Kazakhsatn

Macroeconomic Situation

THE BLEYZER FOUNDATION
Turning Transitions Into Prosperity

February 2011

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- **In 2010, GDP grew by 7% with nominal GDP per capita exceeding $9,000.**
- **In January, industry grew by 5.8% on continued expansion in mining and solid output gains in metallurgy and machine building.**
- **The state budget posted a small surplus in January of about 0.2% of projected full year GDP.**
- **Annual inflation was 8.1% in January as dearer foods continued to push up consumer prices.**
- **In 2010, the current account returned to a surplus of about $5 billion.**
- **Kazakhstan will hold a snap presidential election on April 3rd.**

Executive Summary

The Kazakh economy grew by 7% in 2010 thanks to a robust industrial turnaround and a solid recovery of the service-providing sectors. Nominal GDP exceeded $145 billion, which puts GDP per capita at about $9,100. In real terms, GDP per capita was up by 8% compared to the beginning of the global financial crisis.

Goods producing sectors, which represent over 44% of GDP, remain a vital part of the economy. Industry, which generates nearly a third of the national output, contributed 40% to overall economic growth in 2010. A steady expansion of mining and a manufacturing recovery will continue to support this trend. In fact, manufacturing has already surpassed its precrisis peak thanks to growing metallurgy and machine building. Strong global demand for energy and industrial metals is supporting economic growth this year as well. In January, industry gained 5.8% on a 5% growth in mining and a 7.5% increase in manufacturing. After all, commodity prices are surging thanks to a recovery in global manufacturing. This testifies to the continued strength of the global economy, which bodes well for Kazakh commodity producers.

Meanwhile, the service-providing sectors of the Kazakh economy are supported by improving consumer spending- last year, the trade sector alone contributed over one fifth to overall GDP growth. There are signs that the service-providing industries remain on the uptrend – in January 2011, retail sales were up by 11% versus the same month a year ago. After all, the jobless rate is below 6%, while the average real wage grew by 7% in 2010. As a result, growing aggregate payroll and increasing social payments will be supporting personal consumption.

In addition, tighter economic links with China (in 2010, China was the largest export market for Kazakhstan, accounting for over 17% of all exports versus only 11% three years ago) will help Kazakhstan gain from the rapid economic growth of its Asian neighbor. Indeed, in 2010 Kazakh exports bounced back by 37% thanks to a 72% growth of exports to China. All of this reflects increasing consumption of energy and base metals by Chinese industry and construction. This trend is likely to persist in the years ahead as China continues to grow above 9%.

Higher commodity prices helped push the current account surplus to $5 billion in 2010. This is rekindling appreciation pressures on the national currency. According to the central bank of Kazakhstan, in January and the beginning of February 2011, the monetary authority purchased more foreign currency than in all of 2010 to stem further strengthening of the exchange rate. As a result, at present total foreign reserves of Kazakhstan exceed $62 billion compared to less than $51 billion a year ago.

That said, increasing global food prices are contributing to inflation in Kazakhstan as well. In January, food prices in Kazakhstan grew at the fastest monthly rate in over three years, which pushed overall consumer prices by over 8% compared to January 2010. After all, dearer foods have a large impact on the buying power of Kazakh consumers, who still spend nearly 40% of their income on groceries.

That said, consumers still feel more upbeat compared to their mood a year ago, which should help sustain an ongoing recovery of consumer spending. In addition, consumer deleveraging appears to be losing momentum, with the stock of retail credit leveling out at the end of 2010. Banks are reporting stronger demand for mortgages and consumer loans. According to the latest loan officer survey on lending practices by the central bank, about a fifth of Kazakh lenders expect to relax credit requirements for retail borrowers in the first quarter of 2011. This gradual resumption of bank lending to consumers should add strength to personal spending as well.

	2006	2007	2008	2009	2010e	2011f
GDP growth, % change yoy	10.7%	8.9%	3.3%	1.2%	7%	5%
GDP per capita, $	5 262	6 757	8 398	6 710	9 100	9 200
Industrial production, % change yoy	7.2%	5.0%	2.1%	1.5%	10%	5%
State budget deficit, % of GDP	0.8%	-1.7%	-2.1%	-2.9%	-2.5%	-2.5%
Governmet external debt (including NBK), % of GDP	2.9%	1.8%	1.6%	2.4%	2.7%	2.0%
Unemployment, end of period	7.8%	7.3%	6.6%	6.6%	5.8%	5.5%
Inflation, end of period	8.4%	18.8%	9.5%	6.2%	7.8%	7-8%
Retail sales, % change yoy	15.0%	10.7%	3.1%	-3.9%	12.3%	-
Gross forex reserves of the NBK, $ billion, end of period	19.1	17.6	19.9	23.2	28.3	-
Assets of the National Oil Fund, $ billion, end of period	14.1	21.0	27.5	24.4	30.6	-
Current Account Balance, $ billion	-2.0	-8.2	6.6	-4.2	4.9	3.0
External debt, $ billion	74.0	96.9	108.1	111.7	112.0	120.0
Exchange rate, tenge/$, annual average	126.1	122.6	120.3	147.5	147.4	142.0

Where Opportunities Emerge.

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Economic Growth

Last year, Kazakh GDP increased by 7% in real terms on a robust industrial turnaround and a solid recovery of the service-providing sectors. As a result, nominal GDP exceeded $145 billion, which puts GDP per capita at about $9,100. Meanwhile, real GDP per capita, which more than doubled over the past decade, is up by 8% compared to the beginning of the global financial crisis (see chart 1).

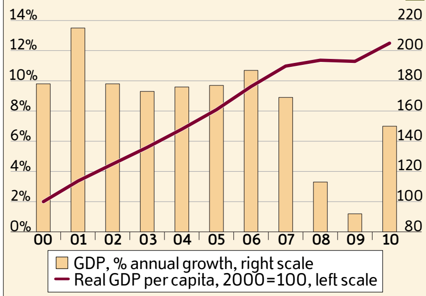
Despite weakness in construction, goods producing sectors, which represent over 44% of GDP, remain a vital part of the economy. Industry, which generates nearly a third of the national output, grew by 9.6%, contributing 40% to the overall economic growth in 2010 (see chart 2). A steady expansion of the mining sector (which still creates close to 60% of all value added in Kazakh industry) and a manufacturing recovery will continue to support this trend. In fact, manufacturing has already surpassed its precrisis peak thanks to growing metallurgy and machine building (see chart 3). Meanwhile, output in construction was virtually flat, increasing by only 1% in 2010 following a 3% drop a year ago.

Strong global demand for energy and industrial metals is supporting economic growth this year as well. In January, industry gained 5.8% on a 5% growth in mining and a 7.5% increase in manufacturing (see chart 4). Output in metallurgy was up by about 11%, while machine building grew by 24%. After all, commodity prices (see chart 5) are surging thanks to continued growth in global manufacturing. Indeed, according to the JPMorgan Global Manufacturing Purchasing Managers Index, global manufacturing activity rose to a nine-month high in January on stronger readings in the U.S., Germany, China, India and Japan. This testifies to the continued strength of the global economic recovery, which bodes well for Kazakh commodity producers. On the downside, global inflationary pressures appear to be on the rise as higher commodity prices are pushing input costs. In addition, recent crude oil supply disruptions in the Middle East (with most of the production shut down in Libya) are pushing oil prices above $100 per barrel (see chart 6). True, Kazakhstan stands to gain from these trends as mineral products and metals account for nearly 90% of its exports. At the same time, higher input costs exert a toll on the world economic recovery. Slower global economic growth may dampen output growth in Kazakhstan as well.

That said, commodity prices are becoming more tightly linked to the strength of economic growth in emerging Asia, and China in particular. More than that, consumers in those countries are less burdened by debt and are increasingly willing to spend. As a result, emerging Asia growth prospects are more favorable, while its economy is more resilient than in developed countries. This means that Kazakhstan, which last year increased exports to China by 72% to over $10 billion, will continue to benefit from China's hunger for resources. Indeed, Sino-Kazakh relations have considerably deepened over the past several years – in 2010, China was the largest export market of Kazakhstan, accounting for over 17% of all exports versus only 11% three years ago. Both countries now work together in the energy sector, petrochemical industry, metals and uranium production. This cooperation may extend to the non-resource sectors as well. For example, Kazakhstan and China have recently announced plans to set up a $1-billion joint investment fund to develop non-oil industries. In February, China and Kazakhstan signed a memorandum on the construction of a high speed railway line between Astana and Almaty. All told, tighter economic links with China will help Kazakhstan gain from the rapid economic growth of its Asian neighbor.

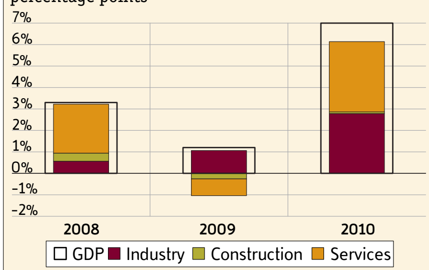
Lastly, the service-providing sectors of the Kazakh economy (which account for about 53% of the national output) are supported by improving consumer spending. Last year, trade contributed over one fifth to overall GDP growth, while the mining sector accounted for only 13%. There are signs that the service-providing industries remain on the uptrend. In January 2011, retail sales were up by 11% versus the same month a year ago, while passenger and freight traffic volumes grew by 16% and 24%, respectively. After all, the jobless rate has been

The economy bounced back in 2010 1



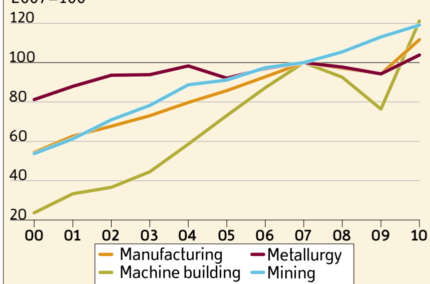
Source: ASRK, The Bleyzer Foundation

Economic growth in 2010
contributions to GDP growth by sector, percentage points 2



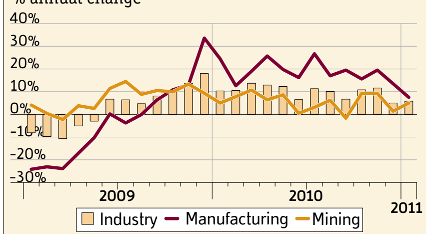
Source: ASRK, The Bleyzer Foundation

Metallurgy is recovering 3
2007=100



Source: ASRK, The Bleyzer Foundation

Industry remains on an uptrend 4
% annual change



Source: ASRK

Global commodity prices 5
January 2011, % change

	vs 2009	vs 2010
Aluminum	47%	12%
Copper	86%	27%
Iron ore	120%	20%
Steel product index	6%	5%
Crude oil, average	50%	17%
Natural gas Index	11%	9%

Source: The World Bank

below 6% since May 2010. Meanwhile, the average real wage grew by 7% last year thanks to salary increases in the mining sector and higher public-sector wages. As a result, growing aggregate payroll and increasing social payments will be supporting personal consumption.

Fiscal Policy

The state budget ended the first month of 2011 with a surplus of about $290 million (or 0.2% of projected full year GDP, see chart 7). Tax revenues continued to recover at a double-digit rate, increasing by 46% versus January 2010. Last year, tax revenues bounced back by 32% compared to 2009 on a 30% increase in corporate income tax collections and a 31% rise of VAT revenues. A similar trend is likely to persist this year as well thanks to booming domestic and foreign trade and healthy corporate profits.

In February, the government amended the 2011 republican budget, increasing its expenditure by about $2 billion to 20.6% of projected full year GDP (see chart 8). This revision was a result of increased spending on the Presidential Program “Building the Future Together”. This program, which was released during the Address of the President of the Republic of Kazakhstan in January, prioritizes employment growth and better public education and healthcare. At the same time, the government also modified its macroeconomic projections and now expects to get about $1.4 billion more in revenues thanks to a brighter economic outlook. As a result, the republican budget deficit is projected to stay below 3% in 2011. This puts the non-oil deficit (which excluded an $8 billion transfer from the National Oil Fund) below 8% of GDP for the first time since the beginning of the global economic crisis.

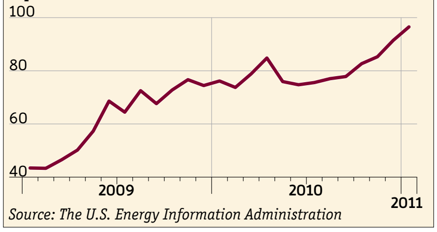
Monetary Policy

Higher global food prices are driving inflation in Kazakhstan. In January 2011, the FAO Food Price Index was 3.4% higher than in the month before as cereal prices jumped to their highest level since July 2008. Tight global supply of staple foods (such as wheat, maize and sugar) may be creating upward price pressures until the beginning of the next harvest season. As a result, in January, food prices in Kazakhstan grew at the fastest monthly rate in over three years, which pushed overall consumer prices up by 1.7% versus December 2010. This makes consumer prices 8.1% higher compared to January 2010 (see chart 9). After all, dearer foods have a large impact on the buying power of Kazakh consumers, who still spend nearly 40% of their income on groceries. In fact, consumer confidence fell slightly in January on growing concerns over higher food costs. That said, consumers still feel more upbeat compared to their mood a year ago, which should help sustain an ongoing recovery of consumer spending.

In addition, consumer deleveraging appears to be losing momentum, with the stock of retail credit staying relatively stable since the second half of 2010 (see chart 10). Banks are reporting stronger demand for mortgages and consumer loans, while intensified competition in the retail sector is prompting lenders to ease credit requirements (see chart 11). Indeed, according to the latest loan officer survey on lending practices by the central bank, about a fifth of Kazakh lenders expect to relax credit requirements for retail borrowers in the first quarter of 2011. A resumption of bank lending to consumers should add strength to personal spending as well.

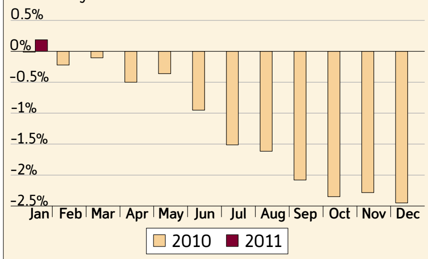
That said, bank lending is likely to experience only a gradual recovery as many banks still lack long-term funding. Indeed, since the beginning of the global financial crisis, Kazakh lenders have lost access to international financial markets, which had been the main source of the precrisis credit expansion. As a result, bank credit stood virtually flat over the past three years, while the ratio of bank loans to GDP shrank to 35% in 2010 from 57% in 2007 (see chart 12). This means that at present, bank credit plays a relatively modest role in the creation of GDP compared to the years before the onset of the economic downturn.

Europe Brent spot price 6
$ per barrel



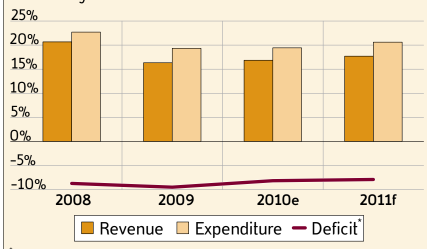
Source: The U.S. Energy Information Administration

State budget balance 7
% of full year GDP



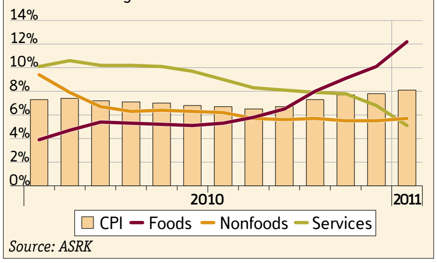
Source: Ministry of Public Finance, The Bleyzer Foundation

Republican budget 8
% of full year GDP



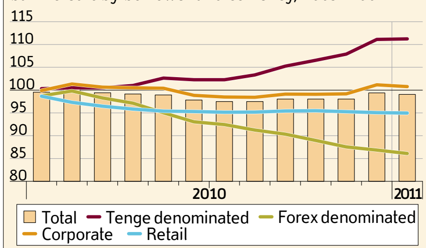
**Excluding transfers from the National Oil Fund.*
Source: Ministry of Public Finance, The Bleyzer Foundation

Consumer prices 9
% annual change



Source: ASRK

Consumer deleveraging is easing 10
bank credit by borrower and currency, 2009=100



Source: NBK, The Bleyzer Foundation

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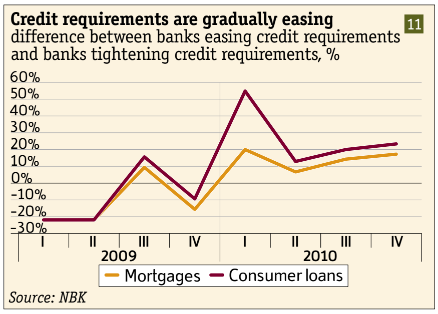
International Trade and Capital

Last year, exports grew by 37% to $59.2 billion or about 40% of GDP. As a result, the foreign trade surplus swelled to $29.5 billion versus only $14.8 billion in 2009 (see chart 13). Meanwhile, exports to China jumped by 72% to over $10 billion. In particular, exports of Kazakh crude oil to China (about 53% of all exports to China) increased by more than two times thanks to 64% growth of volumes shipped (last year, total exports of Kazakh crude oil inched up by only 1.4% to 65.6 million tons). Exports of refined copper and copper alloys (about 10% of all Kazakh exports to China) increased by 65% to $1.1 billion. Lastly, exports of Kazakh uranium to China grew by over 60% to nearly $1 billion. China also accounted for nearly half of all iron ore exports from Kazakhstan and over a quarter of the total exports of ferroalloys. All of this reflects increasing consumption of energy and base metals by Chinese industry and construction. This trend is likely to persist in the years ahead as China continues to grow above 9%, with the growth composition gradually shifting towards domestic consumption.

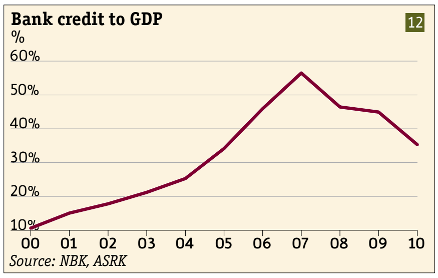
Lastly, higher commodity prices and weak demand for imports (partially thanks to lower investments in construction and pipelines) helped push the current account surplus to $5 billion compared to a deficit of $4.2 billion in 2009 (see chart 14). This is rekindling appreciation pressures on the national currency. According to the central bank of Kazakhstan, in January 2011 and in the beginning of February, the monetary authority purchased about $3 billion to avoid further strengthening of the exchange rate (similar purchases amounted to only $2 billion in 2010). As a result, at present total foreign reserves of Kazakhstan exceed $62 billion compared to less than $51 billion a year ago.

Other Developments and Reforms Affecting the Investment Climate

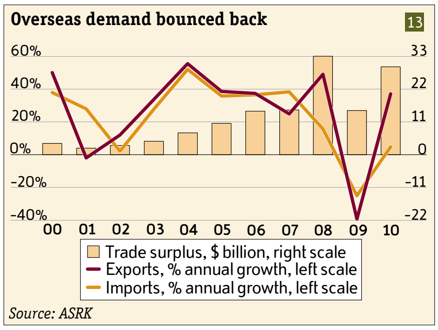
At the beginning of February, the President of Kazakhstan called for a snap presidential election (originally scheduled for 2012) on April 3rd. Earlier, the President rejected a plan to hold a referendum (which was declared unconstitutional by the country's Constitutional Council) designed to extend his tenure in the office until 2020.



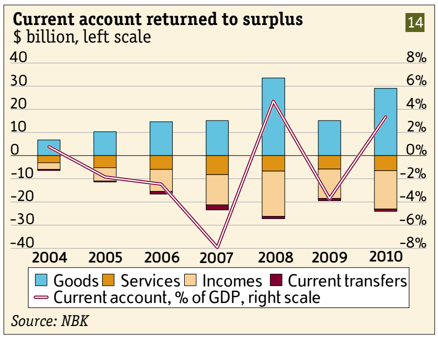
Credit requirements are gradually easing 11
difference between banks easing credit requirements and banks tightening credit requirements, %
Source: NBK



Bank credit to GDP 12
Source: NBK, ASRK



Overseas demand bounced back 13
Source: ASRK



Current account returned to surplus 14
Source: NBK