KAZAKHSTAN: Geopolitical balancing act to limit economic damage

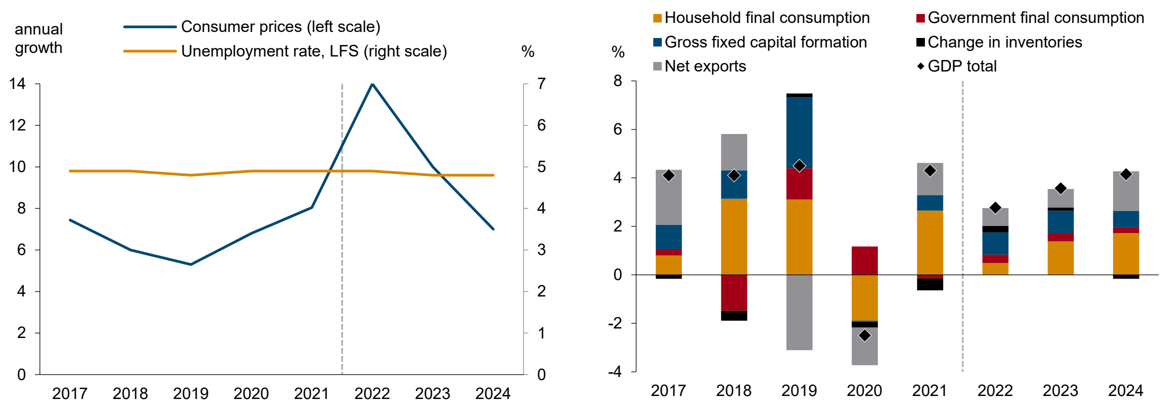
ALEXANDRA BYKOVA

Amid all the geopolitical shocks, Kazakhstan's balancing act has helped it limit the economic damage. Nevertheless, the economy has been weakening, having been hit by all the disruptions, and is expected to grow by 2.8% this year. Although infrastructure investments, import substitution policies and fiscal stimulus to consumption should all go some way to supporting growth, in view of the lower oil prices, the further recession in Russia and the unfavourable external environment we have revised our real GDP forecast for 2023-2024 slightly downwards.

Figure 6.9 / Kazakhstan: Main macroeconomic indicators

Inflation and unemployment, in %

Real GDP growth and contributions



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

Economic growth is slowing down, having been hit by high inflation and disruptions caused by the economic shocks in the wake of the Russian invasion of Ukraine. Since it peaked in March, the short-term economic indicator that captures annual real growth in the main sectors of the economy[15] has been slipping gradually each month: from 6.5% over the first three months to 3.7% in January-August. The slightly poorer sentiment indicators for manufacturing and services in August also point to an expected cooling later this year.[16] Manufacturing and construction are likely to suffer further from disruptions to logistics and high input prices caused by both global trends and robust linkages with the Russian economy.

15 The main sectors include agriculture, industry, construction, trade, transport and communications; value added in those economic activities amounts to more than 60% of GDP.

16 The Tengri Partners Kazakhstan Manufacturing and Services PMI, compiled by IHS Markit.

The strong ties with Russia have hurt the economy less than we anticipated in our Spring Report, but a sharper decline in exports is expected later, when controls on the export of sanctioned goods become stricter. In dollar terms, exports to and imports from Russia fell by 5.1% and 1%, respectively, in March-July, compared to the same period of 2021. Given Russia's large shares in commodity trade – 11.5% of exports and 42.1% of imports last year – such a modest reduction has proved less damaging to the economy than we previously expected. The smaller impact is a result of the shallower recession in Russia, a restructuring in trading partners[17] and anecdotal evidence of 'grey' exports to Russia.[18] Although Kazakhstan has officially declared its compliance with the Western sanctions and the restrictions on trade, official trade statistics depict a 180% increase in exports of 'machinery and equipment' to Russia over seven months.[19] Following recent official statements, stricter control of sanctioned goods is to be expected.

In the face of increasing external pressure, Kazakhstan's geopolitical balancing act to avoid economic damage is becoming more difficult. The escalation of the Russian war in Ukraine has intensified the external shocks to Kazakhstan, which is heavily exposed to external pressure, due to its high trade and investment dependence, as well as its geographical location and the transport routes it uses. Kazakhstan has been complying with the anti-Russian sanctions on trade in order to avoid secondary sanctions, but it now faces Russian disgruntlement amid the fading hopes of 'grey' imports. President Tokayev continues to reaffirm his friendly relations with Russia and his commitment to the Eurasian Economic Union (EAEU), despite some existing tensions, such as disruptions to the Caspian Pipeline Consortium (CPC) pipeline in the Russian port of Novorossiysk (most probably politically motivated). The state management company has had to bail out and take over Kazakhstan's second-largest bank, a subsidiary of the Russian Sberbank, which is under sanctions. Although banks in Kazakhstan have, to some extent, benefited from the influx of money from Russian clients, some – including the largest Halyk bank – have recently been refusing to use the Russian Mir payment system, due to the threat of secondary sanctions by the US. The labour and housing markets are facing certain challenges, after several tens of thousands of people fled Russia to Kazakhstan to escape mobilisation.

The reorientation of trade, transport and investment flows is gradually taking shape, but its impact will be felt predominantly in the long term. Kazakhstan is seeking to secure political support from China to counterbalance Russia and protect its political independence from Moscow. The government is prioritising domestic production so as to reduce import dependence. Kazakhstan is looking for new partnerships in logistics, trade and investment. The strategic partnership with Turkey has been expanded, and now also focuses on military cooperation. New investments of around USD 0.9bn are expected from the United Arab Emirates. Cooperation has begun with Azerbaijan, Georgia and Turkey on the Trans-Caspian East-West transport corridor, which bypasses Russia. However, as these projects are mostly long term, a very substantial vulnerability to geopolitical risk will likely remain in the near future.

17 For example, Kazakhstan was able to rapidly diversify its imports of 'machinery and equipment' away from Russia: these grew by 10.8% over the first seven months of 2022, despite a decline by 20.4% in Russian imports.

18 The media have reported unauthorised exports to Russia – without the trademark owner's permission – of cars, smartphones and soft drinks.

19 Harmonised System (HS) codes 84-92: machinery, equipment, vehicles, instruments and apparatus.

After impressive growth in the first half of the year, driven by high global commodity prices, exports are expected to weaken, given the projected drop in oil prices and constraints on oil production growth. Strong export growth (56.8%), mainly driven by the high price of oil, metals and wheat, and much lower import growth (14.8%) led to a current account surplus of 6.4% of GDP in the first half of 2022. A turnaround in oil prices in the second half of the year is likely to limit the current account surplus to 3% of GDP for the whole year. Real oil-sector growth will be weak in 2022, due to several CPC pipeline disruptions and the recent drop in production at the Kashagan oil field, following an accident and the subsequent repair work. Although the recent announcement of a cut in OPEC+ quotas led to a slight increase in oil prices, we do not expect quotas to fully offset the downward pressure generated by the global economic slowdown. We assume that oil prices will fall on an annual basis in 2023 and 2024. Oil production is set to recover after the turmoil of this year, but growth will be constrained by quotas. However, according to official estimates, oil production should increase by around 10% in 2024, when the Tengiz oil field finally expands its capacity. Possible new disruptions to the CPC pipeline remain a serious downside risk for the oil sector.

We expect substantial investment in infrastructure and construction over the forecast horizon. Real fixed capital investment grew by 5.7% over the first eight months of 2022, mainly driven by housing construction, numerous publicly funded infrastructure projects, private expansion investments at the Tengiz oil field, and maintenance and repair work in other oil fields. Kazakhstan is keen to attract private foreign investment into import-substituting production. President Tokayev officially announced in September that there would be new public investment in hospitals and road construction in rural areas. Large public and private investment in transport and logistics infrastructure is expected to encourage the diversification of transport routes. An upgrade to the capacity of the port of Aktau and of domestic pipelines should ensure greater use of the Baku-Tbilisi-Ceyhan pipeline and oil shipments across the Caspian Sea.

Although business sentiment is clouded by worsening access to credit and uncertainty about the economic outlook, import substitution policies are likely to support manufacturing growth further. Manufacturing posted real growth of 4.8% over the first eight months, but business surveys in August showed mixed feelings about future demand: around 15% of respondents expected an improvement, while around 12% thought there would be a deterioration. Around 11% pointed to a worsening of credit conditions, given the high interest rates. By contrast, a slowdown in input costs is seen as a positive sign. We expect import substitution measures – such as subsidised loans, direct funding of investment projects and tax preferences – to support the production of food, fuels, chemical and construction materials. The relocation of large companies from Russia to Kazakhstan is likely to have a moderately positive impact, though probably rather in the medium term,[20] with IT services likely to benefit the most.

Our forecasts for inflation have been revised upwards, as the figures for the second half of the year so far have been higher than anticipated, and the expectation is that this trend will continue. Annual consumer price inflation accelerated from 8.5% in January to 16.1% in August, driven by food prices (sugar and flour prices soared by 90% and 49%, respectively), rents and utility bills, which picked up after the moratorium ended in July, though the prices of key vehicle fuels continue to be regulated. Inflationary pressure is also coming from the depreciation of the tenge: 44% against the rouble and

[20] According to official data, only a few of the 43 companies that expressed interest in a relocation have actually done so or are planning to do so in the near future. They include Honeywell, Huawei, Ural Motors, Carlsberg and Philip Morris.

10.5% against the dollar by the end of September, compared to the beginning of the year. Inflation expectations remained high in August. Nevertheless, the central bank kept the policy rate unchanged at 14.5% in September, in view of the slower growth of the country's main trading partners and the recent decline in global food and energy prices. Against this backdrop, we expect inflation to moderate gradually, albeit from a higher level; we have therefore revised our inflation forecasts upwards to the end of the forecast horizon.

Sluggish private consumption in 2022 should improve next year, as inflation gradually eases and the new fiscal stimulus takes effect. Although there is no sign of a deterioration in the labour market so far, real income increased by only 1.4% over the first seven months on account of the high inflation. Real wages grew by 12.6% year on year in Q1, boosted by a minimum wage hike in January; but their growth slowed to 8.8% in Q2. Weak retail trade (2.1% real annual growth over the first eight months) also points to weak consumption in 2022. The still high growth in loans to households has decelerated slightly, from 42% in January (year on year) to 38% in August, mostly at the expense of long-term loans. The recently announced new fiscal package includes a minimum wage hike of 16% in 2023, a gradual increase in pensions and maternity benefits over the next few years, and subsidised loans for education. These new fiscal measures, along with the easing of inflation, should help consumption growth to recover. Transfers from the National Oil Fund (which recorded high revenues this year), the privatisation of state enterprises and a 'luxury tax' from 2024 will finance those fiscal measures and keep the budget deficit under control.

We expect the early presidential election in November – ahead of the parliamentary elections in 2023 – to strengthen President Tokayev's hold on power and reinforce the current policy stance. After recent constitutional amendments, Tokayev continues to distance himself from former President Nazarbaev: an amnesty was announced for those convicted in the wake of the January protests, the capital city reverted from Nur-Sultan (in honour of Nazarbaev) to its previous name of Astana, and a relative of the former president was convicted of corruption. These policies, along with new social support measures, are likely to stave off broad social discontent and ensure the current president's smooth re-election.

In summary, we expect the economy to grow by 2.8% in 2022 and to accelerate in coming years, driven by investment and a recovery in consumption. The growth forecast for 2022 remains unchanged, as a sharper slowdown in the second half of the year should be offset by the lower than previously expected negative impact of trade with Russia. We have revised our GDP forecast for 2023 downwards to 3.6%, due to the expected sharper decline in oil prices and a growth slowdown among the country's major trading partners. The revisions are not great, however, as new infrastructure investment and the financial stimulus for consumption should cushion the adverse impact.

Table 6.9 / Kazakhstan: Selected economic indicators

	2019	2020	2021 1)	2021 January-June	2022 January-June	2022 Forecast	2023 Forecast	2024 Forecast
Population, th pers., average	18,514	18,756	19,001	18,696	18,932	19,200	19,400	19,700
Gross domestic product, KZT bn, nom.	69,533	70,649	83,952	32,265	40,034	103,500	112,600	122,000
annual change in % (real)	4.5	-2.5	4.3	2.4	3.6	2.8	3.6	4.1
GDP/capita (EUR at PPP)	18,680	17,870	19,720	.	.	.	.	.
Consumption of households, KZT bn, nom.	35,571	36,661	41,440	.	.	.	.	.
annual change in % (real)	6.1	-3.7	5.1	.	.	1.0	2.8	3.5
Gross fixed capital form., KZT bn, nom.	16,318	17,463	19,276	.	.	.	.	.
annual change in % (real)	13.8	-0.2	2.6	.	.	4.0	4.0	3.0
Gross industrial production								
annual change in % (real)	4.1	-0.5	3.6	1.5	3.5	2.6	3.5	4.0
Gross agricultural production								
annual change in % (real)	-0.1	5.7	-2.3	3.5	1.4	.	.	.
Construction industry								
annual change in % (real)	13.2	11.6	8.3	11.9	9.2	.	.	.
Employed persons, LFS, th, average	8,781	8,732	8,807	8,793	8,822	8,870	8,980	9,100
annual change in %	1.0	-0.6	0.9	0.5	0.3	0.7	1.2	1.3
Unemployed persons, LFS, th, average	441	449	450	451	453	460	450	460
Unemployment rate, LFS, in %, average	4.8	4.9	4.9	4.9	4.9	4.9	4.8	4.8
Reg. unemployment rate, in %, eop	1.1	1.5	1.1	2.4	2.2	.	.	.
Average monthly gross wages, KZT 2)	186,815	213,003	250,311	241,187	298,722	299,600	342,700	377,700
annual change in % (real, gross)	9.1	6.8	8.8	9.0	10.6	5.0	4.0	3.0
Consumer prices, % p.a.	5.3	6.8	8.0	7.3	11.9	14.0	10.0	7.0
Producer prices in industry, % p.a.	5.1	-8.0	32.5	22.3	37.0	36.0	10.0	5.0
General governm. budget, nat. def., % of GDP								
Revenues	18.3	20.6	18.9	22.5	24.8	23.0	20.0	20.0
Expenditures	20.2	24.5	21.9	26.0	25.1	25.0	22.7	22.6
Deficit (-) / surplus (+)	-1.8	-4.0	-3.0	-3.5	-0.3	-2.0	-2.7	-2.6
General gov. gross debt, nat. def., % of GDP	24.9	30.5	27.6	27.6	22.2	23.0	24.0	25.0
Stock of loans of non-fin. private sector, % p.a.	5.9	5.5	26.5	12.9	27.5	.	.	.
Non-performing loans (NPL), in %, eop	8.1	6.9	3.3	4.8	3.6	.	.	.
Central bank policy rate, % p.a., eop 3)	9.25	9.00	9.75	9.00	14.00	14.50	11.00	8.00
Current account, EUR m 4)	-7,398	-6,648	-6,648	-3,112	5,177	6,500	-1,200	-3,700
Current account in % of GDP	-4.6	-4.4	-4.0	-4.9	6.4	3.0	-0.5	-1.5
Exports of goods, BOP, EUR m 4)	51,953	41,437	50,999	22,397	38,658	82,000	81,900	83,900
annual change in %	2.4	-20.2	23.1	-6.0	72.6	60.8	-0.1	2.4
Imports of goods, BOP, EUR m 4)	36,729	33,335	35,140	15,496	19,579	46,400	54,100	58,900
annual change in %	23.8	-9.2	5.4	1.1	26.4	32.0	16.6	8.9
Exports of services, BOP, EUR m 4)	6,926	4,423	4,916	2,227	2,984	6,500	7,100	7,400
annual change in %	11.6	-36.1	11.1	-6.0	34.0	32.2	9.2	4.2
Imports of services, BOP, EUR m 4)	10,199	7,149	6,455	2,811	3,600	8,500	9,100	9,600
annual change in %	0.4	-29.9	-9.7	-29.2	28.0	31.7	7.1	5.5
FDI liabilities, EUR m 4)	3,332	6,324	3,876	1,657	3,878	8,300	.	.
FDI assets, EUR m 4)	-1,941	1,199	2,252	515	1,323	1,900	.	.
Gross reserves of CB excl. gold, EUR m 4)	9,004	9,827	9,586	11,117	9,110	.	.	.
Gross external debt, EUR m 4)	142,474	134,102	145,784	140,246	156,236	157,000	158,000	160,000
Gross external debt, % of GDP	87.8	89.5	87.5	93.6	73.1	73.0	68.0	65.0
Average exchange rate KZT/EUR	428.51	471.44	503.88	511.27	491.33	484	485	495

1) Preliminary. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) Base rate (overnight repo rate as a target). - 4) Converted from USD.

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