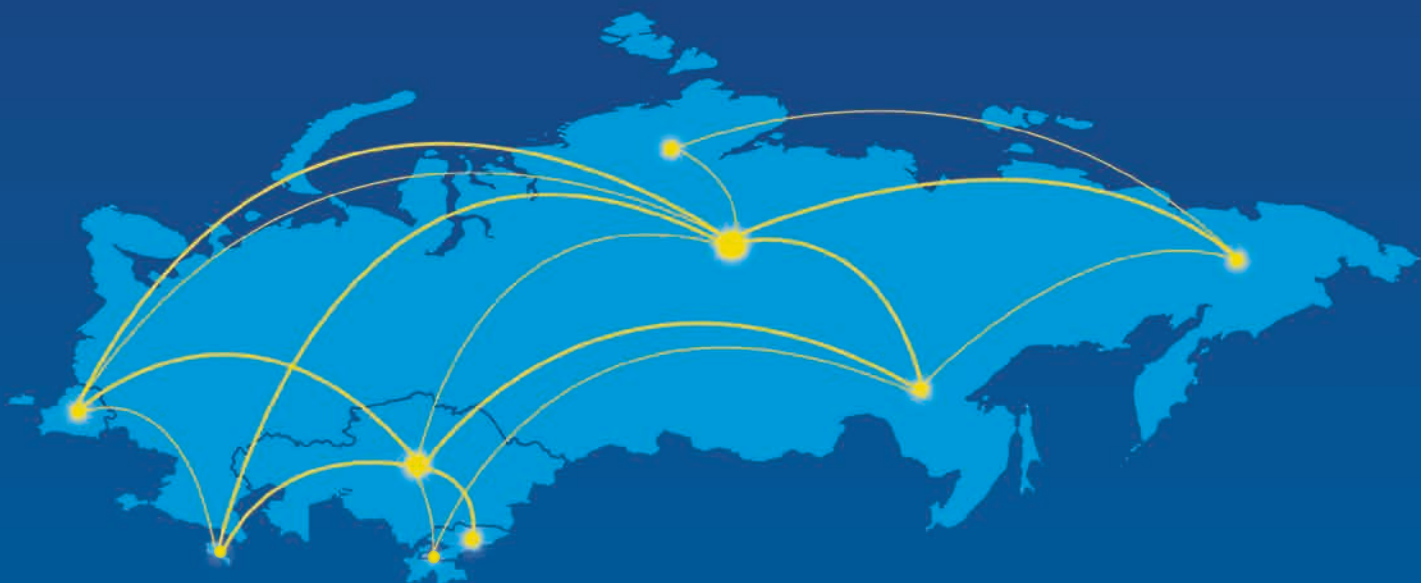


# EDB MACRO REVIEW



04'2019

Republic of Kazakhstan

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# INFORMATION DISCLOSURE

This Review includes a detailed description of the current internal and external macroeconomic setting and an agreed set of forecasts that takes into account the interrelationships between the economies of the EDB operating region and the external sector.

The forecasts of the main macroeconomic indicators were prepared by the EDB jointly with the EEC using an integrated system of models based on a multi-country structural dynamic macroeconomic general equilibrium model. More detailed information about the structure of the integrated system of models, its main components, and its use for analysis of the macroeconomic situation and forecasting is contained in a joint EDB and EEC report entitled "Forecasting System for the Eurasian Economic Union".

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# LIST OF ABBREVIATIONS

**CA** – Current Account

**EAEU** – Eurasian Economic Union

**EDB** – Eurasian Development Bank

**EEC** – Eurasian Economic Commission

**GDP** – Gross Domestic Product

**IBC** – Interbank Credit Market

**KZT** – Kazakh tenge

**NBRK** – National bank of the Republic of Kazakhstan

**RK** – Republic of Kazakhstan

**U.S. or USA** – United States of America

**USD** – United States Dollar

**%** – Percent

**% YoY** – Year-on-Year Growth Rate

# SUMMARY

In 2018, Kazakh GDP grew by 4.1%, supported by increased oil production and a favorable price situation in the world energy market. Revival of credit activity fostered expansion in consumer and investment demand.

Separate sectors' contribution to overall economic growth changed during the year. In the 1<sup>st</sup> half of 2018, the GDP increase was driven by high rates of growth in oil production and the manufacturing sectors. In the 2<sup>nd</sup> half of 2018, industry reduced its contribution to GDP growth while trade turnover and construction activity growth accelerated.

Inflation was 5.3% YoY in 2018, within the National Bank's target range (5–7%). The decrease in motor fuel prices after the upgrade of major oil refineries was completed, as well as the reduction in electricity and heat tariffs for households, did much to slow down inflation.

As inflation slowed in 2018, the National Bank reduced its base interest rate repeatedly, to reach 9.25% at the end of the year (compared to 10.25% a year before).

The Kazakh tenge exchange rate vs. the U.S. dollar and euro decreased in 2018. Trends in the Kazakh currency were in line with those of developing economies' currencies, i.e. a weakening as the U.S. Federal Reserve System increased its rate and the world's economic and political risks overall grew.

Kazakhstan's consolidated budget posted a surplus in 2018, the first time since 2015. The factors behind the budget improvement included the State's increasing incomes amid a relatively favorable external environment and economic growth, as well as decreased public spending on reviving the banking system compared to 2017.

In 2019, we expect economic growth to slow down to 3.3% as oil production declines due to planned oilfield repair works. Next year, we forecast GDP growth at 3.5%. Inflation in 2019–2021 is projected to be within the National Bank's target range (4–6%) and to gradually approach its lower limit by the end of the projection period, as the interest rate on interbank loans in tenge is kept near its neutral level, which we estimate at 7.5–8%.

# STATUS OF THE ECONOMY



## Economic Activity

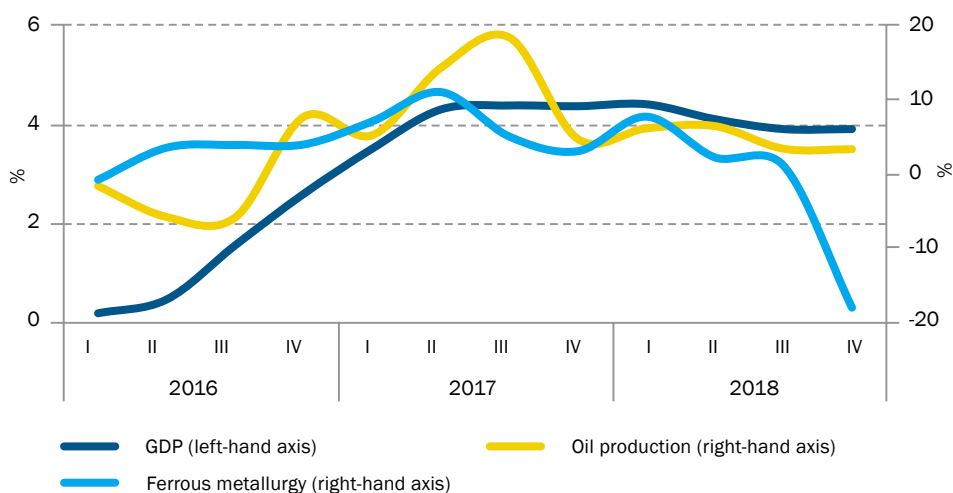
### Stable GDP growth

In 2018, Kazakh GDP grew by 4.1%, supported by increased oil production (up 4.8% vs. 2017). Domestic consumer and investment demand also contributed positively to GDP growth, assisted by a revival in lending after the banking system's restructuring and recapitalization in 2017.

### Growth drivers change during the year

GDP growth varied from quarter to quarter between 3.7% and 4.5% YoY in 2018. Separate sectors' contribution to overall economic growth varied during the year. In the 1<sup>st</sup> half of 2018 GDP growth was driven by relatively high rates of oil production and manufacturing output growth. In the 2<sup>nd</sup> half of 2018, industry reduced its contribution to GDP growth as the Kashagan oil deposit (which began operation in late 2016) reached its plateau phase, and also due to an accident at ArcelorMittal Temirtau, the country's biggest iron-and-steel works. The decrease in industry growth indicators in the 2<sup>nd</sup> half of 2018 was partially offset by accelerated growth in retail trade and construction as lending and real incomes increased.

**Figure 1.**  
**GDP and Output in**  
**Certain Industries**  
(growth YoY)



**Source:** Statistics Committee of the RK Ministry of National Economy, authors' calculations

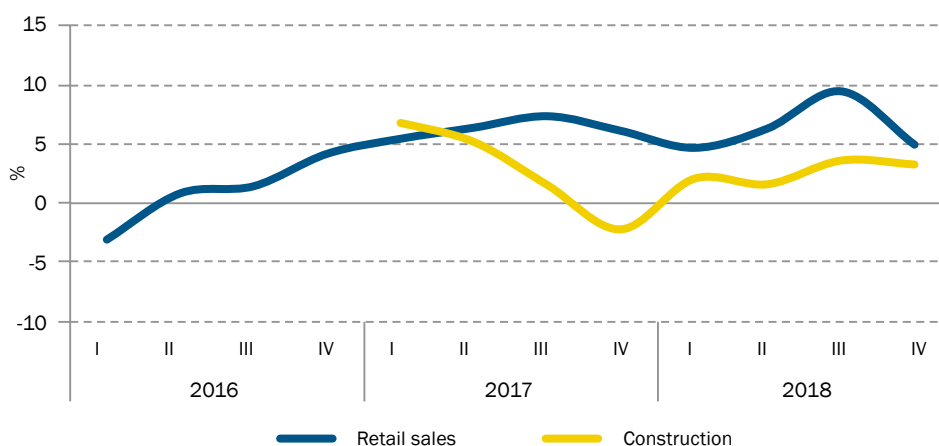
## Consumer demand grows

Household consumption grew in 2018, as indicated by 6.5% growth in retail sales compared to 2017. The leading factors behind consumer activity growth were the increases in real incomes (4.3%) and in the portfolio of bank loans to individuals, which grew by 16.8% YoY by the end of 2018.

## Growth in investment in fixed assets

In 2018, investment in fixed assets increased by 17.2% in real terms (vs. 5.5% growth in 2017). The most significant investment went into the manufacturing industries, in which 40.4% more was invested in 2018.

**Figure 2.**  
**Retail Sales and**  
**Construction Volumes**  
(growth YoY)



**Source:** Statistics Committee of the RK Ministry of National Economy, authors' calculations

## Industrial growth slowdown

In 2018, industry growth slowed to 4.1% compared to 7.1% in 2017, mainly on account of a slowdown in oil production against the previous year's high base. Ferrous metallurgy also held back the overall industrial output trend after the ArcelorMittal Temirtau accident. We expect the output decline in the metallurgical industry to be short-lived, as production at the Temirtau works will be restored in 1Q2019, according to reports in the Kazakhstani media<sup>1</sup>.

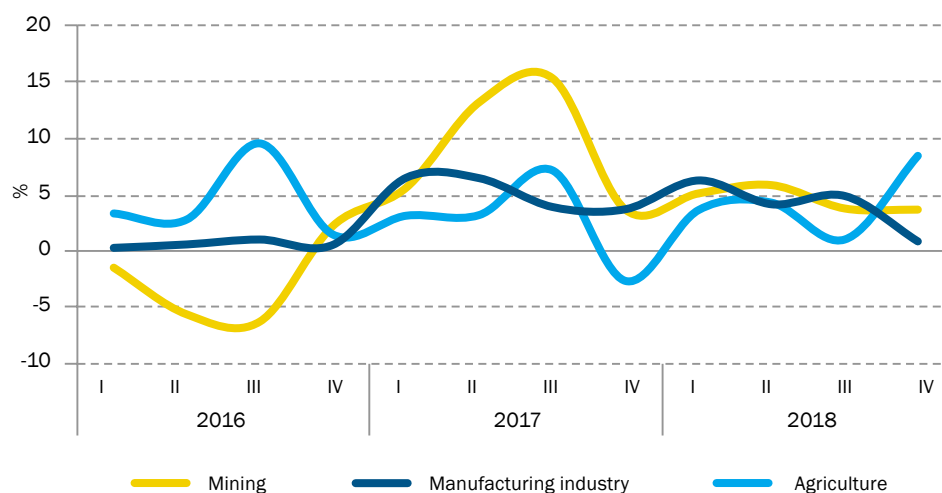
Most manufacturing industries increased their output in real terms in 2018 compared to 2017: the food industry by 1.6%; oil refining by 8.8%; the chemical industry by 8.1%; non-ferrous metallurgy by 5.4%; and machine-building by 14.1%.

## Growth in agriculture

Agricultural output increased by 3.4% in 2018, largely on account of output acceleration in the sector in late 2018.

<sup>1</sup> See e.g. Kapital: "ArcelorMittal-Temirtau to increase steel output by 18.4%", 16 March 2019, <https://kapital.kz/economic/76721/arselormittal-temirtau-uvlichit-proizvodstvo-stali-na-18-4.html>

**Figure 3.  
Production**  
(growth YoY)

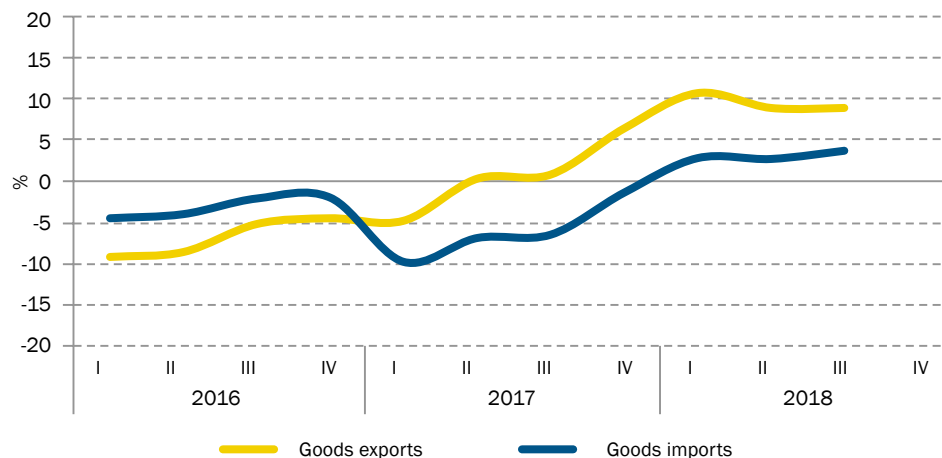


**Source:** Statistics Committee of the RK Ministry of National Economy

### Export volumes grow

The real growth in exports accelerated in 2018, as indicated by the 9M2018 data that shows an 8.9% YoY increase in exports in January to September 2018. Exports increased against the backdrop of growing oil production, ore mining, and non-ferrous metals output. Imports also switched to positive real growth for the first time since 2013 as domestic consumption increased.

**Figure 4.  
Foreign Trade  
Volumes**  
(growth YoY)



**Source:** Statistics Committee of the RK Ministry of National Economy

## The Labor Market

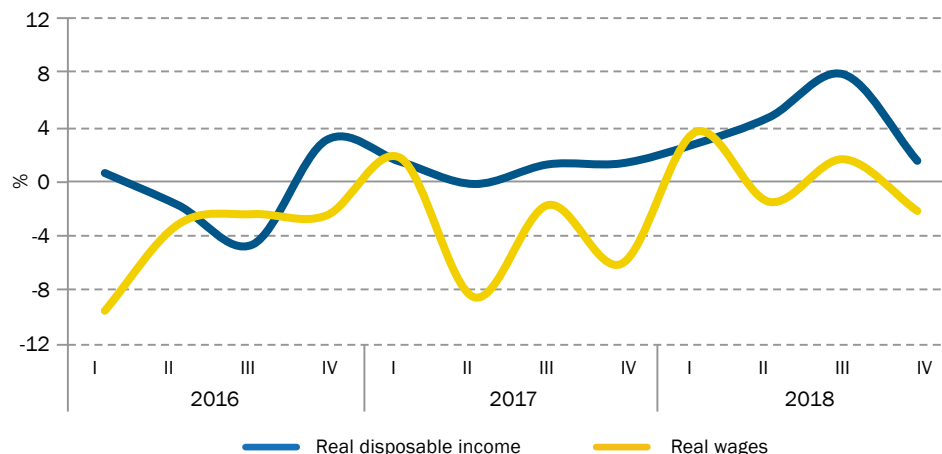
### Accelerated real income growth

The growth in the real disposable incomes accelerated to 4.3% in 2018 (versus 1% in 2017). The increase in real income was mainly driven by a two-stage increase in pensions (in January and July 2018). Average real wages resumed their growth and rose by 2.3% in 2018 after a 2.1% decline in 2017.

## Unemployment level unchanged

The level of unemployment remained the same, 4.9% at the end of 2018. Employment increased by 2.2% in 2018, as did the workforce (9.2 million people in 2018).

**Figure 5.**  
Real Disposable  
Income and Average  
Wages  
(growth YoY)



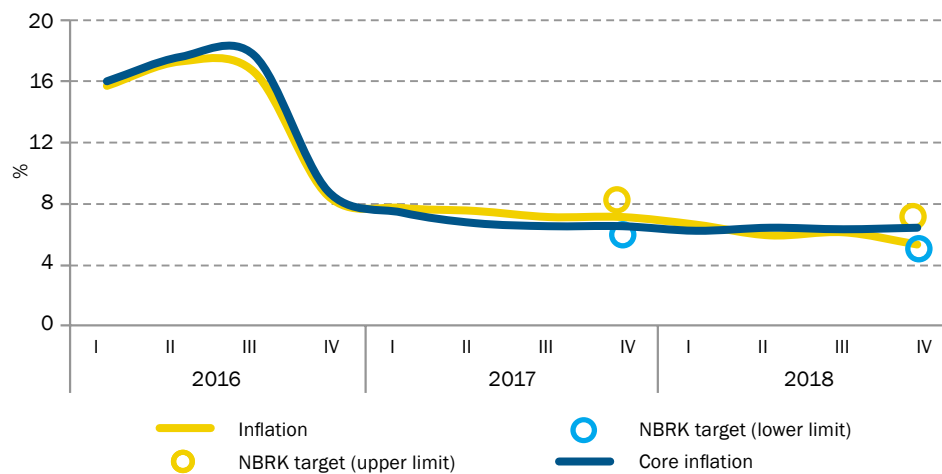
**Source:** Statistics Committee of the RK Ministry of National Economy

## Inflation

### Inflation within target range

Inflation was 5.3% in 2018 — close to the lower limit of the National Bank's 2018 target range (5–7%). The slowdown of inflation in 2018 particularly resulted from the balanced policy pursued by the National Bank. In 4Q2018, inflation was reduced by additional factors: the lower motor fuel prices after supply grew following the completion of the modernization program at the country's leading oil refineries, and lower heat and electricity prices for individuals. Core inflation remained stable in 2018, at 6.4% as of December 2018.

**Figure 6.**  
Inflation  
(the last month in the  
quarter vs. the last month of  
the same quarter the year  
before)



**Source:** Statistics Committee of the RK Ministry of National Economy, National Bank of the RK

### Food prices growth slows

Food price growth was 5.1% YoY in 2018, down from 6.5% the year before. It decreased due to the higher agriculture output in 2018.

Non-food price growth was 6.4% in 2018, down from 8.9% the year before. Lowered motor fuel prices contributed to the slowdown of inflation in this segment.

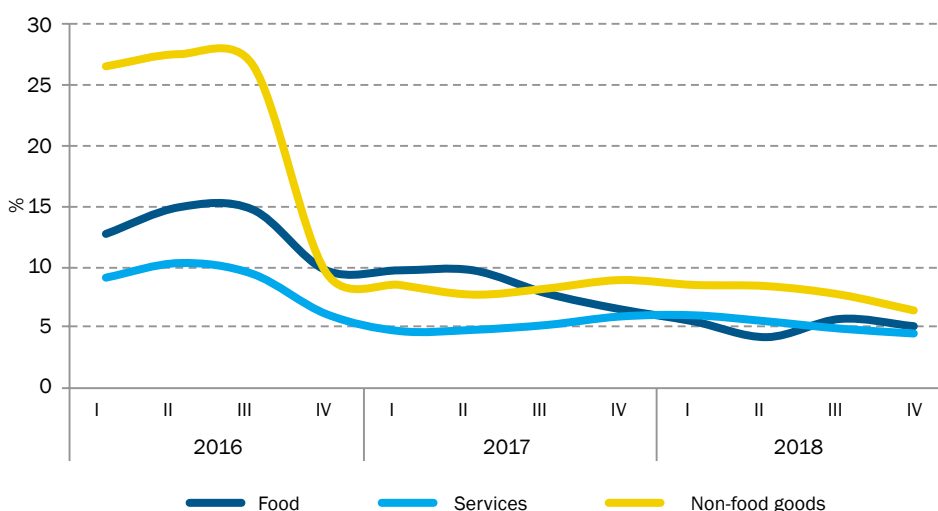
### Lower electricity and heat prices

Services' prices grew by 4.5% in 2018, down from 5.9% the year before, as the State took steps to regulate them. In particular, electricity and central heating prices were reduced in 4Q2018.

### Lower inflationary expectations

Inflationary expectations decreased in 2018. According to the National Bank, at the end of 2018 the population expected 5.0% inflation in the following 12 months (7.1% a year before). The surveys used by the National Bank indicate that the volatility of the Kazakh tenge to U.S. dollar exchange rate in 2018 may have had a limited effect on the inflationary expectations.

**Figure 7.  
Inflation Components**  
(last month in the quarter vs.  
the last month of the same  
quarter the year before)



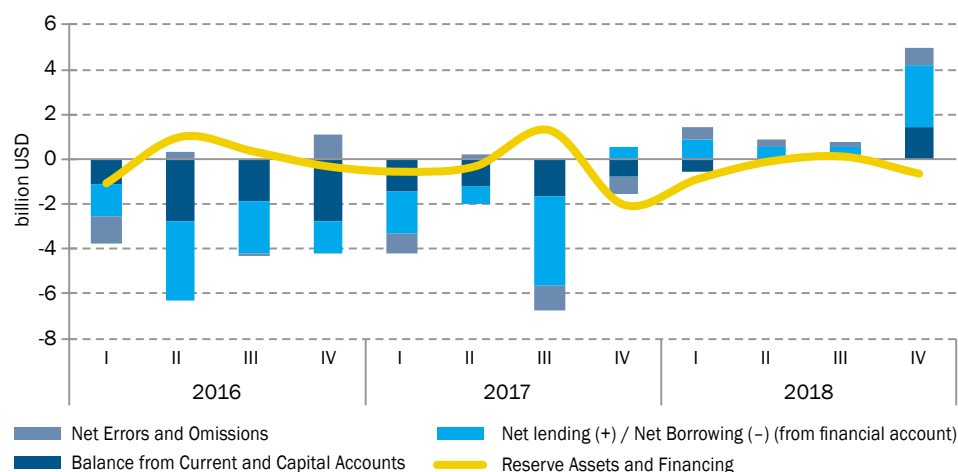
**Source:** Statistics Committee of the RK Ministry of National Economy

## The External Sector

### Stronger balance of payments

Kazakhstan's balance of payments strengthened in 2018, as indicated by the surplus of foreign trade in goods and services. It increased to USD 21.7 billion in 2018 from USD 13.2 billion in 2017. A further indicator was the decreased current account deficit to USD 0.05 billion from USD 5.1 billion in 2017.

**Figure 8.**  
**RK Balance of Payments**

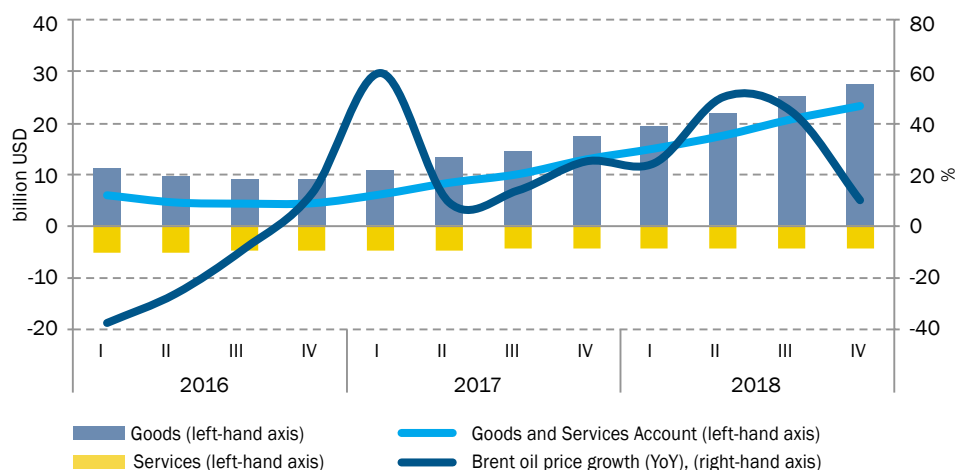


**Source:** National Bank of the RK

### Goods exports growth

The improvement of the RK trade balance in 2018 was driven by growing exports (USD 59.6 billion vs. USD 47.3 billion the year before), mainly on account of greater supply volumes and higher prices of mineral products than in 2017. The value of goods imports in 2018 increased to USD 33.3 billion from USD 30.6 billion in 2017, which was mainly due to growing supplies of machines and equipment from abroad to Kazakhstan.

**Figure 9.**  
**Foreign Trade Balance**  
(four quarters' moving total)

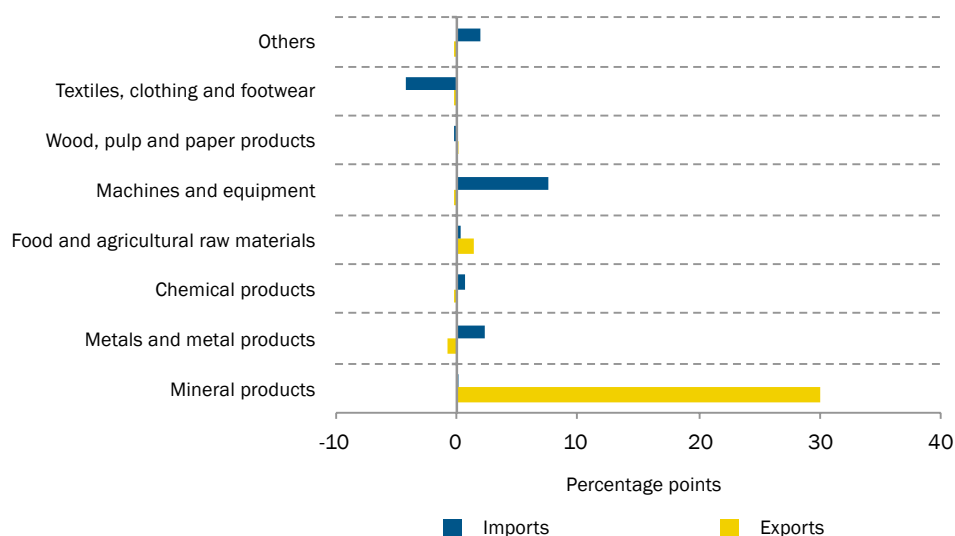


**Source:** NBRK, Bloomberg, authors' calculations

### Growing exports to non-EAEU markets

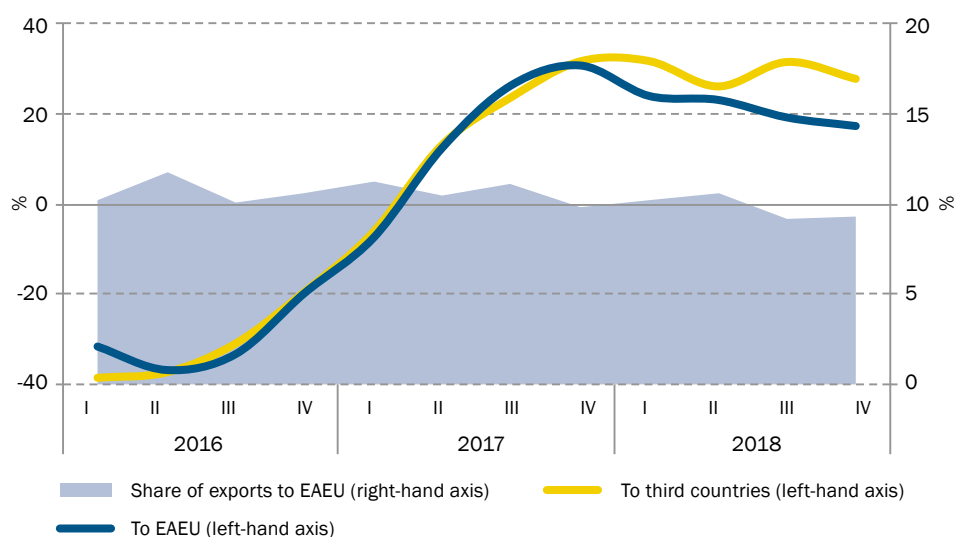
Kazakhstan's merchandise exports increased mainly on account of growing sales to non-EAEU countries. This resulted from growing exports of mineral products, mainly to markets outside the region. As a result, while Kazakhstan's exports grew by 25.7% overall compared to 2017, exports to the EAEU grew by 12.0%.

**Figure 10.**  
**Product Groups'**  
**Contribution to**  
**Growth of Exported**  
**and Imported Goods**  
**in 2018**



Source: EEC, authors' calculations

**Figure 11.**  
**Exported Goods**  
*(four quarters' total*  
*growth rate vs. the*  
*preceding four quarters'*  
*total)*



Source: Statistics Committee of the RK Ministry of National Economy, authors' calculations

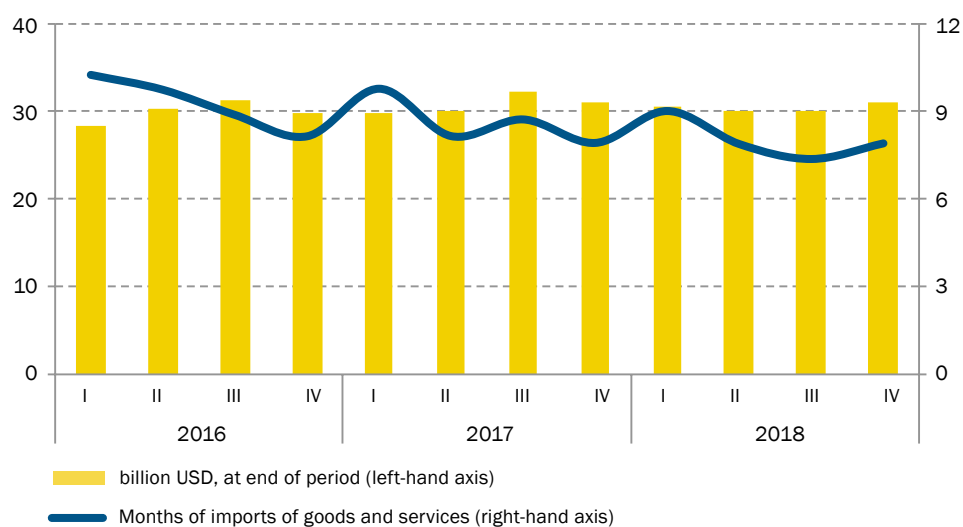
### Net inflow of private sector capital

According to the National Bank, net capital inflow of the private sector amounted to USD 0.682 billion in 2018 (vs. USD 2.372 billion net outflow in 2017). Capital inflow was observed in the banking sector and other sectors.

### NBRK international reserves stable

The National Bank's international reserves remained stable as it pursued a flexible national currency exchange rate policy. At the end of December, reserves were USD 30.9 billion (USD 31 billion at the end of 2017), and the level remains above the traditional sufficiency criteria.

**Figure 12.**  
**International**  
**Reserve Assets**



**Source:** NBRK, authors' calculations

## The Fiscal Sector

### Public finances improved

The state of Kazakhstan's public finances improved in 2018. The consolidated budget of Kazakhstan, which includes the National Fund's revenues and transfers from the National Fund to the Government, posted a surplus for the first time since 2015, totaling KZT 1.6 trillion, or 2.8% of GDP. The deficit of the Republican budget was KZT 0.7 trillion, or 1.2% of GDP, down from 1.4 trillion tenge, or 2.6% of GDP, the year before.

### Budget revenues grow

The improvement in the budgetary sector resulted from public revenue growth in a relatively favorable external setting and the oil production increase. The consolidated budget's income increased to KZT 13.3 trillion in 2018 from KZT 10.8 trillion in 2017.

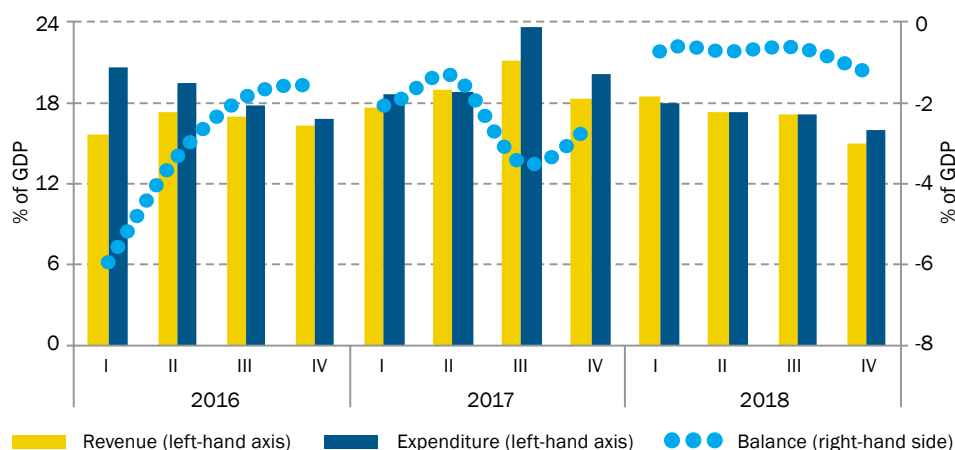
### Lower bank recovery expenses

The budget's reduced expenditures had a positive effect on its balance. The consolidated budget's spending decreased to KZT 11.4 trillion from KZT 12.5 trillion in 2017, while the Republic's budget expenditures decreased to KZT 9.3 trillion from KZT 10.7 trillion. The considerable reduction of public spending resulted from the absence of banking system recovery expenses comparable to those made in 2017.

### Public debt increases

As of the end of 2018, public and publicly guaranteed debt was KZT 16 trillion, or 27.3% of GDP, up from 14.0 trillion tenge, or 26.3% of GDP, in late 2017. 2018 saw the growth of both domestic and external public debt in the form of securities, treasury bonds, and Eurobonds.

**Figure 13.**  
**The Republic's Budget**  
(cumulative year-to-date)

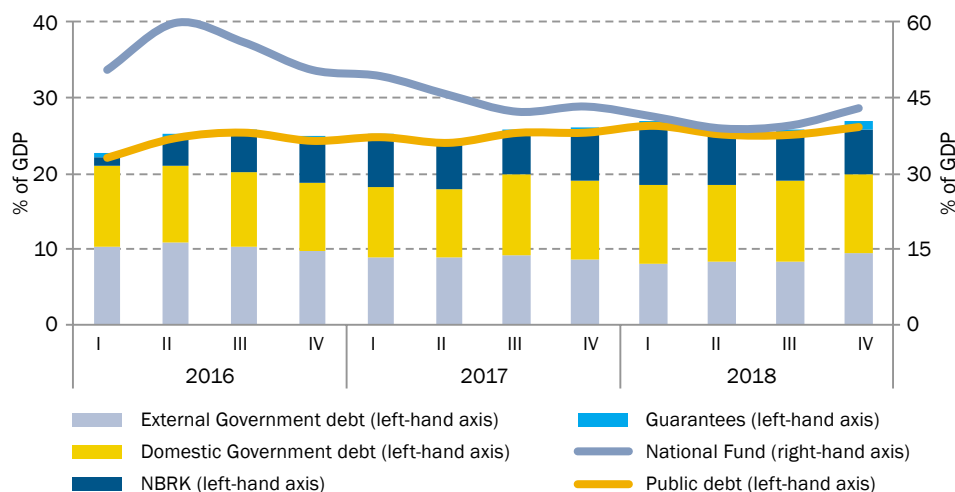


Source: RK Ministry of Finance, authors' calculations

### Eurobonds placement successful

In November 2018 Kazakhstan placed two series of Eurobonds worth a total of USD 1.05 billion, maturing in 2023 and 2028. This was the first placement of Kazakh public bonds in the international markets since July 2015. The coupon rate of the issue maturing in 2023 was 1.55%, and that of the issue maturing in 2028 was 2.375% per annum. The successful placement of the Eurobonds was facilitated in particular by Kazakhstan's investment grade ratings being confirmed by the international rating agencies (S&P, Fitch and Moody's).

**Figure 14.**  
**Public Debt and National Fund Assets**  
(at end of period)



Source: RK Ministry of Finance, authors' calculations

### Monetary Conditions

#### NBRK base interest rate reduced

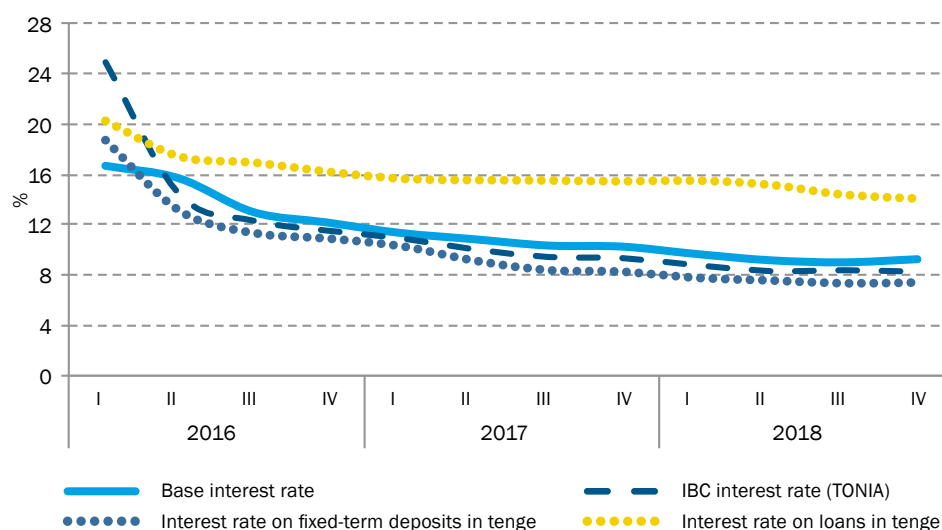
The NBRK base interest rate was reduced to reach 9.25% as of the end of 2018, down from 10.25% at the end of 2017. The National Bank reduced the rate on four consecutive occasions between January and June 2018 as inflation declined. The inflationary risks

mounting in the 2<sup>nd</sup> half of 2018 as the tenge exchange rate weakened and world food prices grew led the National Bank to increase its base interest rate by 0.25 percentage points in October 2018.

### Interbank market rates decline

In 2018, short-term interbank loan interest rates varied in accordance with the National Bank's base interest rate. For most of the time the interbank rates kept near the lower limit established by the National Bank (base rate +/- 1%) as there was a structural liquidity surplus. Movements in the rates on deposits with Kazakh banks also follow the base interest rate changes closely. The 2016–2018 trends in bank loan rates appeared to have been impacted by the processes in the Kazakh banking sector, as well as the base rate. Relatively low growth of lending, resulting from the difficult financial situation of a number of banks, hindered loan interest rate reductions in 2017 even though the base rate decreased. The implementation of banking sector recovery measures contributed to the decrease in bank lending prices in 2018.

**Figure 15.**  
**Interest Rates**  
(the period's average)



**Source:** NBRK, authors' calculations

### New lending grows

The growth in new bank lending to the Kazakh economy accelerated to 24.4% in 2018 from 10.0% in 2017, mainly on account of resumed growth of new lending to non-financial legal entities (+22.4% in 2018 after -1.3% in 2017). Yet, due to the process of the restructuring of troubled banks' assets, credit portfolio growth remains low, at 3.0% in 2018 after zero growth in 2017.

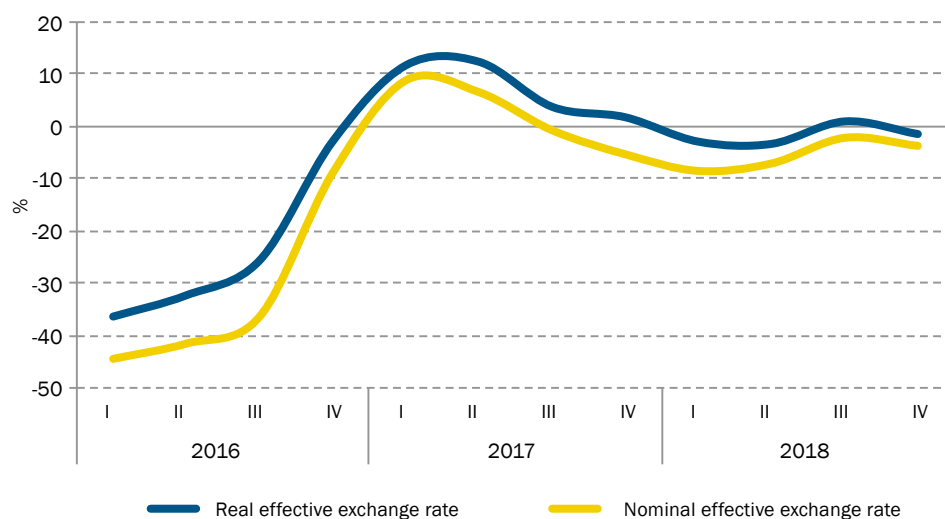
### Loans less dollarized

Bank loans have become less dollarized. The share of foreign currency loans to legal entities was 36.2% at the end of 2018, decreasing from 37.3% at the end of 2017, mainly on account of the share of foreign currency loans to individuals falling to 3.3% at the end of 2018 from 6.4% at the end of 2017. Tenge volatility versus foreign currencies amid a flexible exchange rate policy limits borrowers' demand for foreign currency loans and offers of such loans by the banks.

### Kazakh Tenge weakens versus U.S. dollar and euro

The Kazakh currency followed the general trend in the market for developing economies' currencies, weakening as the U.S. Federal Reserve System increased its rate and the world's economic and political risks overall mounted. The real effective tenge exchange rate decreased by 2.1% in 2018 vs. 2017. The exchange rate decreased due to the weakening of the nominal tenge exchange rate versus the U.S. dollar and euro.

**Figure 16.**  
**Tenge Exchange Rate**  
(the period's growth rate year on year, + = tenge strengthening)



**Source:** NBRK, authors' calculations

# ECONOMIC OUTLOOK

## Background

### External demand decelerates

According to our estimates, in 2019 the oil prices will regain some of the ground lost in late 2018: the average Urals price should be about USD 65 per barrel. In the medium term, oil prices should decline gradually as world demand decelerates. A slow price growth trajectory is likely in world food markets. We expect positive gold price movements. In 2019, external demand growth should decelerate, mainly due to the predicted slowdown in Russian and Chinese economic growth.

### Economic policy priorities unchanged

Macroeconomic stability and steady growth of the economy will remain economic policy priorities. Our projection assumes that the authorities' fiscal policy will continue to support the development policy measures pursuant to Kazakhstan's key program documents: the Kazakhstan 2050 strategy, the Strategic Plan for the Development of the RK to 2025, the State Program for Industrial and Innovative Development, the Nurlı Zhol infrastructure development program, the agro-industrial complex development program, and others. Monetary policy in 2019–2021 will aim to keep inflation within its 4–6% target range.

**Table 1. Forecast Key Foreign Economic Indicators**

|             | Average annual<br>Urals oil price (USD per<br>barrel) | Russia's real<br>GDP growth rate,<br>% | China's real<br>GDP growth rate,<br>% | Inflation in Russia,<br>% (the year's<br>average) | Inflation in China,<br>% (the year's<br>average) |
|-------------|-------------------------------------------------------|----------------------------------------|---------------------------------------|---------------------------------------------------|--------------------------------------------------|
| <b>2019</b> | 65.0                                                  | 1.5                                    | 6.3                                   | 5.0                                               | 2.4                                              |
| <b>2020</b> | 64.7                                                  | 2.0                                    | 6.0                                   | 4.2                                               | 2.8                                              |
| <b>2021</b> | 63.4                                                  | 2.2                                    | 5.9                                   | 4.0                                               | 2.9                                              |

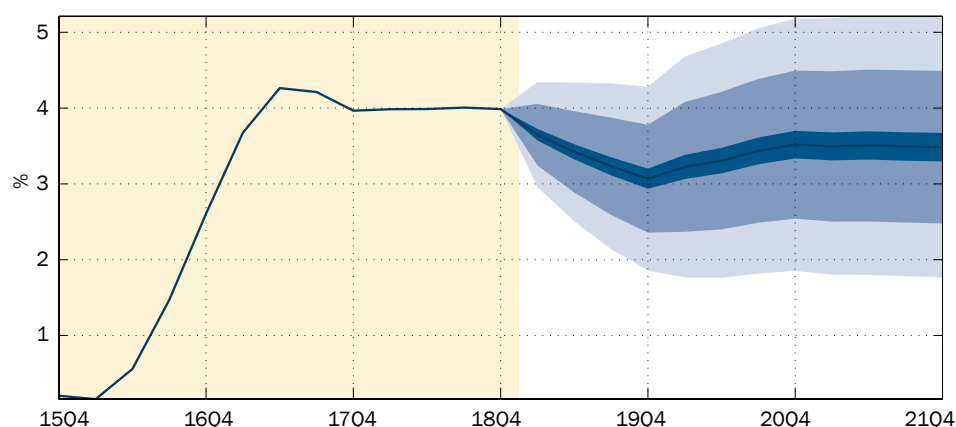
**Source:** authors' calculations, EEC

## Economic Activity

### Economic growth to slow down in 2019

GDP growth will decelerate to 3.3% in 2019. The main factors behind the slowdown will include the oil production decrease due to planned large-scale repair works on the main Kazakhstan's oil fields. Economic growth will be constrained by external demand as well.

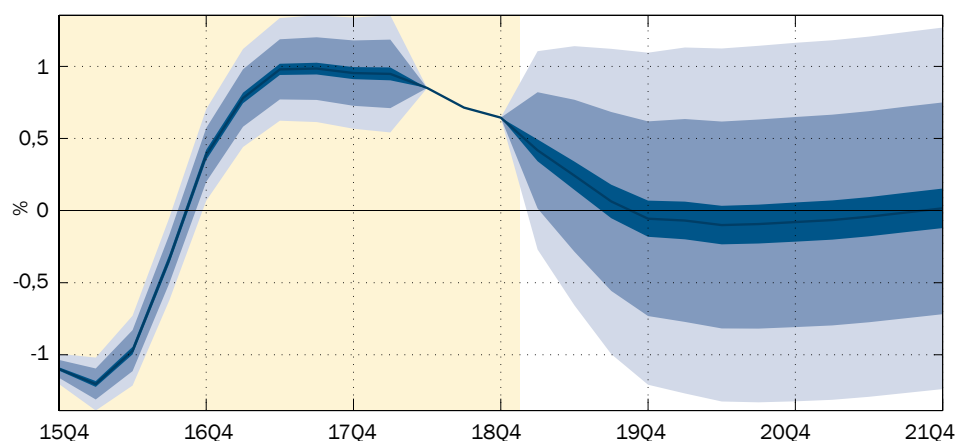
**Figure 17.<sup>2</sup>**  
**Real GDP<sup>3</sup>**  
*(growth YoY)*



**Source:** authors' calculations, EEC

The main risks faced by Kazakhstan's economy in 2019 result from the deterioration of the external environment. These risks may materialize if the worldwide economic slowdown turns out to be greater than expected, which may in particular depress the demand for, and prices of, Kazakhstan's export commodities.

**Figure 18.**  
**Output Gap**



**Source:** authors' calculations, EEC

### **GDP growth to approach potential rate in medium term**

In the medium term, the growth of the Kazakh economy will approach its potential rate, that we estimate at 3.5%. In 2020, accelerated GDP growth will be driven by oil production recovery. Subsequently, GDP growth will remain stable amid labor productivity growth, strong demographic trends, and a stable inflow of investment into the economy. Investment activity will be supported by decreasing interest rates in the country as inflation subsides, investors become more confident in the stability of the Kazakh economy, and the development policy provided for by the national programs is implemented.

<sup>2</sup> Here and elsewhere the fan chart ranges correspond to the 10%, 50% and 75% confidence intervals.

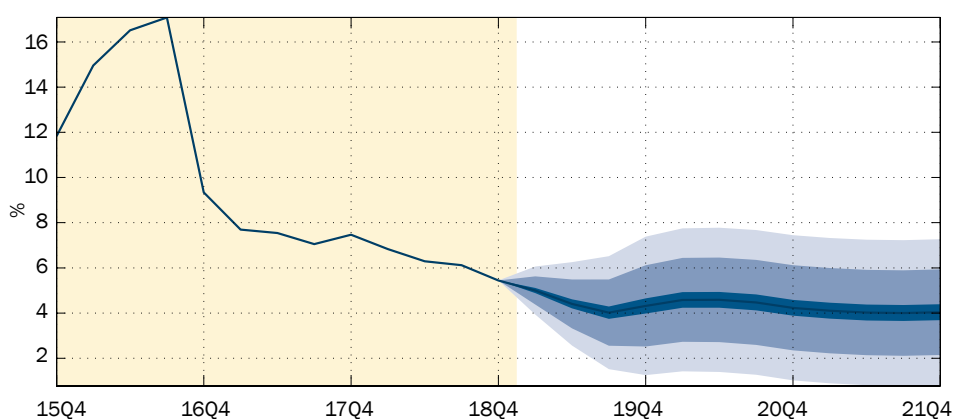
<sup>3</sup> Seasonally adjusted data.

## Inflation

### Inflation to keep within NBRK target range

In 2019, annual inflation is expected to slow down to 4.3%, held back by a slowdown in economic activity and the reduction in utility prices (electricity, heat, and water tariffs) early in the year. In 2020–2021 inflation will fluctuate within the NBRK target range (4–6%) and will gradually approach its lower limit towards the end of the projection period. The main inflationary risks come from the high volatility in prices of Kazakhstan's main export commodities, which may increase and hence cause greater fluctuations of the national currency's exchange rate.

**Figure 19.**  
Inflation<sup>4</sup>  
(period, YoY)



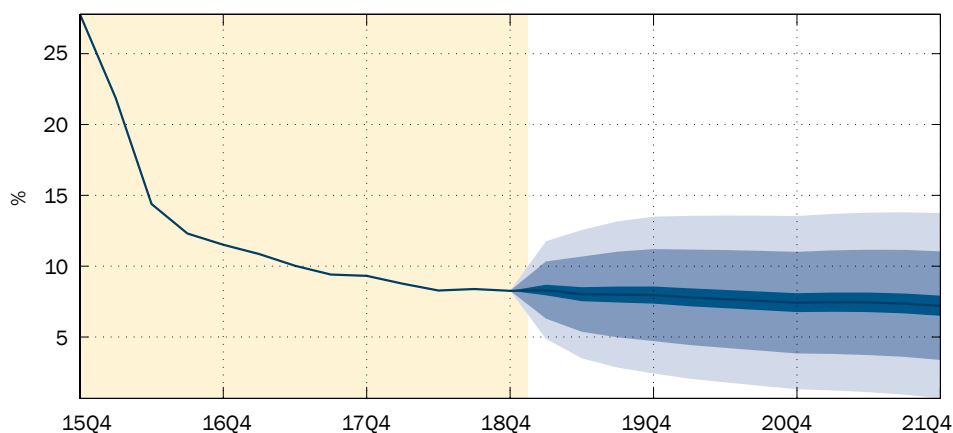
Source: authors' calculations, EEC

## Monetary Conditions

### NBRK rate to decrease gradually to neutral level

We project the tenge interbank loan market rate to fluctuate in 2019–2021 around its neutral level, which we estimate at 7.5–8%. This interest rate pattern will help keep inflation within the NBRK target range in the medium term.

**Figure 20.**  
TONIA Rate  
(period average)



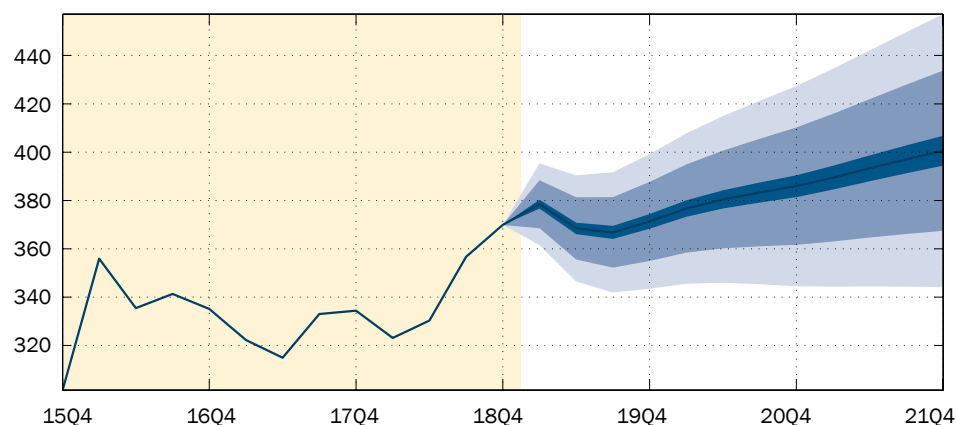
Source: authors' calculations, EEC

<sup>3</sup> Seasonally adjusted data.

### Kazakh tenge to recover vs. the U.S. dollar and euro in short run

The recovery of the tenge exchange rate versus the U.S. dollar and euro in 2019 will give way to smooth weakening consistent with the long-term trend in 2020–2021. In 2019 the tenge will regain some of the ground lost in late 2018, as the energy markets stabilize after volatility observed in the second half of 2018. In the medium term, the tenge will still tend to weaken as inflation in Kazakhstan is projected to be higher than in its main trade partner countries.

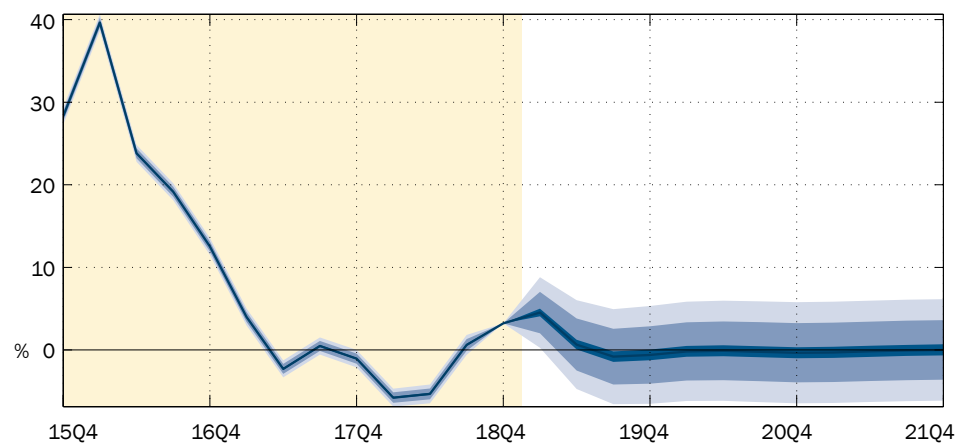
**Figure 21.**  
Tenge to U.S. Dollar  
Exchange Rate  
(KZT per USD)



Source: authors' calculations, EEC

The main risks to the Kazakh tenge exchange rate come from oil price movements.

**Figure 22.**  
Real Kazakh tenge to  
U.S. Dollar Exchange  
Rate Gap  
(+ = the tenge is  
undervalued)



Source: authors' calculations, EEC

**Key Macroeconomic Indicators of the RK**

| Indicator                                                                                        | 2016  | 2017  | 2018  | 2019F | 2020F | 2021F |
|--------------------------------------------------------------------------------------------------|-------|-------|-------|-------|-------|-------|
| <b>GDP in constant prices</b><br>(% growth YoY)                                                  | 1.1   | 4.0   | 4.1   | 3.3   | 3.4   | 3.5   |
| <b>Consumer price index</b><br>(% growth in December to previous year's December)                | 8.5   | 7.1   | 5.3   | 4.3   | 4.2   | 4.0   |
| <b>TONIA rate</b><br>(the year's average % per annum)                                            | 15.6  | 9.9   | 8.4   | 8.1   | 7.6   | 7.4   |
| <b>Nominal Kazakh Tenge to U.S. Dollar exchange rate,</b><br>KZT per USD<br>(the year's average) | 342.2 | 326.1 | 345.0 | 371.2 | 381.6 | 395.1 |

**Source:** authors' calculations, EEC. F – forecast



## **Eurasian Development Bank**

### **RESEARCH DEPARTMENT, EURASIAN DEVELOPMENT BANK**

Your comments and suggestions  
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