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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

**EDB** – Eurasian Development Bank

**EEC** – Eurasian Economic Commission

**GDP** – Gross Domestic Product

**pp** – percentage point

**RK** – Republic of Kazakhstan

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

**VAT** – Value added tax

**%** – per cent

**% YoY** – Year-on-Year growth rate
**SUMMARY**

In the first half of 2019, GDP growth accelerated to 4.1% YoY, driven by recovering output in metallurgy and expanding consumer and investment demand. It was constrained by an oil extraction decrease that resulted from a complete work stoppage (for planned repairs) on the Kashagan oil field.

Domestic consumer demand was stimulated by growing social expenditures from the Republic’s budget and by an expansion of retail lending. Investment activity is mainly concentrated in the mining industries.

Inflation will stay within its target range (4.0–6.0% as of end 2019). Its temporary slowdown in 1Q2019 was caused by a reduction of utility tariffs. Inflation began to accelerate again from 2Q2019 as the tenge weakened, world food prices grew, and domestic demand expanded.

The current account deficit increased due to a weak price situation in the world oil and metals markets, which worsened the trade balance.

The State budget’s deficit was 0.9% of GDP in the first half of 2019 versus 0.7% of GDP in the same period a year before. On the budget’s income side, the share of transfers from the National Fund increased, while expenditures were mainly increased by allocating more funds to the implementation of the Government’s social initiatives.

In April 2019, the National Bank of Kazakhstan reduced its policy rate by 25 basis points, to 9.0%, as consumer prices growth slowed down more quickly than it had expected. In the second half of 2019, inflation risks increased, and the monetary regulator responded by raising its policy rate by 9.25% in September 2019.

Economic activity is projected to accelerate in 2019, largely on account of expanding domestic demand. In the medium term, the economy is expected to continue its steady growth at near potential rates.

The inflation trends will be shaped by rising food prices and growing consumer demand. In the medium term, consumer price growth is projected to keep within the target range.
STATE OF THE ECONOMY

Economic Activity

Economic Growth Recovers

In the first half of 2019 GDP grew by 4.1% YoY, up from 3.8% in 1Q2019. Economic activity increased as output recovered at the ArcelorMittal Temirtau JSC metal works, after an accident that occurred in late 2018, and as both consumer and investment demand expanded. It was held back by a temporary decrease of output in the mining industries as oil production was halted on the Kashagan oilfield (for planned repairs) and wells were closed for technical reasons at Karachaganak.

Domestic Demand is Key Driver of Growth

Household demand continues to strengthen as real incomes rise. The public authorities’ consumption expanded considerably in 2Q2019 as the Government implemented new social initiatives.

Real exports grew, mainly on account of trade in non-oil goods. Oil product exports in real terms declined due to weaker demand from key trade partners as well as reduced oil production.

Figure 1. GDP and Select Industries’ Output (period’s growth rate year-on-year)

Source: Statistics Committee of the RK Ministry of National Economy, calculations by the authors
Investment Retains Positive Growth Trend

Imports in real terms also increased, mainly due to higher domestic investment demand.

Investment in fixed capital grew by 11.7% YoY in the first half of 2019, up from 7.0% YoY in 1Q2019. Yet its performance in 2019 is somewhat weaker than its growth rate in the first half of 2018, when investment increased by 25.8% YoY, largely on account of oil refinery modernization. In the first half of 2019, the main volume of investment went into the mining industries, mainly into the Tengiz extraction capacity expansion project.

Housing construction, supported by the implementation of State programs, acts as an additional driver of investment activity.

Growth Continues in Industry and Trade

In the first half of 2019, retail trade was the greatest contributor to economic growth (1.1 pp), supported by consumer lending trends, pension and wage rises, as well as by fiscal loosening and a reduction in utility charges.

Industrial output growth slowed down to 2.6% YoY in the first half of 2019, down from 5.2% YoY a year before, but still made a considerable contribution to the GDP increase (0.8 pp). The index deteriorated due to the suspension of production at key oilfields and by lower metallurgy output resulting from the ArcelorMittal Temirtau accident that occurred in late 2018.

The construction industry was the third most significant driver of the economy in the first half of 2019, contributing 0.5 pp. The construction of industrial facilities, motorways and the Saryarka gas pipeline drove that sector’s growth trends.
In the first half of 2019, real incomes grew by 4.7% YoY as wages increased and inflation slowed down temporarily. Accelerated growth of average monthly nominal wages was observed in virtually all sectors of the economy. This was particularly driven by the increase of salaries in the budget sector and the minimum wage raise of 50%.

The recorded unemployment level was 4.8% as of 30 June 2019.
The consumer price index rose by 5.4% YoY in June 2019, while keeping within its target range (4.0–6.0%). Inflation was volatile in the first half of 2019. While in 1Q2019 annualized growth of consumer prices decelerated, an upward trend appeared in 2Q2019. The key factors behind the decrease of inflation early this year included a high supply of agricultural produce in 2018, limited growth of fuel and lubricant prices as modernized oil refineries began operation, and the depreciation of regulated services in January and February 2019.

In April 2019, consumer price index growth began accelerating as domestic demand expanded, world grain and meat prices rose, and the tenge weakened against the U.S. dollar.

The food component’s contribution to inflation grew to 3.0 pp in June 2019, from 2.1 pp in January 2019, and food appreciation accelerated to 8.2% YoY, from 5.8% YoY.

Price growth in other segments of the consumer basket held back inflation in the first half of this year. Thus, non-food goods appreciation slowed down from 6.4% YoY in January 2019 to 6.1% YoY in June 2019, while service tariff growth declined from 3.4% YoY to 1.2% YoY.
In the first half of 2019, the current account posted a deficit of USD 1.9 billion (vs. USD 1.4 billion a year before). The deficit expanded due to a weak price situation in the world markets of oil and metals, which worsened the trade balance. The growing deficit of the balance of services was also a detractor. The decline of foreign direct investors’ income slowed down the growth of the current account deficit to some extent.

A net capital outflow via financial account transactions was recorded in the first half of 2019 as residents increasingly placed financial assets abroad and repaid external debt on public sector and bank debt, while households’ demand for foreign currency grew. The growth of incoming foreign direct investment on account of profits obtained and reinvested and by the return of Kazakh investors’ funds, previously invested in foreign subsidiaries, partly offset capital outflow on other financial instruments.
Gross International Reserves Grow

Gross international reserves (excluding the RK National Fund’s assets) amounted to USD 28.2 billion as of end July 2019, which covers 7.2 months’ imports of goods and services. The share of monetary gold increased from 46.5% to 60.4% over the first half of 2019.

Consolidated international reserves\(^1\) amounted to USD 88.2 billion as of end June 2019, a 0.8% decrease since the beginning of the year.

Figure 8. International Reserve Assets

\[\text{Source: RK National Bank}\]

Trade Balance Surplus Lower in 1H2019

According to provisional data from the State Revenue Committee of the RK Ministry of Finance, the decrease in the trade balance surplus in the first half of 2019 resulted from an import increase, while exports decreased compared to the same period of 2018.

The decrease in export revenue in the first half of 2019 was mainly caused by declining sales of fuel and energy commodities (by 4.8% YoY) and metals and metal products (by 2.0% YoY). Exports were supported by growing sales of food (by 12.0% YoY) and machines and equipment (2.1 fold).

The growth of imports in the first half of 2019 resulted primarily from greater imports of machines and equipment (a 28.1% YoY increase).

\[^1\] These comprise international reserves of the RK National Bank and assets of the National Fund.
The Republic's budget posted a deficit of 0.9% of GDP in the first half of 2019 (vs. 0.7% of GDP a year before).

**Budget Income Growth Driven by Transfers**

The increase in the budget's income in the first half of 2019 was driven by growth of both transfers (up 25.8% YoY) and tax revenues (up 19.0% YoY). Transfers from the National Fund constituted 38.7% of the budget's income (vs. 37.3% a year before).

**Greater Expenditures**

The Republic's budget expenditures increased in the first half of 2019 mainly as welfare expenses grew (by 24.2% YoY), public sector employees' wages and salaries increased and more funds were allocated to the Government's social initiatives.

**Figure 9.**

*Product Groups' Contribution to Goods Export and Import Growth (January to June 2019 vs. January to June 2018)*

**Figure 10.**

*The Republic's Budget (the period's cumulative balance)*

Source: State Revenue Committee of the RK Ministry of Finance, calculations by the authors

Source: RK Ministry of Finance, calculations by the authors
Public Debt Remains Stable

Public debt was 15.5 trillion tenge as of end June 2019, 0.6% more than at the beginning of the year. The decrease of the debt to GDP ratio resulted from economic growth outpacing the increase in public sector debt. In the first half of 2019 the Government’s domestic liabilities mainly grew due to the placement of long Government treasury bonds (+18.5% since the beginning of 2019). The Government’s foreign debt decreased in the period under review as international financial institutions’ loans were repaid and the RK National Bank’s liabilities decreased.

Figure 11. Public Debt

Source: RK Ministry of Finance, calculations by the authors

Monetary Conditions

Base Rate Reduced from 9.25% to 9.0% in 1H2019

The RK National Bank reduced its base rate by 25 basis points, to 9.0%, in April 2019. The width of the interest rate band remained the same. As estimated by the regulator, inflation in February and March 2019 slowed down more rapidly than it had expected, which was one of the reasons behind the base rate reduction.

Interbank Market Rates Decline

The trends in short-term interbank loan rates in the first half of 2019 were consistent with the trajectory of the National Bank’s base rate. Against a background of a structural liquidity surplus, they fluctuated near the lower limit of the National Bank’s interest rate band (+/-1% of the base rate) most of the time. The TONIA rate became more volatile in June 2019 as banks’ demand for tenge liquidity increased.

The rates on fixed-term deposits in tenge stayed at the 7.4% level during the first half of 2019. The price of loans in national currency decreased to 14.2% in January to June 2019, from 15.3% a year before.
The loan portfolio grew by 0.6% YoY, largely on account of the retail sector. Thus, the volume of new loans issued to individuals in the first half of 2019 increased by 28.2% YoY, and it increased by 3.0% YoY to legal entities. In June 2019 the deposit base decreased by 3.0% YoY, mainly on account of a decrease in foreign currency deposits by 4.4% YoY.

In the first half of 2019 the tenge weakened by 15.3% YoY against the U.S. dollar amid mounting inflationary expectations in May and June 2019. The real effective tenge exchange rate decreased by 5.5% YoY in the first half of 2019. A weakening was recorded for all currency pairs in the tenge’s real effective exchange rate basket.
ECONOMIC OUTLOOK

Background

Economic activity in the world’s major economies slowed down in the first half of the year. The growth slowdown in the Eurozone, the USA and China largely resulted from the negative effect of world trade tensions on net exports and investment. In Russia, the GDP growth rate decreased in the first half of 2019 amid a tightened fiscal policy, with the VAT rate increased and the budget’s investment expenses temporarily reduced. The global economic slowdown also had a negative effect on the Russian Federation’s foreign trade operations in January to June of this year.

External Demand Weak

The projection’s base scenario assumes the global trade tensions to persist at their level prevailing in September 2019, with no additional protectionist measures anticipated (besides those announced). In this situation, the increasingly uncertain outlook for the global economy will continue to hinder investment activity in the USA, Eurozone and China in the medium term, which will lead to a gradual slowdown of their potential growth. Stimulative domestic policies will continue to support the world’s major economies by keeping their monetary and fiscal conditions lax.

In Russia, the implementation of the national projects is expected to accelerate from the second half of this year, which will lead to a gradual increase of economic activity. The economy will be additionally supported by the easing of monetary policy after the Bank of Russia reduced its key rate in June to September. We project this to result in some 2% annual economic growth in Russia in 2020–2021.

Commodity Price Estimates Lowered

We estimate the external sector’s inflationary pressure on the Kazakh economy to be low. The projection’s base scenario assumes a gradual decrease of oil prices relative to their average level of 2019 as world demand growth slows down. Russian inflation is assumed to temporarily slow down below its target level by the end of the current year and to gradually recover
The projection’s base scenario assumes the stimulative fiscal policy to continue in the medium term. The announced measures intended to improve living standards will support consumer activity in the short run but may increase inflation acceleration risks.

Monetary policy will remain focused on the attainment of the 4–6% inflation target by the end of 2020.

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

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<tr>
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<th>Average annual Urals oil price (USD per barrel)</th>
<th>Metals price index, 2010=100</th>
<th>Russia’s real GDP growth rate, %</th>
<th>Euro Zone real GDP growth rate, %</th>
<th>China’s real GDP growth rate, %</th>
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<tbody>
<tr>
<td>2019</td>
<td>63.6</td>
<td>78.9</td>
<td>1.1</td>
<td>1.1</td>
<td>6.2</td>
</tr>
<tr>
<td>2020</td>
<td>60.7</td>
<td>78.4</td>
<td>1.8</td>
<td>1.3</td>
<td>6.0</td>
</tr>
<tr>
<td>2021</td>
<td>58.9</td>
<td>77.8</td>
<td>2.0</td>
<td>1.5</td>
<td>5.9</td>
</tr>
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*Source: calculations by the authors, EEC*

**Stimulative Fiscal Policy**

The projection’s base scenario assumes the stimulative fiscal policy to continue in the medium term. The announced measures intended to improve living standards will support consumer activity in the short run but may increase inflation acceleration risks.

Monetary policy will remain focused on the attainment of the 4–6% inflation target by the end of 2020.

**Economic Activity**

**Economic Growth to Slow Down in Medium Term**

GDP growth is expected to accelerate in 2019 as the Government implements its measures to stimulate consumption and amid high investment activity. Tenge weakening in real terms will promote the expansion of non-oil exports.

In the medium term, GDP growth will slow down as external demand weakens, world energy and metal prices decrease, and the deficit of the Republic’s budget narrows.
Inflation is expected to accelerate by the end of 2019 as food prices rise and the tenge weakens somewhat. Grain prices are projected to grow after this year’s lower harvest. Meat appreciation will contribute to inflation as swine fever spreads in China and produces an imbalance in the world markets of meat products. The inflationary environment will additionally be supported by expanding domestic demand.

In the medium term, inflationary pressure will weaken as a result of measures taken by the National Bank in the fields of monetary (base rate raised to 9.25% in September 2019) and macroprudential policy (tighter retail lending requirements). Consumer price index growth will be held back by weak inflation in the main trade partner countries.

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Note: seasonally adjusted data.
Source: calculations by the authors, EEC

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2 Here and elsewhere the chart ranges correspond to the 10%, 50% and 75% confidence intervals.
Figure 15. Inflation (last month in quarter vs. last month of same quarter a year before)

Note: seasonally adjusted data.
Source: calculations by the authors, EEC

Monetary Conditions

Exchange Rate to be Stable

The EDB projects the interbank tenge loan rates to fluctuate around their neutral level, that we estimate at 7.5–8%, in 2019–2021. This rate level if maintained will help keep inflation within the RK National Bank’s target range in the medium term.

Tenge weakening will continue in the projection horizon, which results from higher inflation expected in the RK than in its main trade partner countries. The key risks to the tenge exchange rate emanate from the external sector.

Figure 16. TONIA Rate (the period’s average)

Source: calculations by the authors, EEC
Key Macroeconomic Indicators of the RK

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<tr>
<td>GDP in constant prices</td>
<td>1.1</td>
<td>4.0</td>
<td>4.1</td>
<td>4.2</td>
<td>3.5</td>
<td>3.4</td>
</tr>
<tr>
<td>(% growth YoY)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Consumer price index</td>
<td>8.5</td>
<td>7.1</td>
<td>5.3</td>
<td>5.9</td>
<td>5.4</td>
<td>5.1</td>
</tr>
<tr>
<td>(% growth in December to previous year’s December)</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>TONIA rate</td>
<td>15.6</td>
<td>9.9</td>
<td>8.4</td>
<td>8.4</td>
<td>7.6</td>
<td>7.1</td>
</tr>
<tr>
<td>(the year’s average% per annum)</td>
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<td>Nominal Kazakh Tenge to U. S. Dollar Exchange Rate,</td>
<td>342.2</td>
<td>326.1</td>
<td>345.0</td>
<td>383.0</td>
<td>400.7</td>
<td>422.5</td>
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<td>KZT per USD (the year’s average)</td>
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**Note:** P = Projected  
**Source:** calculations by the authors, EEC
Your comments and suggestions concerning this review are welcome at: pressa@eabr.org