



## KAZAKHSTAN: Waiting for devaluation

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The drop in global oil prices and the depreciation of the Russian rouble has led to deterioration in Kazakhstan's economic outlook. In 2015, growth will slow down to 2%, the lowest level since 2009. In the biennium 2016-2017, GDP growth will revive, rising to 3.5% and 4.5%, respectively. The National Bank is likely to embark on a gradual devaluation of the tenge vis-à-vis the US dollar, by about 15% by the end of 2015. A new economic policy known as *Nurly Zhol* is expected to boost investment in the country over the medium term.

At the end of 2014, the main risks to Kazakhstan's economy became reality: the world oil prices plummeted and the Russian rouble depreciated by more than 50%. Developments in the Kazakhstani oil sector, the backbone of the country's economy, have profound effects on the whole economy, in particular on exports – as oil accounts for more than 70% of merchandise exports. Depreciation of the Russian rouble causes an additional loss of competitiveness of Kazakh exporters, in particular in the agricultural sector, as both Russia and Kazakhstan are major wheat exporters. As a result, we forecast that merchandise exports will fall by about 25% in USD terms in 2015.

An effective revaluation of the tenge also negatively affects domestic manufacturers who have to compete with cheaper imports from Russia (in particular with imported food, petroleum products, cars, construction materials). Early February 2015, the National Chamber of Entrepreneurs of Kazakhstan submitted a request to the government to impose an embargo on imports of these products from Russia. If this drastic measure is to be taken, this will be yet one more sign of the inefficiency of the customs union between the two countries (and Belarus).

Regardless of whether the embargo will be introduced, pressures to devalue the national currency have been mounting. Economic agents have fresh memories of the surprise 19% devaluation in February 2014; therefore they have very low trust in the government's promises of keeping a stable exchange rate. The widespread anticipation of devaluation has caused an increased dollarisation of the economy: the share of foreign exchange deposits in the total deposits stock increased to 55.6% by the end of 2014 (up by 18 percentage points as compared with December 2013). Simultaneously, due to the lack of tenge liquidity, banks have virtually stopped issuing loans denominated in tenge. Investment decisions are being put on hold under the increased uncertainty about the timing and scale of the devaluation.

The government has announced that it wants to avoid any sharp movements of the USD/KZT exchange rate and has introduced several measures to fight dollarisation and mitigate devaluation pressures. In December 2014, the National Bank strongly recommended commercial banks to decrease maximum

interest rates on deposits denominated in US dollar from 4% to 3% (and most of the banks immediately followed the recommendation). In February 2015, the President addressed domestic companies with foreign exchange revenues with the request to exchange them (partly) into tenge; as many companies in the country belong to a quasi-state sector, this request can be regarded more as an order for them. Third, the National Bank has announced that it is going to provide commercial banks with additional tenge liquidity.

But it appears that devaluation of the tenge is inevitable anyway as its expectations are not likely to fade away any time soon. We expect that this time devaluation will be more protracted; by the end of 2015, the tenge will weaken by about 15% with respect to the US dollar. Plans announced by the National Bank to switch to inflation targeting in the medium run also signal that it will aim at greater exchange rate fluctuations.

In addition to the unfavourable global demand developments, the restart of production in the Kashagan oil field is likely to take place only in 2017. The cost of the Kashagan oil field project, already the world's most expensive one, is set to rise by nearly USD 4 billion as the companies developing it are forced to replace 200 km of leaking pipelines. Thus during the forecast period oil production will not rise significantly, and it will be primarily demand factors that will determine the commodity's export dynamics – as world oil prices are assumed to gradually pick up in 2016-2017, Kazakhstan's oil export will grow moderately.

Imports of goods will also decrease in 2015, but not as dramatically as exports – probably by some 10% in USD terms according to our forecast – as increased investment will call for more import of machinery and equipment even if the tenge is devalued. The current account will go into the red in 2015. In 2016-2017, imports will restore their growth though at a somewhat slower pace than exports – and the current account will slowly improve and return into positive territory in 2017.

In light of these developments we have made a downward revision of our forecast for the country's GDP: in 2015, growth will slow down to 2%, the lowest level since 2009; in 2016-2017, GDP growth will gradually revive to 3.5% and 4.5%, respectively.

In response to the slowing growth, in November 2014, President Nazarbayev announced a new economic policy called *Nurly Zhol* (Path to the Future) aimed at boosting investment in the country. Under this policy, an additional USD 3 billion (around 1.4% of GDP) will be transferred annually from the National Oil Fund during 2015-2017 to finance the development of the country's infrastructure<sup>1</sup> and credit facilities for small and medium-sized enterprises. In February 2015, President Nazarbayev requested to additionally include some short-term anti-crisis measures in the Path to the Future programme, such as support to the domestic agricultural and machine-building sectors, protection of the domestic market against imports, etc. He also requested government spending in 2015 to be cut by 10% (not affecting social expenditures<sup>2</sup>) – apparently aiming at assuring fiscal sustainability and macro

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<sup>1</sup> The Path to the Future programme envisages the development not only of the transportation and logistics infrastructure (highways, railways and airlines) – which is of high importance for the landlocked country with the ninth largest territory in the world – but also of industrial, energy, housing and education infrastructure.

<sup>2</sup> Expenditures on healthcare, education and social security accounted for about 48% of total government spending in 2014.

stability under the expected loss of fiscal revenues from the oil sector. Regardless of the request, the budget deficit is likely to remain at 2-2.5% during the forecast period.

While it is difficult to assess the short-term measures yet as they have not been described in detail, the infrastructure projects are likely to give a boost to the economy only in the medium term. They will also make economic growth more investment-driven. Government financing has already accounted for a significant portion of gross fixed capital investment (about 20% in 2014), and the share is likely to rise under the lack of access to long-term bank credit for many companies as banks are still struggling to cleanse their balance sheets and secure long-term funding. In 2014, loans on capital expenditures accounted for a mere 6% of total loans issued to corporate clients, and the volume of such loans was 19% lower than a year earlier.

Table 1 / Kazakhstan: Selected Economic Indicators

	2010	2011	2012	2013	2014 <sup>1)</sup>	2015 Forecast	2016 Forecast	2017
Population, th pers., average <sup>2)</sup>	16,322	16,557	16,791	17,035	17,289	17,400	17,550	17,700
Gross domestic product, KZT bn, nom. <sup>3)</sup>	21,816	27,572	30,347	35,275	38,033	40,700	45,100	49,300
annual change in % (real) <sup>3)</sup>	7.3	7.5	5.0	6.0	4.3	2.0	3.5	4.5
GDP/capita (EUR at exchange rate)	6,800	8,200	9,400	10,200	9,200	9,900	11,100	12,400
GDP/capita (EUR at PPP)	13,600	15,600	16,800	17,400	18,000	.	.	.
Consumption of households, KZT bn, nom. <sup>3)</sup>	9,721	11,569	13,623	17,535	18,900	20,600	22,500	24,600
annual change in % (real) <sup>3)</sup>	11.8	10.9	11.0	12.6	1.0	1.5	3.0	4.0
Gross fixed capital form., KZT bn, nom. <sup>3)</sup>	5,307	5,772	6,761	7,473	8,400	7,900	9,000	9,900
annual change in % (real) <sup>3)</sup>	3.8	3.9	9.1	4.9	4.0	5.0	5.0	7.0
Gross industrial production								
annual change in % (real)	9.6	3.8	0.7	2.5	0.2	2.0	3.0	6.0
Gross agricultural production								
annual change in % (real)	-11.7	26.8	-17.8	11.7	0.8	4.0	5.0	5.0
Construction industry								
annual change in % (real)	2.4	2.8	3.1	3.5	4.1	7.0	8.0	8.0
Employed persons, LFS, th, average <sup>4)</sup>	8,114	8,302	8,507	8,571	8,642	8,730	8,820	8,910
annual change in %	2.7	1.1	1.0	0.7	0.8	1.0	1.0	1.0
Unemployed persons, LFS, th, average <sup>4)</sup>	497	473	475	471	460	.	.	.
Unemployment rate, LFS, in %, average <sup>4)</sup>	5.8	5.4	5.3	5.2	5.1	5.0	5.0	5.0
Reg. unemployment rate, in %, end of period	0.4	0.4	0.4	0.3	0.4	.	.	.
Average monthly gross wages, KZT <sup>5)</sup>	77,611	90,028	101,263	109,141	120,455	.	.	.
annual change in % (real, gross)	7.6	7.1	7.0	1.9	3.9	.	.	.
Consumer prices (HICP), % p.a.	7.1	8.3	5.2	5.8	6.7	7.5	6.0	5.0
Producer prices in industry, % p.a.	25.2	27.2	3.5	-0.3	9.5	-10.0	8.0	3.0
General governm.budget, nat.def., % of GDP								
Revenues	19.7	19.5	19.2	18.1	19.2	.	.	.
Expenditures	22.1	21.5	22.1	20.1	22.1	.	.	.
Deficit (-) / surplus (+)	-2.4	-2.1	-2.9	-2.0	-2.9	-2.5	-2.5	-2.0
Public debt, nat.def., % of GDP	14.8	12.3	13.0	12.9	15.2	16.0	17.0	18.0
Central bank policy rate, % p.a., end of period <sup>6)</sup>	7.0	7.5	5.5	5.5	5.5	.	.	.
Current account, EUR mn <sup>7)</sup>	1,044	7,325	816	844	2,377	-6,800	-3,200	500
Current account in % of GDP	0.9	5.4	0.5	0.5	1.5	-4.0	-1.6	0.2
Exports of goods, BOP, EUR mn <sup>7)</sup>	46,231	61,198	67,629	64,435	59,909	54,300	62,500	75,500
annual growth rate in %	46.8	32.4	10.5	-4.7	-7.0	-9.4	15.1	20.8
Imports of goods, BOP, EUR mn <sup>7)</sup>	24,769	28,985	37,954	38,244	32,880	35,700	39,300	44,600
annual growth rate in %	19.4	17.0	30.9	0.8	-14.0	8.6	10.1	13.5
Exports of services, BOP, EUR mn <sup>7)</sup>	3,102	3,116	3,757	3,854	4,277	5,500	6,100	6,700
annual growth rate in %	5.4	0.5	20.6	2.6	11.0	28.6	10.9	9.8
Imports of services, BOP, EUR mn <sup>7)</sup>	8,561	7,882	9,941	9,049	9,137	11,400	12,500	13,900
annual growth rate in %	18.4	-7.9	26.1	-9.0	1.0	24.8	9.6	11.2
FDI inflow (liabilities), EUR mn <sup>7)</sup>	5,615	9,885	10,618	7,514	7,150	7,300	8,100	8,900
FDI outflow (assets), EUR mn <sup>7)</sup>	2,855	3,719	1,394	1,437	527	1,400	1,600	2,400
Gross reserves of NB excl. gold, EUR mn	19,044	19,477	16,665	13,940	17,682	.	.	.
Gross external debt, EUR mn <sup>7)</sup>	89,259	96,951	103,150	109,037	118,500	.	.	.
Gross external debt, % of GDP	80.1	71.8	65.1	62.5	74.2	.	.	.
Average exchange rate KZT/EUR	195.67	204.11	191.67	202.09	238.10	237	231	225
Purchasing power parity KZT/EUR <sup>8)</sup>	98.37	106.61	107.78	118.76	122.03	.	.	.

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

1) Preliminary and wiiw estimates. - 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.