Euler Hermes Economic Research

Country Report

Kazakhstan

Devaluation and Kashagan oilfield shutdown affect growth

General Information

GDP	USD201.7 billion (World ranking 49, World Bank 2012)
Population	16.8 million (World ranking 61, World Bank 2012)
Form of state	Republic / authoritarian presidential rule
Head of government	Nursultan A. NAZARBAYEV
Next elections	2016, presidential

Strengths

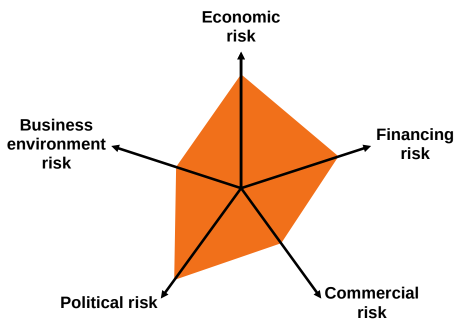
- Abundance of raw materials, in particular hydro-carbons
- The National Fund of the Republic of Kazakhstan held assets of around USD77bn in mid-2014
- Healthy public finances
- Rising oil export capacities over the next decade

Weaknesses

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

Country Rating

C3



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 (2012)

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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 in 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.

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	5.0	5.9	3.5	5.0
Inflation (%, end-year)	6.0	4.8	7.3	6.0
Fiscal balance (% of GDP)	4.5	5.0	4.3	3.9
Public debt (% of GDP)	12.4	13.5	13.3	13.7
Current account (% of GDP)	0.5	-0.1	0.6	-0.6
External debt (% of GDP)	67.3	66.3	73.0	74.3

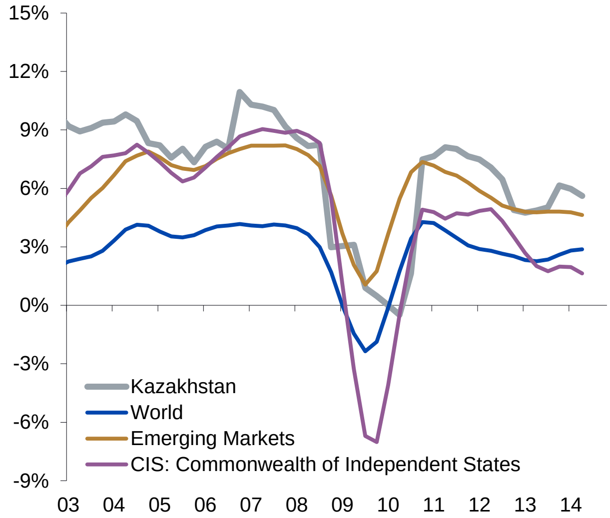
Sources: National sources, IHS, Euler Hermes

Slowdown of growth

Growth fell sharply to +3.2% in 2008 and +1.2% in 2009 as oil prices plunged and the global credit squeeze pushed the Kazak banking sector into a systemic crisis. Growth has recovered thereafter though it has remained below the pre-crisis ratios, as a result of weaker external demand as well as the impact of the ongoing banking crisis on domestic demand. Real GDP growth accelerated from +5% in 2012 to +5.9% in 2013, driven by strong private consumption (+10.1%) and fixed investment (+9.9%) and modest public consumption (+1%), while exports declined (-0.2%) and imports expanded solidly (+5.2%).

In H1 2014, real GDP growth decelerated again to +3.9% y/y. Details for Q2 are not available as yet, but those for Q1 indicate a sharp slowdown of private consumption (+0.8% y/y), fixed investment (+0.3% y/y) and imports (-6.9% y/y), most likely all affected by the 20% currency devaluation in February. Public consumption picked up to +4.5% y/y in Q1 and exports gained slightly by +1.1% y/y. On the supply side, growth has been hampered by the shutdown of the off-shore Kashagan oilfield since October 2013, due to damage to the pipeline infrastructure, as well as maintenance and repair works at other oil and copper plants. As a result, mining has declined by -0.6% y/y in H1 and manufacturing by -0.3% y/y. EH expects the devaluation, the ongoing shutdown of Kashagan and the economic weakness of Russia (2nd largest trade partner of Kazakhstan) to continue to weigh on the Kazakh economy in H2, resulting in full-year growth of +3.5% in 2014, before recovering to about +5% in 2015.

GDP growth (%)



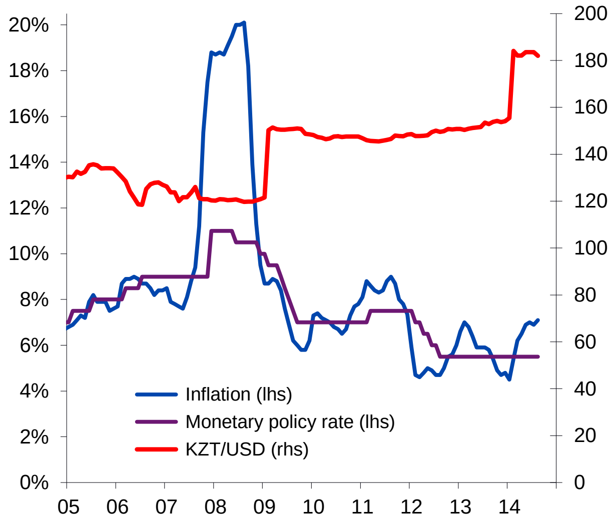
Sources: National sources, IHS, Euler Hermes

Exchange rate and inflation risks

The exchange rate will remain vulnerable to external shocks and sudden devaluation. In February 2011 the central bank returned to a managed floating exchange rate regime, abandoning the 3% trading band around the KZT150:USD1 rate it introduced two years earlier in the wake of the banking crisis. In February 2014 the central bank devalued the KZT by almost 20% 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.

Inflation has been somewhat elevated in recent years, mostly in the range of 4.5-10% since 2009. The recent KZT devaluation has boosted headline inflation to 7.1% in August 2014. We expect it to remain above 7% until early 2015.

Monetary policy interest rate, inflation rate (y/y), and exchange rate



Sources: National sources, IHS, 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 good, profitability remains weak and non-performing loans stood at about 20% of total loans in 2013 (30% including BTA). Amid relatively loose monetary policy, private sector credit growth has accelerated to a critical level of around 20% y/y in early 2014, requiring close monitoring.

Public finances favourable

A fiscal surplus of 5% of GDP was recorded in 2013 and we expect further surpluses of around 4% of GDP in 2014-2015. Total public debt is low at just over 13% of GDP.

Current account unproblematic

The current account shifted from a surplus of 0.5% of GDP in 2012 to a small deficit of 0.1% in 2013 as a result of the weak export performance. EH forecasts a return to a surplus of about 0.6% of GDP in 2014 as the KZT devaluation will suppress imports.

Foreign exchange reserves still adequate

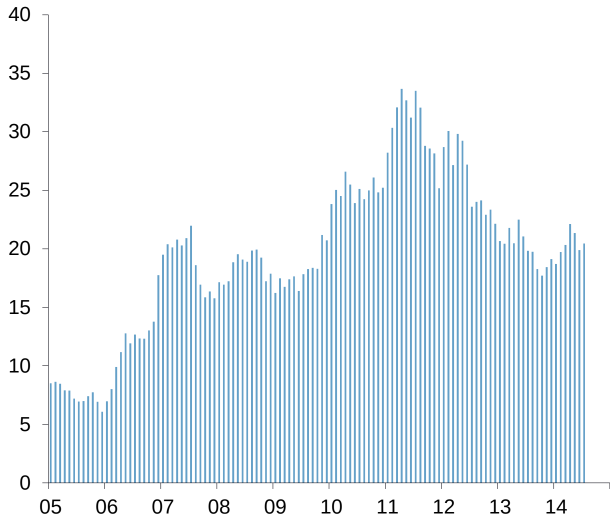
Foreign exchange (FX) reserves had gradually fallen from a peak of USD33.7bn in April 2011 to USD17.7bn in October 2013 but appear to have stabilised since then, standing at USD20.5bn in July 2014. The current level of FX reserves is comfortable with regard to import cover (four months). In other terms, however, reserves cover just about 40% of the estimated external debt payments falling due (ST debt plus principal repayments on M/LT debt) in the next 12 months, well below an adequate ratio of at least 100%.

However, the assets in Kazakhstan's National Oil Fund have steadily increased since 2009 and reached USD76.8bn in July 2014, providing some cushion in the event of a renewed downtrend in FX reserves.

High external debt burden

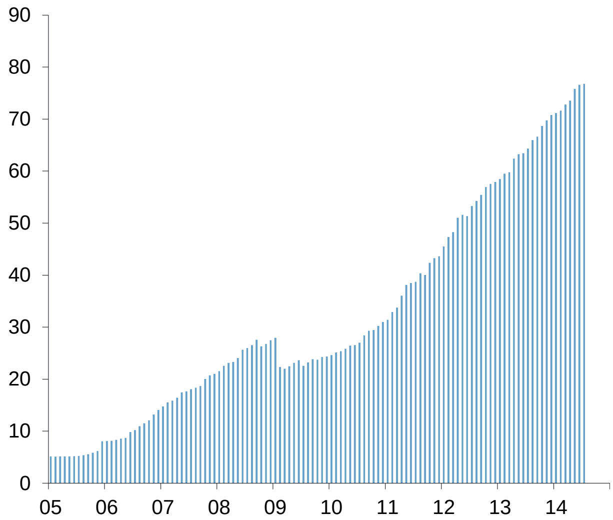
Gross external debt was relatively high at USD151bn at end-Q1 2014, equivalent to about 68% of GDP or 166% of export earnings. This is a legacy of the large-scale foreign borrowing of Kazakh banks until 2007. The debt service ratio will remain hefty for some time, estimated at around 40% annually in 2014-2015.

Foreign exchange reserves (USD bn)



Sources: National sources, IHS, Euler Hermes

Assets of the National Oil Fund (USD bn)



Sources: National sources, IHS, Euler Hermes

Last review: 2014-09-08
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