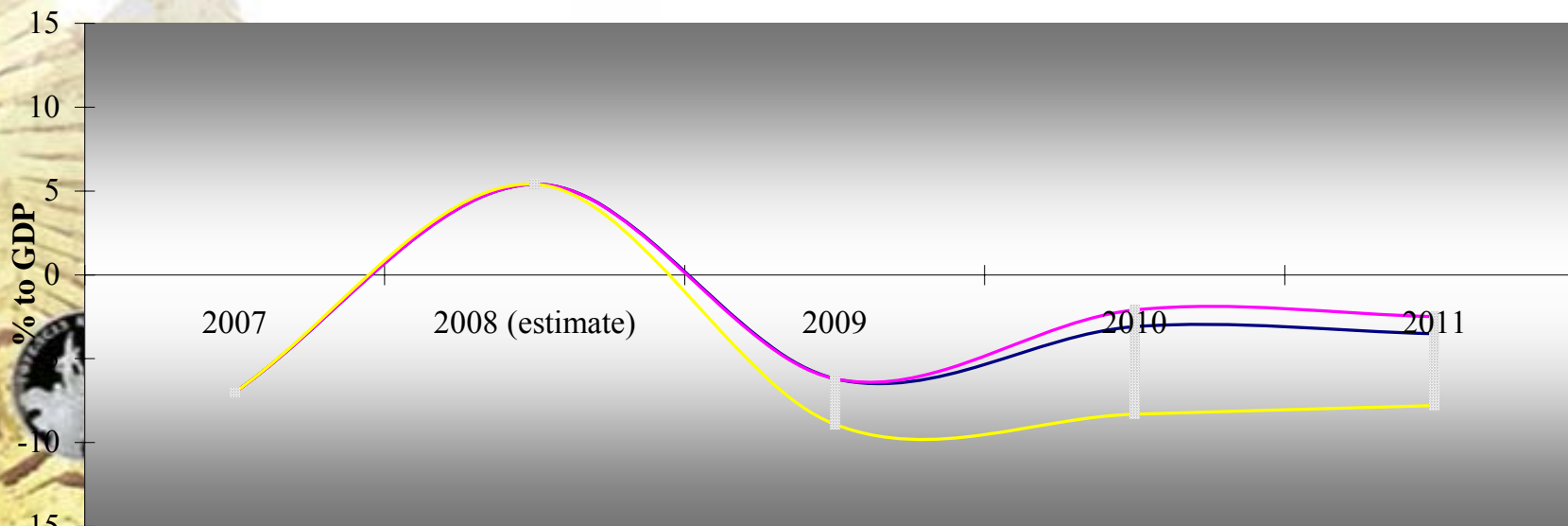
Interbank money market indices





CA sustainability

(% to GDP)

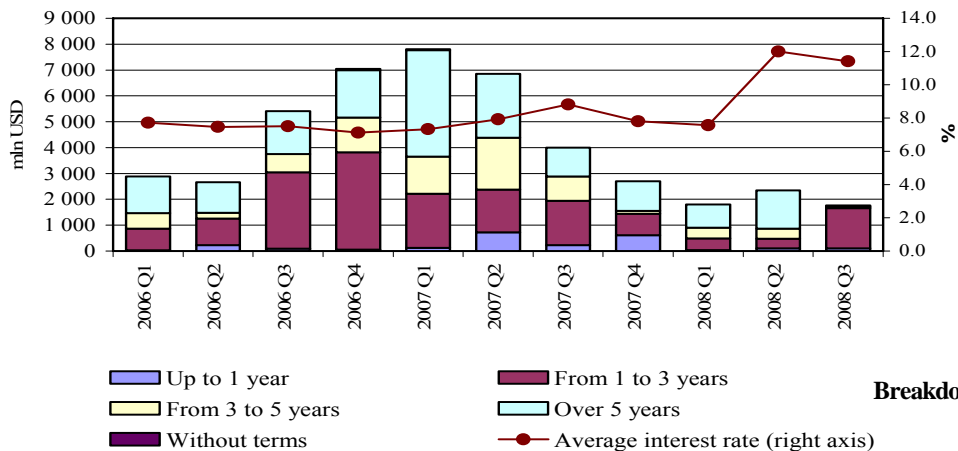


- Current account - baseline
- Current account - scenario of real GDP (2010-2011)
- Current account - scenario of oil prices with influence on GDP

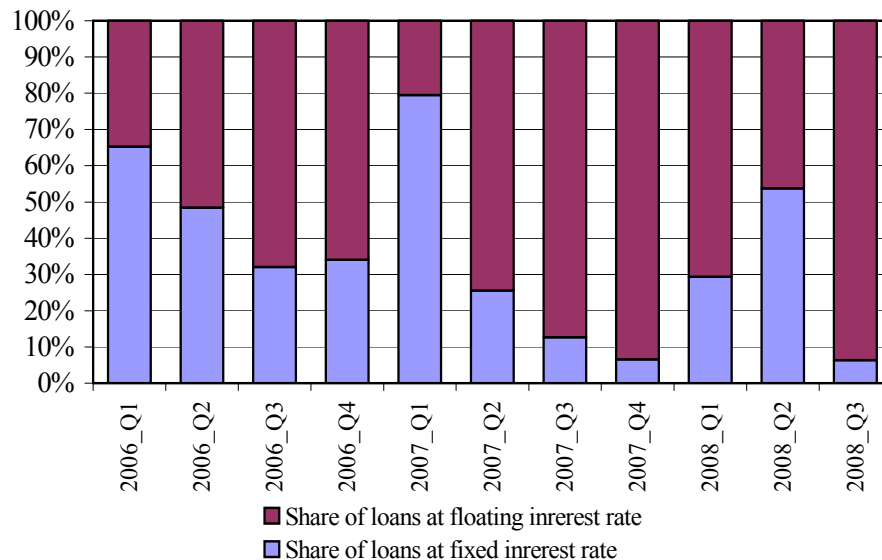


Structural Funding Risk

Maturity structure of foreign borrowings by banks and interest rate



Breakdown of banks' foreign borrowing by interest rates



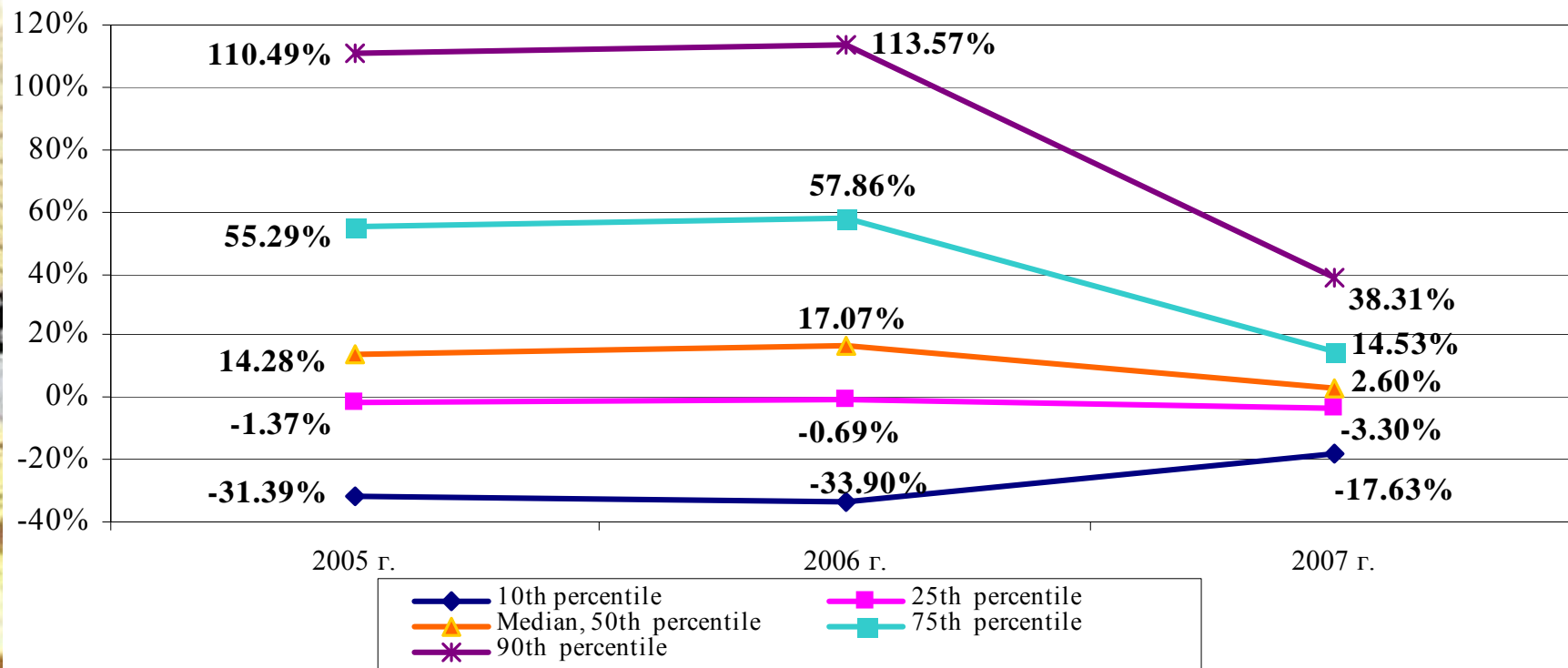
Source: NBRK





Corporate sector profitability

ROA distributions by percentiles

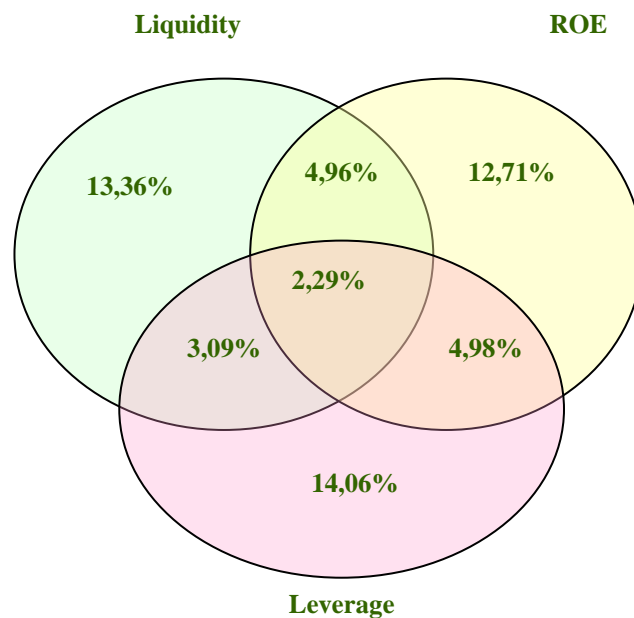
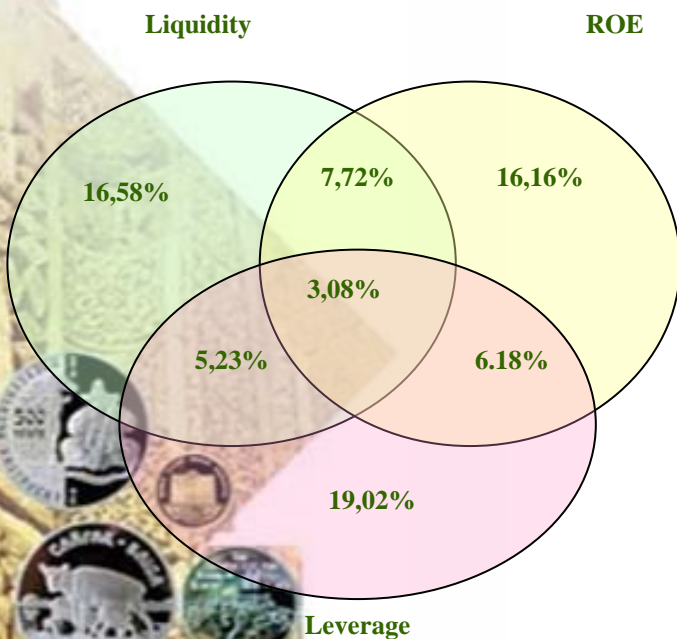




Vulnerable group

2007

2006



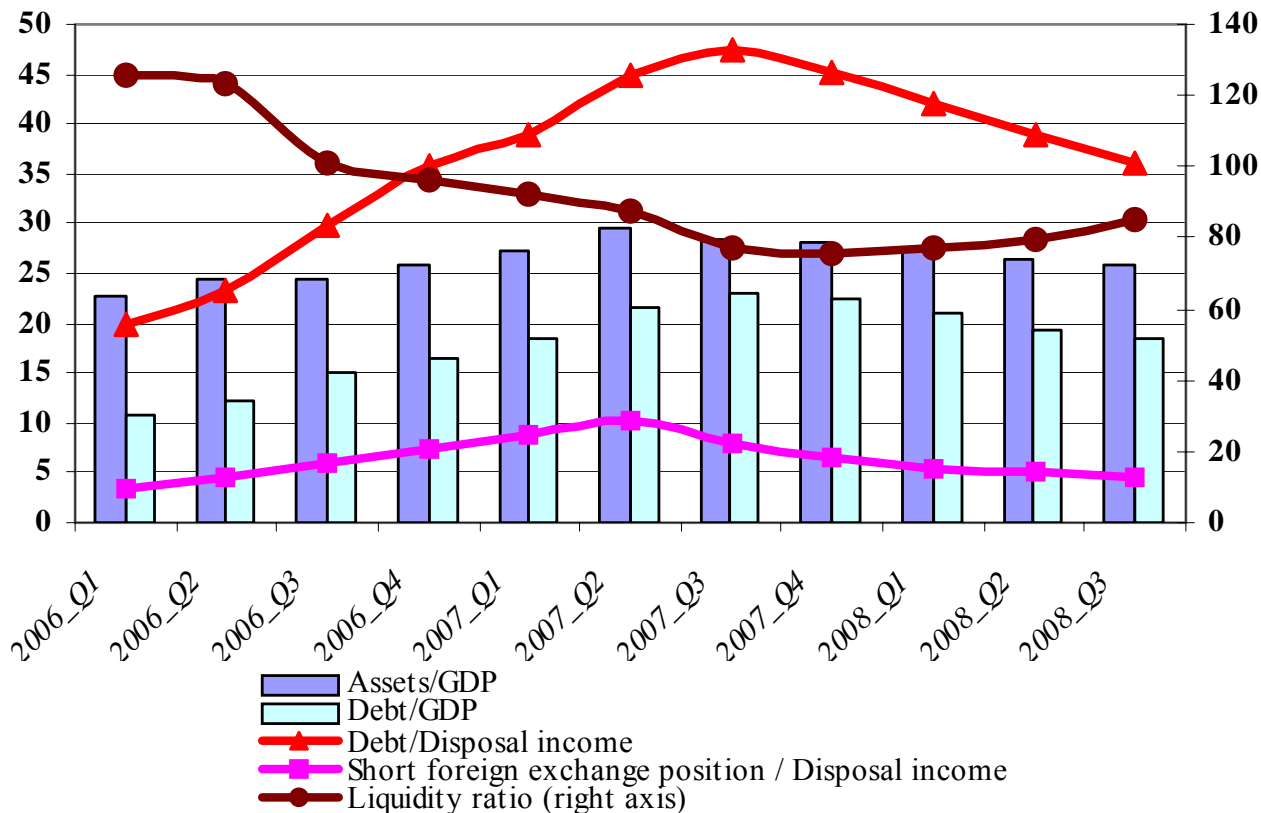


Currency mismatch (mid- and large enterprises)

<i>At the end of 1 half of 2008</i>	FX balance position in % to capital	Current FX liquidity	Net of operating cash flows in FX in % to capital
Total	-28.0%	1.51	35%
Agriculture	-0.5%	0.10	1%
Industry	-0.3%	2.23	51%
<i>Mineral Resources industry</i>	-3.3%	2.00	65%
<i>Manufacturing Industry</i>	7.7%	3.50	32%
<i>Electricity, gas and water supply</i>	-10.2%	0.68	1%
Construction	-24.6%	0.36	1%
Trade and repair	-38.6%	0.14	-28%
Hotels and Restaurants	-60.9%	0.12	-2%
Transport and communication	-16.0%	1.36	2%
Finance	-3.6%	3.12	-6%
Real estate, rent and other services	-668%	0.12	16%



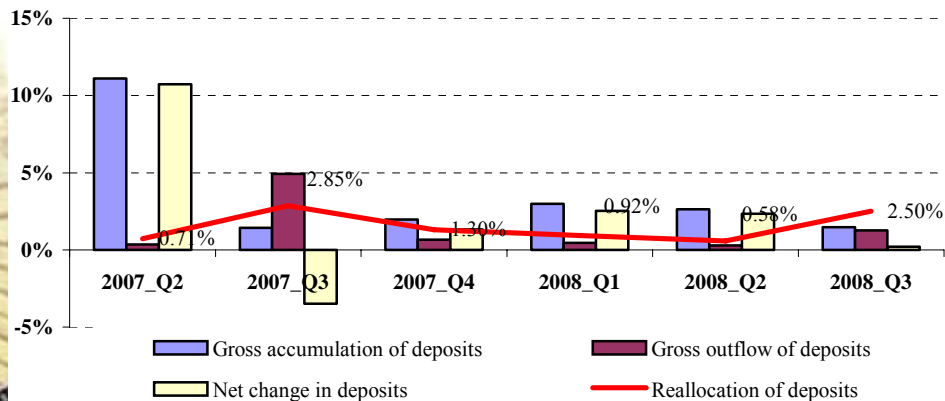
Households position



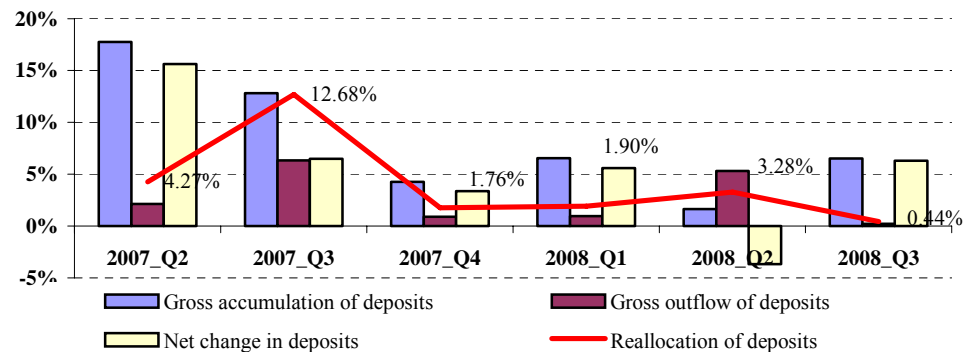


Risks tolerance of depositors

Term and conditional deposits under 700 ths. KZT



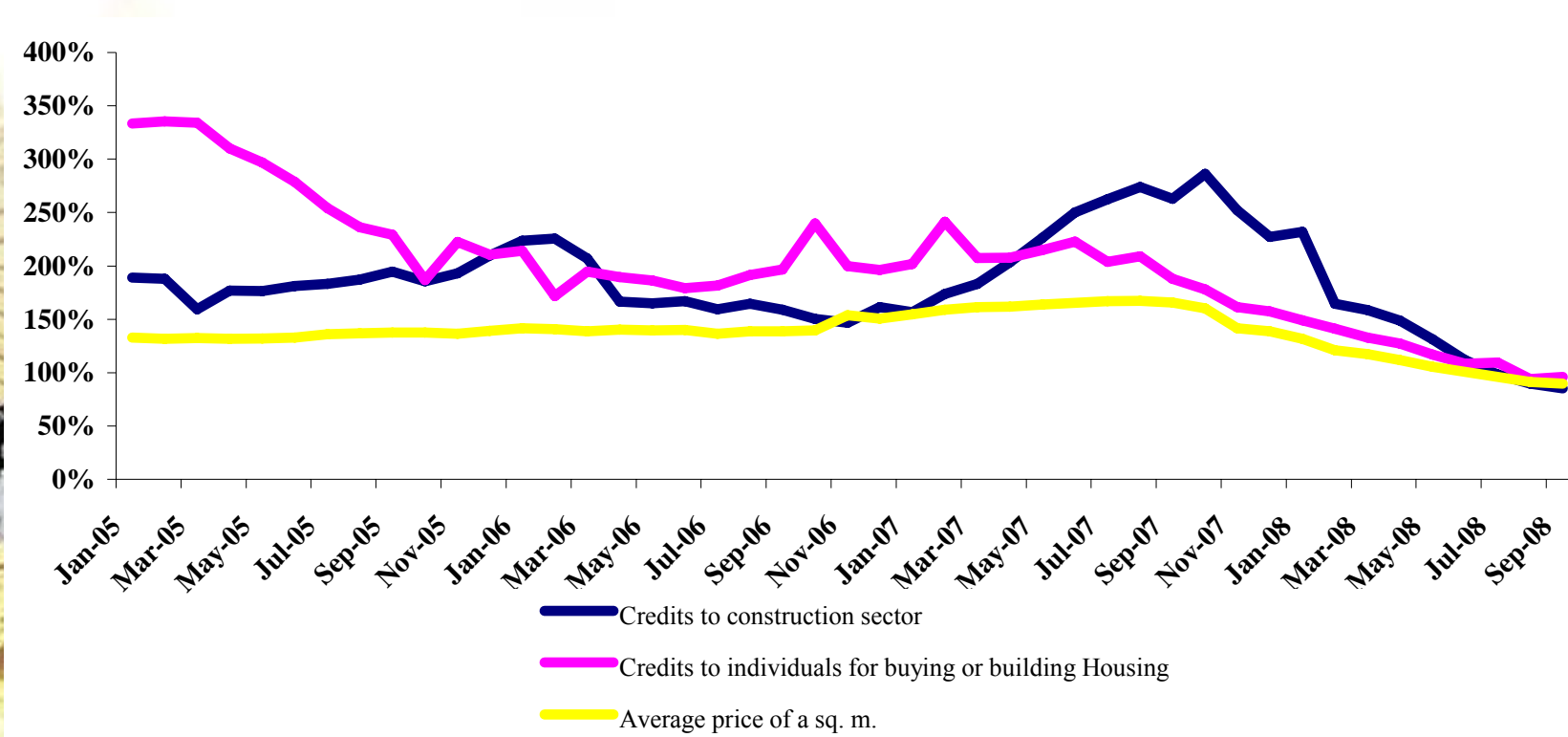
Term and conditional deposits over 700 ths. KZT





Credits and real estate market interdependence

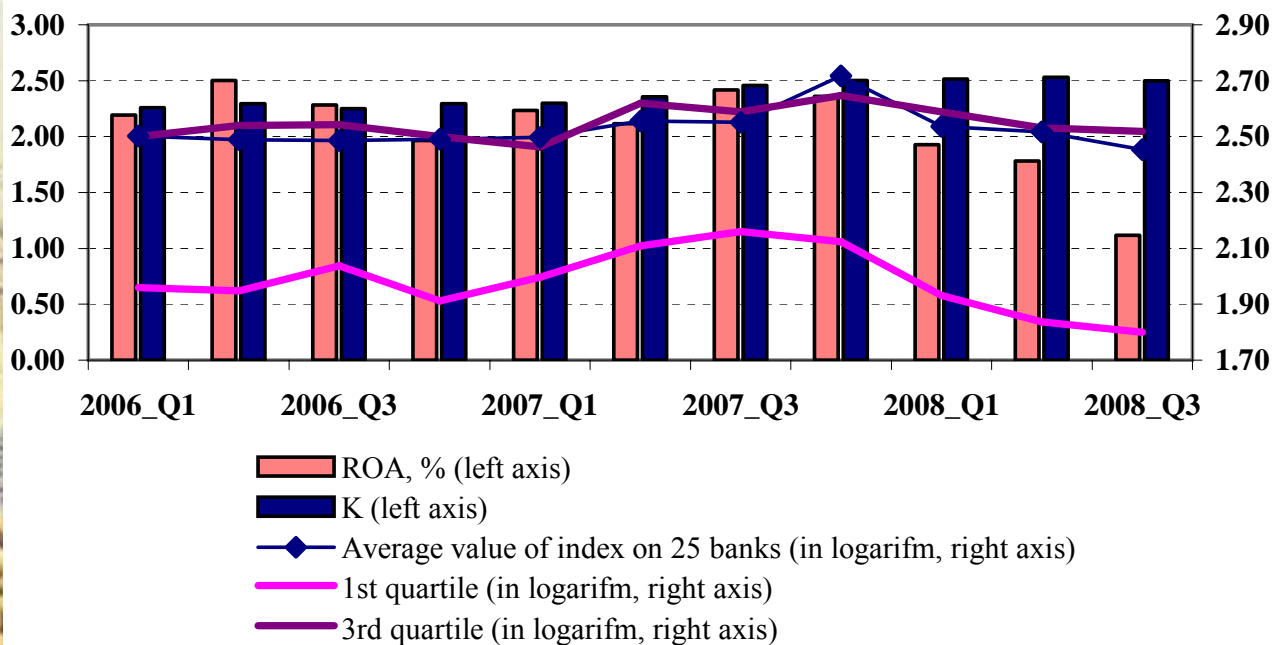
Connection between credits and housing prices, growth speed y-o-y





Distance to default

z-score





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5. Principles and dilemmas of public intervention





Memorandum on Financial Stability

Principles of public interventions (1):

- - state support to financial sector is provided only in exceptional cases, when it is expected that inaction would end up in disruption of financial stability conditions otherwise;
- - priority of private sector solutions (recapitalization, mergers and acquisition, etc.) concerning financial stability of institutions compared to state intervention;



Memorandum on Financial Stability

Principles of public interventions (2):

- minimization of the financial risk of tax payers, i.e. risk that potential gains of state intervention and state support for the financial sector will be inadequate to the state financial expenditures;
- absence of full and unconditional state guarantee on the financial institutions support;
- building conditions for realization of private solutions for financial institutions stability maintenance;



Crisis (anti-) Dilemmas

- **Price vs. Financial Stability**
- **Building capacity to withstand shock vs. Addressing Structural Problems**
- **Fair pricing vs. Price distortions**
- **Rules vs. discretion**
- **Fair cost sharing vs. Moral Hazard**
- **Benefits maximization vs. Cost minimization**

(!) Exit strategy



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Thank you!
