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Kazakhstan: Strong growth continues, but problems in the banking sector remain

GDP growth for 2011 is forecast at 7% thanks to high global oil prices. Oil exports are hampered by shortcomings in terms of both transport infrastructure and production capacities. In the biennium 2012-2013 the Kazakh economy will grow by 6%. Both consumer and investment demand will rise, the latter more rapidly. The banking sector has not yet fully recovered from the crisis. As asset cleansing gets underway in the banking sector, the economy will benefit from a gradual improvement in access to funding. As a result of high global food prices, CPI in 2011 will increase to 8%. In the biennium 2012-2013, inflation will slow down to around 7%.

Kazakhstan's economy showed a strong performance in the first quarter of 2011 – real GDP growth reached 6.6% year on year, which was only 0.5 percentage points lower than in the first quarter of 2010. The biggest contribution to growth was made by wholesale and retail trade (14.6% real growth year on year), mining (5%) and manufacturing (8%). In manufacturing, it was primarily metallurgy that contributed to the fast growth. The real estate sector, which accounts for almost 10% of the economy, showed sluggish dynamics with 0.5% real growth year on year, reflecting still persisting consequences of the housing bubble burst.

We revise upwards our GDP forecast for 2011 primarily due to higher than previously expected global oil prices. The more favourable global commodities market situation will cause merchandise exports to grow faster in 2011 – by 20% in euro terms.

In 2012-2013, merchandise exports growth will slow down to 10% and 8% respectively in euro terms as oil prices are not expected to surge further, and limitations of the oil transit infrastructure will be a bottleneck for faster export growth volumes. Currently, Kazakhstan has almost reached the limits of oil pipelines capacity; now new investment is needed to expand it. Recently Caspian Pipeline Consortium members have agreed to invest over USD 5 billion to double by 2014 the capacity of the major Kazakh pipeline that connects the country's oil fields to Russian terminals in the Black Sea. The oil production sector also

poses limitations for export growth. Though the first phase of the Kashagan oil field operation is expected later this year (producing 0.37 million b/d), full-scale operation of the field, which would allow Kazakhstan to double its oil production (to about 3 million b/d), is likely to be postponed again – until after 2015 – due to issues related with the high costs of the project.

As indicated by the wholesale and retail trade dynamics, consumer demand is exhibiting strong growth. The major factors behind this trend are rising salaries – both in the private and public sector – and social transfers. In particular, pensions were raised by 30% at the beginning of 2011, students' scholarships and wages of public sector employees will increase by 30% starting from July 2011. Higher tax revenues (primarily due to higher oil export tax receipts) and the improved GDP forecast for 2011 allowed the Kazakh government to revise the current year budget and increase government expenditures by the equivalent of about USD 2 billion (or 1% of GDP), thus a further increase in social expenditures is likely. Employment has also been picking up: in the first quarter of 2011 it rose by 1.3% year on year. As a result of those trends, we expect real household consumption to increase by 6% in 2011. Continuing growth of real household income will provide for real household consumption growth by 5% in 2012 and 2013.

Gross fixed capital formation is forecasted to grow by 10% in real terms in 2011, the bulk of it being directed to oil extraction and transport infrastructure. The construction sector will remain lethargic in 2011, with only 4% real growth. In 2012-2013, however, we expect the housing market to revive as financing conditions will ease, and construction sector growth will jump to 8-10% in real terms. Already now there are signs of a market recovery, as housing prices started to rise by 6-7% year on year; yet the pre-crisis level of prices is still out of sight – on the secondary housing market prices are still 20% lower than in 2007. The expected ease of access to financing will also be felt in other sectors which will be able to expand their investment projects. As a result, we forecast real gross fixed capital formation to increase by 7% in both 2012 and 2013.

Strong consumer and investment demand will cause an acceleration of import growth in 2011: we expect merchandise imports to outperform exports in terms of growth and increase by 25% in euro terms. In 2012-2013, the growth of merchandise imports will slow down somewhat, to 15% and 10% respectively. The current account balance is expected to remain positive during the forecasting period at a level of about 3% of GDP.

Inflation has picked up recently in Kazakhstan, reaching 8.6% year on year in April 2011. The biggest contribution to the CPI increase comes from food prices, reflecting the global

food market trends. In March 2011, the National Bank of Kazakhstan increased its key interest rate by 0.5 percentage points to 7.5% in an attempt to tighten its monetary policy. In addition, administrative measures to stabilize food prices were adopted by the government – a reduction of the annual 2010-2011 grain export quota by 1 million tonnes to 6 million tonnes. However, we believe that these measures will not be sufficient to bring the inflation down by much, especially taking into account the quite expansionary fiscal policy. We therefore revise upwards our forecast of CPI for 2011, to 8%. In 2012-2013, inflation will slow down to around 7% in annual terms.

Starting from February 2011, the National Bank of Kazakhstan has officially switched from the earlier exchange rate corridor policy to a managed float. However, de facto the Bank remains strongly committed to maintaining stability of the exchange rate and has been intervening heavily to oppose revaluation pressures. During January to April 2011, the tenge revalued only by 2% with respect to the US dollar, while gross forex reserves were increased by almost USD 9 billion to USD 37 billion, and National Oil Fund assets were increased by USD 5.5 billion to USD 36 billion. The National Bank has been sterilizing its interventions through sales of short-term NBK notes. We expect an only mild revaluation of the tenge over 2011-2013 to 140 KZT/USD on average in 2013.

Though Kazakh banks have ample liquidity as deposits have been increasing relatively fast – by 12% year on year in April 2011; the loans dynamics remains rather stagnant – slight growth of the loans volume started only in March 2011 and reached 2% year on year in April 2011. The major reason for that performance is the persisting high share of non-performing loans in banks' assets (25% of total loans at the end of April 2011), which makes them unwilling to take the risk of issuing new loans. The National Bank of Kazakhstan is currently developing policies to tackle the cleansing of banks' assets. In particular, a fund is being set up that will purchase non-performing loans from banks. Besides, the government intends to support writing off bad loans by banks through subsidies and tax benefits, and to stimulate the creation of companies managing bad assets. These measures, however, are likely to bring any significant effect only starting from the next year.

On 3 April 2011, presidential elections took place in Kazakhstan. The incumbent President Nursultan Nazarbayev, who has been running the country for about 20 years, remained in his post. The opposition did not participate in the elections – either by choice, or because they failed to pass the vetting process; also, the unexpectedly early date of the elections left them without enough time to launch a campaign. The three candidates who were running against Nazarbayev had no chance of winning and some even expressed publicly

their support for Nazarbayev, thus admitting that this was not a real political contest. External election observers from OSCE also noted significant legal shortcomings of the election process, in particular restrictions on potential candidates and on the freedom of assembly. The outcome of the presidential elections is not going to bring about any significant changes to the political system or government policies; rather further stability is to be expected.

Table KZ

Kazakhstan: Selected Economic Indicators

	2007	2008	2009	2010 ¹⁾	2010 1st quarter	2011	2011 Forecast	2012	2013
Population, th pers., average	15484	15674	15880	16210	16049	16475	16500	16600	16700
Gross domestic product, KZT bn, nom.	12850	16053	17008	21648	4021	4910	26600	29900	33600
annual change in % (real)	8.9	3.3	1.2	7.0	7.1	6.6	7	6	6
GDP/capita (EUR at exchange rate)	4900	5800	5200	6800	.	.	8600	9700	11100
GDP/capita (EUR at PPP - wiw)	8800	8800	8600	9300	.	.	.	.	.
Consumption of households, KZT bn, nom.	5641	6871	7913	9602	1836	.	10900	12200	13600
annual change in % (real)	10.9	6.3	0.6	10.9	3.8	.	6	5	5
Gross fixed capital form., KZT bn, nom.	3857	4309	4727	5249	722	.	6700	7500	8500
annual change in % (real)	17.3	1.0	-0.8	3.8	8.3	.	10	7	7
Gross industrial production									
annual change in % (real)	5.0	2.1	2.7	10.0	11.5	6.0	6	5	5
Gross agricultural production									
annual change in % (real)	8.9	-6.4	13.9	-11.7	2.4	1.8	12	5	5
Construction industry									
annual change in % (real)	5.7	1.9	-3.2	1.0	-8.7	3.1	4	8	10
Employed persons - LFS, th, average	7631.8	7857.2	7903.4	8114.2	8029.3	8134.5	8280	8360	8440
annual change in %	3.1	3.0	0.6	2.7	2.5	1.3	2	1	1
Unemployed persons - LFS, th, average	578.8	557.8	554.5	496.5	526.2	475.9	.	.	.
Unemployment rate - LFS, in %, average	7.3	6.6	6.6	5.8	6.2	5.5	5.5	5.3	5.2
Reg. unemployment rate, in %, end of period	0.8	0.7	0.6	.	1.0	.	.	.	.
Average gross monthly wages, KZT	53238	60734	67639	77611	67839	80195	.	.	.
annual change in % (real, gross)	17.8	-2.6	3.8	7.6	0.9	9.0	.	.	.
Consumer prices, % p.a.	10.8	17.1	7.3	7.1	7.6	8.7	8	7	6.5
Producer prices in industry, % p.a.	12.4	36.8	-22.0	25.2	45.5	23.0	18	5	6
General government budget, nat. def., % GDP									
Revenues and grants	22.5	25.1	20.6	19.9	.	.	.	.	.
Expenditures and net lending	24.1	27.2	23.5	22.3	.	.	.	.	.
Deficit (-) / surplus (+), % GDP	-1.7	-2.1	-2.9	-2.4	.	.	-2.5	-2.0	-1.0
Public debt, nat. def., in % of GDP	7.1	8.3	12.2	14.8	.	.	13	11	11
Central bank policy rate % p.a., end of period ²⁾	9.0	10.5	7.0	7.0	7.0	7.5	.	.	.
Current account, EUR mn ³⁾	-6077	4298	-3126	3252	2002	3547	4500	4200	4400
Current account in % of GDP	-7.9	4.7	-3.8	2.9	10.2	14.4	3.2	2.6	2.4
Exports of goods, BOP, EUR mn ³⁾	35309	48905	31506	45814	9789	13549	55200	60700	65600
annual growth rate in %	14.3	38.5	-35.6	45.4	56.3	38.4	20	10	8
Imports of goods, BOP, EUR mn ³⁾	24288	26128	20770	24065	4027	5383	30000	34500	37900
annual growth rate in %	26.4	7.6	-20.5	15.9	-14.3	33.7	25	15	10
Exports of services, BOP, EUR mn ³⁾	2603	3007	3036	3196	651	699	3400	3600	3900
annual growth rate in %	15.9	15.5	1.0	5.3	-13.2	7.4	6	6	8
Imports of services, BOP, EUR mn ³⁾	8566	7556	7204	8508	1686	1761	10000	11200	12500
annual growth rate in %	22.7	-11.8	-4.7	18.1	6.0	4.4	18	12	12
FDI inflow, EUR mn ³⁾	8120	9732	9876	7501	2458	2344	8400	9100	10000
FDI outflow, EUR mn ³⁾	2303	818	2236	5878	14	463	2500	2700	2900
Gross reserves of NB excl. gold, EUR mn	11970	13711	16184	21360	20146	24959	.	.	.
Gross external debt, EUR mn	65791	76278	78933	90029	.	.	.	.	.
Gross external debt in % of GDP	85.9	84.1	95.5	81.4	.	.	.	.	.
Average exchange rate KZT/EUR	167.75	177.04	205.67	195.67	204.86	199.91	189	186	182
Purchasing power parity KZT/EUR, wiw ⁴⁾	93.86	116.20	124.54	144.22	.	.	.	.	.

1) Preliminary. - 2) Refinancing rate of NB. - 3) Converted from USD with the average exchange rate. - 4) Based on ICP benchmark results 2005 and wiw estimates.

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