Euler Hermes Economic Research

Country Report

Kazakhstan

Country risk increases as economy is hit by lower oil prices and impact of Russia crisis

General Information

GDP	USD231.90 bn (World ranking 46, World Bank 2013)
Population	17 mn (World ranking 61, World Bank 2013)
Form of state	Republic / authoritarian presidential rule
Head of government	Nursultan A. NAZARBAYEV
Next elections	2016, legislative (lower house)

Strengths

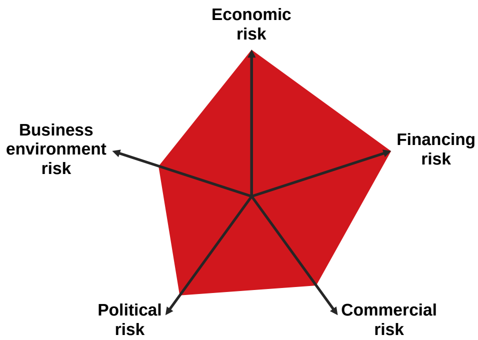
- Abundance of raw materials, in particular hydrocarbons
- The National Fund of the Republic of Kazakhstan (NFRK, the national oil fund) still holds ample assets as of USD69 bn in May 2015 (though this was down from a peak of USD77 bn in August 2014)

Weaknesses

- Authoritarian political regime
- Increasingly interventionist and protectionist economic strategy
- Regional instability in Central Asia
- High vulnerability to world commodity prices
- Vulnerability to Russian business cycle
- Weak monetary policy track record
- Exchange rate vulnerability to external shocks
- Banking sector crisis not yet resolved
- High external debt burden

Country Rating

D4



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
China	22%	1	35%	Russia
Russia	15%	2	25%	China
France	9%	3	6%	Ukraine
Germany	6%	4	5%	Germany
Italy	5%	5	2%	Italy

By product (% of total)

Exports		Rank		Imports
Crude Oil	52%	1	8%	Commercial Vehicles
Non Ferrous Metals	7%	2	5%	Crude Oil
Natural Gas	5%	3	4%	Tubes
Iron Steel	5%	4	4%	Knitwear
Refined Petroleum Products	4%	5	4%	Engines

Source: Chelem (2013)

Economic Overview

Lack of economic diversification

Kazakhstan possesses substantial crude oil and natural gas reserves, as well as plentiful supplies of other minerals and metals. It also is a large agricultural producer, mainly livestock and grain. Surging commodity prices supported a strong economic performance between 2000-2007, reflected in average annual growth of real GDP of 10.2%. On the demand side, growth had been driven by private consumption and private sector investment, fuelled by strong wage expansion and an excessive credit boom, with the latter increasingly funded by large-scale foreign borrowing of Kazakh banks. However, the 2007-2009 global financial crisis unmasked the high risks related to inadequate economic diversification and heavy dependence on international financial flows. While the domestic banking crisis is still unresolved, the ongoing vulnerability to global commodity prices (especially oil prices) has been underpinned once again in 2014-2015.

Sharp slowdown of growth

In 2014, real GDP growth decelerated to +4.3% from +6% in 2013, owing to a number of reasons: (i) a slowdown of domestic demand due to the 20% currency devaluation in February 2014; (ii) the shutdown of the off-shore Kashagan oilfield since October 2013 due to damage to the pipeline infrastructure; (iii) reduced global demand for Kazakhstan's main export commodities; (iv) the sharp decline in global oil prices since mid-2014; and (v) spillovers from the Russian crisis (notably the KZT appreciation against the sharply falling RUB caused a loss of competitiveness).

In 2015, real GDP growth is forecast to slow down further to +1.8%. This reflects ongoing oil output problems (production at the Kashagan oilfield is now unlikely to resume before 2017), much lower average oil prices than in 2014, economic weakness in Russia (Kazakhstan's main trade partner), and the loss of competitiveness (until the KZT may be devalued). Growth is forecast to recover to about +3% in 2016 as the economy adjusts to lower oil prices and fiscal stimulus takes effect.

Exchange rate and inflation risks

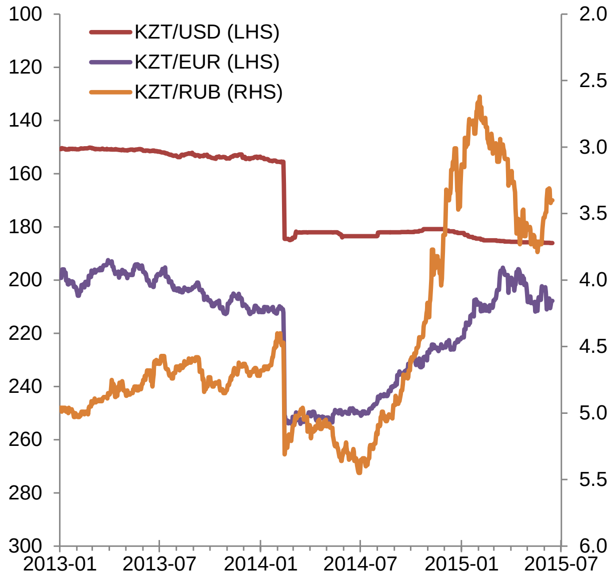
In February 2014 the National Bank of Kazakhstan (NBK; the central bank) devalued the KZT by almost 20% against the USD in a surprise move, citing the impact of U.S. Fed tapering on emerging markets, however, no significant downward pressure on the KZT had been observed at that point. Since then the NBK has held the exchange rate fairly stable in a band of KZT182-188 per USD, which was widened to a band of KZT170-188 in September 2014. However, the sharp depreciation of the RUB against the USD in H2 2014 caused it also to depreciate against the KZT: the Kazakh currency rose from a low of KZT5.45 per RUB in mid-2014 to a high of KZT2.62 in early-February 2015, before weakening to KZT3.40 in mid-June 2015 as the RUB regained some of its earlier losses. Nonetheless, the still relatively strong KZT/RUB exchange rate continues to weigh on the competitiveness of the Kazakh economy and has resulted in downward pressure on the KZT against the USD and increased incentives for dollarization, reflected in many firms and households converting KZT deposits into FX. There is a significant risk that the KZT may be devalued further or depreciate markedly against the USD in the next 6-12 months. In that event, inflation would also pick up again, after it has slowed from 7.4% at end-2014 to 4.3% y/y in May 2015.

Key economic forecasts

	2013	2014	2015f	2016f
GDP growth (% change)	6.0	4.3	1.8	3.0
Inflation (%, end-year)	4.8	7.4	7.2	6.0
Fiscal balance (% of GDP)	5.0	1.9	-3.6	-2.0
Public debt (% of GDP)	12.9	15.1	17.2	19.1
Current account (% of GDP)	0.5	1.6	-4.1	-3.1
External debt (% of GDP)	66.3	73.0	79.0	80.0

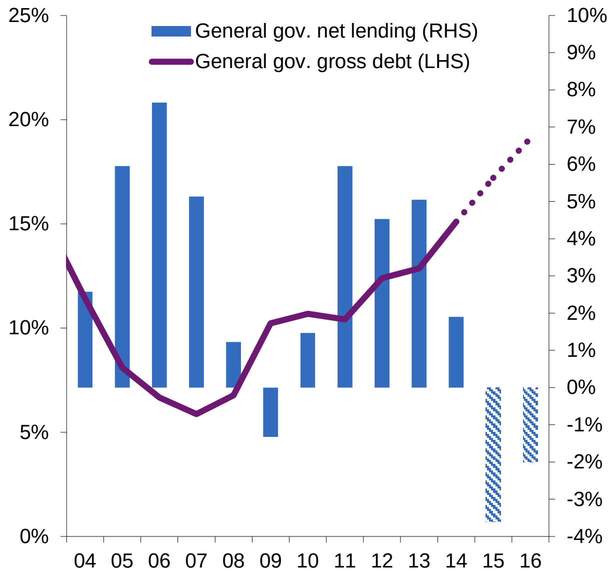
Sources: National sources, IHS, Euler Hermes

Exchange rate



Sources: National Bank of Kazakhstan, Euler Hermes

Public finances (% of GDP)



Sources: National sources, IMF, Euler Hermes

High banking sector risk

The banking sector has been in crisis since 2009 and remains vulnerable as the second default of state-controlled BTA Bank in early 2012 underscored once again. While liquidity and capital adequacy ratios are acceptable, profitability remains weak and the KZT devaluation in 2014 pushed non-performing loans to 34% of total loans in April before they fell back to a still very high 24% at end-2014 thanks to some stepped-up measures by the NBK and the government.

Fiscal account shifts to large deficit ...

The fiscal surplus narrowed from +5% of GDP in 2013 to +1.8% in 2014 and is forecast to shift to a deficit of -3.6% of GDP in 2015 as a result of much lower oil prices and the weakened economy, even though transfers from the NFRK (Kazakhstan's National Oil Fund) to the government budget are set to increase from 4.3% of GDP in 2014 to 6% in 2015. A fiscal deficit of -2% of GDP is forecast for 2016. Total public debt will remain low, however, forecast at about 19% of GDP in 2016.

... as does the current account

The current account balance is forecast to swing from a surplus of +1.6% of GDP in 2014 to a deficit of -4.1% in 2015 as a result of the much weaker export performance. In 2016, the external deficit is projected to narrow to -3.1% of GDP.

High external debt burden

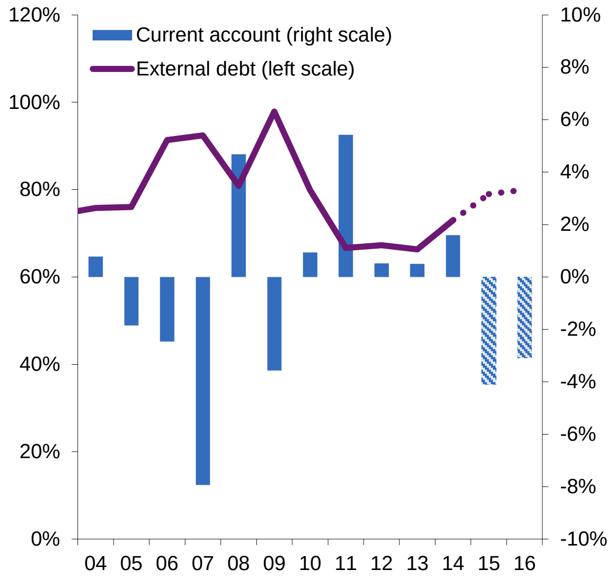
Gross external debt rose to USD157 bn at end-2014 which is relatively high in relations to GDP (73%) or export earnings (184%). This is a legacy of the large-scale foreign borrowing of Kazakh banks until 2007. The debt service ratio will remain hefty for some time, estimated at around 40% annually in 2015-2016.

Foreign exchange reserves are modest

Official FX reserves have gradually fallen from a peak of USD33.7 bn in April 2011 to USD17.7 bn in October 2013 and, after a slight recovery, have stagnated at around USD21 bn since early 2014. Meanwhile, the current level of FX reserves is inadequate with regard to import cover (2.7 months). In other terms, reserves cover just about 40% of the estimated external debt payments falling due in the next 12 months, also well below an adequate ratio of at least 100%.

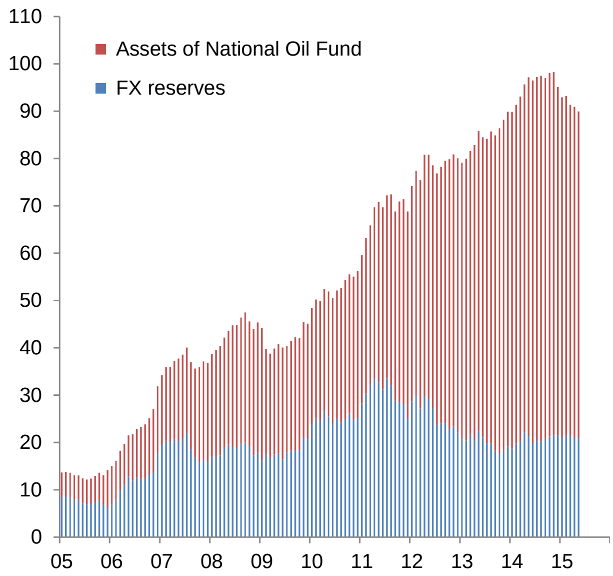
While assets in the NFRK (USD69 bn in May 2015) still provide some cushion with regard to the modest official FX reserves, they have also fallen from a peak of USD77 bn in August 2014 and are expected to fall further due to increased transfers to the budget and to banking sector restructuring.

Current account and external debt (% of GDP)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves and assets of National Oil Fund (NFRK) (USD bn)



Sources: National sources, IMF, Euler Hermes

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