SigmaBleyzer

# Kazakhstan
# Macroeconomic Situation

June 2008

Leilya Shamelova, Edilberto L. Segura

## Summary

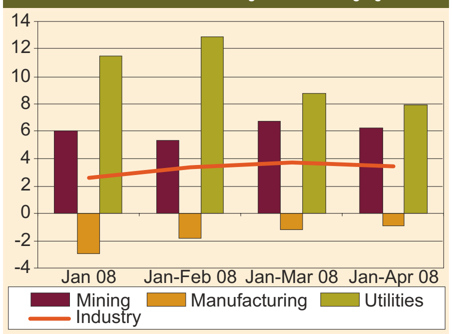

- The government estimates economic growth at 5.3% yoy in 2008, 6% yoy in 2009 and 5.6% yoy in 2010.
- Industry gained 3.5% yoy in January-April.
- During the first four months of 2008, the state budget surplus amounted to USD 120 million or 0.1% of projected full-year GDP.
- The government widened the deficit of the 2008 republican budget from 1.4% to 2.1% of GDP.
- The consumer price index grew by 1% mom in May.
- In the first quarter of this year, the trade in goods surplus stood at USD 8.69 billion.


## Economic Growth

The government estimates economic growth at 5.3% yoy in 2008. Nominal GDP is expected to settle at around KZT 15.6 trillion (USD 130.3 billion). This means that GDP per capita will grow to almost USD 8,000 this year from USD 6,700 in 2007. In addition, the government has revised its forecast of economic growth in 2009–2010 from 9.2% and 8.6% to 6% and 5.6%, respectively.

In April, industrial production totaled USD 27.3 billion, growing by 3.5% yoy. The mining sector slightly decelerated from the previous month and advanced by 6.3% yoy in January-April compared to 8.3% yoy a year ago. This was mainly driven by slower expansion of crude oil extraction. In January-April, Kazakhstan extracted 19.3 million tons of crude oil, up by 6.6% yoy (7.1% yoy the year before). In April, output in manufacturing continued to lag behind last year's level, falling by 0.9% yoy from January-April 2007. Above all, shrinking production of non-metallic mineral products, including construction materials (down by 21.2% yoy), and sluggish performance of metallurgy (down by 0.8% yoy) remained a major drag on growth in manufacturing.

Industrial Growth by Sector, % yoy




Source: ASRK

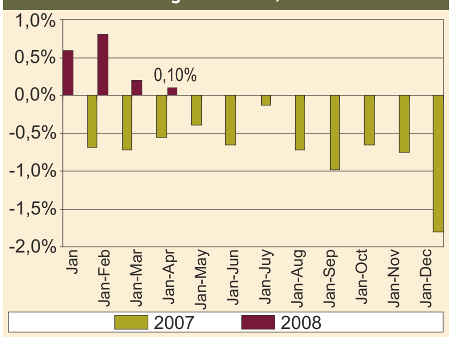
By and large, the Kazakh economy is still rather sensitive to growth of the energy sector. The government has recently revised its forecast for global crude oil prices in 2008. According to the projections, a barrel of Brent crude oil will cost about USD 95. As a result, the economy is poised to benefit from booming export revenues as fossil fuels account for more then two thirds of all Kazakh exports. Equally important, the oil transit capacity of the Caspian Pipeline Consortium (CTC) oil pipeline, Kazakhstan's major oil transit route, is expected to be upgraded from its current 32 million tons to 67 million tons per year by 2013. The volume of Kazakh oil transported through the CTC will reach 50 million tons. This means that existing production and transit constraints on the crude oil extraction industry of Kazakhstan are anticipated to be eased. Indeed, Kazakhstan has recently lowered its forecast for 2008 crude oil production to 67.6 million tons due to tightening oil transit capacity. However, the ongoing expansion of existing transit routes as well as diversification of the Kazakh oil pipeline network (most importantly to China and Western Europe) will allow the country to visibly increase its crude oil exports in the medium-term.

The government has already signed a treaty with Azerbaijan on crude oil exports through the Baku-Tbilisi-Ceyhan (BTC) pipeline. The BTC is an alternative transit route for exporting Kazakh oil to Europe and will be used to ship crude oil from the giant off-shore Kashagan oil field. The initial transit capacity of the BTC will be 25 million tons per year, and will be later expanded to 38 million tons.

## Fiscal Policy

In January-April 2008, the state budget registered a surplus in the amount of KZT 14.3 billion (or nearly USD 120 million). State budget revenues grew by 25.5% yoy as tax revenues advanced by 18% yoy. Budget expenditures accelerated by 25% yoy as the government pumped in more funds to support the real economy. In April 2008, public spending on industry and public housing more than doubled compared to the same period of 2007. Budget transfers to transport and communication sectors surged by 60% yoy. Meanwhile, spending on social security grew at a modest 6.9% yoy. This may imply that higher budget spending is unlikely to create additional inflationary pressures, while, at the same time, it will help to support economic growth.

State Budget Balance, % of GDP




Source: The Ministry of Finance of RK, The Bleyzer Foundation

As an additional measure to sustain economic growth, which has moderated since the beginning of the year, the Ministry of Economy and Budget Planning (MEBP) revised the 2008 republican budget. Recent amendments to the legislation increased budget expenditures by KZT 153 billion (USD 1.3 billion). Thus, the republican budget deficit will grow from 1.4% to 2.1% of GDP in 2008. These additional funds will be utilized to finance specific social projects, including substantial support to the residential construction sector. The budget amendments also envision higher transfers to the republican budget from the National Oil Fund (NFRK) — up by KZT 125 billion (USD 1.04 billion). According to the MEBP, these transfers are designed to back the non-oil economy and bring extra liquidity to the financial system. Finally, the higher budget deficit will be covered by the emission of locally traded government securities, which should also stimulate the development of the domestic capital market.

Revised Republican Budget 2008

| | KZT billion | % to GDP |
|---|---|---|
| Revenues | 2721.8 | 18 |
| Tax revenues | 2209.28 | 14.7 |
| Transfers from NFRK | 466.43 | 3.1 |
| Expenditures | 2829.16 | 18.9 |
| Deficit | 315. | 2.1 |

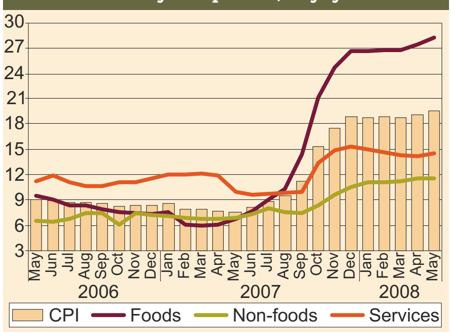
Source: The 2008 Budget Law (with amendments)

In an attempt to streamline the national taxation system and accelerate tax reform, the government made several amendments to the Tax Code. Starting January 1st 2009, oil producing companies registered in Kazakhstan (with the exception of entities operating under the contracts ratified by the Parliament) will be required to pay royalties and export duties on crude oil. At present, this levy is applied to about 30% of all crude oil produced in the country.

## Monetary Policy

In May, the consumer price index grew by 4.5% from the beginning of the year (ytd) as compared to 3.4% ytd a year before. Growing prices of foods remain the key driver of inflationary trends. Indeed, food prices accelerated by 28.3% yoy in May. All in all, tight global agricultural markets continue to influence local markets for grain and grain derived products. In particular, prices of rice and bakery jumped by 9.4% mom and 2.7% mom in May, respectively. Prices of non-food commodities have been on an upward trend

CPI by Component, % yoy




Source: NBK, The Bleyzer Foundation

Copyright © SigmaBleyzer, 2007.
All rights reserved.

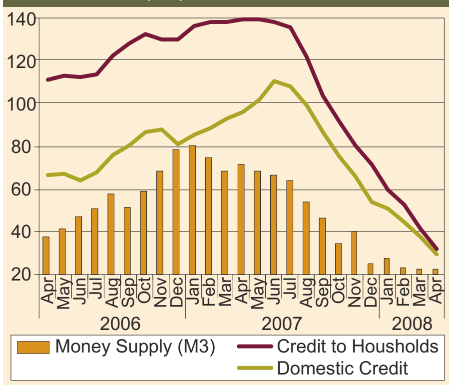


Chief Economist Edilberto L. Segura
Editor Rina Bleyzer O'Malley

as well on the back of increasing prices of fuels. Prices of gas and diesel fuel, pushed by the tight local supply of processed oil products, increased by 1.8% mom and 8.2 % mom, respectively.

In January-April, the stock of domestic credit continued to decelerate, growing by only 29.7% yoy compared to 96% yoy during the same period of 2007. Notably, credit to households has been declining since the beginning of the year — from USD 21.5 billion in January to USD 20 billion in April. As a result, the growth of money supply settled at 22% yoy, down by 2% mom. All told, slower growth of the money supply and consumer credit will almost certainly help to contain inflation in 2008.

**Money Supply (M3) and Domestic Credit, % yoy**




Source: NBK, The Bleyzer Foundation

Asset quality in the banking sector has improved since the beginning of 2008. In January-April, the total volume of assets grew by KZT 7.8 billion or by 0.1% ytd, while the gross equity capital of the banking sector increased to USD 15.3 billion, gaining 3.4% ytd. The quality of banks' credit portfolios has marginally improved as well. The share of standard credits grew from 39.7% to 41.1%, while the proportion of doubtful loans decreased from 58.8% to 56.5%. At the same time, the share of non-performing loans slightly increased to 2.4%. This means that local commercial banks still face a formidable challenge of revamping their risk and liquidity management on the back of moderating credit growth. On a positive note, the ratio of banks' assets to liabilities increased slightly since the beginning of the year and stood at 1.2% in April. Finally, during the first four months of 2008, Kazakh banks repaid USD 6 billion of their external obligations. As a result, the Kazakh banking system has been withstanding the global credit crunch, while policies enacted by the central bank and the government appear to be working well to maintain financial stability.

The international liquidity position of the government remains solid as well. In May, the forex reserves of the National Bank of Kazakhstan (NBK) amounted to USD 21.5 billion, up by 3.9% mom. The gross forex reserves of Kazakhstan, including USD 24.05 billion of assets of the National Oil Fund, stood at USD 45.5 billion.

To support the liquidity of the national banking system, the NBK is considering cutting banks' reserve requirements on external obligations from 8% to 6%. This measure, according to monetary authorities, will send back an additional KZT 100 billion (or about USD 833 million) to the assets of banks.

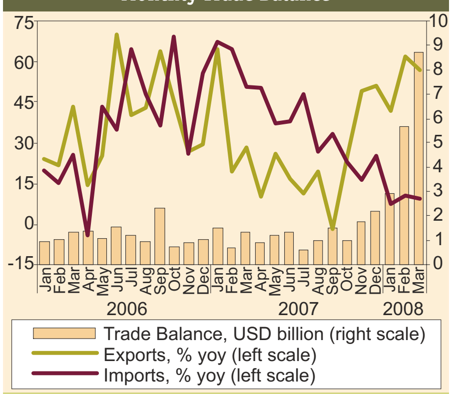
In summary, the banking sector remains in a healthy shape. Not a single bank has ceased operations, while all repayments of external liabilities are being made on time and in the full amount. Commercial banks have already serviced USD 6 billion since the beginning of the year, with another USD 5.6 billion left in 2009 and USD 4.1 billion in 2010.

The central bank anticipates further moderation of credit growth, which will ease inflationary pressures. However, rapid acceleration of food and fuel prices on the back of tight domestic supply still carries material risks for inflation. Thus, to stabilize fuel prices, the government has recently banned export of all refined oil products until September 1st to alleviate short-term supply shortages.

## International Trade and Capital

In the first quarter of 2008, the foreign trade surplus amounted to USD 8.69 billion, growing by nearly 143% yoy as exports surged by 57% yoy, while imports cooled to 9.6% yoy. Further expansion of the trade in goods surplus is expected during the rest of the year as Kazakhstan continues to enjoy high commodity prices. Meanwhile, a visible deceleration of imports (imports jumped by over 60% yoy in January-March 2007) is a clear sign of weakening domestic demand. This means that booming export revenues and slowing imports are increasingly likely to help reduce the current account gap in 2008. Indeed, the government estimates the current account deficit to settle at around 6% of GDP in 2008, compared to nearly 7% in 2007.

**Monthly Trade Balance**




Source. ASRK, The Bleyzer Foundation

Impressive FDI inflows into the Kazakh economy are also a positive factor for mitigating pressures on external imbalances. Despite some turbulence in the financial sector, foreign investors are strengthening their presence in the country. Kazakhstan recently signed several multibillion investment contracts during the Middle East session of the World Economic Forum held in Egypt on May 18–20. The contract on creating a Qatar-like energy hub in western Kazakhstan to maintain the Caspian region oil and gas industry will attract USD 400 million, with further expansion to USD 10 billion. In addition, an agreement was signed to create the Islamic Finance Bank (with a capitalization of USD 750 million) in Kazakhstan and the first ever in the region. In addition, the state-controlled development fund JSC Kazyna is to partner with an investment company of the United Arab Emirates to establish a financial institution that will allocate over USD 500 million to Kazakhstan. Arab businessmen are also interested in the tourist industry of Kazakhstan and may commit over USD 1.5 billion to develop resort zones in the Caspian Sea.

## Other Developments Affecting Investment Climate

The World Bank intends to allocate nearly USD 150 million in direct credits to the Kazakh government for the implementation of several projects on education, healthcare and customs administration. These three new loans have to be ratified by the parliament. The loans carry a maturity of 15 years and have a five year grace period. These funds will be used to finance the introduction of international standards and institutional capacity-building in the healthcare sector, to improve education research and to increase efficiency and productivity of the customs administration.

A new investment fund, **CITIC Kazyna Investment Fund I**, has been founded to finance infrastructure projects in Kazakhstan. The treaty was signed between the two major shareholders, JSC Kazyna Capital Management (the daughter company of JCS Kazyna) and CITIC Capital Holdings Limited. The capitalization of the fund is set at USD 200 million.