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Kazakhstan: slipping into a mild recession

We revise downwards our forecast for Kazakhstan's economy as exports are hit more severely by a drop in external demand, and problems in the banking system turn out to be even more profound than previously expected. The GDP will decline in 2009, though only by a relatively modest 2%. Recovery will start already in 2010, when real GDP will bounce by 2%, in particular owing to the expected increase in world oil prices. In 2011, economic growth may speed up to 4.5%.

In the first quarter of 2009, by preliminary estimates the GDP contracted by 2.2% year-on-year, with a decline recorded in almost all sectors apart from agriculture and communications. The continuing fall in housing prices, and a virtual halt of issuing mortgage loans and loans to the construction sector caused a decline of construction output in the first quarter of 2009 by 4% y-o-y.

Export of goods fell by more than 40% y-o-y (in EUR terms) during the first quarter of 2009, by far outpacing imports' sliding dynamics. Thus the current account reached a deficit of EUR 0.8 billion – compared to the EUR 1.9 billion surplus in the first quarter of the previous year. Plunging external demand inevitably caused a drop in industrial production, which is mostly export-oriented – by 4.6% y-o-y in the first quarter of 2009. Only the oil extraction industry was able to increase its export volume sufficiently so as to partly compensate the global oil price decline. Manufacturing output decreased by 12% y-o-y, with the strongest declines in the chemical industry, machine-building and metallurgy – sectors oriented mostly on external demand.

We forecast that, in 2009, exports will fall at a much higher rate than imports, thus the current account will again run a deficit. Insufficient external demand will cause industrial production to decline by 4%. In 2010-2011, however, a revival of the global commodity markets will allow exports to speed up their growth significantly, thus industrial production will pick up, and the current account deficit will diminish noticeably. It will take more time for the construction sector to recover, since repercussions of the burst of the housing bubble are likely to influence the market in 2010 as well.

The government has been pumping resources into the country's banking sector. About USD 2.2 billion of additional capital has already been allotted to recapitalize the four biggest Kazakh banks, an additional USD 3.5 billion were directed to thirteen banks to encourage loan refinancing programmes.¹ However, so far the success of this policy has been limited. Banks' lending to the

¹ The total anti-crisis package envisages allocating about USD 14 billion (or about 10% of the GDP) over the period 2009-2010 to help the banking sector (recapitalize banks, provide liquidity support and promote residential mortgage lending) and to finance three sector-specific programmes: small and medium-sized enterprises, agriculture and infrastructure development.

economy has been decreasing – the amount of newly issued loans during the first four months of 2009 was 10% lower than during the same period of the previous year. The share of overdue loans in the total stock of loans more than doubled during this period – from 3.3% to 7.5% (as compared with January-April of 2008).

In February 2009, the state effectively nationalized the largest bank BTA, which allegedly faced the threat of bankruptcy, by acquiring 75% of its stakes for 0.2% of their book value. The fourth largest bank Alliance agreed to sell 76% of its shares to the state for a symbolic total amount of 100 tenge (USD 0.66), but the deal has not been completed yet. Now the government has been conducting talks on sales of BTA shares to the Russian Sberbank. This move appears to contradict the government's stated plan to take minority blocking stakes in troubled domestic banks and offer them back to the shareholders once the problems are solved. Many observers believe that political motivations play an important role in the bailouts, as some other banks suffering from liquidity problems are subject to different treatment.²

In April 2009, both BTA and Alliance defaulted on their external debt – creating a precedent in the region. The government announced that it would not take upon itself debts of these two banks and that it would propose several options of debt restructuring to investors. Fitch downgraded three other Kazakh banks out of the top five ones following the default by BTA and Alliance, reacting to the state's limited willingness to bail out the troubled banks with its own money and the worsening of assets quality, caused in particular by the devaluation of the tenge in February 2009.

The quality of banks' assets will continue deteriorating due to the economic downturn and the worsening of the financial position of borrowers, and access to external financing will not improve in the near future. Thus the state will further need to provide support to banks and facilitate access to sources of finance for the real sector of the economy. Fortunately, the high level of accumulated foreign currency reserves (about USD 42 billion – including assets of the National Oil Fund) will allow the government to continue interventions in case of necessity. Moreover, an additional safety cushion was created by borrowing USD 10 billion as an assistance package from China – in return for allowing the China National Petroleum Corporation to purchase a major stake in the MangistauMunaiGaz concern. Half of the loan is going to be devoted to bolstering the country's energy sector, while the other half will be given to the state-owned Development Bank of Kazakhstan.

In the medium run, a reform of the banking sector is needed – a strengthening of supervision and higher reliance of banks on domestic financing (deposits in national currency), rather than primarily on external borrowing.

In June 2009, Kazakhstan officially halted negotiations with the WTO due to the decision to create a customs union with Russia and Belarus and enter the WTO as a single block. Such a decision can be hardly called favourable for Kazakhstan, as accession to the WTO will now become much more

² See, for example, 'Kazakhstan: Politics and finance prompted BTA takeover', *Oxford Analytica*, 3 April 2009.

difficult technically and will definitely take much longer, thus postponing the potential benefits of the country's membership in this organization.

Falling prices of oil and virtually flat food prices helped to contain annual inflation in the one-digit range during the first five months of 2005. The February devaluation of the tenge does not seem to create major inflationary pressures. We forecast that inflation will remain within the one-digit range during the whole forecasting period and will gradually subside – reflecting the expected tightening of monetary policy as the economy will be getting over the crisis.

We do not expect the National Bank of Kazakhstan to move to a more flexible exchange rate regime during the period covered as maintaining confidence of households and firms will remain a priority until the problems in the financial sector are resolved. Rising FDI inflows and foreign currency revenues from oil exports in 2010-2011 will allow the government to keep the tenge within the $\pm 3\%$ range of the announced 150 tenge per US dollar.

Table KZ

Kazakhstan: Selected Economic Indicators

| | 2005 | 2006 | 2007 | 2008 ¹⁾ | 2008 1st quarter | 2009 | 2009 Forecast | 2010 Forecast | 2011 Forecast |
|---|---------|---------|---------|--------------------|---------------------|---------|------------------|------------------|------------------|
| Population, th pers., average | 15147.1 | 15308.1 | 15490.7 | 15684.3 | 15600.5 | 15813.5 | 15820 | 15860 | 8010 |
| Gross domestic product, KZT bn, nom. | 7590.6 | 10213.7 | 12763.2 | 15936.5 | 3207.2 | 3045.9 | 16400 | 18400 | 20800 |
| annual change in % (real) | 9.7 | 10.7 | 8.7 | 3.3 | 6.1 | -2.2 | -2 | 2 | 4.5 |
| GDP/capita (EUR at exchange rate) | 3000 | 4200 | 4900 | 5700 | . | . | 5400 | 6400 | 6800 |
| GDP/capita (EUR at PPP - wiiw) | 7300 | 8200 | 9000 | 9200 | . | . | . | . | . |
| Consumption of households, KZT bn, nom. | 3686 | 4547 | 5468 | 6652 | 1467 | . | 7500 | 8400 | 9400 |
| annual change in % (real) | 10.9 | 12.7 | 11.0 | 3.7 | 10.2 | . | 3 | 4 | 5 |
| Gross fixed capital form., KZT bn, nom. | 2123 | 3084 | 3857 | 4353 | 646 | . | 4000 | 4500 | 5200 |
| annual change in % (real) | 28.1 | 29.7 | 17.3 | 1.7 | 10.9 | . | 2 | 3 | 7 |
| Gross industrial production | | | | | | | | | |
| annual change in % (real) | 4.8 | 7.0 | 4.5 | 2.1 | 3.7 | -4.6 | -4 | 5 | 7 |
| Gross agricultural production | | | | | | | | | |
| annual change in % (real) | 7.3 | 7.0 | 8.4 | -5.6 | 3.7 | 3.6 | 4 | 6 | 6 |
| Construction industry | | | | | | | | | |
| annual change in % (real) | 47.4 | 28.6 | 5.7 | 1.8 | 8.5 | -4.2 | -5 | 5 | 7 |
| Employed persons - LFS, th, average | 7261.0 | 7403.5 | 7631.8 | 7857.2 | 7763.9 | 7830.4 | . | . | . |
| annual change in % | 1.1 | 2.0 | 3.1 | 3.0 | 3.6 | 0.9 | . | . | . |
| Unemployed persons - LFS, th, average | 640.7 | 625.4 | 578.8 | 557.8 | 573.8 | 583.1 | . | . | . |
| Unemployment rate - LFS, in %, average | 8.1 | 7.8 | 7.3 | 6.6 | 6.9 | 6.9 | 7.5 | 7 | 6.5 |
| Reg. unemployment rate, in %, end of period | 1.3 | 1.1 | 0.8 | 0.7 | 0.8 | 0.8 | . | . | . |
| Average gross monthly wages, KZT | 34060 | 40790 | 53238 | 60734 | 55422 | 62671 | . | . | . |
| annual change in % (real, gross) | 11.7 | 10.3 | 17.8 | -2.5 | -2.3 | 3.9 | . | . | . |
| Consumer prices, % p.a. | 7.6 | 8.6 | 10.8 | 17.1 | 13.4 | 8.7 | 9.5 | 8 | 7 |
| Producer prices in industry, % p.a. | 23.7 | 18.4 | 12.4 | 36.9 | 20.8 | -28.7 | -10 | 9 | 8 |
| General governm. budget, nat. def., % GDP | | | | | | | | | |
| Revenues and grants | 28.1 | 27.9 | 22.6 | 25.3 | . | . | . | . | . |
| Expenditures and net lending | 22.3 | 20.4 | 24.3 | 27.4 | . | . | . | . | . |
| Deficit (-) / surplus (+), % GDP | 5.8 | 7.5 | -1.7 | -2.1 | . | . | -3.5 | -3.5 | -3.0 |
| Public debt in % of GDP | 9.3 | 11.3 | 7.2 | 8.3 | . | . | . | . | . |
| Base rate of NB % p.a., end of period | 8.0 | 9.0 | 9.0 | 10.5 | 11.0 | 9.5 | . | . | . |
| Current account, EUR mn ²⁾ | -848.1 | -1525.3 | -5355.2 | 4700 | 1900 | -800 | -3900 | -2400 | -1900 |
| Current account in % of GDP | -1.8 | -2.4 | -7.0 | 5.2 | 10.7 | -4.8 | -4.6 | -2.3 | -1.7 |
| Exports of goods, BOP, EUR mn ²⁾ | 22733.5 | 30880.8 | 35308.6 | 52600 | 10640.0 | 6275.6 | 39500 | 46200 | 50800 |
| annual growth rate in % | 37.1 | 35.8 | 14.3 | 48.9 | 37.0 | -41.0 | -25 | 17 | 10 |
| Imports of goods, BOP, EUR mn ²⁾ | 14442.2 | 19216.1 | 24288.4 | 28100 | 4864.3 | 4724.1 | 26700 | 29400 | 32900 |
| annual growth rate in % | 29.9 | 33.1 | 26.4 | 15.6 | -3.1 | -2.9 | -5 | 10 | 12 |
| Exports of services, BOP, EUR mn ²⁾ | 1790.1 | 2236.7 | 2596.0 | 3200 | 625.0 | 606.4 | 3200 | 3500 | 4000 |
| annual growth rate in % | 10.7 | 25.0 | 16.1 | 23.3 | 13.7 | -3.0 | -1 | 10 | 13 |
| Imports of services, BOP, EUR mn ²⁾ | 6021.2 | 6946.7 | 8490.5 | 8000 | 1550.3 | 1442.1 | 7400 | 7900 | 8700 |
| annual growth rate in % | 46.5 | 15.4 | 22.2 | -5.4 | -1.5 | -7.0 | -7 | 7 | 10 |
| FDI inflow, EUR mn ²⁾ | 1583.5 | 4958.2 | 7440.3 | 9882.3 | 1362.6 | 1950.8 | . | . | . |
| FDI outflow, EUR mn ²⁾ | -117.2 | -308.7 | 2368.6 | 2590.2 | 1134.9 | 227.6 | . | . | . |
| Gross reserves of NB excl. gold, EUR mn | 5965 | 14525 | 11970 | 13711 | 12434 | 14320 | . | . | . |
| Gross external debt, EUR mn | 36643 | 56252 | 65436 | 77738 | 64004 | . | . | . | . |
| Gross external debt in % of GDP | 79.9 | 87.2 | 86.0 | 86.4 | 68.6 | . | . | . | . |
| Average exchange rate KZT/EUR | 165.42 | 158.27 | 167.75 | 177.0 | 180.36 | 180.88 | 191.8 | 180.0 | 189.6 |
| Purchasing power parity KZT/EUR, wiiw ³⁾ | 68.78 | 81.45 | 91.40 | 110.33 | . | . | . | . | . |

1) Preliminary. - 2) Converted from USD with the average exchange rate. - 3) Based on ICP benchmark results 2005 and wiiw estimates.

Source: National statistics (National Bank, Agency of Statistics etc). Forecasts by wiiw.