Kazakhstan

Good oil sector performance and sizable public investment contributed to robust expansion and a strong balance of payments in 2011. Growth is forecast to moderate in 2012, reflecting the slowdown expected in Europe and the Russian Federation, before recovering somewhat in 2013 as the world economy strengthens. Structurally, the economy remains dependent on oil production and constrained by financial sector weakness. Over time growth will depend on the success of the government's diversification efforts, largely funded by oil earnings.

Economic performance

Growth since independence has turned largely on strong oil and gas exports. Much of the proceeds have been saved in the National Fund for the Republic of Kazakhstan (NFRK), with portions transferred to the budget to fund public investment.

Global recovery helped growth rebound to 7.0% in 2010, and then to an estimated 7.5% in 2011, reflecting a surge in agricultural production, a strong upturn in services, and continued government investment in some industries (Figure 3.4.1). Agriculture, hit by a severe drought in 2010, was aided in 2011 by particularly favorable weather, which helped it grow by 26.7%. Grain production more than doubled, achieving record yields.

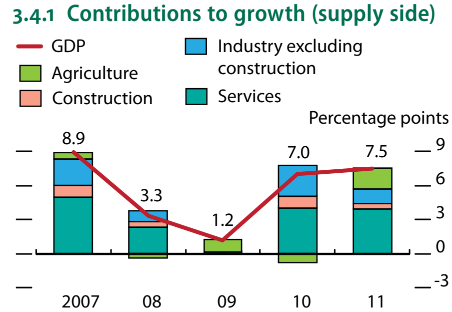
Industrial output (excluding construction) rose by 3.5%, driven mainly by a 6.2% increase in manufacturing, due to rapid growth in chemicals, metallurgy, and machinery and vehicles. Mining picked up by about 1.3%. Oil output fell by 0.5%, affected by social unrest in a key production area, although gas condensate and natural gas output climbed by 6.1% and 5.2%, respectively. Construction expanded by 2.7%, reflecting government stimulus and investment in infrastructure.

Services rose by 7.7%, driven by strong growth in wholesale and retail trade (14.5%), transport and warehousing (6.8%), and communications (18.7%). Financial services and insurance contracted by 4.5%, although the credit market expanded for the first time since the global financial crisis. Real estate activity slowed to 1.4% from 3.5% in 2010, despite continued support from the government for residential construction.

On the demand side, based on 9 months' data, total consumption is estimated to have risen by almost 11%, driven by nearly 18% growth in government consumption and a 9% rise in private consumption, as higher household income strongly boosted retail trade (Figure 3.4.2).

Gross fixed capital formation moved up by an estimated 4.5%, underpinned by higher investment in manufacturing, transport and warehousing, information and communication, and real estate. Much of this investment involved government support under the Accelerated

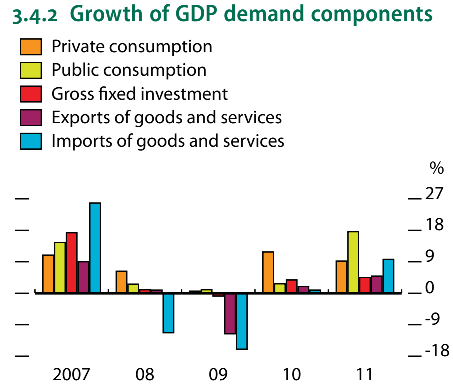
3.4.1 Contributions to growth (supply side)



Note: Data in 2011 are not directly comparable to earlier years because of a break in the series.

Source: Agency of Statistics of the Republic of Kazakhstan.

3.4.2 Growth of GDP demand components



Note: Data for 2011 are for 9 months only.

Source: Staff estimates based on data from Agency of Statistics of the Republic of Kazakhstan.

This chapter was written by Christopher Hnanguie and Manshuk Nurseitova of the Kazakhstan Resident Mission, ADB, Astana.

Program of Industrial and Innovative Development, which aims to promote economic diversification and greater competitiveness through its more than 600 government-led projects, many implemented by the government's National Welfare Fund, Samruk-Kazyna (SK). Net exports rose by about 5%, reflecting higher oil prices.

Average annual inflation rose to 8.3%, slightly above the target of 6–8% set by the National Bank of Kazakhstan (NBK) (Figure 3.4.3). The acceleration reflected double-digit increases in food and fuel prices, despite stringent price regulation and efforts to contain fuel prices by having the national oil and gas company sell imported fuel products at a loss. Inflation accelerated during the first 8 months of the year, as food prices surged, and then slowed toward year-end. In the year through December, inflation was 7.4%.

The fiscal deficit narrowed slightly to 2.1% of GDP, from 2.4% of GDP in 2010, as revenue growth outpaced the rise in expenditure. Thanks to notable increases in both tax and nontax receipts—reflecting strong economic growth, higher export duties for oil products and larger receipts from the Russian Federation under the Customs Union agreement, and increased nontax income (penalties, fines, and dividends)—revenue rose by 35.6%. Total revenue, including transfers from the NFRK, remained at 19.7% of GDP.

Reductions in the number of government employees and more careful monitoring of government spending helped limit expenditure to 21.7% of GDP. Spending for education, health care, and social assistance remained at about the same share of GDP as in 2010. Public sector wages were increased by 18–24% through November, while pensions and social allowances were raised by 30% and 9%, respectively.

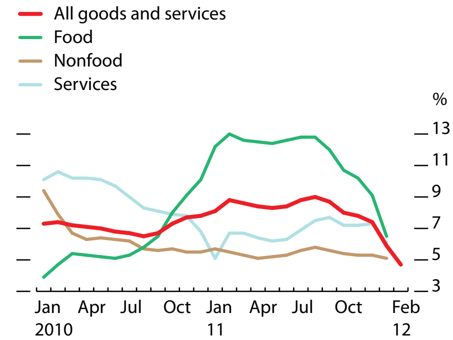
Broad money expanded by 15.0% and reserve money by 10.3% owing to higher net foreign assets at the NBK and commercial banks. The NBK, reversing the easing carried out during the crisis, raised the refinancing rate from 7.0% to 7.5% in March 2011 in response to higher inflation and maintained it through year-end.

With the foreign exchange market supporting the tenge (the national currency), the NBK returned to a managed float regime in March 2011 with limited intervention, buying in the first half of the year and selling in the second half, to minimize exchange rate fluctuations (Figure 3.4.4). In nominal terms, the tenge remained largely stable against major currencies and depreciated slightly against its currency basket. The real exchange rate, however, appreciated by 5.7% against the dollar and by 1.0% against the euro because of relative inflation rates, but depreciated by 2.8% against the Russian ruble toward end-2011, after appreciating between August and mid-December.

Positive trends in the economy led Standard & Poor's and Fitch to raise their sovereign ratings by one notch each, to BBB+ and BBB, respectively, in November. But the banking sector remains weak, and about one-third of loans are nonperforming.

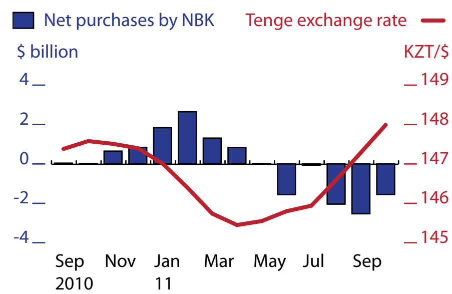
In April the NBK's role expanded to include financial supervision. Reserve requirements for banks were increased in May, from 1.5% to 2.5% on internal liabilities and from 2.5% to 4.5% on other liabilities, to address the high level of nonperforming loans (NPLs). Legal amendments were approved to prolong the guarantee of individual deposits up to T5 million

3.4.3 Inflation



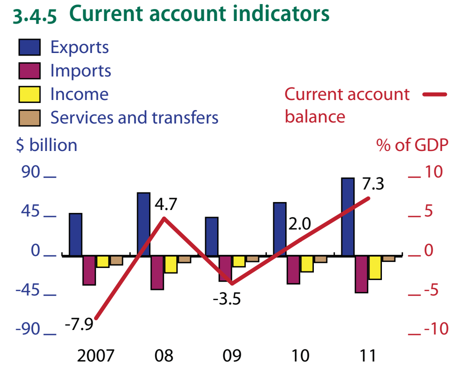
Sources: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 23 March 2012). Agency Statistics of Kazakhstan.

3.4.4 Foreign exchange market and NBK interventions



Source: National Bank of Kazakhstan. Financial Stability. http://www.nationalbank.kz (accessed 23 March 2012).

3.4.5 Current account indicators



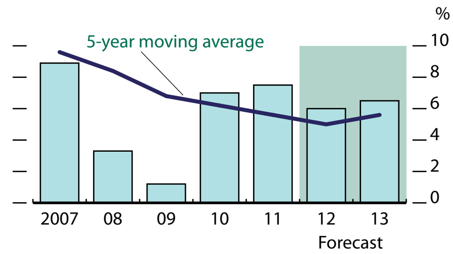
Source: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 22 March 2012).

(a little less than $34,000) and to make the write-off of bad loans tax deductible. The NBK will also establish a distressed assets fund to deal with the banks' bad loans.

The current account surplus more than tripled to an estimated 7.3% of GDP, as the trade surplus surged by 62% to $46.8 billion. Exports rose by 46.1%, reflecting high oil prices, while imports grew by 31.8%. The services account improved but still recorded a deficit of $6.1 billion. In addition, there was a $24.1 billion payment to direct investors (mostly in the oil and mineral sector) and a large outflow from net remittances, estimated at $1.3 billion, as Kazakhstan is a destination for foreign labor (Figure 3.4.5).

Net foreign direct investment tripled to about $8.8 billion. Gross official reserves of the NBK rose by $1.05 billion to $28.8 billion during the year, while the NFRK's external assets rose by 43% to $43.7 billion. External debt fell from 79.8% of GDP at end-2010 to 66% at end-September, with external private sector debt estimated at 63% of GDP, half of which was intracompany debt of multinational subsidiaries operating in extractive industries. Government external debt remained very low at about 2.3% of GDP. State enterprises' debt, which is not reported as public debt, exceeds 10% of GDP, and a June 2011 report by the International Monetary Fund noted indications of growing foreign borrowing by some enterprises in which SK has holdings.

3.4.6 GDP growth



Source: Asian Development Outlook database.

Economic prospects

Economic growth is projected to slow to 6.0% in 2012, reflecting the expected slowdown in the eurozone and the Russian Federation. It should accelerate to 6.5% in 2013, as the world economy strengthens (Figure 3.4.6). Growth could turn out slower if prospects for oil and other commodities worsen, the world outlook deteriorates, or domestic demand is weaker than expected.

Sizable investments under the Accelerated Program should boost manufacturing and construction, while an expected resurgence of mineral prices and minimal decline in oil prices is seen encouraging growth in petroleum and mining. Implementation of the Accelerated Program, supplemented by other programs aimed at improving infrastructure and productivity, and at promoting industrial and social modernization, are likely to support growth by easing bottlenecks and boosting domestic producers' competitiveness.

Integration into the Common Economic Space (CES) with Belarus and the Russian Federation stands to expand trade, particularly if other countries also join. Inflation is projected to decline to 6.5% in 2012 due to lower food prices, and then rise slightly to 6.8% in 2013 as food price inflation resumes (Figure 3.4.7). The 20% rise in the producer price index during 2011 and the need to harmonize tariffs and prices under the CES to higher Russian prices will contribute to inflationary pressures in 2012. However, the authorities are expected to continue using price regulation, subsidies, and bans on individual products to keep observed inflation within the 6–8% target range

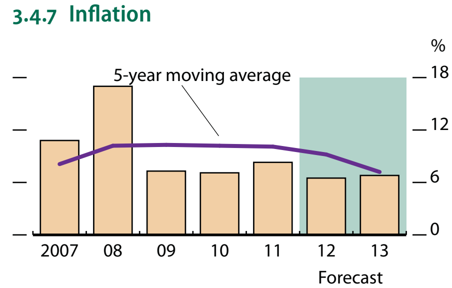
Fiscal policy envisages an increase in the overall budget deficit to about 2.5% of GDP in 2012, as revenue is forecast to decline to about 19% of GDP, while expenditure as a share of GDP is forecast to fall by less

3.4.1 Selected economic indicators (%)

	2012	2013
GDP growth	6.0	6.5
Inflation	6.5	6.8
Current account balance (share of GDP)	1.0	1.0

Source: ADB estimates.

3.4.7 Inflation



Source: Asian Development Outlook database.

than revenue or to increase (Figure 3.4.8). The authorities aim to reduce the deficit to 1.5% of GDP in 2013 through further tax administration reform (by more extensive auditing, registering the remaining small sellers for tax payments, and moving toward universal tax declarations), better procurement methods, and a moratorium on government hiring. Nevertheless, pensions, social assistance, and wages for the social sector will grow in real terms.

In January 2012 the President announced a policy change to broaden the NFRK's objectives with a new investment function. Part of the NFRK's assets will be invested internally to fund government development programs. The NFRK will, for example, lend $4 billion (nearly 2% of GDP) to the national oil and gas company Kazmunaigas in two tranches, in 2013 and 2015, to accelerate production at the Kashagan oil field, the world's largest field discovered in recent decades.

In 2012 and 2013, annual transfers from the NFRK, which are budgeted at a fixed amount of around $8 billion, will be topped up with T180 billion (about $1.2 billion or 0.6% of GDP) to allow more flexibility in meeting or expanding social expenditure without exceeding budget deficit targets. In addition, $300 million–500 million (roughly 0.2–0.3% of GDP) in revenue is expected from sales of shares in state enterprises to the population and pension funds through the proposed launch of the People's IPO Program in 2012. Total government debt (excluding state enterprises' debt) is not expected to exceed 15% of GDP in 2012 and 2013, a very low rate by international standards.

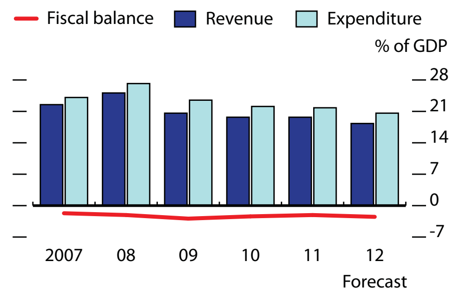
In January 2012, 12-month inflation fell to 5.9%, the lowest in many years. In mid-February, the NBK reduced the refinancing rate by 0.5% and is considering another decrease in April if inflation remains low. Thus interest rates generally may also decline moderately. As for the exchange rate, in the first 2 months of 2012 the tenge remained stable, slightly above 148/$1, and strengthened somewhat after February.

Despite government support to the financial sector, a persistent high level of NPLs is a major concern and a key constraint to economic growth. At end-2011, banking sector performance was worse (in terms of credit-to-GDP and asset-to-GDP ratios, share of NPLs, return on assets, and return on equity) than at end-2010. In addition, the large BTA Bank, which was recapitalized and restructured in 2009–2010, remains in difficulty and in January 2012 requested approval for a second restructuring. In this situation, SK—a major shareholder—may be forced to bail out the bank using public money. Over the medium term, NPLs may also rise as a result of financial assistance provided through interest-rate subsidies and partial credit guarantees under the government's Roadmap of Business 2020 program, which helped increase bank lending in 2011.

The poor performance of the state pension funds also presents a macroeconomic risk, given the aging population. Between losses on external assets and poor returns on the more than 40% of their funds invested in low-interest-rate government securities, the funds have lost over 20% of their real value during the past 6–8 years and could be hard hit if another crisis occurs.

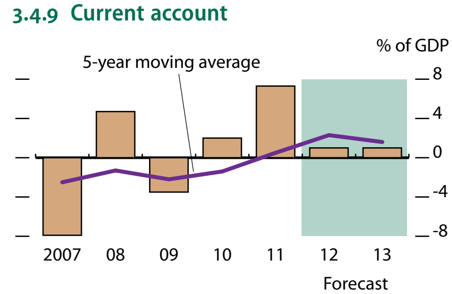
The current account is forecast to record surpluses of about 1.0–1.5% of GDP in 2012 and 2013 (Figure 3.4.9). Surpluses of at least 20% of GDP are projected for the trade balance, supported by high prices for oil

3.4.8 Fiscal indicators



Sources: Ministry of Finance of the Republic of Kazakhstan. National Budget 2012–2013.

3.4.9 Current account



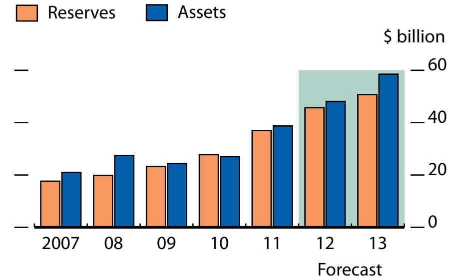
Source: Asian Development Outlook database.

and other commodities and easier access to the Russian transport and communications network, including oil pipelines, under the CES. The services account is set to improve, with completion of the infrastructure development around the Kashagan project and transition to the production phase. Income-related outflows may also increase, however, as continued mineral earnings generate higher payments to foreign investors.

Capital inflows should average about $4 billion in 2012 and 2013, while gross reserves are forecast to reach $32 billion and $35 billion at the close of 2012 and 2013. The NFRK's assets will grow more slowly than during 2011, given the government's intention to invest NFRK resources extensively in the economy, but they will likely exceed $50 billion at end-2012, offering substantial resources for future development (Figure 3.4.10).

Total external debt is forecast to remain at 65–70% of GDP at the end of this year and next (Figure 3.4.11). The share of intracompany debt will remain unchanged and public external debt (excluding state enterprises' debt) will maintain its traditionally low level.

3.4.10 Gross official reserves and assets of the National Oil Fund



Sources: National Bank of Kazahkstan. http://www.nationalbank.kz (accessed 23 March 2012). International Monetary Fund. 2011. *Country Report No. 11/150*. June.

Policy challenge—diversifying the economy

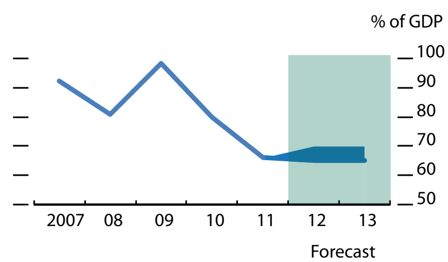
Kazakhstan's dependence on petroleum and mining makes it vulnerable to swings in international prices. And it is hard to establish a more inclusive growth model, as jobs in petroleum are limited, involving either low-skill employment or a few highly paid, specialized positions. Thus some energy earnings should be spent on developing new, competitive industries that can support a shift away from oil dependence, especially as entry into the CES provides access to much broader markets.

To help diversify its economy, Kazakhstan needs to expand its current efforts to develop competitive projects under the Accelerated Program based on its comparative advantages (mainly in agriculture, construction materials, oil and gas refining and infrastructure, metallurgy, chemicals, pharmaceuticals, defense, and energy development). Such expansion will likely require it to modernize and renovate infrastructure, which may create investment opportunities for specialized private investors in public–private partnerships, including non-oil multinational companies. Investment in infrastructure is needed to attract new technology, both to address a growing electricity deficit and to modernize transport, water supply, and sanitation in order to cut costs and expand services.

The careful use of government policy instruments—tax incentives, subsidies, regulations, and expenditure for activities that support industry—can assist private ventures with good potential, particularly in exporting. The experience of Asia's newly industrialized economies suggests that successful industrial programs are those that have the government serving as a facilitator and regulator rather than lead implementer, leaving that function to the market.

At the same time, scarce resources must not be used to aid poorly performing firms or to help vested interests seeking support for unprofitable activities. State support should be limited in time, supportive of competition, and terminated when projects fail. In addition, government funding should accompany—and not replace—broader reforms in governance and regulation, as well as efforts to build human capital by strengthening education and training.

3.4.11 External debt



Note: Data for 2011 are as of September only.

Sources: National Bank of Kazakhstan. http://www.nationalbank.kz (accessed 23 March 2012). ADB estimates.