Kazakhstan

The economic contraction bottomed in the middle of 2009 and the economy marked positive, albeit modest, growth for the year, bolstered by a rally in international oil prices in the second half. An expansionary fiscal policy directed through an anticrisis program, an accommodative monetary policy, and banking sector stabilization constituted the main policy focus. Weak domestic demand and limited access to credit curbed inflation pressures. The outlook is for modest growth with moderate inflation and a current account surplus, though the banking sector still faces difficulties and domestic demand will remain weak.

Economic performance

In the second half of 2008, the oil-driven boom of previous years was put into a tailspin by the onset of the global financial crisis (because domestic banks had overborrowed from abroad) and then by the downdraft in oil prices. In 2009, GDP contracted by 2.2% in the first 3 quarters, but managed a marked rebound to post growth of 1.2% for the year (Figure 3.4.1) on the impetus of strengthening oil and commodity prices.

On the supply side, industry (excluding construction) grew by 1.8%, with output on the rise over much of the year (Figure 3.4.2). A fillip to growth came from a 13.8% expansion in agriculture as good weather produced a record grain harvest. Services output shrank marginally, and construction dropped by about 5%.

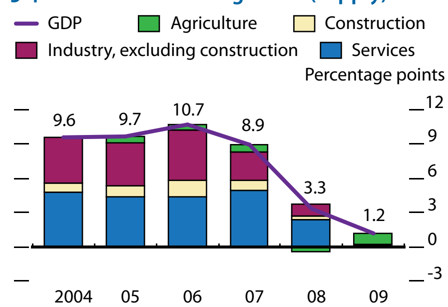
While data on the expenditure side are not yet available, private consumption and (non-oil) investment likely contracted or stagnated. One of the most significant impacts of a local banking crisis, which has wracked the country since end-2007 and essentially froze lending, has been a sharp slowdown in domestic demand.

In prior years, local banks had relied on external borrowing to finance large increases in construction, real estate, and personal lending. When international capital dried up (from late 2007), the banks faced an increasingly serious liquidity crisis that in effect ended new lending, deflating the property boom and leaving many projects unfinished (Figure 3.4.3). Moreover, many consumers found themselves overindebted as the economy slowed. In response, the government adopted an anticrisis program (Box 3.4.1).

Annual average inflation fell to a low of 7.3% in 2009, from 17.3% in 2008, due to weak domestic demand and low international commodity prices, particularly at the start of the year. Even February's currency devaluation (adding upward price pressure to imports) could not outweigh the inertia of weak private consumption. Year-on-year inflation at end-December was 6.2% (Figure 3.4.4). By main component, food was

This chapter was written by Kiyoshi Taniguchi of the Uzbekistan Resident Mission, ADB, Tashkent; and Asset Nussupov, consultant of the Kazakhstan Resident Mission, ADB, Almaty.

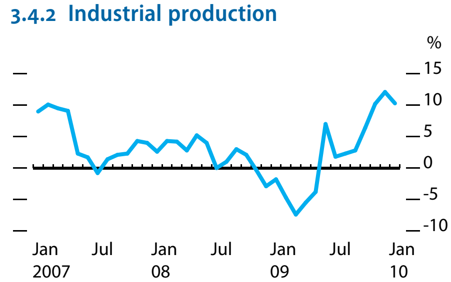
3.4.1 Contributions to growth (supply)



Source: Agency of Statistics of the Republic of Kazakhstan.

Click here for figure data

3.4.2 Industrial production



Source: Agency of Statistics of the Republic of Kazakhstan.

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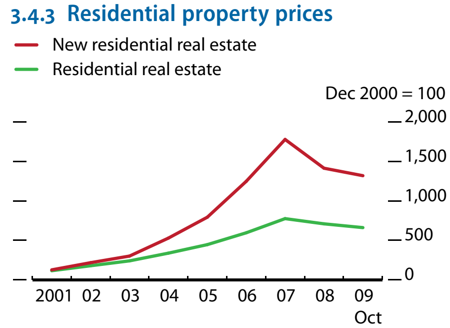
3.4.3 Residential property prices



Source: Agency of Statistics of the Republic of Kazakhstan.

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3.4.1 Dealing with domestic crisis

In response to banking and real-sector woes, the government launched an anticrisis plan in late 2008. A total of $10 billion or 9.5% of GDP, largely from the National Fund of the Republic of Kazakhstan—the national oil fund—was pledged.

The plan focused on the following: capital injections in four major banks (made through Samruk Kazyna, the government holding company for state-owned assets that also provides development finance); support for construction and the real estate market; assistance to small and medium-sized enterprises and agriculture; and public investment in industry. The initiative has stabilized the economy but a strong revival in the non-oil sectors does not appear at hand.

To deal with the banking crisis, the government early in 2009 effectively nationalized two of the largest banks and provided two financial institutions with relatively smaller amounts of capital. In the course of 2009, however, four financial institutions defaulted on external debt obligations, and all are now in negotiation with their creditors to restructure a total of about $20 billion in debt.

To strengthen confidence in banks, the authorities enhanced the existing deposit guarantee for individuals from T700,000 to T5 million. To back up this move, they also increased the capital base of the deposit insurance fund to T100 billion.

In addition, a distressed asset fund was established in October 2009. The government provided most of its resources, though the fund is relatively small.

up only 3.0% from a year earlier while nonfood items and services were about 8.5% higher.

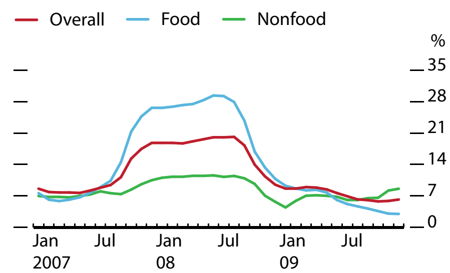
On the monetary front, inflation's tumble created space for monetary easing. The National Bank of Kazakhstan (NBK), the central bank, cut the refinancing rate (the main policy rate) seven times in 2009 from 10.5% at the start of the year to 7.0% by September. It also lowered reserve requirements from 2.0% to 1.5% for domestic obligations and from 3.0% to 2.5% on foreign borrowing to boost banks' liquidity. Broad money grew by 17.9% during 2009, mainly reflecting an increase in net foreign assets. Even though bank credit to the economy marked a 5.8% increase in 2009, growth came from the change in valuation of foreign currency loans due to the devaluation (Figure 3.4.5).

The exchange rate came under increasing downward strain toward the end of 2008, as oil and commodity prices fell, and as pressure on the foreign reserves mounted. The NBK devalued the tenge, the local currency, by about 20% from T120/$1 to T150/$1 (with a 3% band) on 4 February 2009 (Figure 3.4.6). This step essentially matched an adjustment in the Russian ruble in late January.

The devaluation proved a success on the whole, because speculative pressures against the currency dissipated, the rate remained relatively stable against the dollar, and the foreign exchange reserve position strengthened over the rest of the year. However, the rate adjustment entailed costs of higher debt service on foreign borrowing and ate into the benefit that falling global commodity prices had for inflation. Subsequently, on upwardly mobile hydrocarbon prices and the nascent global economic recovery, the NBK widened the trading band to T127.5–165/$1 from 5 February 2010.

Reflecting the slow economic activity as well as tax-easing measures that underpinned the anticrisis program, current revenue (comprising tax and nontax revenue and capital receipts) contracted by 18.9% in 2009. In moves to support domestic demand and to mitigate the downturn's impact on vulnerable groups, the government pushed up its social outlays, including a 25% increase in public servants' salaries and pensions. Current expenditure rose by an estimated 10.4%. Taking account of smaller capital

3.4.4 Inflation



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 9 March 2010).
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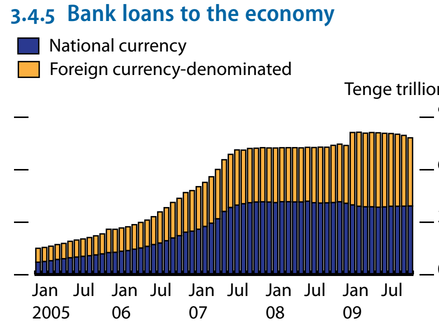
3.4.5 Bank loans to the economy



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 9 March 2010).
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expenditure and transfers from the National Fund of the Republic of Kazakhstan (NFRK), the general government budget deficit widened to 3.1% of GDP in 2009 from 2.1% a year earlier (Figure 3.4.7).

Export revenue is estimated to have declined by 38.9% year on year in 2009 (mainly on lower oil prices), and imports by 25.2%, primarily due to weak domestic demand, slimming the trade surplus by more than half to $15.2 billion. Both exports and imports strengthened in the second half, and nearly three-fourths of the annual trade surplus was earned in this period.

The stronger second-half performance stemmed from increased exports on the back of better oil prices. Imports stayed anemic, reflecting what was only a slight improvement in economic activity in this period. A sharp fall in the large income payments made to foreign investors in the oil industry offset around two-fifths of the drop in the trade surplus (Figure 3.4.8). As a result, the current account was held to a deficit estimated at $3.4 billion (3.2% of GDP) in 2009 following the $6.3 billion surplus in 2008 when oil prices were much higher.

Capital inflows more than covered the current account deficit, generating an estimated overall balance-of-payments surplus of $2.5 billion and bringing the NBK's international reserves to $23.2 billion at end-2009 (Figure 3.4.9). Assets of the NFRK were $24.4 billion at this time. Assets of both the NBK and the NFRK grew in the first 2 months of 2010.

In 2009, the government committed $10 billion from the NFRK to support the anticrisis plan. After that drawdown, the NFRK stood at around $27 billion–$28 billion, of which the foreign currency reserve accounted for $23 billion, and a bond to Samruk Kazyna for $5 billion (denominated in tenge).

Private sector external debt (excluding intracompany debt, which is mainly related to oil and gas corporations) grew rapidly over the years through end-2007 to $95.3 billion (78% of GDP), when bank debt peaked at $46 billion. Subsequently, there was only a moderate increase in private debt to $108.5 billion at end-2009, and bank debt declined to $30.1 billion (Figure 3.4.10).

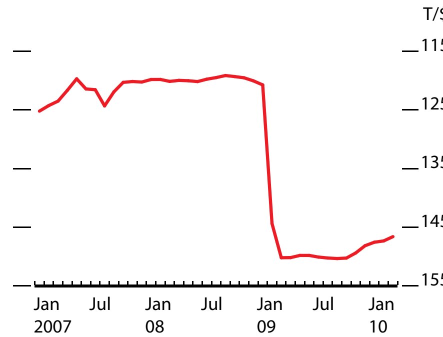
Economic prospects

GDP is projected to grow modestly by 2.5% in 2010 and 3.5% in 2011, as the global recovery consolidates. Oil prices are expected to move up to average $82 a barrel in 2010 and $86 in 2011, and oil production is expected to increase by 4.6% or to 80 million tons in 2010, which will continue to grow by 5.0% or to 84 million tons in 2011. Construction will likely face difficulties still, as the property market adjusts, though it should post moderate growth as infrastructure and oil sector investment expand.

Agricultural growth over the forecast period will likely be modest due to the base-year effect of 2009's large gain. Foreign direct investment in oil and gas projects will continue at a relatively high level.

Public expenditure will continue exceeding non-oil sector private investment over the forecast period. Even though fiscal space will stay tight in 2010, the government will persist in its expansionary policy to

3.4.6 Exchange rate



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 31 March 2010).

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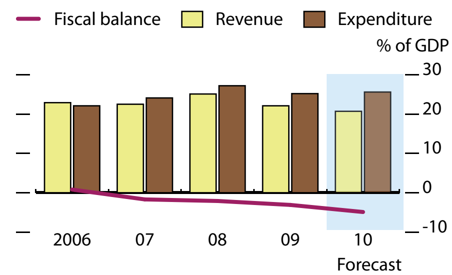
3.4.7 Fiscal indicators



Sources: Ministry of Finance; ADB estimates.

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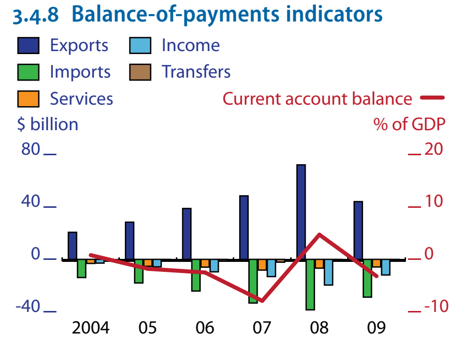
3.4.8 Balance-of-payments indicators



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 31 March 2010).

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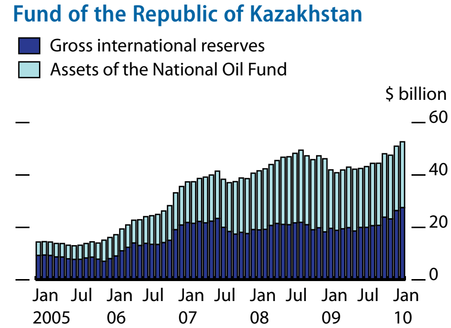
3.4.9 Reserves and assets of the National Fund of the Republic of Kazakhstan



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 9 March 2010).

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maintain a high level of social outlays and investments in infrastructure. Total expenditure and net lending together are expected to grow by 4.6%. At the same time, total revenue and grants are expected to contract by 3.6% in view of tax concessions and continued slow growth. The budget envisages a fiscal deficit of 4.9% of GDP in 2010. The budget will continue to be boosted by a transfer of T1.2 trillion from the NFRK.

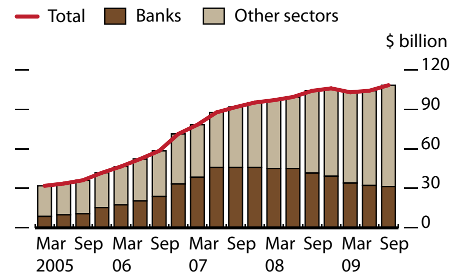
Inflation is forecast at 6.8% in 2010 and 6.5% in 2011 on the assumption that domestic demand remains weak, and access to credit stays tight due to the time needed to resolve the domestic banking problems. Even though global commodity prices will edge up, moderate appreciation in the exchange rate will help offset external price pressures.

The current account is forecast to be in surplus in 2010 and 2011. Exports are expected to increase by 30% in 2010, due to higher prevailing oil prices, and then advance by about 13% in 2011 on about a 5% strengthening in both oil prices and export volumes in conjunction with some further gains in non-oil exports as the global recovery strengthens further. Since domestic demand will gradually come back throughout the forecast period, imports will increase moderately.

These estimates point to a substantial trade surplus, though a pickup in income payments on direct investment in the oil sector will likely hold the current account surplus to about $2.8 billion in 2010 and $4.6 billion in 2011 (2.3% and 3.3% of GDP, respectively).

The main downside risk to the forecast is in weaker oil prices. In addition, it is important that ongoing negotiations on foreign debt restructuring by the defaulting banks be concluded soon so that more normal financing conditions for investment and consumption can reassert themselves. If economic recovery in the Russian Federation is slower than expected, export demand will be crimped.

3.4.10 Private external debt



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 31 March 2010).

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3.4.1 Selected economic indicators (%)

	2010	2011
GDP growth	2.5	3.5
Inflation	6.8	6.5
Current account balance (share of GDP)	2.3	3.3

Source: ADB estimates.

Development challenges

The economy is still narrowly based, with economic activity and investment concentrated in the hydrocarbon and mining sectors. The current crisis has underlined the need to accelerate polices to diversify the production base beyond these sectors and their immediate feed-in industries.

In this context, under the state program for advanced industrial development and industrialization, the government plans to implement 162 projects totaling T6.5 trillion (about $45 billion) in investments during 2010–2014.

For its part, the thin financial market requires deepening through improvements to the capital market's infrastructure and through revamps to the banking system. Moreover, it is critical to strengthen bank supervision to monitor risk-management and asset-valuation practices, if another round of asset boom and bust is to be avoided.