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

Kazakhstan's economy exhibited outstanding real growth of 7.5% in 2011. We forecast that strong GDP growth of 5-6% in real terms will continue in 2012-2014. The oil sector will remain the backbone of the economy, accounting for the bulk of its exports and FDI. Investment growth is forecasted to speed up in 2012-2014 to about 8-10%, in particular owing to a number of state-financed investment projects. Banking sector vulnerabilities have been accumulating, with the share of non-performing bank loans reaching 21.7% and the BTA bank negotiating a second restructuring.

Kazakhstan's economy demonstrated outstanding performance in 2011, with real GDP increasing by 7.5%. We forecast that strong GDP growth of 5-6% in real terms will continue in 2012-2014. Improved prospects for the economy are reflected in the country's upgraded ratings by S&P and Fitch.¹ The oil sector will remain the backbone of the economy, accounting for the bulk of its exports and FDI. Non-fuel exports further decreased their share in 2011 by about 6 percentage points to 22%; metals are the second largest exports item with a share of about 12%. We base our forecast of Kazakhstan's robust economic performance on the assumption that the world oil price dynamics will continue to be favourable for the country, as prices will remain at around 100 USD per barrel.

In 2011, rapid growth in Kazakhstan's commodity exports brought about a record-high current account surplus at a level of 7.4% of GDP. Most of the export growth occurred in value terms owing to the increase in global oil prices – the average price of crude Brent increased by about 39% in 2011. The physical volume of oil production rose only by 1% in 2011 – the increase being so modest partly due to the strikes of oil field workers in the West of the country. In the next three years, oil prices are not expected to soar further, and therefore Kazakhstan will have to rely on an increase in the production volume to boost its oil export revenues. We forecast that the increase in oil production will be very moderate in

¹ In November 2011, Fitch Ratings upgraded Kazakhstan's long-term foreign issuer default ratings from 'BBB-' to 'BBB', while Standard & Poor's upgraded the rating from 'BBB' to 'BBB+'.

2012 – about 2%; higher oil output growth is expected in 2013 with the Kashagan oil field starting its operation. This oil field is expected to produce around 400 thousand barrels of oil per day in the first phase.² This would allow Kazakhstan to increase its oil output by about 25% in 2013, which will translate into 15% growth of merchandise exports in 2013.

Development of the Kashagan field and increasing production and transportation capacities of other major oil fields will provide for a stable significant influx of FDI into the country. After the Kazakh government muscled into the fourth largest oil field Karachaganak by forcing the Karachaganak Petroleum Operating Consortium to sell it 10% of the stakes at the end of 2011, the state now has stakes in all the major oil fields. Thus government policy in the oil sector is likely to be more stable and predictable for investors in the near future.

Investment growth is forecasted to speed up in 2012-2014 to about 8-10% and outpace household consumption growth. Investment is expected to grow not only in the oil extraction, but in other sectors as well. The president of Kazakhstan announced in January 2012 ambitious investment plans which are to be financed from the National Oil Fund. In particular, money has to be channelled into the construction of roads and railroads, a fertilizer plant (USD 2 billion), a heat and power plant (USD 2.3 billion), an oil refinery at the Atyrau oil field (USD 1.7 billion), a gas processing plant (USD 5 billion), and some other projects.

Increased oil production will allow growth in exports to speed up in 2013-2014. However, it will also mean higher repatriated income of foreign investors, which will put a downward pressure on the current account. The increase in domestic investment and FDI will translate into growth of imports of equipment and services. Thus, the current account surplus will gradually decrease from 5.7% of GDP in 2012 to 4.4% of GDP in 2014.

Credit in Kazakhstan started to increase in 2011: in December, the amount of outstanding loans increased by 15.7% year on year, as compared to -0.7% year on year in December 2010. However, non-performing loans are still on the rise – in December 2011, the share of non-performing loans reached 21.7%, 1.7 percentage points higher as compared with December 2010. The bulk of the non-performing loans are corporate ones, with construction, real estate and trade having the highest shares. It is these sectors that were hit the hardest in 2008, and the ongoing increase in the share of non-performing loans is a

² By 2020, the Kashagan oil field should increase its output to the peak level of about 1.5 million barrels of oil per day and become the biggest field in the country in terms of production.

delayed consequence of that hit: companies stop servicing their debt and banks have to admit more bad loans in their portfolios. In the BTA bank, which was restructured as a result of the crisis³, the share of non-performing loans reached about 75%. In January 2012, the bank defaulted on its USD 160 million Eurobond coupon payment, and Fitch Ratings has downgraded the bank's Long-term Issuer Default Rating to 'RD' from 'C'. Now another agreement on the bank's restructuring is being negotiated.

Kazakh banks still have limited access to external financing and its share in total liabilities has been steadily declining – from 45% at the end of 2008 to 20% at the end of 2011. Thus, deposits of firms and households have become a primary source of funding. There are 15 banks with foreign capital in Kazakhstan, but they account only for about 23% of the banking sector assets, and many of them, including the biggest foreign bank ATF belonging to UniCredit Bank Austria, experienced losses in 2011. This environment reinforces risk aversion of banks and prevents them from any faster issuance of new loans.

The National Bank of Kazakhstan introduced important measures to restore the banking system's health, such as removing tax impediments to writing off bad loans, discouraging foreign currency lending, and increasing minimum capital requirements. However, additional measures are needed to reduce non-performing loans and bring back banks' willingness to issue loans.

The Customs Union between Belarus, Kazakhstan and Russia has been moving to a new level of integration: in December 2011, the member countries agreed on the forming of a Single Economic Space in 2015 and created the supranational governing body – the Eurasian Economic Commission. Also, the government announced that the country is going to enter the WTO already in 2012, as bilateral negotiations with almost all the members of the Working Group have been successfully concluded.

Early parliamentary elections were held in Kazakhstan on 16 January 2012. According to the voting results, the pro-Presidential party Nur Otan lost its monopoly status in the parliament, as two other parties managed to get 7.3% of votes each. Observers from the Organization for Security and Cooperation in Europe (OSCE) called the elections orchestrated and not meeting the fundamental principles of democratic elections, as the rights of citizens were seriously limited and opposition was practically banned from the

³ Kazakhstan was the first country to experience a sudden stop of external financing in 2007. Two major banks, BTA and Alliance, which were extremely dependent on external financing, had to go through restructuring in 2010.

election process. The change in the parliament's composition did not cause any visible political adjustments as the government remained unchanged.

Human rights issues have been escalating in Kazakhstan. A prolonged strike of oil field workers for pay rise in Zhanaozen in the West of the country turned into a violent confrontation on 16 December 2011. Firing on protesters by police resulted in 15 people killed and about 100 people wounded. The investigation of the incident led to the arrest of several opposition leaders who are accused of inciting striking oil workers to violence. International human rights watchdogs criticize the arrests as politically motivated. However, these issues are not likely to translate into large-scale unrest as the opposition has limited influence on the society and the country's territory is too big for coordinated widespread actions.

Table KZ

Kazakhstan: Selected Economic Indicators

	2006	2007	2008	2009	2010	2011 ¹⁾	2012	2013 Forecast	2014
Population, th pers., average ²⁾	15308	15484	15674	16093	16323	16558	16700	16800	16900
Gross domestic product, KZT bn, nom.	10214	12850	16053	17008	21816	27301	31500	35400	39600
annual change in % (real)	10.7	8.9	3.3	1.2	7.3	7.5	6	5	5.5
GDP/capita (EUR at exchange rate)	4200	4900	5800	5100	6800	8100	9400	10500	11800
GDP/capita (EUR at PPP - wiiw)	8000	8800	8900	8500	9300	10000	.	.	.
Consumption of households, KZT bn, nom.	4547	5641	6871	7913	9721	11390	12920	14380	15850
annual change in % (real)	12.7	10.9	6.3	0.7	10.0	8	5	4	4
Gross fixed capital form., KZT bn, nom.	3084	3857	4309	4727	5307	6590	7540	8790	10250
annual change in % (real)	29.7	17.3	1.0	-0.8	3.8	3.5	8	9	10
Gross industrial production									
annual change in % (real)	7.0	5.0	2.1	2.7	10.0	3.5	4	5	7
Gross agricultural production									
annual change in % (real)	7.0	8.9	-6.4	13.9	-11.7	26.7	2	8	5
Construction industry									
annual change in % (real)	28.6	5.7	1.9	-3.2	1.0	2.7	5	8	8
Employed persons - LFS, th, average	7403.5	7631.8	7857.2	7903.4	8114.2	8302.8	8390	8470	8550
annual change in %	2.0	3.1	3.0	0.6	2.7	2.3	1	1	1
Unemployed persons - LFS, th, average	625.4	578.8	557.8	554.5	496.5	473.1	.	.	.
Unemployment rate - LFS, in %, average	7.8	7.3	6.6	6.6	5.8	5.4	5.2	5	5
Reg. unemployment rate, in %, end of period	1.1	0.8	0.7	0.6
Average gross monthly wages, KZT	40790	53238	60734	67639	77565	89887	.	.	.
annual change in % (real, gross)	10.3	17.8	-2.6	3.8	7.0	7.2	.	.	.
Consumer prices, % p.a.	8.6	10.8	17.1	7.3	7.1	8.5	8	7	6
Producer prices in industry, % p.a.	18.4	12.4	36.8	-22.0	25.2	20	6	7	6
General governm.budget, nat.def., % GDP									
Revenues and grants	27.9	22.5	25.1	20.6	19.7	19.7	.	.	.
Expenditures and net lending	20.4	24.1	27.2	23.5	22.1	21.8	.	.	.
Deficit (-) / surplus (+), % GDP	7.5	-1.7	-2.1	-2.9	-2.4	-2.1	-2.5	-1.5	-1.0
Public debt, nat. def., in % of GDP	11.3	7.1	8.3	12.2	14.7	16	16	16	15
Central bank policy rate % p.a., end of period ³⁾	9.0	9.0	10.5	7.0	7.0	7.5	.	.	.
Current account, EUR mn ⁴⁾	-1592	-6077	4298	-2917	2269	9776	8800	8100	8600
Current account in % of GDP	-2.5	-7.9	4.7	-3.5	2.0	7.3	5.6	4.6	4.3
Exports of goods, BOP, EUR mn ⁴⁾	30881	35309	48905	31506	45814	63856	69100	79400	89000
annual growth rate in %	35.8	14.3	38.5	-35.6	45.4	39.4	8	15	12
Imports of goods, BOP, EUR mn ⁴⁾	19216	24288	26128	20770	24065	30260	35500	42500	48900
annual growth rate in %	33.1	26.4	7.6	-20.5	15.9	25.7	17	20	15
Exports of services, BOP, EUR mn ⁴⁾	2246	2603	3007	3038	3199	3172	3490	3770	4000
annual growth rate in %	25.4	15.9	15.5	1.0	5.3	-0.8	10	8	6
Imports of services, BOP, EUR mn ⁴⁾	6979	8566	7556	7200	8518	7521	8590	9450	10390
annual growth rate in %	15.9	22.7	-11.8	-4.7	18.3	-11.7	14	10	10
FDI inflow, EUR mn ⁴⁾	5002	8120	9732	9496	8040	9434	10200	11200	10800
FDI outflow, EUR mn ⁴⁾	-306	2303	818	2265	5888	3133	3610	3900	4320
Gross reserves of NB excl. gold, EUR mn	14525	11970	13711	16184	21360	22697	.	.	.
Gross external debt, EUR mn	56252	65791	76278	78933	90029	93660	.	.	.
Gross external debt in % of GDP	87.2	85.9	84.1	95.5	80.7	70.0	.	.	.
Average exchange rate KZT/EUR	158.27	167.75	177.04	205.67	195.67	204.11	202	202	199
Purchasing power parity KZT/EUR, wiiw ⁵⁾	83.35	93.87	115.30	123.85	143.49	164.62	.	.	.

1) Preliminary and wiiw estimates. - 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.