SigmaBleyzer

Kazakhstan Macroeconomic Situation

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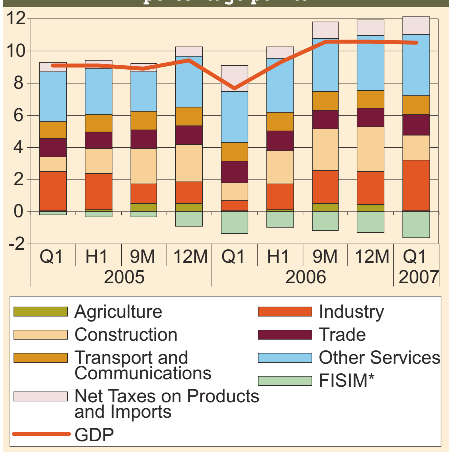
Summary

- During the first quarter of 2007, real GDP grew by 10.5% year-over-year (yoy) on the back of booming construction and strong industrial production.
- In January-April, industry grew by 9.5% yoy driven by recovering output in the oil and natural gas extracting sectors.
- In January-March, the state budget posted a deficit in the amount of KZT 84.7 billion (USD 684 million) or about 3.3% of period GDP.
- In May, consumer price inflation remained on a relatively moderate deceleration trend, edging down to 7.6% yoy from 7.7% yoy in the previous month.
- During the first quarter of 2007, the foreign trade surplus amounted to USD 3.6 billion, decelerating to 8% yoy from 44% yoy in the same quarter of 2006 on the back of booming imports, which jumped by 60.1% yoy.
- Kazyna Sustainable Development Fund was appointed as the lead operator of the state program Thirty Corporate Leaders of Kazakhstan.

Economic Growth

Over the last seven year, Kazakhstan achieved a spectacular economic rebound propelled by strong world prices for minerals (oil, gas and other base resources) as well as rapidly recovering domestic consumption and investments. If in 1995–1999 GDP declined on average by 1.1% year-over-year (yoy) in real terms, starting in 2000, GDP growth has been consistently over 9% yoy. Although the oil sector had a significant impact on output growth in related industries (for example construction and transportation), recent trends suggest that the contribution to GDP growth of the non-extracting industry as well as the service sector, especially finance and telecommunications, has been steadily increasing.

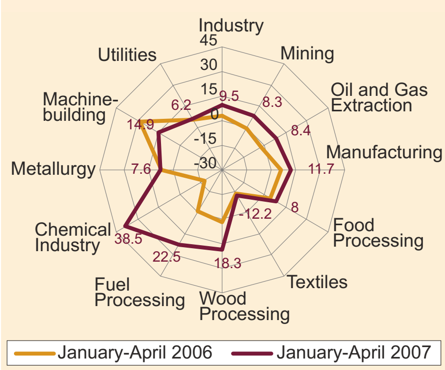
Contributions to GDP Growth by Sector, percentage points



*FISIM – Financial Intermediation Services Indirectly Measured
Source: ASRK, The Bleyzer Foundation

During the first quarter of 2007, real GDP growth accelerated to 10.5% year-over-year (yoy) from 7.7% yoy, registered a year ago. The strong economic expansion during the first three months of this year was based on booming industrial output (industrial output growth recovered to 9.4% yoy from 1.8% yoy a year ago), outstanding performance of construction (which grew by 43.4% yoy), as well as the robust progress of service sectors, where value added increased by 11.1% yoy. The rapid output growth in industry and construction has been crucial to economic growth, as during the first quarter of 2007 about one third of GDP growth was generated in industry, while another 15% was brought by construction.

Industrial Output by Sector, % yoy

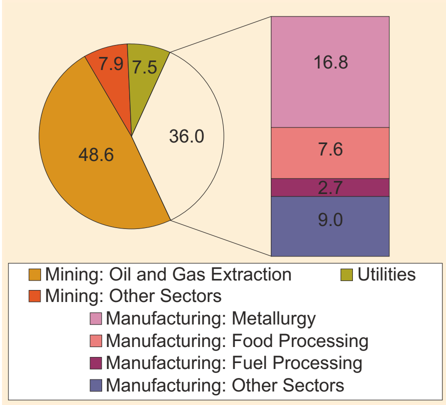


Source: ASRK

During the first four months of 2007, the extracting industry gained 8.3% yoy after experiencing a contraction of 0.7% yoy in January-April 2006. The sound performance of oil and natural gas extraction sectors, where output grew by 8.4% yoy (up from -2.4% yoy a year ago), was a fundamental driver of the output upturn in the mining industry. Output growth in manufacturing almost doubled to 11.7% yoy from 6.2% yoy in January-April 2006. Higher growth rates were observed in metallurgy, food processing and the production of fuels — sectors that generate more than three quarters of output in manufacturing. In particular, output in metallurgy, which accounts for slightly less than one half of all manufacturing, increased by 7.6% yoy (up from 7% yoy in January-April 2006). Output in food-processing, which contributes 21% to manufacturing, grew by 8% yoy (up from 4.3% yoy a year ago). In January-April 2007, fuel processing (with a modest 7% of manufacturing) showed an exceptional recovery, gaining 22.5% yoy against a 0.4% yoy decline observed a year ago. In addition, output in the chemical industry grew by an impressive 38.5% yoy on the back of a 17.2% yoy decrease in the first four months of the previous year. Output in utilities (about 7.5% of industrial production) increased by 6.2% yoy, up from 5.2% yoy growth posted in January-April 2006.

Although solid economic performance was observed in the real sector at the beginning of 2007, the composition of industrial output still signals a relatively high level of economic growth vulnerability to external shocks. Industry is rather exposed to the risks of volatile world commodity prices, since the extracting industry accounts for 56% of total industrial production with about 49% of output coming from oil and natural gas extraction (86% of all extracting industry). Furthermore, manufacturing is biased toward resource based sectors as metallurgy and fuel processing generate 56% of manufacturing output or about 20% of all industrial production.

Composition of Industrial Production in January-April 2007, % of total industrial output



Source: ASRK, The Bleyzer Foundation

At the same time, a safe cushion is provided by rapidly evolving services sectors. In the first quarter of 2007, the services sectors (about 53% of GDP in 2006) contributed about 60% to GDP growth. More than two thirds of this contribution came from four sectors — trade (up by 9.6% yoy), transportation (5.7% yoy), communications (32% yoy) and financial services (53.9% yoy). The impact of the communications and financial services sectors on GDP growth has notably improved due to consistently high double digit growth rates posted by these sectors. If in the first quarter of 2006 these two sectors generated about one tenth of GDP growth, in January-March 2007 they contributed almost one fourth.

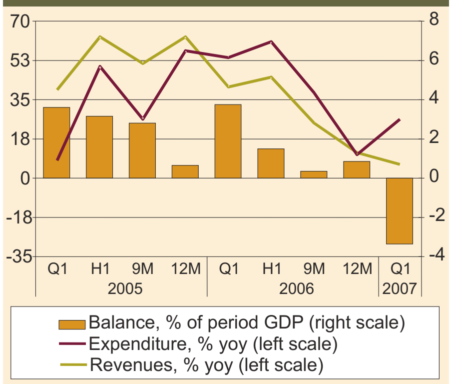
Finally, in January-April, output growth in agriculture (with a share of 5.5% of GDP in 2006) remained relatively stable as output in this sector increased by 3.9% yoy or only marginally lower than 4.1% yoy growth registered during the same period of the previous year.

Fiscal Policy

During the last seven years, the government was able to maintain a stable and balanced fiscal stance principally due to export and corporate income tax revenues, which were supported by steadily growing world prices of minerals. The transparency and efficiency in the utilization of oil revenues have been notably improved with the establishment of the National Fund of the Republic of Kazakhstan. This fund was established in 2001 to stabilize volatile inflows of oil revenues and channel them into domestic developmental projects. As a result, the government adhered to a rather prudent fiscal policy by limiting excessive expenditure and deficit growth and gradually reduced the level of public external debt to about 2% of GDP in 2006.

During January-March 2007, state budget revenues amounted to KZT 590 billion (USD 4.8 billion) modestly increasing by about 6% yoy in nominal terms against the first quarter of the previous year, while state budget expenditures grew by over 26% yoy to KZT 543.7 billion (USD 4.4 billion). The state budget deficit (adjusted for the net purchases of financial assets) widened to KZT 84.7 billion (USD 684 million) or about 3.3% of period GDP.

State Budget Parameters



Source: MFRK, ASRK, The Bleyzer Foundation

The execution of the revenue side of the state budget in Kazakhstan is rather sensitive to the collection of principal taxes, since the share of tax revenues in the state budget is relatively high (94% in 2006). As a result, the modest growth of budget revenues during the first quarter of 2007 was driven by decelerating tax revenues. In January-March, tax revenues declined by 7.9% yoy in nominal terms against the same period of 2006 on the back of a 13% yoy contraction of corporate income tax collection and a 6.5% yoy decline of VAT revenues. Moreover, the collection of payments for the utilization of natural and other resources (resources tax) has shrunk by approximately three times. These three taxes generated approximately 70% of all tax revenues in 2006. In particular, the corporate income tax contributed 35.2% to tax revenues, while the VAT and resources tax contributed 22.2% and 13.6% respectively. On a positive note, in January-May 2007 personal income tax (up by 34% yoy), social tax (up by 25.6% yoy), excises (up by 25.3% yoy) and custom duties (up by 61% yoy) posted strong revenue collection, which was largely driven by rapidly increasing consumer incomes, which fueled domestic trade and demand for imports.

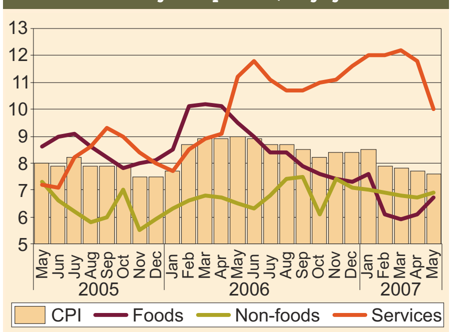
At the beginning of 2007, the government moderately loosened its fiscal stance. In January-March 2007, current expenditures of the state budget increased by 26.2% yoy driven by rapid growth of the public sector wage bill (up by 30% yoy), expanding current transfers to the population (up by 44.4% yoy) and accelerated government spending on goods and services (up by 35.2% yoy). Capital expenditures of the state budget, which account for 16% of all government spending, surged by 31.3% yoy on the back of higher growth of fixed capital accumulation in the public sector.

Monetary Policy

Although in the beginning of 2000's the consumer price index decelerated to less than 7% yoy, in recent years inflationary pressures have tended to increase. Inflation is principally driven by expanding domestic demand associated with rapidly growing consumer incomes, booming domestic credit and increasing government spendings. Furthermore, the pressure on the national currency to appreciate in real terms is till high due to sizable inflows of external funds both in the form of oil revenues and foreign investments. At the same time, the National Bank has been very active to reduce the exposure of the Kazakh economy to upward price adjustments by allowing relatively free float of the exchange rate and imposing stricter and more effective control over the growth of money supply. The recent domestic credit boom can be attributed to the continuing process of financial deepening of the economy. However, unrestricted credit growth could result in risks to financial stability in terms of deteriorating quality of commercial banks' credit portfolios and increasing foreign indebtedness of domestic lending institutions.

In May 2007, the consumer price index (CPI) remained on a relatively moderate deceleration trend that started at the beginning of the year. The CPI edged down to 7.6% yoy from 7.7% yoy in April as inflation of service tariffs tapered off to 10% yoy from 11.8% yoy in April. In contrast, prices of foods and non-food commodities continued to move upward in May, increasing by 6.7% yoy and 6.9% yoy respectively. In May the price index of foods was driven by increasing prices of meat products, which gained 2.5% month-over-month (mom) as well as higher prices of fruits and vegetables (up by 0.9% mom). Increasing prices of fuels (prices of gas and diesel oil grew by 0.9% mom and 0.7% mom respectively) have pushed up the price index of non-foods.

CPI by Component, % yoy

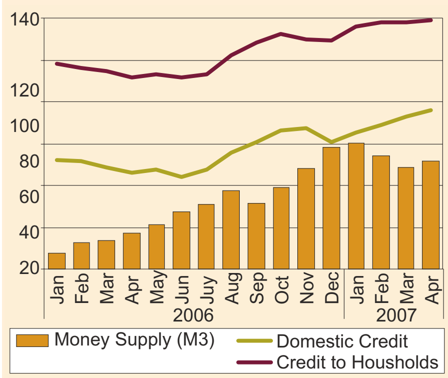


Source: ASRK

Although in May 2007 CPI inflation was 1.5 percentage points below the 9% yoy inflation registered in May of the previous year, inflationary pressures stemming from increasing household incomes and a more expansionary fiscal policy are still present. Furthermore, aggregate demand continues to be fueled by sizable inflows of foreign capital as well as brisk domestic investment activity. At the same time, demand driven inflationary pressures are less pronounced, since in January-April investments in fixed capital decelerated to 12.7% yoy from 37.9% yoy growth posted a year ago due to a 39.5% yoy decline of foreign investments in fixed capital. However, there are distinct signs of economic overheating as the growth of real wages, which increased by 22.2% yoy in the first quarter of 2007, continues to surpass labor productivity growth by more than two times.

The capacity of the government to achieve price stability relies on the magnitude of the monetary policy response to current inflationary risks, as the impact of monetary policy on inflation and the real sector has been notably growing due to a booming banking industry and rapidly expanding domestic credit.

Money Supply (M3) and Domestic Credit, % yoy



Source: NBRK, The Bleyzer Foundation

In April, money supply, measured by the monetary aggregate M3, jumped by 71.5% yoy up from 68.7% yoy registered in March due to vigorous growth of domestic credit. During the first four months of this year, domestic credit expanded by 96% yoy to KZT 5,595 billion (USD 45.8 billion) driven by impressive growth of credit issued to households, which surged by 139% yoy. Household credit is the most dynamic component of credit issued in the economy as its average growth rate exceeded 120% yoy in 2006. This type of credit amounts to more than one third of all domestic credit, while its ratio to GDP almost doubled during the last year hitting 15.8%.

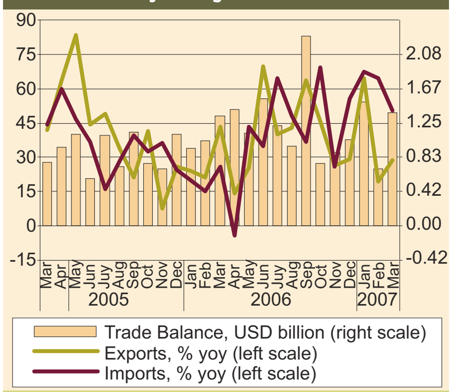
Rapid expansion of household credit poses two major challenges to the monetary authority. First, household credit inflates consumer demand, which has a spillover effect on the economy in terms of higher prices. Second, growing consumer credit may jeopardize financial stability due to deteriorating quality of banks' credit portfolios. On a positive note, the capacity of households to serve their debts has been improving, being backed by growing incomes and positive economic prospects. Furthermore, about 77% of all domestic credit is long-term, while the growth rate of short-term credit consistently lags behind the growth of long-term credit. As a result, the exposure of households and the corporate sector to short-term liabilities tend to fall off, which reduces the risk of a default on loan repayment in case of unfavorable short-term macroeconomic shocks. In addition, the NBRK takes an active stance in advancing its regulatory and supervisory capacity to strengthen control over price stability and the quality of domestic credit.

International Trade and Capital

Kazakhstan has been consistently registering huge surpluses in its trade in goods due to growing world demand for energy and mineral resources. However, the sustainability of long-term economic growth in Kazakhstan is vulnerable to the volatility of external demand as over two thirds of export revenues are generated by the extracting industry. Despite the large surpluses in trade in goods, the current account was relatively balanced due to a massive deficit in trade in services (mainly driven by imports of construction, transportation and other services related to the extracting sectors) and a bulky repatriation of profits earned by foreign investors.

During the first quarter of 2007, exports grew by 36.6% yoy to USD 10.1 billion while imports soared by 60.1% yoy to USD 6.5 billion. As a result, the foreign trade surplus amounted to USD 3.6 billion, increasing by a modest 8% yoy compared to the 44% yoy growth of the foreign trade surplus registered in the same period of the previous year. The observed deceleration of the trade surplus can be attributed to rapidly increasing imports, whose growth rate has been outpacing the growth of exports since the beginning of 2007.

Monthly Foreign Trade Balance

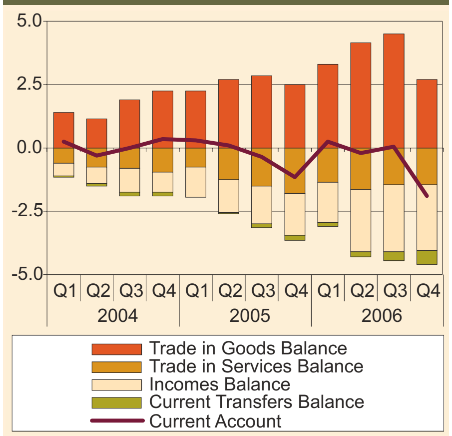


Source: ASRK, NBRK, The Bleyzer Foundation

In January-March 2007, exports of mineral products continued to represent the lion's share of exports from Kazakhstan. With a share of about 74% in total exports, mineral products (up by 26.5% yoy during the first three months of 2007) generated over one half of export growth in the first quarter of this year. Exports of metallurgical products (14% in total exports) surged by 71.8% yoy. As a result, exports of metallurgical and mineral products produced about 4/5 of the growth of export revenues in the first quarter of 2007. This implies that the Kazakh economy is heavily supported by external demand for base resources, which exposes the sustainability of economic growth to unfavorable movements of world prices of these resources.

The buoyant performance of imports was due to strong investment and consumer demand. In particular, during the first quarter of 2007, imports of machinery (which accounts for 45% of all imports) increased by 65.4% yoy generating about one half of the growth rate of imports. Imports of mineral, metallurgical and chemical products gained 62.4% yoy, 76.6% yoy and 36.8% yoy respectively, generating another 40%. Rapid expansion of imports is likely to continue on the back of robust domestic demand supported by growing incomes, increasing public sector spending as well as strong performance of industry, which pushes up demand for imported inputs and capital goods.

Current Account Components, USD billion

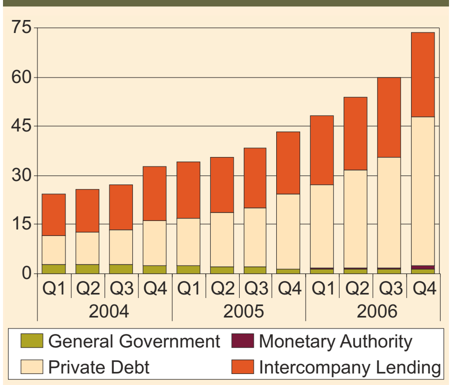


Source: NBRK

In 2006, the current account deficit amounted to USD 1.89 billion or about 2.3% of GDP. Despite a sizable trade in goods surplus of USD 14.6 billion, the large trade in services deficit (USD 5.9 billion) as well as incomes deficit (USD 9.3 billion) pushed the current account to negative levels. More than half of the trade in services deficit was generated by imports of construction services, while another 30% came from the imports of professional and technical services. In 2006, the incomes deficit was mainly generated by repatriated profits by foreign direct investors, which amounted to USD 7.8 billion.

At the end of 2006, the stock of private and public foreign external debt swelled by 69% yoy to USD 73.5 billion or about 95% of GDP. While the stock of external debt accumulated by the government remained flat at USD 1.5 billion (2% of GDP), private external debt grew by 69.5% yoy to USD 70.9 billion. In 2006, banks, which hold about 47% of all private external debt, were the most active entities borrowing abroad as their liabilities to foreign lenders jumped by 117.7% yoy. Although the indebtedness of the private sector increased dramatically during the last year, 35.8% of all private external debt came in the form of direct intercompany lending by foreign investors, which significantly alleviates external debt related burdens and risks imposed on the private sector.

Gross External Debt, USD billion



Source: NBRK

Strong foreign capital inflows and abundant export revenues continue to drive the liquidity stock of Kazakhstan. In May 2007, the international reserves of NBRK amounted to USD 21.8 billion, which represents an increase of 13.7% since the beginning of the year. The assets of the National Fund of the Republic of Kazakhstan have been steadily growing as well. In January-May, the value of these assets amounted to USD 17.5 billion, increasing by 24% since December 2006.

Other Developments Affecting the Investment Climate

The investment climate in Kazakhstan has been consistently improving on the back of political stability, accelerated structural reforms, the liberalization of business activities, and the rising social welfare of population. The European Union (in 2000) and the U.S. Department of Commerce (in 2002) granted Kazakhstan the status of "market economy". Furthermore, leading international rating agencies have already assigned investment grade ratings to Kazakhstan. Finally, Kazakh authorities possess a very strong leadership potential to advance with economic restructuring and industrial diversification.

During his first on-line conference, the President of Kazakhstan, Nursultan Nazarbayev, announced that domestic commercial banks are willing to put USD 1.5 billion into the state program Thirty Corporate Leaders of Kazakhstan. In addition, according to Mr. Nazarbayev, 200 potential investment projects with the total value of USD 100 billion were approved during the recent meeting of the state committee on economic modernization.

At the end of May, the Kazyna Sustainable Development Fund of the Republic of Kazakhstan was appointed as the lead operator of Thirty Corporate Leaders of Kazakhstan, which was developed according to the decree of the President of Kazakhstan on "Actions to Modernize the Economy of RK". Kazyna will consolidate information about potential investment projects received from private and state parties and conduct preliminary due diligence on these projects. Selected investment projects accompanied by project-tailored packages of state support will be presented to the special state Committee for approval. Kazyna also announced its intention to develop a network of regional investment funds to accelerate economic diversification at the local level.

Key Macroeconomic Indicators

	2001	2002	2003	2004	2005	2006
Population (million people)	14.8	14.9	15.0	15.1	15.2	15.4
Real Sector						
GDP (USD billion)	22.1	24.4	30.8	43.2	56.1	77.2
GDP per capita (USD)	1,491	1,643	2,063	2,865	3,688	5,017
Real GDP Growth	13.5	9.8	9.3	9.6	9.7	10.6
Gross Fixed Capital Formation (%, yoy)	44.7	10.6	16.6	23.1	34.1	10.6
Industry (share in GDP)	30.7	29.5	29.1	29.3	30.2	29.6
Industrial output (%, yoy)	13.8	10.5	9.1	10.4	4.8	7.0
Agriculture (%, yoy)	17.3	3.4	2.1	-0.5	7.3	7.0
Construction (%, yoy)	27.3	19.5	9.8	11.2	37.8	35.6
Services (%, yoy)	12.3	9.8	11.0	10.9	10.4	10.8
Monetary and Fiscal Policy						
State Budget Balance (% GDP)	-0.4	-0.3	-1	-0.3	0.6	0.8
International Reserves ($ billion)	2.5	3.1	5	9.3	7.1	19.1
Assets of the National Fund ($ billion)	1.2	1.9	3.7	5.1	8.1	14.1
Consumer Inflation (eop)	8.4	5.9	6.8	6.9	7.6	8.6
Public External Debt (% of GDP)	17.2	14.3	11.7	7.3	3.9	2.0
Money Supply — M3 (%, eop yoy)	45.1	32.8	27.0	69.8	25.2	78.1
Domestic Credit (%, eop yoy)	66.4	79.9	13.1	24.8	47.3	69.1
External Sector						
Exchange Rate (KZT TOD / $)	149.6	155.1	145.1	130	133.9	127.9
Exports, USD billon	8.6	9.7	12.9	20.1	27.8	38.3
Imports, USD billion	6.4	6.6	8.4	12.8	17.4	23.7
Current Account ($ billion)	-1.4	-1.0	-0.3	0.3	-1.1	-1.8
Current Account (% of GDP)	-6.3	-4.2	-0.9	0.8	-1.8	-2.2
Total External Debt (% of GDP)	68.5	74.8	74.3	75.7	77.3	95.1
Direct Intercompany Lending (% of GDP)	40.1	43.9	38.9	38.6	34.3	32.9
Net FDI inflows (% of GDP)	12.9	8.8	7.2	12.6	3.7	8.2
FDI stock (USD billion)	12.9	15.5	17.6	22.4	25.6	34.5

Source: NBRK, ASRK, IMF