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## Kazakhstan: Banking sector problems still to be solved

***The Kazakh economy will not have the capacity to reach the 7% real growth target officially set for 2012. That notwithstanding, growth will still be relatively strong: 6% year-on-year. In 2013-2014 the economy will continue to rely on the oil sector as a primary source of growth. Developments in the banking sector continue to suffer from the consequences of the 2008 crisis, as the share of non-performing loans in Kazakhstan remains high.***

After remarkable results in 2011 (7.5% growth of real GDP), economic growth in Kazakhstan slowed down in the first quarter 2012 to 5.6% year-on-year: 1 p.p. lower than in the first quarter 2011. The main reason for this slowdown in growth lay in the decline in the extraction of oil: 2.3% in real terms. At the same time, oil exports increased during the first quarter 2012 by 13.1% in real terms. The decline in total production can thus be attributed to lower domestic sales. Preliminary investment data show that in the oil sector, fixed capital investment dropped during the first quarter 2012. In the manufacturing sector, however, investment outlays increased over that same period by a hefty 25.1% year-on-year in real terms; output in the manufacturing sector increased by 7.8% year-on-year in real terms during the first quarter 2012.

We believe that the oil sector's sluggish performance is merely a temporary matter. In the course of the current year production will pick up, as will investment given the sector's investment plans, especially those for the Kashagan project<sup>1</sup>. Other sectors will also step up investment. In particular, investment in construction will enjoy a boost thanks to sizeable state-funded infrastructure projects.

Although no data on consumption in the first quarter of 2012 are available, the rapid wage rise in real terms over that period (11.5% against 9% in the first quarter 2011) leads us to assume that household consumption remained strong throughout the first quarter 2012. However, we do not believe that household consumption can keep growing at the same

<sup>1</sup> Karachaganak is an oil field discovered in 2000, which is estimated to have commercial reserves of 9 to 16 bn barrels of oil – the largest field found during the last 30 years. In February 2012, USD 45bn funding was approved by Kazakhstan to develop the field.

high rate as it did in 2011, since real wages are unlikely to continue growing as rapidly as in 2011. We thus envisage growth in household consumption being slower than that of gross fixed capital formation during the forecast period.

Exports are expected to rise rapidly this year on the back of the high oil prices: in the first quarter 2012, merchandise exports increased by 31.7%, in particular owing to a 13.1% increase in the Brent crude oil price (USD 118.6 per barrel as against USD 104.9). We do not expect oil prices to change dramatically in the biennium 2013-2014. Export growth will thus to a large extent be more in terms of volume - and hence at a more moderate rate. The current account balance will gradually decrease, yet remain positive and relatively high. That will allow the National Bank to accumulate more foreign exchange reserves. The tenge/USD exchange rate will remain virtually stable over the forecast period. The National Bank is expected to allow somewhat greater exchange rate fluctuations, but de facto will continue to keep the exchange rate fixed to the USD.

We forecast that the Kazakh economy will not have the capacity to reach the 7% real growth target set for 2012 by the country's President. That notwithstanding, growth will still be relatively strong: 6% year-on-year. In the biennium 2013-2014, the economy will continue to rely on the oil sector as a primary source of growth. Although the manufacturing sector will register rapid growth, it will remain relatively small in volume terms compared to the oil sector. With price developments on the global oil market expected to be less favorable for Kazakhstan over the period 2013-2014, the country's real GDP will grow at a somewhat slower rate: 5-5.5% year-on-year. An inherent risk in that forecast lies in the prolonged recession in the eurozone, Kazakhstan's major oil market; it could well have a significant negative impact on global oil prices.

In the first quarter 2012 inflation dropped to 5% year-on-year. That reflects the impact of the slowdown in international food prices, a record bumper harvest and the administrative measures launched to limit price increases for fuel and dietary staples. Those factors will continue to have an impact; by the end of 2012, CPI is expected to reach only 5.5% annually – 3 p.p. lower than in 2011. Moderate levels of inflation of about 6% have also been forecast for the biennium 2013-2014.

Developments in the banking sector continue to suffer from the consequences of the 2008 crisis. On the one hand, the banking system's performance shows signs of noticeable improvement. For example, the stock of loans started to grow in 2011. In April 2012, growth gained speed: up to 16.9% year-on-year as against 2.3% year-on-year in April 2011. The bulk of newly issued loans over the period January-April 2012 was directed towards trade

(37.5% of the newly issued loans), purchases of consumer goods by households (14.3%) and manufacturing (10.5%). Mortgage loans accounted for only 2% of the newly issued loans during that period, whereas their share in the total stock of loans in April 2012 was 9.5%. On the other hand, the share of non-performing loans in Kazakhstan has remained high. In the narrowest sense of the term, the share of non-performing loans stood at 22.5% in April 2012, while another 22% of the total loans stock are considered doubtful. The reason for the latter share being so high lies in the Kazakh banking practice of restructuring many of the banks' non-performing loans by simply extending their maturity date.

In an attempt to deal with the non-performing loans issue, the government recently set up an impaired assets fund; it is to be independently managed and financed via pension funds, banks and the National Bank. However, the fund's efficiency will be limited, as it is not allowed to purchase loans related to real estate that account for about 90% of all non-performing loans. In order to deal with real-estate issues, it is envisaged that banks will set up their own special-purpose vehicles in the form of companies tasked to manage distressed assets. The process has just started and no concrete steps have been undertaken to date. Under those circumstances, resolution of the non-performing loans issue is likely to be a protracted affair.

Another potential problem facing the banking sector in Kazakhstan is that of liquidity constraints. Up until recently, rapidly growing deposits were the major source of funding for the banks (88% of total liabilities in April 2012). Furthermore, as deposits grew faster than loans, the banks enjoyed ample liquidity. By the beginning of 2012, however, growth in loans had outstripped growth in deposits. Moreover, deposits have proven to be quite a risky source of financing on account of their volatility. By their very nature, corporate deposits are volatile, and current regulations allow withdrawal of household deposits (which account for more than a half of total deposits) at any time – thus term deposits are virtually non-existing in the country. Kazakh banks will thus have to search actively for additional sources of funding: a difficult proposition considering the still limited scope for foreign borrowing after the sudden stop in banks international funding in 2008..

None the less, banking sector issues will continue to have but a limited impact on the real economy of Kazakhstan, as most investment is financed either by companies drawing down their own funds (49% of total investment in 2011), by foreign funding (21% - primarily in the oil sector) or by government resources (19.5%). In the period January-April 2012, the share of the companies' own funds in investment outlays further increased to 55%. Loans accounted only for 10.6% of fixed capital financing in 2011, their share decreasing a further 1.1 p.p. over the period January-April 2012.

There have been developments in the foreign trade policy of Kazakhstan: the country has completed all the bilateral negotiations necessary for accession to the WTO. The one final step remaining is that of concluding the round of multilateral negotiations: something that might be accomplished within a year. Russia, one of Kazakhstan's partners in the Customs Union, is expected to join the WTO by September 2012. It is expected that Russia will have to change its import tariffs and the other members of the Customs Union will have to adopt those changes - in particular, the changes relating to lowering the level of protection in the automotive industry. That particular sector in Kazakhstan was one of those most profoundly affected when the Customs Union was set up. Import duties were increased significantly, and where second-hand cars were concerned, the levies were prohibitive. In less than a year after the introduction of the new import tariffs in Kazakhstan in July 2011, the car market has changed dramatically. Cars produced in Russia secured the lion's share of the market (in particular, Lada and Hyundai of Russian assembly), while locally assembled cars increased their market share as well (in particular, assembly lines of Chevrolet, UZ-Daewoo, and Ssang Young) – mostly to the detriment of new and used cars from Asia.

Table KZ

## Kazakhstan: Selected Economic Indicators

	2008	2009	2010	2011 <sup>1)</sup>	2011 1st quarter	2012	2012 Forecast	2013 Forecast	2014
Population, th pers., average <sup>2)</sup>	15674	16093	16323	16558	16475	16717	16700	16800	16900
Gross domestic product, KZT bn, nom.	16053	17008	21816	27301	4910	5838	31400	35300	39500
annual change in % (real)	3.3	1.2	7.3	7.5	6.6	5.6	6	5	5.5
GDP/capita (EUR at exchange rate)	5800	5100	6800	8100	.	.	9600	10600	11500
GDP/capita (EUR at PPP - wiiw)	8900	8500	9300	10000	.	.	.	.	.
Consumption of households, KZT bn, nom.	6871	7913	9721	11390	.	.	12620	13910	15330
annual change in % (real)	6.3	0.7	10.0	8	.	.	5	4	4
Gross fixed capital form., KZT bn, nom.	4309	4727	5307	6590	.	.	7830	9130	10650
annual change in % (real)	1.0	-0.8	3.8	3.5	.	.	8	9	10
Gross industrial production									
annual change in % (real)	2.1	2.7	10.0	3.5	6	2.9	4	5	7
Gross agricultural production									
annual change in % (real)	-6.4	13.9	-11.7	26.7	1.8	-5.1	2	8	5
Construction industry									
annual change in % (real)	1.9	-3.2	1.0	2.7	3.1	-0.7	5	8	8
Employed persons - LFS, th, average	7857.2	7903.4	8114.2	8302.8	8134.5	8462.5	8390	8470	8550
annual change in %	3.0	0.6	2.7	2.3	1.3	4.0	1	1	1
Unemployed persons - LFS, th, average	557.8	554.5	496.5	473.1	475.9	478.5	.	.	.
Unemployment rate - LFS, in %, average	6.6	6.6	5.8	5.4	5.5	5.4	5.2	5	5
Reg. unemployment rate, in %, end of period	0.7	0.6	.	.	.	.	.	.	.
Average gross monthly wages, KZT	60734	67639	77565	89887	80195	93947	.	.	.
annual change in % (real, gross)	-2.6	3.8	7.0	7.2	9	11.5	.	.	.
Consumer prices, % p.a.	17.1	7.3	7.1	8.5	8.7	5	5.5	6	6
Producer prices in industry, % p.a.	36.8	-22.0	25.2	20	23	9.8	10	7	6
General governm.budget, nat.def., % GDP									
Revenues and grants	25.1	20.6	19.7	19.7	.	.	.	.	.
Expenditures and net lending	27.2	23.5	22.1	21.8	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-2.1	-2.9	-2.4	-2.1	.	.	-2.5	-1.5	-1.0
Public debt, nat. def., in % of GDP	8.3	12.2	14.7	16	.	.	16	16	15
Central bank policy rate % p.a., end of period <sup>3)</sup>	10.5	7.0	7.0	7.5	7.5	7.0	.	.	.
Current account, EUR mn <sup>4)</sup>	4298	-2950	1814	10136	1680	2896	12300	10600	9200
Current account in % of GDP	4.7	-3.6	1.6	7.6	6.8	9.6	7.6	6.0	4.7
Exports of goods, BOP, EUR mn <sup>4)</sup>	48905	31504	46376	63551	12251	16815	76300	83600	88600
annual growth rate in %	38.5	-35.6	47.2	37.0	24.7	37.3	20.1	9.6	6.0
Imports of goods, BOP, EUR mn <sup>4)</sup>	26128	20769	24786	29601	5382	7432	37700	43200	47900
annual growth rate in %	7.5	-20.5	19.3	19.4	31.3	38.1	27.4	14.6	10.9
Exports of services, BOP, EUR mn <sup>4)</sup>	3007	3038	3203	3239	677	786	3790	4000	4080
annual growth rate in %	15.5	1.0	5.4	1.1	3.8	16.0	17.0	5.5	2.0
Imports of services, BOP, EUR mn <sup>4)</sup>	7556	7200	8534	7845	1370	2054	10000	10760	11410
annual growth rate in %	-11.8	-4.7	18.5	-8.1	-19.1	50.0	27.5	7.6	6.0
FDI inflow, EUR mn <sup>4)</sup>	9732	9497	8109	9274	3058	3546	10600	11400	10800
FDI outflow, EUR mn <sup>4)</sup>	818	2266	5902	3254	1409	342	3977	4355	4317
Gross reserves of NB excl. gold, EUR mn	12630	14352	19044	19474	22762	20390	.	.	.
Gross external debt, EUR mn	76278	78674	89261	95811	87450	.	.	.	.
Gross external debt in % of GDP	84.1	95.1	80.1	71.6	65.4	.	.	.	.
Average exchange rate KZT/EUR	177.04	205.68	195.67	204.11	199.91	194.12	195	198	203
Purchasing power parity KZT/EUR, wiiw <sup>5)</sup>	115.30	123.85	143.49	164.71	.	.	.	.	.

1) Preliminary. - 2) From 2009 according to census 2009. - 3) Refinancing rate of NB. - 4) Converted from USD with the average exchange rate. - 5) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: National statistics (National Bank, Agency of Statistics etc). Forecasts by wiiw.