



KAZAKHSTAN: Economic growth loses pace

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Kazakhstan's economic growth will drop to an annual rate of 4.5-5% over the period 2014-2016 owing to the delay in the launch of the Kashagan oil field and weaker external demand. The recent devaluation of the national currency appears to have had a net negative impact on the country's economy, while the improvement in the current account balance will be only temporary. The banking sector in Kazakhstan continues to struggle with an excessive number of non-performing loans

After a rather strong performance in 2013, Kazakhstan's economy has significantly slowed down its growth in the first half of 2014 – to 3.9% in real terms year-on-year (according to preliminary data) as compared to 6% in 2013. The main culprit of the deteriorating dynamics is the oil sector, which has faced problems both on the production and demand sides. Oil production is expected to remain this year at the 2013 level of 81.8 million tonnes instead of previously planned 83 million tonnes, as the launch of the Kashagan project was postponed until late 2016 because of technical issues.¹ In 2015-2016, oil production will be able to increase only marginally.

In addition to the supply-side issues, demand for oil has started to decline in major exports markets of Kazakhstan: in January-July 2014, oil exports to China fell by 29% year-on-year in USD terms, to the Netherlands by 20%, and to France by 8% – together these countries accounted for 37% of Kazakhstan's oil exports in 2013. Overall, during this period oil exports increased by 1% y-o-y in USD terms as compared with January-July 2013 – primarily on the back of a 13% increase in oil exports to Italy, which accounted for almost a quarter of the country's oil exports in 2013. In 2014-2016, global demand for oil is likely to remain sluggish, but we do not expect world oil prices to fall much below USD 100 per barrel. Thus Kazakhstan's oil exports are forecasted to remain stagnant during this period.

Regardless of slightly positive oil exports dynamics, total merchandise exports decreased during January-June 2014 by 2% y-o-y in USD terms due to a demand-driven fall of exports to the CIS countries (most importantly Russia² – by 22% y-o-y) and China³ (by 21% y-o-y). The sharp devaluation

¹ The Kashagan field contains an estimated 13 billion barrels of recoverable oil reserves, which makes it one of the largest oil fields discovered in the last 50 years. Due to numerous technical difficulties the field's launch is already almost a decade behind schedule and the estimated cost of the project has shot up from the original USD 50 billion to USD 135 billion. Kashagan briefly started producing oil in September 2013, only to shut down 13 days later due to a leak in a gas pipeline running from the oilfield to the shore.

² Main export products sold to Russia are metal ores (25% of exports in 2013), iron and steel (13%), and inorganic chemicals (12%).

³ Main export products sold to China are mineral fuels (62% of exports in 2013), copper (11%), and ores (8%).

of the tenge in February 2014 has not had much positive effect on exports as the largest component of exports – oil and mining products – are priced in USD. At the same time, there was a strong effect of the devaluation on import dynamics: during January-June 2014 goods imports decreased by 15% y-o-y in USD terms. As a result, the current account balance turned positive in the first quarter of 2014 and reached a record high level of USD 6.3 billion. However, the current account surplus will diminish by the year-end, as annual export growth is forecasted to be negative, in part because wheat export is expected to decline after a poor harvest. External demand for commodities is assumed to be weak during the forecasting period, therefore Kazakhstan's exports are forecasted to have a sluggish dynamics. Import growth is expected to recover in 2015-2016, thus the current account balance will gradually decline and turn negative already in 2015.

The devaluation appears to have caused more negative effects to the country's economy than positive ones. First, it was a major blow to confidence of both businesses and consumers. Besides, the devaluation caused higher import prices and eroded the purchasing power. During the first quarter of 2014, real household consumption and gross fixed capital formation remained practically at the level of the first quarter of 2013. Government policies to mitigate the negative effects of the devaluation via a KZT 1 trillion (equivalent to 2.5% of GDP) investment stimulus package to be deployed within two years, wage hikes in the public sector and an increase in social benefits are not likely to fully offset them. Therefore household consumption and investment will grow at a slower pace during the forecasting period than it had been previously assumed. Taking into account also the oil sector problems, we reduce our forecast of Kazakhstan's GDP growth – to 4.5% in 2014 and 2015, and to 5% in 2016 (from 6% in 2014, 6.5% in 2015, and 5.5% in 2016). The negative risks to the forecast are a significant slowdown of economic growth in China and a recession in Russia, and a sustained decline in global oil and other commodities' prices.

The KZT/USD exchange rate is likely to remain stable during the next three years. The risks to the stability of the national currency would be plummeting world oil prices or rapid depreciation of the Russian rouble. The head of the country's National Bank announced that another devaluation of the tenge might take place if the world oil prices fall to 80 USD/barrel or if the Russian rouble depreciates to more than 43 RUB/USD.

The banking sector in Kazakhstan continues to struggle with a high level of non-performing loans (NPLs) – the legacy of the 2007-2008 crisis. In July 2014, the share of NPLs in the loans stock was at 31.6%. About 80% of NPLs belong to corporate clients; the share of NPLs in the portfolio of corporate loans was at 43% in July 2014. By the end of 2015, banks are obliged to decrease the share of NPLs in their loan portfolios to 15% (and by 2016 to 10%), otherwise their licences will be revoked. At the moment, 15 out of 38 banks have NPL shares above 15%, among them 8 out of the 10 largest banks by assets size. BTA and Alliance, the banks that went through restructuring, have NPL shares at 91% and 61% respectively. The National Bank has introduced tax incentives for writing off bad loans, but decreasing NPLs at such a scale might turn out to be rather challenging.

Another issue troubling the banking system is the dollarisation of deposits that has intensified after the February devaluation: the share of foreign exchange deposits reached 45% in July 2014, 5pp higher than in January 2014. Banks rely heavily on deposits as a source of financing, and given that the share of foreign exchange loans is only at about 33%, the currency mismatch is growing, and this limits possibilities for loan increases.

The overall loans dynamics has been positive: the value of newly issued loans during January-July 2014 was 11.5% higher than during the same period in 2013. Growth has been taking place primarily in short-term loans, mostly retail consumer loans and working capital loans. Issued loans for capital expenditures decreased during January-July 2014 by 19% year-on-year, and bank loans accounted only for 9% of total financing of gross fixed capital expenditures during this period. Most likely the recovery of the banking system will be prolonged and loans will not become a significant source of investment financing during the forecasting period.

Table 1 / Kazakhstan: Selected Economic Indicators

	2010	2011	2012	2013 ¹⁾	2013 January-June	2014	2014 Forecast	2015 Forecast	2016
Population, th pers., average ²⁾	16,322	16,557	16,791	17,035	16,970	17,223	17,150	17,300	17,450
Gross domestic product, KZT bn, nom. ³⁾	21,816	27,572	30,347	34,140	14,153	15,560	37,500	41,500	46,200
annual change in % (real) ³⁾	7.3	7.5	5.0	6.0	5.1	3.9	4.5	4.5	5.0
GDP/capita (EUR at exchange rate)	6,800	8,200	9,400	9,900	.	.	9,200	10,400	11,400
GDP/capita (EUR at PPP)	13,700	15,900	16,900	18,300	.	.	.	.	.
Consumption of households, KZT bn, nom. ³⁾	9,721	11,569	13,623	16,030	6,460	.	18,300	20,300	22,600
annual change in % (real) ³⁾	11.8	10.9	11.0	10.1	16.8	.	4.5	4.5	5.0
Gross fixed capital form., KZT bn, nom. ³⁾	5,307	5,772	6,761	7,972	2,407	.	9,400	10,500	11,900
annual change in % (real) ³⁾	3.8	3.9	9.1	9.9	7.1	.	6.0	7.0	8.0
Gross industrial production									
annual change in % (real)	9.6	3.8	0.7	2.3	1.8	-0.4	2.0	4.0	7.0
Gross agricultural production									
annual change in % (real)	-11.7	26.8	-17.8	11.7	2.9	3.3	-4.0	5.0	5.0
Construction industry									
annual change in % (real)	2.4	2.8	3.1	3.5	0.7	4.2	5.0	8.0	10.0
Employed persons, LFS, th, average ⁴⁾	8,114	8,302	8,507	8,571	8,568	8,619	8,660	8,750	8,840
annual change in %	2.7	1.1	1.0	0.7	0.9	0.6	1.0	1.0	1.0
Unemployed persons, LFS, th, average ⁴⁾	497	473	475	471	472	463	.	.	.
Unemployment rate, LFS, in %, average ⁴⁾	5.8	5.4	5.3	5.2	5.3	5.1	5.1	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.4	0.3	0.7	0.6	.	.	.
Average monthly gross wages, KZT ⁵⁾	77,611	90,028	101,263	109,141	104,712	114,760	.	.	.
annual change in % (real, gross)	7.6	7.1	7.0	1.9	0.5	3.2	.	.	.
Consumer prices (HICP), % p.a.	7.1	8.3	5.2	5.8	6.6	6.2	9.0	6.0	6.0
Producer prices in industry, % p.a.	25.2	27.2	3.5	-0.3	-1.4	10.1	11.0	4.0	5.0
General governm. budget, nat. def., % of GDP									
Revenues	19.7	19.5	19.2	18.7	22.2	24.2	.	.	.
Expenditures	22.1	21.5	22.1	20.7	22.7	25.0	.	.	.
Deficit (-) / surplus (+)	-2.4	-2.1	-2.9	-2.1	-0.4	-0.9	-3.0	-1.5	-1.5
Public debt, nat. def., % of GDP	14.8	12.3	13.0	13.3	11.7	13.2	15.0	14.0	14.0
Central bank policy rate, % p.a., end of period ⁶⁾	7.0	7.5	5.5	5.5	5.5	5.5	.	.	.
Current account, EUR mn ⁷⁾	1,044	7,325	816	844	2,477	4,803	2,000	-200	-2,500
Current account in % of GDP	0.9	5.4	0.5	0.5	3.5	7.5	1.3	-0.1	-1.3
Exports of goods, BOP, EUR mn ⁷⁾	46,231	61,198	67,629	64,435	32,814	30,777	62,900	66,700	69,400
annual growth rate in %	46.8	32.4	10.5	-4.7	-4.0	-6.2	-2.4	6.0	4.0
Imports of goods, BOP, EUR mn ⁷⁾	24,769	28,985	37,954	38,244	18,189	14,324	35,800	39,800	43,000
annual growth rate in %	19.4	17.0	30.9	0.8	12.0	-21.2	-6.4	11.2	8.0
Exports of services, BOP, EUR mn ⁷⁾	3,102	3,116	3,757	3,854	1,911	1,938	4,200	4,600	4,800
annual growth rate in %	5.4	0.5	20.6	2.6	8.4	1.5	9.0	9.5	4.3
Imports of services, BOP, EUR mn ⁷⁾	8,561	7,882	9,941	9,049	4,217	4,108	9,400	10,500	11,600
annual growth rate in %	18.4	-7.9	26.1	-9.0	-6.3	-2.6	3.9	11.7	10.5
FDI inflow (liabilities), EUR mn ⁷⁾	5,615	9,885	10,618	7,514	4,338	2,838	7,900	8,200	8,600
FDI outflow (assets), EUR mn ⁷⁾	2,855	3,719	1,394	1,437	1,073	-407	1,600	1,800	1,900
Gross reserves of NB excl. gold, EUR mn	19,044	19,477	16,665	13,940	16,157	14,608	.	.	.
Gross external debt, EUR mn ⁷⁾	89,259	96,951	103,150	109,037	111,602	114,206	.	.	.
Gross external debt, % of GDP	80.1	71.8	65.1	64.5	64.8	72.8	.	.	.
Average exchange rate KZT/EUR	195.67	204.11	191.67	202.09	198.21	241.83	239	231	232
Purchasing power parity KZT/EUR ⁸⁾	98.37	106.61	107.78	114.94	.	.	.	.	.

Note: Gross industrial production and producer prices refer to NACE Rev. 2 (including E - Water supply, sewerage, waste management and remediation activities).

1) Preliminary. - 2) According to census March 2009. - 3) From 2011 according to SNA'08 (SNA'93 before) and FISIM reallocated to industries. - 4) From 3rd quarter 2011 according to census March 2009, wiiw estimates for growth in 2011 and 2012. - 5) Excluding small enterprises, engaged in entrepreneurial activity. - 6) Refinancing rate of NB. - 7) Converted from USD and based on BOP 6th edition. - 8) wiiw estimates based on the 2011 International Comparison Project benchmark.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.