Kazakhstan

In 2010 the economy showed a V-shaped recovery, driven by a revival in external demand, higher oil prices, and anticrisis measures. The outlook is for steady moderate growth and a comfortable current account surplus. Nevertheless, limited credit availability from restructured but still weak banks and rising inflation are headwinds. To diversify the economy and raise productivity, the government is implementing an industrial-innovation program.

Economic performance

The recovery that started in the last quarter of 2009 continued into 2010, giving full-year growth of 7.0% (Figure 3.4.1). Improved global economic conditions, a revival in external demand for oil and minerals, and mounting oil prices all played a role, as did anticrisis measures put in place in 2009. Bank restructuring was also a positive factor, though private credit to the economy stayed weak.

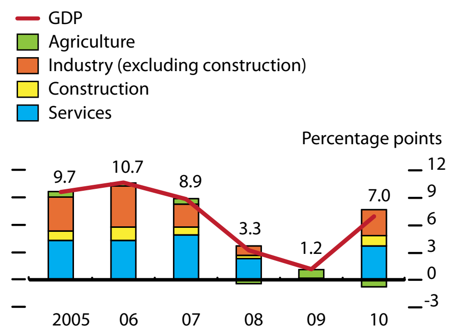
This solid growth performance was driven by 9.6% growth of industry. Manufacturing expanded by 18.4% and mining by 5.3%. Construction, which slowed sharply during 2007–2009, gained some momentum and grew at 1.0% in 2010. Agriculture contracted by 11.7% in 2010 as a result of damage that severe summer droughts caused to about 10% of arable land. With overall economic activity picking up, services expanded by 6.0%.

On the demand side, after a stagnant 2009 and with the recovery beginning to take hold, private consumption and gross fixed investment grew by 7.5% and 7.0%, respectively, in 2010 (Figure 3.4.2). Credit conditions stayed tight, which may have held back further increases in private consumption and investment. After the slump of 2009, export volume grew by 9.5% in 2010, as demand for oil and other key exports picked up. With rising consumption and investment, imports grew by 6.5% in 2010.

Overall average annual inflation reached 7.1% in 2010, remaining within the target band of 6%–8% of the National Bank of Kazakhstan (NBK). In January 2011, year-on-year headline inflation was, however, at 8.1%, 0.8 percentage points higher than a year earlier. This rise was largely due to the continued increase in prices of food items (Figure 3.4.3). The sharp drop in agricultural output as a result of the severe droughts that afflicted Kazakhstan and the Russian Federation in 2010 contributed to the food price surge. Inflation for nonfood items and services continued to moderate, indicating some slack in the economy.

With the economy beginning to gain traction but also showing signs of weak private sector activity, the NBK kept the refinancing rate at 7.0% during 2010, unchanged since September 2009. It also maintained the

3.4.1 Contributions to growth (supply)



Source: Agency of Statistics of the Republic of Kazakhstan.
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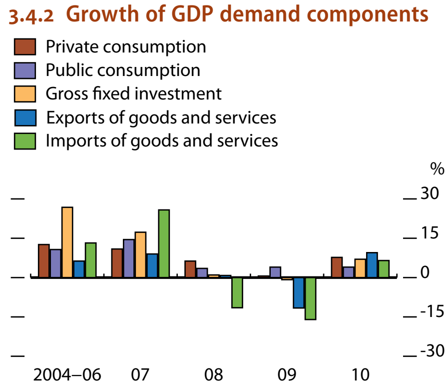
3.4.2 Growth of GDP demand components



Sources: Agency of Statistics of the Republic of Kazakhstan; Economics Intelligence Unit. 2011. *Kazakhstan Country Report*. March.
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This chapter was written by Utsav Kumar, consultant of the Central and West Asia Department, ADB, Manila; and Christopher T. Hnanguie and Manshuk Nurseitova of the Kazakhstan Resident Mission, ADB, Astana.

reserve requirements, which it had lowered to a historical low in March 2009, to boost liquidity. Broad money supply increased by 14.1% in 2010, largely on account of higher net foreign assets (Figure 3.4.4). Credit to the economy grew by 6%, though that to the private sector rose by only 0.8% in 2010, reflecting both weak private sector activity and risk aversion among banks.

After the onset of the financial crisis and with falling oil prices, foreign exchange reserves came under stress. The NBK devalued the tenge in February 2009 by about 20%, following a similar adjustment in the Russian Federation, from T120/$ in 2008 to T150/$, with a 3% band. As the economic recovery gathered pace and oil prices came back from their lows, the NBK introduced in February a wide, asymmetric trading band of +10%/-15% around T150/$. Over the course of the year, the nominal exchange rate appreciated marginally.

Budget revenue increased due to the improvement in economic activity, higher oil prices, and the reintroduction in mid-August 2010 of an oil export duty of $20 per ton. Transfers from the oil fund, the National Fund of the Republic of Kazakhstan (NFRK), were also used to support the budget. As a result, current revenue climbed by 28%.

Total expenditure increased by 21%: 19% on current items, due to higher social spending and wages; 55% on capital items, due to investments in priority projects. The fiscal deficit narrowed to 2.5% of GDP in 2010 from 2.9% a year earlier. Most of the deficit was financed through domestic sources, although foreign financing increased.

After a contraction in 2009, exports jumped by 38.5% in 2010 due to the improved global economic environment and higher oil prices. Imports recovered to grow by 10.3% in 2010. The modest pickup in imports points to weak private domestic demand as well as lack of credit. The $28.9 billion trade surplus was partly offset by a persistent services deficit, as well as by a negative balance in the income and current transfers accounts combined (Figure 3.4.5).

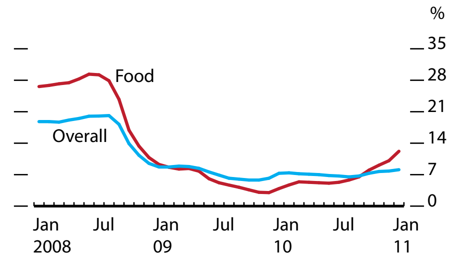
The current account balance moved back into positive territory from a deficit of $4.4 billion (3.8% of GDP) to a surplus of $4.3 billion in 2010 (3.0%). Gross international reserves at end-2010 climbed by 22.5% to $28.3 billion. Assets of the NFRK rose by 25.5% to $30.6 billion (Figure 3.4.6). An important development on the trade front was the formation of a three-country customs union (Box 3.4.1).

Total external debt grew rapidly from the early 2000s, reaching about 92% of GDP just as the global capital markets began to wobble in August 2007. The rapid increase in debt was due to external borrowing by banks to finance consumption and construction (Figure 3.4.7). The debt composition has changed significantly, with public and publicly guaranteed debt, always low, now accounting for only 4.3% of the total. Almost half the total private debt outstanding is intracompany debt, mainly reflecting liabilities for direct investment by oil companies.

The vulnerabilities of the banking system were exposed as the global crisis bit, putting pressure on foreign reserves as well as on the exchange rate. Banks' external debt came down after the crisis through September 2010.

The two largest banks had to be nationalized after the crisis, which had hit the banking system hard. The external debt obligations of these

3.4.3 Inflation



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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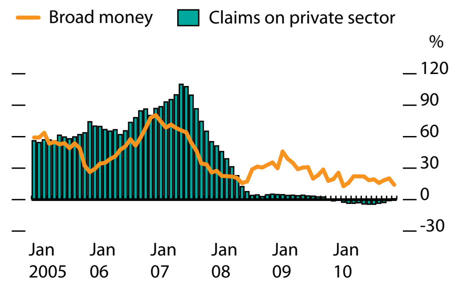
3.4.4 Growth of monetary aggregates



Note: Increase in private sector credit for February 2009–January 2010 were adjusted to exclude valuation changes on foreign currency–denominated loans stemming from the February 2009 devaluation.

Source: International Monetary Fund. International Financial Statistics online database (accessed 15 March 2011).

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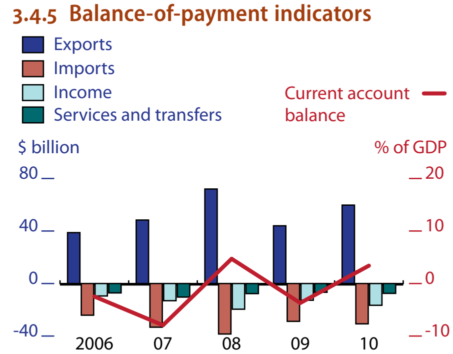
3.4.5 Balance-of-payment indicators



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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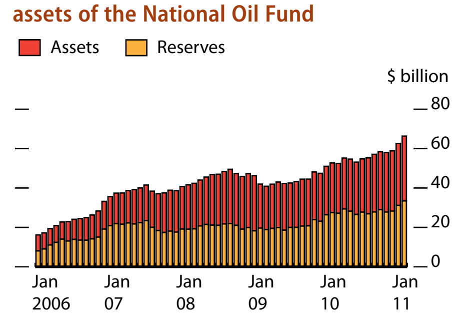
3.4.6 Official reserves and foreign exchange assets of the National Oil Fund



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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3.4.1 Customs union among Belarus, Kazakhstan, and the Russian Federation

The three countries formed a customs union in 2010. It removes duties on goods originating in member states and enforces a common external tariff for trade with third countries. It also establishes a common customs territory in which terminology, a customs code, and customs duties will be unified.

The union took effect on 1 January 2010 with a unified customs rate. At this first stage, the three countries removed most duties on trade among themselves.

On 1 July 2010, a customs code was launched between Kazakhstan and the Russian Federation, coming into force a few days later in Belarus. This second stage led to the adoption of common external tariffs.

In the third stage, customs clearance and control procedures at the Kazakh–Russian Federation border are scheduled to be abolished by 1 July 2011. (Such measures were implemented at the Belarus–Russian Federation border in July 2010.) By January 2012, a single economic space will be achieved among the three countries.

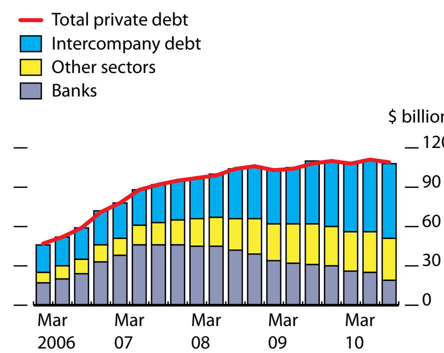
The tariff regime is based heavily on that in the Russian Federation, and Kazakhstan had to raise tariffs on around 45% of all imported items. The average common customs tariff rate is 10.6%, whereas previously Kazakhstan's simple most-favored-nation applied tariff was only 6.16%.

The value-added tax rate applied to third countries is 17%. Import customs duties from goods originating outside the union will be distributed among the three countries according to an agreed formula of 87.97% for the Russian Federation, 7.33% for Kazakhstan, and 4.70% for Belarus.

two banks and of two other smaller banks had to be restructured, resulting in debt relief of $11 billion. Overall, the share of nonperforming loans in the total loan portfolio is about 30%, and is a key factor hampering lending activity.

In addition, the restructuring of external debt has affected the private sector's access to international markets. The country's leading private bank, Kazkommertsbank, postponed its issuance of international bonds, citing unfavorable market conditions (although state-owned KazMunayGas and Kazakhstan Temir Zholy were readily able to raise money in international markets in 2010). Continued risk aversion has affected credit availability, in turn holding back private consumption and investment.

3.4.7 Private external debt



Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 15 March 2011).

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Economic prospects

The recovery of agriculture after the sharp contraction of 2010, capital expenditure by the government on priority projects in its program for 2010–2014, a sustained global recovery, and an increase in oil demand and prices will help run the growth momentum in 2011 and 2012. At the same time, banks' continued fragility and steep oil and food price rises may undermine the global economy and work against Kazakhstan's growth. The forecast is for GDP to grow by 6.5% in 2011 and 6.8% in 2012.

Construction will continue to face weaknesses as a result of lack of credit and the inability of the private sector to raise funds in international markets on attractive terms. Private consumption and total investment are expected to see continued growth in 2011 and 2012. Credit availability will be an important factor if higher growth rates are to be achieved. However, higher oil prices and external demand will help to boost consumption as well as investment in the oil sector.

The government is considering several programs that will help to support private consumption and investment over the projection horizon and beyond. One of them, Employment 2020, targets the self-employed, especially those in rural areas. It will provide support in the form of

3.4.1 Selected economic indicators (%)

	2011	2012
GDP growth	6.5	6.8
Inflation	8.5	6.0
Current account balance (share of GDP)	3.5	3.5

Source: ADB estimates.

relocation from economically depressed regions, subsidized leases of property, and day care for children.

Another, the Business Roadmap 2020, for entrepreneurs and exporters in priority sectors, will provide assistance in the guise of subsidized interest rates, guarantees for bank credits, grants, cofinancing of investment projects, and rescheduling of certain tax payments.

An increase in oil exports coupled with a doubling of the oil export duty to $40/ton from 1 January this year is adding to state coffers. A concurrent shift from a personal income tax flat rate to a progressive income tax (with rates at 10%–20%) will also lift revenue, as will a decision to hold off reducing the corporate income tax rate (currently at 20%) until 2013. Both social and capital expenditure on priority projects will climb. Overall, the government is likely to achieve its target of narrowing the fiscal deficit to 2.2% in 2011 and 1.7% in 2012.

With the surge in global food prices and the region still reeling from the effects of the severe droughts, the prices of many food items are likely to rise further. In February 2011, the government introduced price ceilings for essential food items. A utility fee increase in January 2011 and a boost to consumption from wage increases in the second half of 2011 will add to inflation pressures.

Some slack still appears to be in the economy, however—as observed from moderate prices of nonfood items and services—and this will help to contain inflation this year, to 8.5%, as inflation pressures subside later in the year. Inflation in 2012 is expected to be 6.0%.

Though the trading band for the exchange rate was widened in February 2010, the NBK has intervened to prevent the tenge from appreciating sharply. On 28 February 2011, it abolished the corridor for the tenge/$ exchange rate and introduced a managed float regime. It is unlikely that the tenge will be allowed to breach T141/$, as further appreciation, combined with the inflation differential with the advanced countries, could result in a loss of competitiveness.

The current account balance is projected to remain positive in 2011 and 2012, at 3.5% of GDP. Imports will increase on the back of higher private consumption and investment as banks become more willing to lend, and of government investment in a variety of priority projects. Exports will markedly increase further due to higher oil prices and stronger demand for oil. The trade surplus will be offset by the deficit on other components of the current account.

Development challenges

Diversifying the economy's industrial base, lowering reliance on natural resources, and generating more balanced and equitable development constitute the premier development challenges. Another is to increase competitiveness (Box 3.4.2).

3.4.2 Accelerated Industrial and Innovative Development Program

The primary thrust of the government's industrialization program (released in March 2010) is diversifying the economy and reducing reliance on oil. The second is increasing national competitiveness.

The program lists the following (among others) as critical to success: developing the priority sectors of the economy (heavy machinery, information and communications, education, and health care); strengthening the "social effectiveness" of the priority sectors and investment projects; and creating a favorable industrialization environment.

The strategy identifies four sectors where the efforts of the state will be concentrated:

- Traditional industries: natural gas sector, mining and metallurgy, atomic energy, and chemical industry.
- High domestic demand: machine building, pharmaceuticals, construction, and building materials.
- Predominantly export oriented: agribusiness, light industry, and tourism.
- Sectors of the future: information and communications technology, biotechnology, alternative power engineering, nuclear energy, and space.

State support to the priority sectors includes provision of physical infrastructure (such as information and communications, energy, and transport) and social infrastructure (such as skilled human resources).

Such support also includes measures to reduce administrative barriers, guidelines on technical regulations, and providing a conducive environment for foreign direct investment.