

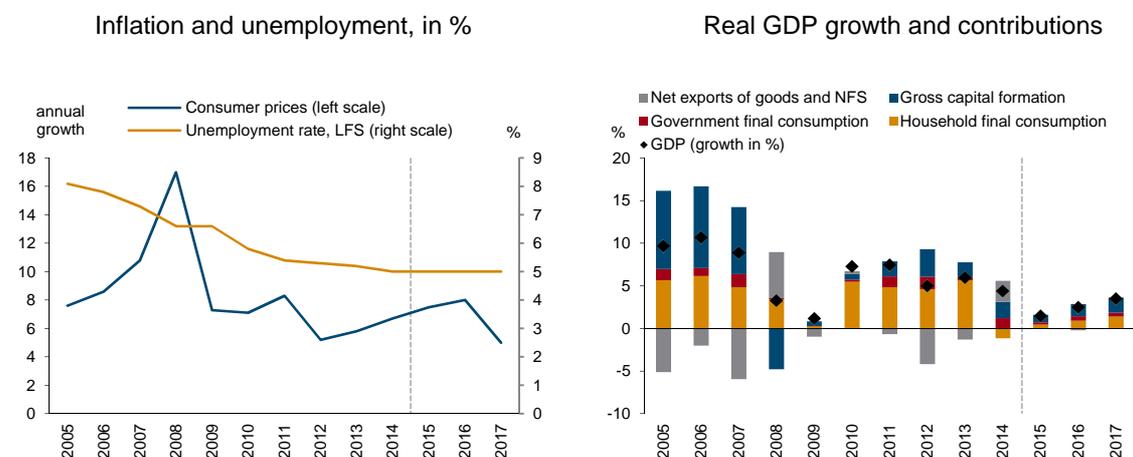


KAZAKHSTAN: Tenge set freely floating as economic growth stumbles

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Increasing costs of keeping the KZT/USD exchange rate within the given band forced the government to switch to a floating currency regime, as a result of which the tenge depreciated by about 50%. A substantial weakening in external demand and sluggish domestic private consumption and investment will limit GDP growth to 1.5% in 2015. In 2016-2017, growth is expected to accelerate to 2.5% and 3.5%, respectively, since fiscal stimuli are expected to boost investment, while exports will gradually recover.

Figure 47 / Kazakhstan: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

According to preliminary data, Kazakhstan's real GDP grew only by 1.7% year on year in the first half of 2015, 2.2pp less as compared with the same period a year earlier. The primary reason for that significant growth slowdown has been the worsening economic performance of the country's key trading partners, Russia and China, and a further decline in global commodity prices. Kazakhstan's export revenues have been experiencing a dramatic slump – during January-June 2015, the value of goods exports decreased by 42% year on year in USD terms. Exports of mineral products, which accounted for 80% of merchandise exports in 2014, halved during that period. Metals, the second biggest export sector, experienced a 21% decline. Food and machinery exports, which are exported primarily to the CIS markets, decreased at double-digit rates as well, with the latter having fallen by a remarkable 69% year on year.

Merchandise imports have been falling at a slower rate than exports, by 15% year on year in January-June 2015. According to data of the National Bank of Kazakhstan, imports have so far declined mainly in value terms, as exporters to Kazakhstan could benefit from increased competitiveness owing to the depreciation of their currencies with respect to the tenge. Regardless of the increasing costs of controlling the exchange rate of the national currency, the Kazakhstani government had appeared adamant to keep the KZT/USD exchange rate relatively stable and had been repeatedly making announcements that the exchange rate would remain limited by the bounds of the corridor (which was broadened from 170-188 KZT/USD to 170-198 KZT/USD in July 2015). However, on 20 August 2015, the government suddenly announced that the national currency would become fully floating effective immediately, and the National Bank would turn to inflation targeting as its main policy goal. On the next day the tenge lost 35% of its value as the exchange rate reached 255 KZT/USD; depreciation deepened in mid-September, when the tenge further depreciated to about 280 KZT/USD. This trend forced the National Bank to resort to interventions in the foreign exchange market to prevent speculative overshooting. As the National Bank will be keeping an eye on the market ready to intervene if necessary, the KZT/USD exchange rate is not likely to experience sharp movements in the near future (provided the global commodity prices remain stable in the next years as we assume).

Though overall the switch to the floating exchange rate and inflation targeting is widely considered to be a move in the right direction, the timing and manner in which it was carried out are rather questionable. Normally inflation targeting is introduced when there are no significant external and financial sector imbalances: then the central bank can focus on inflation control without potentially conflicting objectives, and costs of transition to the new policy are minimal. This was obviously not the case for Kazakhstan, where adjustment to the shock of significant devaluation is going to translate into higher inflation of 7.5-8% p.a. in 2015-2016, to further erode the purchasing power of households, which have already seen their real incomes fall in 2015, and to increase the burden of the external debt for domestic companies. Moreover, giving repeatedly false promises to the market has led to an erosion of trust in the monetary authorities of Kazakhstan. A sign of the low trust is the increased dollarisation in the economy: the share of deposits in foreign currency reached 59% by the end of August 2015, while the share of foreign exchange deposits in total deposits of physical persons was as high as 73%. The share of loans in foreign currency, by contrast, has been steadily decreasing and is currently around 25%. The growing currency mismatch of the banks' balance sheets limits their liquidity and contributes to the slowdown of loans issuing: the loans stock has been on the decline since March 2015 as the issuance of new loans has been falling at double-digit rates in annual terms. On the bright side, the decision to switch to a floating exchange rate will allow the National Bank not to burn further its international reserves, and the devaluation will help the competitiveness of domestic producers.

In an attempt to mitigate the negative effects of the abrupt depreciation, the government has introduced several measures, such as a compensation of the depreciation-related losses to the holders of tenge-denominated deposits (only deposits below KZT 1 million, equivalent to about USD 3700, are covered; the compensation will be given to those who do not withdraw their deposits for 12 months). Besides, the government intends to partially compensate the losses of low-income households through raising stipends and disability benefits, public sector salaries, and a higher indexation of pensions starting from 2016.

The counter-cyclical fiscal stimulus package 'Nurly Zhol' (Path to the Future), introduced earlier, is running and is expected to provide a boost to investment. About USD 3 billion (around 2% of GDP) from

the National Oil Fund will be transferred annually during 2015-2017 to finance the development of the country's infrastructure and credit facilities for SMEs. Additional funds to finance the stimulus package will be coming from multilateral development banks (MDBs), with projects focused on the structural reform component, in particular targeting business climate improvements and support to SMEs, which should also support private investment in the country. Besides the government is very active in attracting investment from China through joint investment projects; in September 2015, new joint investment deals worth about USD 23 billion were signed with Chinese companies. The primary focus of Chinese companies has been the transport infrastructure and the oil sector, now the range of projects is expected to broaden to include some manufacturing industries.

A positive and long-awaited development has been the significant decline in the share on non-performing loans (NPLs) in the banking system. The legal and tax obstacles to NPL write-offs have been removed and as a result, by the end of July 2015, the share of NPLs in total loans went down to 9.4%, a minus of about 14pp as compared with the beginning of 2015. The share of NPLs decreased primarily in the portfolio of corporate clients (from some 35% to 6.5%), while in the portfolio of physical persons' loans the share of NPLs did not change much during that period and was at more than 13% in July 2015. However, even cleansed balance sheets will not help much in reviving credit growth if banks continue to experience liquidity issues.

Following more than 19 years of accession negotiations, on 27 July 2015, Kazakhstan became a member of the WTO. The country has agreed to gradually phase out its discriminatory policies such as VAT exemptions to agricultural producers or local content requirements in the mining sector. In 2020, foreign banks and insurance companies will be allowed to open their branches in the country. The accession terms also envisage that the weighted average import tariff of Kazakhstan will be at 6.5%, which is almost 4pp lower than the average import tariff in the Eurasian Economic Union (EAEU); for agriculture the average tariff will be set at 10.2% versus 17.2% in the EAEU. This implies that Kazakhstan's membership in the customs union of the EAEU will be significantly hindered, as de facto there will be border controls with Russia in order to prevent re-exports of Kazakh imports. For Kazakhstani exporters there will be a sizeable list of exclusions from the list of products eligible for free market access to the EAEU.

Primarily as a result of external factors, such as low commodity prices and the poor performance of the Russian and Chinese economies, GDP growth in Kazakhstan during the period 2015-2017 will be slower than we previously forecasted. According to our forecast, in 2015, the economy will grow by a meagre 1.5% due to plunging exports and also sluggish private consumption and investment. Over the biennium 2016-2017, growth is expected to accelerate to 2.5% and 3.5% respectively. Exports will gradually recover primarily in volume terms as Kazakhstani non-oil exporters will be able to benefit from increased competitiveness brought about by the devaluation. Oil exports will grow in 2017 provided production of the Kashagan oil field is resumed as scheduled. Investment is expected to pick up steam in 2016-2017, in particular owing to the fiscal stimulus programmes, improved SME financing, and an increase in FDI.

Table 14 / Kazakhstan: Selected economic indicators

	2011	2012	2013	2014 ¹⁾	2014 January-June	2015	2015 Forecast	2016 Forecast	2017
Population, th pers., average ²⁾	16,557	16,791	17,035	17,289	17,223	17,479	17,500	17,750	18,000
Gross domestic product, KZT bn, nom. ³⁾	27,572	30,347	35,275	39,041	15,718	17,092	41,600	45,600	49,300
annual change in % (real)	7.5	5.0	6.0	4.4	3.9	1.7	1.5	2.5	3.5
GDP/capita (EUR at exchange rate) ³⁾	8,200	9,400	10,200	9,500	.	.	10,100	8,400	8,800
GDP/capita (EUR at PPP) ³⁾	15,700	16,600	17,500	18,300	.	.	.	.	.
Consumption of households, KZT bn, nom. ³⁾	11,569	13,623	17,535	18,122	6,554	.	.	.	.
annual change in % (real)	10.9	11.0	12.6	-2.3	-2.4	.	1.0	2.0	3.0
Gross fixed capital form., KZT bn, nom. ³⁾	5,772	6,761	7,473	7,771	2,627	.	.	.	.
annual change in % (real)	3.9	9.1	4.9	0.2	5.1	.	3.0	5.0	7.0
Gross industrial production									
annual change in % (real)	3.8	0.7	2.5	0.2	-0.4	0.6	-1.0	2.0	5.0
Gross agricultural production									
annual change in % (real)	26.8	-17.8	11.7	1.0	3.3	3.0	.	.	.
Construction industry									
annual change in % (real)	2.8	3.1	3.5	4.1	4.2	5.1	.	.	.
Employed persons, LFS, th, average ⁴⁾	8,302	8,507	8,571	8,510	8,619	8,512	8,380	8,460	8,540
annual change in %	1.1	1.0	0.7	-0.7	0.6	-1.2	-1.5	1.0	1.0
Unemployed persons, LFS, th, average ⁴⁾	473	475	471	452	463	448	440	450	450
Unemployment rate, LFS, in %, average ⁴⁾	5.4	5.3	5.2	5.0	5.1	5.0	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.3	0.4	0.6	0.7	.	.	.
Average monthly gross wages, KZT ⁵⁾	90,028	101,263	109,141	120,455	114,760	121,433	132,100	148,400	162,100
annual change in % (real, gross)	7.1	7.0	1.9	3.9	3.2	0.5	2.0	4.0	4.0
Consumer prices (HICP), % p.a.	8.3	5.2	5.8	6.7	6.2	5.3	7.5	8.0	5.0
Producer prices in industry, % p.a.	27.2	3.5	-0.3	9.5	10.1	-22.6	-10.0	5.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	19.5	19.2	18.1	18.8	24.2	23.5	18.0	19.0	19.0
Expenditures	21.5	22.1	20.1	21.5	25.0	23.4	21.0	21.5	21.0
Deficit (-) / surplus (+)	-2.1	-2.9	-2.0	-2.8	-0.9	0.1	-3.0	-2.5	-2.0
Public debt, nat.def., % of GDP	12.3	13.0	12.9	14.8	12.7	14.1	16.0	17.5	18.0
Central bank policy rate, % p.a., end of period ⁶⁾	7.5	5.5	5.5	5.5	5.5	5.5	16.0	14.0	12.0
Current account, EUR mn ⁷⁾	7,326	823	646	4,511	5,221	-1,998	-5,400	-4,400	-3,800
Current account in % of GDP ⁷⁾	5.4	0.5	0.4	2.8	8.0	-2.4	-3.1	-2.9	-2.4
Exports of goods, BOP, EUR mn ⁷⁾	61,198	67,629	64,435	60,418	31,282	22,325	52,700	54,600	59,600
annual growth rate in %	32.4	10.5	-4.7	-6.2	-4.7	-28.6	-12.8	3.6	9.2
Imports of goods, BOP, EUR mn ⁷⁾	28,985	37,954	38,244	32,800	14,634	15,276	33,800	35,400	38,200
annual growth rate in %	17.0	30.9	0.8	-14.2	-19.5	4.4	3.0	4.7	7.9
Exports of services, BOP, EUR mn ⁷⁾	3,116	3,756	3,988	4,945	2,222	2,710	5,700	6,000	6,300
annual growth rate in %	0.5	20.5	6.2	24.0	15.2	22.0	15.3	5.3	5.0
Imports of services, BOP, EUR mn ⁷⁾	7,882	9,925	9,379	9,727	4,356	4,753	11,200	11,700	12,400
annual growth rate in %	-7.9	25.9	-5.5	3.7	2.2	9.1	15.1	4.5	6.0
FDI liabilities (inflow), EUR mn ⁷⁾	9,885	10,618	7,536	5,306	2,709	2,928	5,800	.	.
FDI assets (outflow), EUR mn ⁷⁾	3,719	1,394	1,488	1,756	-198	1,780	2,500	.	.
Gross reserves of NB excl. gold, EUR mn	19,477	16,665	13,940	17,682	14,608	19,001	.	.	.
Gross external debt, EUR mn ⁷⁾	96,951	103,150	109,137	129,324	114,143	139,653	146,100	150,000	154,500
Gross external debt, % of GDP ⁷⁾	71.8	65.1	62.5	78.9	69.6	79.2	82.9	100.2	97.2
Average exchange rate KZT/EUR	204.11	191.67	202.09	238.10	241.83	206.79	236	305	310
Purchasing power parity KZT/EUR ⁸⁾	106.25	108.66	118.23	123.46	.	.	.	.	.

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) According to SNA'08. - 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. From September 2015 one day (overnight) repo rate. - 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.