

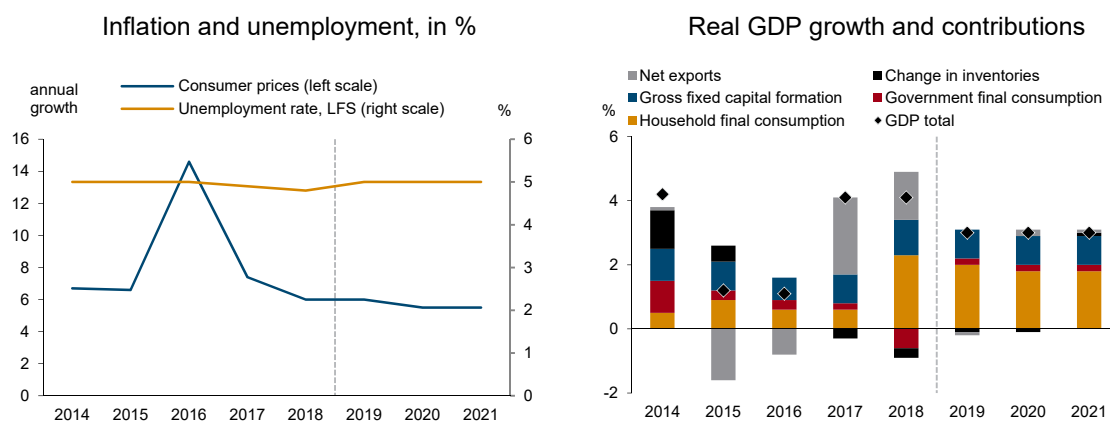


## KAZAKHSTAN: Falling oil prices bring economic diversification to the fore

OLGA PINDYUK

GDP growth reached 4% year on year in 2018, mainly owing to high oil prices and expansion of production in the oil sector. In 2019, the negative effect of the drop in oil prices on the economy will be somewhat offset by government stimulus measures directed primarily at stimulating private consumption. Nevertheless, economic growth will slow down to about 3% p.a. during the forecast period.

Figure 6.9 / Kazakhstan: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

**2018 was a relatively successful year for the Kazakh economy, which grew by about 4% year on year primarily on the back of higher global oil prices.** The average price of Brent crude oil in 2018 was 31.5% higher than in 2017, which allowed exports, the main driving force behind economic growth, to increase in 2018 by about 25% year on year in USD terms. Additionally, the oil sector received a boost from the supply side as total oil output in 2018 reached the record level of 90.3 million tonnes – 4 million tonnes more than in the previous year. Output expansion was driven in particular by the operation of the recently launched Kashagan oil field.

**The expected drop in oil prices in 2019 creates a challenge for the economy, which has not diversified sufficiently to soften the blow.** The shutdown of the three main oil fields Karachaganak, Kashagan, and Tengiz in 2019 for major repairs, which is estimated to last for about a month, will be an additional factor adversely affecting performance of the extractive sector. As a result, we forecast that merchandise exports will fall in 2019 by 15% and then rebound in 2020-2021 – but only modestly as oil prices are assumed not to grow significantly during this period.

**Government policies to promote economic diversification have not been very successful so far.**

The extractive sector still plays the central role in the economy – it accounted for about 75% of total goods exports and for 69% of fixed capital investment in industry in 2018. Moreover, it continues to attract the bulk of FDI, two other important sectors being metallurgy and retail and wholesale trade.

**On 21 February 2019, President Nursultan Nazarbayev dismissed the government, citing its failure to diversify the economy away from the energy sector, as well as to raise living standards.**

He announced a number of measures to strengthen social welfare at a conference of his Nur Otan party on 27 February and promised to allocate considerable funds to pay for the measures. This will mark a sharp change in the economic policy course, which recently was focused on promoting investment, in particular into infrastructure development.

**Structural reforms will remain high on the governmental agenda during the forecast period, but are not likely to advance significantly.** In November 2018, the government adopted the 'Kazakhstan 2025' strategic development plan, which contains a roadmap for a new model of private sector growth, as well as measures to increase productivity, and develop human capital, competition and investment. In line with President Nazarbayev's request, KZT 500 billion (equivalent to 0.85% of 2018 GDP) will be allocated during 2019-2021 to support the manufacturing industry and non-commodity exports. Additionally, the National Bank is required to allocate long-term tenge liquidity of at least KZT 600 billion (1% of 2018 GDP) to provide affordable loans for priority sectors.

**Government stimulus measures will somewhat offset the dampening effect of falling oil prices on the economy.** On the downside, state support has been costly and is associated with risks of rising imbalances in the economy as the state's role in the economy increases. Credit subsidies introduce distortions to economic activity and might have inflationary effects. Besides, funding of subsidies by the National Bank runs contrary to the requirement of its independence and interferes with its focus on inflation targeting. Risks to the efficiency of the new policies are as usual related to corruption and funds misappropriation.

**The clean-up of the banking sector has continued, with a USD 3.4 billion bailout of the second largest lender Tsesnabank.** First Heartland Securities, part of a group controlled by the state-owned Nazarbayev University, bought the bank after Kazakh authorities agreed to take a further KZT 604 billion (USD 1.6 billion) of non-performing loans off its balance sheet. It was the second purchase of bad debts from Tsesnabank by Kazakhstan's problem asset fund in less than six months, following a KZT 450 billion transfer in September 2018. The state also provided a liquidity injection to the bank making the total bill for the bailout exceed KZT 1.1 trillion.

**Banks have continued to expand their loans portfolios mainly with loans to households.** In December 2018, the stock of loans to households was 16.8% higher as compared with December 2017, while for corporate loans growth was negative at -4.6%. The dynamics of the latter was caused to a large extent by perceived lack of good borrowers among corporate clients and higher cautiousness of banks in the face of tightening banking supervision. In addition, writing-off of non-performing loans, the bulk of which is concentrated in the corporate segment, also played its role.

**Double-digit growth in loans to households, whose incomes have been rising rather modestly, can hardly be sustained in the long run.** A bubble could develop if banks do not restrain their loan activity in this market. However, decent credit growth is still quite likely over the forecast period for the following reasons: the end of the sector's consolidation, finalising writing off distressed assets, and government programmes of forex mortgage loans refinancing and loans to 'priority economic sectors'.

**The trade surplus widened in 2018 by more than USD 10 billion (about 6% of 2018 GDP) as merchandise import growth was less impressive in 2018 as compared to exports – 7.5% year on year in USD terms.** Machinery and equipment, metals and chemicals, which together account for about two thirds of merchandise imports, contributed the most to growth. The current account balance managed to stay in positive territory in 2018 – for the first time since 2014.

**During 2019-2021, sluggish oil price dynamics will cause the trade surplus to gradually shrink, consequently the current account balance will go back into the red.** Rising depreciation pressures on the tenge will make the National Bank of Kazakhstan more cautious in its monetary policy this year. On 15 January 2019, it left the base interest rate unchanged at 9.25% and signalled the possibility of a rate increase during the year if the external conditions are unfavourable. However, in the absence of big oil price shocks, significant depreciation and a spike in inflation are not likely. Inflation is expected to remain in the target corridor of 4-6% and gradually decline over the forecast period.

**The government is determined to continue fiscal consolidation, though the budget for 2019 envisages wage increases, higher social spending and support for SMEs and manufacturing sectors.** Expansionary policies will be introduced in order to stimulate private consumption over the next few years. The increase in expenditures is expected to be financed from higher VAT and corporate income tax revenues, so that transfers of the National Oil Fund can phase out as planned.

**On March 19, 2019, President Nazarbayev announced his resignation after 29 years in power.** His duties will be performed by Senate Speaker Kassym-Jomart Tokayev until the early presidential elections take place. Even though he is stepping down as head of state, Nazarbayev will retain a wide-ranging degree of authority under his title of Leader of the Nation and as a lifelong head of the national Security Council. This should facilitate a smooth transition of power in the country, but it is not clear yet who will be Nazarbayev's successor and what changes in policies to expect.

**Given lower oil prices, GDP growth will slow down to about 3% p.a. during the forecast period.** Private consumption, supported by the state stimulus programmes, will make the biggest contribution to growth. Sizeable progress in diversification of the economy is not likely to happen during the forecast period as the effects of the related government policies are more long-term in nature.

**Table 6.9 / Kazakhstan: Selected economic indicators**

	2014	2015	2016	2017	2018 <sup>1)</sup>	2019	2020	2021
						Forecast		
Population, th pers., average	17,288	17,543	17,794	18,038	18,276	18,450	18,630	18,820
Gross domestic product, KZT bn, nom.	39,676	40,884	46,971	53,101	58,786	63,900	69,100	74,700
annual change in % (real)	4.2	1.2	1.1	4.1	4.1	3.0	3.0	3.0
GDP/capita (EUR at PPP)	18,300	18,800	18,400	19,100	19,800	.	.	.
Consumption of households, KZT bn, nom.	18,806	21,492	25,087	26,991	29,900	.	.	.
annual change in % (real)	1.1	1.8	1.2	1.2	4.5	4.0	3.5	3.5
Gross fixed capital form., KZT bn, nom.	8,552	9,355	10,671	11,622	14,500	.	.	.
annual change in % (real)	4.4	4.2	3.0	4.0	5.0	4.0	4.0	4.0
Gross industrial production								
annual change in % (real)	0.3	-1.6	-1.1	7.3	4.1	2.0	2.0	2.0
Gross agricultural production								
annual change in % (real)	1.0	3.4	5.4	3.0	3.4	.	.	.
Construction industry								
annual change in % (real)	4.6	5.8	7.4	2.8	4.1	.	.	.
Employed persons, LFS, th, average	8,510	8,624	8,553	8,585	8,720	8,810	8,900	8,990
annual change in %	-0.7	1.3	-0.8	0.4	1.6	1.0	1.0	1.0
Unemployed persons, LFS, th, average	452	451	446	442	440	460	470	470
Unemployment rate, LFS, in %, average	5.0	5.0	5.0	4.9	4.8	5.0	5.0	5.0
Reg. unemployment rate, in %, eop	0.4	0.4	0.4	0.8	1.0	.	.	.
Average monthly gross wages, KZT <sup>2)</sup>	121,021	126,021	142,898	150,827	163,500	180,200	195,800	212,800
annual change in % (real, gross)	3.9	-2.3	-1.1	-1.7	2.3	4.0	3.0	3.0
Consumer prices (HICP), % p.a.	6.7	6.6	14.6	7.4	6.0	6.0	5.5	5.5
Producer prices in industry, % p.a.	9.5	-20.5	16.8	15.3	19.0	-10.0	1.0	1.0
General governm.budget, nat.def., % of GDP								
Revenues	18.5	18.7	19.8	21.8	18.4	19.0	20.0	20.0
Expenditures	21.2	20.9	21.4	24.5	19.8	21.5	22.0	22.0
Deficit (-) / surplus (+)	-2.7	-2.2	-1.6	-2.7	-1.4	-2.5	-2.0	-2.0
General gov.gross debt, nat.def., % of GDP	14.6	22.7	25.0	26.3	27.3	24.0	23.0	22.0
Stock of loans of non-fin.private sector, % p.a.	7.2	4.7	0.3	0.0	3.0	.	.	.
Non-performing loans (NPL), in %, eop	23.5	8.0	6.7	9.3	7.4	.	.	.
Central bank policy rate, % p.a., eop <sup>3)</sup>	5.50	16.00	12.00	10.25	9.25	9.00	8.25	7.50
Current account, EUR mn <sup>4)</sup>	4,621	-4,632	-8,029	-4,770	784	-4,800	-5,100	-4,200
Current account in % of GDP	2.8	-2.8	-6.5	-3.3	0.5	-3.1	-3.2	-2.5
Exports of goods, BOP, EUR mn <sup>4)</sup>	60,440	41,961	33,673	43,772	52,470	46,200	46,600	47,100
annual change in %	-6.2	-30.6	-19.8	30.0	19.9	-11.9	0.9	1.1
Imports of goods, BOP, EUR mn <sup>4)</sup>	33,162	30,530	25,366	28,418	29,252	31,800	33,300	34,100
annual change in %	-13.3	-7.9	-16.9	12.0	2.9	8.7	4.7	2.4
Exports of services, BOP, EUR mn <sup>4)</sup>	4,981	5,842	5,699	5,699	5,892	6,400	6,700	7,000
annual change in %	22.9	17.3	-2.4	0.0	3.4	8.6	4.7	4.5
Imports of services, BOP, EUR mn <sup>4)</sup>	9,721	10,448	9,997	9,610	9,387	10,000	10,300	10,400
annual change in %	3.6	7.5	-4.3	-3.9	-2.3	6.5	3.0	1.0
FDI liabilities, EUR mn <sup>4)</sup>	5,437	5,755	15,273	4,119	362	.	.	.
FDI assets, EUR mn <sup>4)</sup>	1,982	2,992	3,140	847	-3,080	.	.	.
Gross reserves of NB excl. gold, EUR mn <sup>4)</sup>	17,920	18,555	19,191	15,505	14,460	.	.	.
Gross external debt, EUR mn <sup>4)</sup>	129,438	140,266	155,980	140,158	143,200	149,700	151,000	149,900
Gross external debt, % of GDP	77.7	84.3	125.7	97.2	99.1	97.4	93.5	89.7
Average exchange rate KZT/EUR	238.10	245.80	378.63	368.32	406.66	416	428	447

1) Preliminary and wiiw estimates. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) From 2015 one-day (overnight) repo rate, refinancing rate of NB before. - 4) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.