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Research Report on Kazakhstan

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Introduction

Despite reaching independence from the Soviet Union in 1991, Kazakhstan's proximity to Russia is not only geographical, but also political and commercial. Given such level of partnership, Kazakhstan has historically been exposed to Russia's economic position apart from its own risks. Kazakhstan, the second largest oil and gas producer in the CIS union after Russia, is highly dependent on revenues coming from taxation of that industry. While the consolidated budget shows high levels of surplus, much of these figures are still explained by strong oil and gas revenues (leading to deficit in non-oil and gas budget). High inflation rates combined with sharp devaluations of Tenge are the main drivers of current deposit dollarization levels, which introduces additional risks to the current situation of the country.

Main Economic Indicators of Kazakhstan

Macro indicators	2011	2012	2013
Gross pub. debt, bill Tenge	2869	3760	4536
Nominal GDP, bill Tenge	27571	30347	33521
Nominal GDP growth, %	26,4	10,1	10,5
Gross gov. debt/GDP,%	10,4	12,4	13,5
Deficit (surplus)/GDP,%	6,0	4,5	5,0
Inflation rate,%	7,4	6,0	4,8
Curr. Account balance/GDP,%	5,4	0,3	0,1

Development indicators	2013
Inequality adj. HDI	0,75
GDP per capita (Thou. of USD)	14,4

Sources: RAEX (Europe) calculations based on data from World Bank, IMF, Bloomberg

Debt load of the Kazakhstan Government stands at acceptable levels. Even though gross government debt/GDP almost doubled from 6,8% in 2008 to 13,5% in 2013, current values are still tolerable. For that reason, level of government debt (4 537 billion of Tenge in 2013) introduces no risk to Kazakhs economy. What is more, short-term debt doesn't show potential risk given that its 2013 value accounted for 1,24% of the government budget income.

Government budget showed strong consolidated surplus during 2012-13, but major part of this surplus is generated by oil trade. Surplus figures registered in recent years in the consolidated budget of Kazakhstan (see table 1) were explained by larger government income which resulted from higher oil prices. In contrast, non-oil budget showed a strong deficit during the period 2012-13 (-9% and -8,1% of GDP respectively), which proves high dependence of government revenues from oil and gas taxation.

High levels of bank deposit dollarization present moderate risk for the economy. The share of dollar-denominated deposits in total deposits showed a sharp increase from around 30% at the beginning of 2013 to 50% by mid-2014. Drivers of dollarization include a number of macroeconomic and institutional factors. On the one hand, high and volatile inflation rates that have prevailed in Kazakhstan during the last six years are one of the main reasons of distrust in Tenge. On the other hand, sharp and abrupt devaluations of Tenge, like those observed at the beginning of 2009 and 2014 (see graph 1), also contribute to deposit dollarization.

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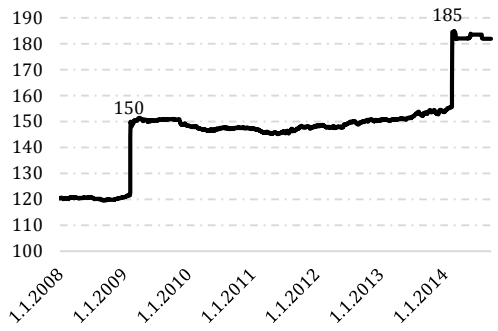
Table 1: Government budget 2012-2013 (% GDP)

	2012	2013
Expenditure	22,4	21,2
Revenues	26,9	26,2
Balance	4,5	5,0
Oil-Balance	13,5	13,1
Non-oil Balance	-9,0	-8,1
Urals oil price, USD/barrel	110,4	107,9

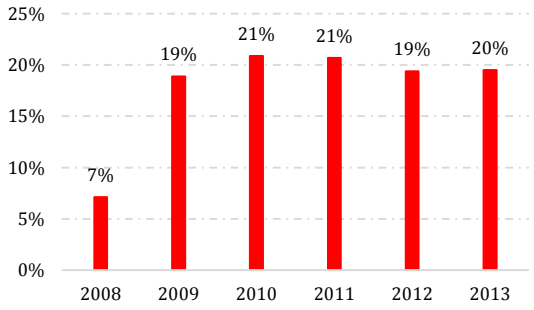
Source: RAEX (Europe) calculations based on data from IMF

Graph 1: Tenge/USD exchange rate



Source: RAEX (Europe) calculations based on data from Central Bank of Kazakhstan

Graph 2: Distressed loans (% of total loans)



Source: RAEX (Europe) calculations based on data from World Bank

Monetary policy carried out by the central bank of Kazakhstan has performed well, but inflation and foreign exchange reserves should be monitored. Even though the central bank of Kazakhstan has the commitment of conducting foreign exchange policy under a managed flotation regime, the sharp devaluation episodes observed in 2009 and 2014 were the results of external shocks (aftermath of 2008 world crisis and devaluation of Ruble at the beginning of 2014). Levels of foreign exchange reserves (27 billion of USD by the end of 2013) can be at risk given current levels of deposit dollarization and managed flotation regime. Like in other countries of the region, inflation rate in Kazakhstan has declined in recent years but current high levels call for keeping on watch future developments of this variable.

Sluggish performance of the banking sector can be further fueled by high levels of distressed loans. The banking sector of Kazakhstan showed negative performance in terms of profitability during 2013 with ROA accounting for -1,9%. Moreover, the share of distressed loans in total loans, which reached 19,5% in 2013 and increased sharply (see graph 2), nourish the risk of further negative profitability of banks.

Recent unification and nationalization of pension funds shall be monitored. The 10 pension funds of Kazakhstan, with total assets of 22,5 billion of USD (10 percent of GDP) have been unified with the aim of improving returns on the assets while maintaining individual accounts. Given that the unified pension fund will be owned by a government agency and managed largely by the National Bank of Kazakhstan, there are still concerns about future management performance of the funds. In addition, despite the fact that Kazakhstan benefits from political and social stability, recent changes in the pension system (which also include raise of the retirement age for women) have generated public discontent.

Conclusion

On the one hand, the government of Kazakhstan shows low levels of debt and strong consolidated surplus, mainly due to higher oil and gas prices which have prevailed since 2011. On the other hand, banking system of Kazakhstan started showing signs of poor performance mainly fueled by the high share of distressed loans. Additionally, non-oil budget showed a strong deficit during the period 2012-13, which proves the high dependence of government revenues from oil and gas taxation. High levels of deposit dollarization as well as high inflation rates call for keeping an eye on future developments of monetary policy in Kazakhstan. Also, future performance of the recently unified and nationalized pension funds remains uncertain.

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