Kazakhstan

Growth rose to 6.0% from 5.0% in 2012, reflecting accelerated private consumption and investment, though the current account surplus shrank further to 0.1% of GDP from 0.3% a year earlier. The pace is projected to remain at 6.0% in 2014 and improve to 6.4% in 2015, as the February 2014 devaluation of the Kazakh tenge and new flows from the Kashagan oilfield should boost exports and the current account surplus.

Economic developments

GDP growth accelerated to 6.0% from 5.0% in 2012, driven mainly by robust private consumption and investment. On the supply side, industry expanded by 2.3%, up from 0.4% in 2012, as mining output rose by 3.1% from 0.4% in 2012. Agriculture rebounded strongly, rising by 10.8% after the 18.5% decline in 2012, as harvests expanded by nearly 20%. Preliminary data for 2013 show growth in services slowing to an estimated 7.4% from the 10.4% recorded in 2012, despite large gains of 12.7% in trade and 14.0% in communications (Figure 3.4.1).

On the demand side, based on 9 months’ data, consumption is estimated to have expanded by over 12.0%, up from 11.4% in 2012. Private consumption rose by 16.1%, versus 11.0% in 2012, fueled by rapid growth in consumer credit, though fiscal tightening slowed growth in public consumption to 1.6% from 13.2% in 2012. Net exports fell by about 30% during the same period, on top of an estimated 40% decline in 2012, as export volumes declined by 7.2% while import volumes rose by 23%. Investment in 2013 expanded by 6.5%, up from 3.8% in 2012, as public investment fell by more than 10% but private investment rose by about 12% (Figure 3.4.2).

The average inflation rate rose to 5.8% from 5.1% in 2012 as service tariffs jumped by 10.6%, up from 6.8% in 2012. Food prices increased by 4.3%, slightly less than the 4.5% recorded in 2012, and other prices by 3.1%, down from 4.3% a year earlier. However, the December-to-December inflation rate fell to 4.8% from 6.0% in 2012 (Figure 3.4.3).

Fiscal policy tightened slightly during 2013, as the republican budget deficit narrowed to 2.1% of GDP from 3.0% in 2012. Revenues contracted slightly to 15.5% of GDP from 15.8%, but expenditure fell to 17.6% of GDP from 18.8% as the government consolidated spending. Total public and publicly guaranteed debt rose to 13.4% of GDP from 13.0% at the end of 2012, while external debt declined to 2.7% of GDP from 2.9% a year earlier. The foreign debt of state-owned enterprises declined to 10.9% of GDP from 12.9% at the end of 2012. However, the International Monetary Fund has warned against the risk of contingent liability from foreign debt incurred by the Samruk-Kazyna sovereign wealth fund equivalent to 30% of GDP.

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Monetary policy aimed in 2013 to contain inflation while supporting growth. Broad money (M3) grew by 10.2% (versus 7.9% in 2012), reflecting 13.4% growth in credit to the economy (as in 2012) and 12.2% growth in deposits (versus 7.3% in 2012) (Figure 3.4.4). Credit to legal entities rose by 8.0%, and to individuals by 27.0%, though credit to small and medium-sized enterprises fell by 9.1%, despite subsidized interest rates and guarantees. Restrictions on consumer lending introduced in October responded to concerns over a possible bubble.

In September 2013, the National Bank of Kazakhstan (NBK) moved from pegging the exchange rate solely to the US dollar to a multicurrency basket peg comprising the ruble at 10%, euro at 20%, and the US dollar at 70%. The NBK was a net seller of currency during the year. While the real effective exchange rate against a basket of 33 currencies did not change, the Kazakh tenge depreciated against the US dollar, as the nominal average exchange rate fell from T149.1 per US dollar to T152.1 and, in January 2014, further to T155.0. On February 11, shortly after the Russian Federation announced its move to a floating exchange rate and the ruble depreciated, the NBK reset the exchange rate band at T185 ±T3 per US dollar, a devaluation of 16.2% against the US dollar, or a 19.4% rise in tenge per dollar (Figure 3.4.5).

The current account surplus fell to 0.1% of GDP from 0.3% at the end of 2012 and 5.4% a year earlier. Export earnings declined by 4.0%, reversing a 2.3% rise in 2012 and reflecting weaker demand and lower prices, with ferrous metals and grain suffering the most. Growth in imports dropped sharply to 1.0% after a 21.6% rise in 2012, as prices for most goods declined but volumes increased. Deficits in the services and income accounts narrowed as the Kashagan oilfield neared completion. Net inflows of foreign direct investment fell by 31.1% to $8.1 billion, while gross reserves fell to $24.7 billion from $28.3 billion at the end of 2012. Assets in the National Fund of the Republic of Kazakhstan rose to $70.5 billion from $57.9 billion a year earlier.

External debt rose from $137.0 billion at the end of 2012 to $148.0 billion by the end of September 2013 (Figure 3.4.6). This was unchanged as a share of GDP at 67.4%, but the ratio of debt service to exports of goods and services rose from 33.7% to 39.5%. Almost half of the external debt, or $72.5 billion, is intra-company debt of multinational corporate subsidiaries operating in Kazakhstan.

**Economic prospects**

Following the tenge devaluation in February 2014, growth is forecast to remain unchanged at 6.0% in 2014 and accelerate to 6.4% in 2015, mainly supported by higher investment and net exports (Figure 3.4.7). On the supply side, industry is forecast to expand by 2.9% in 2014 and a further 4.0% in 2015, as mining revives and the first results of the industrialization program materialize. Production at the Kashagan oilfield, originally forecast to begin in 2014, may be delayed until 2015. Infrastructure development and preparation for the global Expo 2017 (themed “future energy”) will boost construction and related services. Agriculture growth is expected at about 4.0% in 2014, accelerating to 4.4% in 2015 thanks to ongoing support and huge investments under
the state program Agribusiness 2020 to modernize and diversify output beyond grain production. Services should grow by about 8% each year, driven by fast expansion of trade, transport, communications, and business services.

On the demand side, consumption is forecast to grow by 6.2% in 2014 and 6.8% in 2015. The expansion in private consumption is expected to slow to 6.8% in 2014 because of new restrictions on consumer credit, higher taxes on property and transport, and the impact of tenge devaluation on prices, recovering to 7.5% in 2015. Meanwhile, growth in public consumption is projected to accelerate to 4.0% in 2014 and then subside to 3.8% in 2015. An anticipated rise in total investment (equipment plus structures) of 6.8% in both 2014 and 2015 should boost construction by 3%–4%. Net exports are forecast to rise by 4.0% in 2014 and 4.5% in 2015, as devaluation boosts mineral exports and slows import growth.

Inflation is projected to rise to 11.5% in 2014 and then slow to 8.8% in 2015 as the effect of the devaluation ebbs over time. Prices are projected to rise in 2014 by 8.1% for food and 18.6% for other items, which are mainly imported, and by an estimated 6.6% for food and 11.8% for other items in 2015. Prices for services should rise by 8.4% each year.

The augmented republican budget deficit is expected to expand to 2.8% of GDP in 2014. Revenues are projected to reach 15.7% of GDP, reflecting mainly higher revenues from corporations, including a 33.0% increase in the crude oil excise from $60 to $80 per ton. Expenditure is forecast to expand to 18.5% of GDP on increases in social benefits, pensions, and public wages granted to mitigate hardship caused by devaluation. For 2015, revenues are forecast at 13.8% of GDP, expenditures at 16.2%, and the deficit at 2.4% (Figure 3.4.8).

A unified state pension fund with assets estimated at $22 billion is to emerge by the middle of 2014 from the merger of 10 private pension funds. The government is considering another sovereign eurobond issue to provide a benchmark for the corporate sector and refinance debt due in 2014 and 2015.

The government remains committed to limiting its debt to 13.7% of GDP, public and publicly guaranteed debt to 13.9% of GDP (22% if state-owned enterprise debt is included), and debt service to 15% of republican budget revenue. Projections show public and publicly guaranteed debt remaining below its limit in 2014 and 2015.

Monetary policy over the next 2 years will face the challenge of limiting inflation while supporting growth and maintaining the exchange rate. Broad money is projected to rise by about 10% in 2014 and 12% in 2014, as the resolution of the nonperforming loan (NPL) problem helps expand credit to the private sector. Exchange rate policy will focus on the competitiveness of Kazakh exports and depend on the policy of the Russian Federation, Kazakhstan’s major trade and economic partner. However, given the intention to move to a floating exchange rate, the rate’s long-term trend will depend on macroeconomic developments, with the recent tensions in Ukraine introducing downside risk.

Loan quality will remain a concern of bank regulators. A range of tools will be used to remove NPLs from the books of commercial banks,
in some cases by writing off assets; the bankruptcy law was amended to facilitate the process. The goal is to reduce NPLs to less than 20% of loan portfolios by the end of 2014 and below 10% by the end of 2015, though new NPLs arising from currency devaluation may complicate achieving these objectives.

The current account balance is forecast to improve to a surplus of 0.6% of GDP in 2014, because of tenge devaluation, and to 2.3% in 2015 if production begins in the new oilfield (Figure 3.4.9). Import growth is expected to stabilize at 2%–4% in 2014 and 2015, as the devaluation and industrialization slow demand for imported investment goods. The services deficit should remain at about $7 billion in 2014 and 2015 as the development of the Kashagan oilfield winds down but preparations for Expo 2017 begin—though production at Kashagan may widen the deficit in the income account. Reverse remittances are forecast to fall to about $1.5 billion in 2014 and 2015. Gross reserves are projected to reach $28.0 billion in 2014 and $31.0 billion in 2015, reflecting the improved current account. Assets in the National Fund of the Republic of Kazakhstan are projected to reach $73.2 billion at the end of 2014 and $77.7 billion a year later (Figure 3.4.10), with accumulation limited by the use of funds for budget support and mitigating the impact of the devaluation (Box 3.4.1).
Policy challenge—strengthening the financial sector

The health of the banking industry reflects Kazakhstan’s economic situation. Massive loan losses have made banks averse to risk despite having considerable liquidity. Lending has lagged, hindering investment. Since the onset of the global financial crisis in 2009, more than a third of all bank loans have fallen seriously into arrears despite efforts by the government and the NBK to clean bank balance sheets and improve access to finance for priority economic sectors. Unlike in some other countries, banks have to set aside very large provisions against NPLs. In January 2014, provisions equaled 32.5% of all loans outstanding, while 31.4% of loans were 90 days or more past due.

From 2010 to 2013, the authorities introduced a variety of measures to reduce the share of NPLs. These included tax waivers, creating special purpose vehicles as subsidiaries of commercial banks, and establishing collection agencies. In addition, two vehicles to handle distressed assets were established nationally: dynamic provisions to anticipate losses and new restrictions on NPLs were intended to be introduced from 2013 but were poorly designed, inconsistent, and ultimately unsuccessful.

Further regulatory tightening was originally scheduled to take effect in 2014. However, new NBK management, installed in October 2013, agreed with the government to ease regulatory pressures by extending the favorable tax treatment of loan write-offs and by postponing by 6–12 months various steps to tighten the regulatory regime—a move highly praised by the financial community. Changes to bankruptcy procedures are also being considered. At the same time, the NBK has reached agreements with major banks holding sizable NPLs on how to reduce the number of such loans. The NBK expects to see NPLs declining to about 10% of all loans by the end of 2015. Regulatory response to noncompliant banks may go as far as withdrawing bank licenses. Compliant banks, on the other hand, will be eligible to participate in the distribution of T1 trillion mobilized from assets of the National Fund of the Republic of Kazakhstan to mitigate the effect of devaluation, support economic growth, and provide credit to small and medium-sized enterprises. Some of the funds may be used to enable NPL purchases by a fund for problem loans that is a subsidiary of the NBK.

Toward the end of 2013, negotiations intensified with private investors on the most troubled banks nationalized in 2009, and agreements were reached with three—BTA (the largest lender before the financial crisis), Alliance, and Temir—albeit causing substantial loss to the Samruk-Kazyna sovereign wealth fund.

The new, more relaxed regulatory policies may expand lending, thereby supporting the government’s efforts to accelerate industrialization. However, the currency devaluation in February could undermine these efforts to the extent that higher inflation and the revaluation of foreign liabilities raise costs and impair borrowers’ capacity to service their debt. The weaker tenge is already hampering borrowers’ repayment of foreign currency loans and causing NPLs to proliferate. Avoiding further deterioration of bank profitability and capital adequacy may require additional support, including capital injections.