KAZAKHSTAN: Fiscal policy to the rescue

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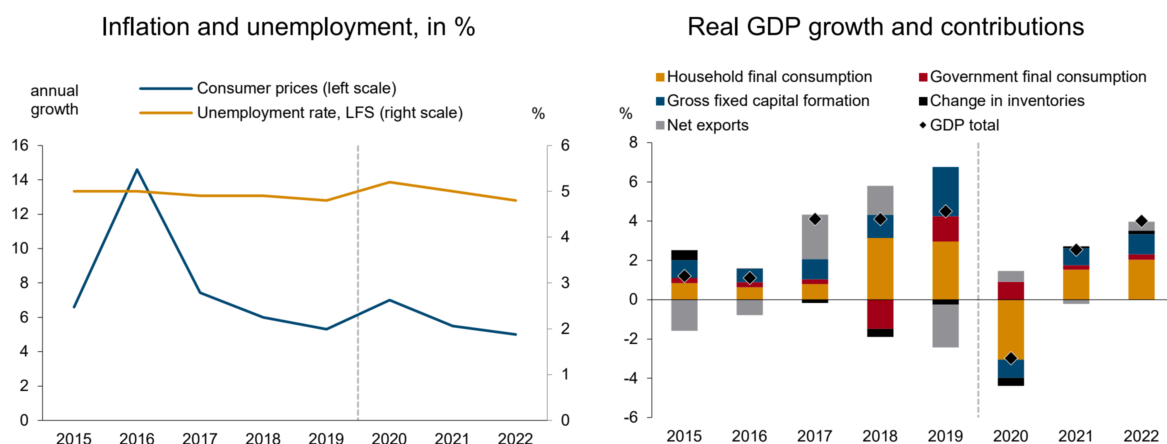
A substantial anti-crisis package is mitigating the impact on the economy of two lockdowns and low oil prices. The cut in oil production, in line with the OPEC+ agreement, will hinder any strong revival of exports in coming years. Thanks to a massive fiscal stimulus, real GDP in 2020 is expected to fall by only 3%. Economic growth will resume in 2021, but will be moderate, at 2.5%; in 2022, it will accelerate to 4%. Further lockdowns and the absence of any recovery in oil prices are the main downside risks to the forecast.

Figure 4.9 / Kazakhstan: Main macroeconomic indicators



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculation. Forecasts by wiiw.

Despite the fallout from the pandemic, a collapse in the oil price in the first half of the year and a cut in oil production in the second half, Kazakhstan will experience a relatively mild recession this year, thanks mainly to a large fiscal stimulus. Compared to other CESEE countries, Kazakhstan recorded a relatively small decline (of 6.1%) in real GDP in the second quarter of 2020 year on year (y-o-y). Nevertheless, the contraction of the economy was more than double that suffered in the worst quarter following the global financial crisis (-2.6% in Q2 2009). After the economy's strong performance in the first quarter, when it saw growth of 2.7% (y-o-y), overall it contracted by 1.8% (y-o-y) in the first half of the year. The negative growth has likely remained in the third quarter: first of all, containment measures were reintroduced in July to mid-August, following a spike in COVID-19 infections and mortality, and in view of the weak capacity of the health system to cope; and secondly, better compliance with OPEC+ obligations to cut oil production means that industrial activity has slowed since June. However, the substantial, targeted state support package – which has been expanded several times during the year (most recently in early September) – has done much to mitigate the negative

impact of the crisis. Assuming no new lockdowns, we are keeping our GDP growth forecast for 2020 unchanged at -3%.

While part of the economy has been severely hit by the restrictions imposed, some industries have stayed afloat thanks to additional public orders, increasing import substitution and growing demand for online activities. Over the first nine months of 2020, the retail and wholesale trade sector recorded a real contraction of 9.5% on an annual basis, while transport suffered a slump of 17.1%. Together, these sectors account for around a quarter of GDP and total employment. By contrast, agriculture, construction and manufacturing grew by 5%, 10.5% and 3.3%, respectively. Demand for digital infrastructure, distance learning and remote work propelled the communication sector to 8.2% real growth y-o-y over the same period. Agriculture has been given special priority under the state anti-crisis measures, due to a concern over food security and the sector's large share of employment (13% of total). It has profited from subsidised loans, tax incentives and direct subsidies. Public orders have boosted pharmaceutical production – essential to ensure that the medicines needed to fight the pandemic are available domestically. Manufacturing enterprises in the priority areas received subsidised loans and direct state funding under the state programme 'Economy of Simple Things', in order to keep them afloat and not jeopardise the longer-term diversification and import-substitution strategy. Since the second lockdown restrictions were lifted in mid-August, business sentiment has been improving, as is reflected in the manufacturing Purchasing Managers' Index (52.6 in September 2020).[15] According to a sentiment indicator compiled by the national statistical office, the heads of industrial enterprises have noted an increase in production volumes and demand in Q3 2020, compared to Q2 2020.

The resources of the National Oil Fund that were accumulated during the economic upswing offer enough flexibility to continue with an expansionary fiscal policy. At the end of September 2020, the assets of the National Oil Fund amounted to USD 57 billion (or 33% of GDP); since the beginning of the year, they have declined by only 7% in dollar terms. The outflow of transfers to the state budget (USD 10 billion in the first nine months of 2020) has been partially offset by an increase in the value of the fund's assets, thanks to an upturn on the financial markets. The transfers have provided for the funding of the fiscal stimuli – both those planned before the pandemic and those introduced subsequently, as part of the anti-crisis package (around 8.7% of GDP). An expansionary fiscal policy will persist in 2021-2022, with a focus on social spending. In 2021, an additional USD 1 billion will be spent on increased pensions and on raising the salaries of teachers and medical workers. Manufacturing and agriculture will be supported with USD 4 billion via the prolongation of targeted programmes. The anti-crisis programme of subsidised loans to small and medium-sized businesses affected by the lockdowns was recently extended to the end of 2021, and its volume was boosted by USD 0.5 billion, to an overall USD 1.9 billion.[16] The moderate revenue from oil and the large fiscal stimuli will mean bigger than anticipated budget deficits in 2020-2022, although a gradual reduction is planned through efficiency gains once public sector reforms are implemented.

Merchandise exports are not expected to return to their 2019 levels before 2022, and their recovery depends greatly on global oil prices. In merchandise exports, the 15.7% contraction in dollar terms over January-August 2020 y-o-y was less pronounced than might have been expected after the plunge in oil prices in March-April. In the first half year, the decline in prices and the reduced demand

[15] A value of over 50 means better sentiment than the previous month.

[16] Until September, banks reportedly granted credits to 1,279 SMEs worth a total amount of USD 0.8 billion.

for oil among some trading partners were partially offset by an increase in export volumes, and a reorientation toward other destinations. Despite OPEC+ obligations to cut production, the volume of oil exports in the first eight months of 2020 was greater than in the same period of 2019. The contraction in oil exports to France, South Korea and Spain (which were among Kazakhstan's top six oil export destinations in 2019) of more than 40% y-o-y in physical terms in the first eight months of 2020 was offset by increased exports to India (which trebled) and to China (which more than doubled) over the same period. Thus, those two countries became Kazakhstan's third and fourth largest oil export destinations. We expect the recovery in exports next year to be moderate, as the OPEC+ obligations will limit oil production until 2022, and will thus restrict the potential for high growth in physical export volumes. The government of Kazakhstan does not expect the 2019 oil production level of 90.5 million tonnes to be reached in the next few years, according to official projections (85 million tonnes in 2020, 86 million in 2020 and 89.6 million in 2022). The possible absence of a recovery in oil prices is a serious downside risk that may hamper the price-based acceleration of exports.

The tenge has weakened rather less this year than it might have done, had there been no policy moves; the depreciation will likely slow further in the next two years, although the dynamics is very uncertain. First, interventions by the national bank and then the mandatory sale of dollar revenues by quasi-state exporters and the conversion from dollars into tenge of the monthly National Oil Fund transfers to the budget have helped to stabilise the currency, in the wake of the oil price collapse. However, the recent weakening of emerging economy currencies, especially the Russian rouble, has again put the tenge under stronger pressure. A sharper tenge depreciation is a downside risk to the recovery of imports. In the baseline scenario, we expect current account deficits of 3.5% for 2020 and 3.2% for 2021. The upward correction of the current account deficit forecast for this year is due to a smaller than expected export decline and a very low net outflow of income on direct investment (the value in the first two quarters of 2020 was only half that in the same period of 2019).

Overall, the investment decline in 2020 will be moderate, as the reduction in investment due to postponed projects in the oil industry is offset by government construction programmes. A large negative contribution to the investment dynamics comes from delayed or postponed investment projects, in particular, from temporary work disruptions at the Tengiz oil field enlargement project, due to COVID-19 clusters in sub-contracting firms and state-imposed lockdowns. However, investment in construction, especially housing, expanded by 17% in the first eight months y-o-y. State programmes of road and housing construction have supported the supply side. The volume of new mortgage loans, partly subsidised by the state, expanded by 42% in August y-o-y (the stock of mortgage loans grew by 27% y-o-y), reinforcing demand for apartments. The adequate supply has prevented a disproportionate acceleration in house prices, which remained in line with CPI inflation over January-August (+6.5% y-o-y). Investment projects, especially in the oil sector, are expected gradually to resume and then to accelerate, in order to meet previously agreed deadlines; this suggests a recovery in investment from 2021 and an acceleration in 2022.

The moderate impact of the crisis on the labour market, thanks to the rescue measures, provides a sound precondition for a recovery in consumption once restrictions are lifted – although the recovery is likely to be slow, on account of slower growth in incomes. As a result of the containment measures, private consumption declined by 8.3% y-o-y over the first half of 2020. The restrained consumption translated into deposit growth of 19% y-o-y in August 2020. Maintaining employment and income have been among the main priorities of the anti-crisis package. Public works by

local authorities and a targeted employment programme have partially absorbed the unemployed, which is a positive factor for the revival of consumption. However, the current slowdown in the growth of wages suggests that consumption will pick up only moderately in the future. Moreover, a tightening of the social distancing restrictions could be on the cards this winter, if infections rise substantially. To sum up, we expect private consumption to increase by 3% in 2021 and by 4% in 2022.

Subsidised loans for some categories of borrower supported credit growth in 2020, while unsecured consumer lending slowed. The anti-crisis package included a moratorium on loan repayments, and the anticipated deterioration in asset quality will be visible only next year. The supervisory authority is closely monitoring several banks with particularly high levels of non-performing loans in their portfolios and low capital adequacy, and the Tengri Bank is the first bank to have had its licence revoked.

A slow recovery is expected in 2021, with real GDP growth of 2.5%; in 2022, growth will accelerate to 4%. Growth will be broad based, supported by a revival in private consumption, exports and investment. Downside risks include another lockdown, a fall in oil prices, another oil production cut by OPEC+, and the slow recovery of trading partners. The parliamentary elections to be held next year are unlikely to bring any political change and the ruling party is likely to retain its majority.

Table 4.9 / Kazakhstan: Selected economic indicators

	2017	2018	2019 1)	2020 1Q	2020 2Q	2020 1-2Q	2020 Forecast	2021 Forecast	2022 Forecast
Population, th pers., average	18,038	18,276	18,514	18,661	18,725	18,696	18,800	19,000	19,200
Gross domestic product, KZT bn, nom.	54,379	61,820	69,533	15,093	13,306	28,400	70,200	76,300	84,100
annual change in % (real)	4.1	4.1	4.5	2.7	-6.1	-1.8	-3.0	2.5	4.0
GDP/capita (EUR at PPP)	17,060	17,840	18,540	.	.	.	.	.	.
Consumption of households, KZT bn, nom.	27,987	31,514	35,374	7,203	6,185	13,388	.	.	.
annual change in % (real)	1.5	6.1	5.8	1.0	-16.6	-8.3	-6.0	3.0	4.0
Gross fixed capital form., KZT bn, nom.	11,799	13,091	16,010	2,654	3,232	5,887	.	.	.
annual change in % (real)	4.5	5.4	11.9	0.1	-5.4	-2.5	-4.0	3.8	4.5
Gross industrial production									
annual change in % (real)	7.3	4.4	4.1	5.8	0.4	3.1	-1.0	2.0	3.0
Gross agricultural production									
annual change in % (real)	3.0	3.5	-0.1	2.5	2.6	2.4	.	.	.
Construction industry									
annual change in % (real)	2.8	4.6	13.2	11.9	8.0	11.2	.	.	.
Employed persons, LFS, th, average	8,585	8,695	8,781	8,794	8,704	8,749	8,780	8,910	9,030
annual change in %	0.4	1.3	1.0	0.7	-0.7	0.0	0.0	1.5	1.3
Unemployed persons, LFS, th, average	442	444	441	442	454	448	480	470	460
Unemployment rate, LFS, in %, average	4.9	4.9	4.8	4.8	5.0	4.9	5.2	5.0	4.8
Reg. unemployment rate, in %, eop	0.8	1.0	1.1	1.6	2.0	2.0	.	.	.
Average monthly gross wages, KZT 2)	150,827	162,673	186,815	200,332	212,035	206,184	210,900	228,100	246,700
annual change in % (real, gross)	-1.7	1.7	9.1	12.2	6.4	9.2	5.5	2.5	3.0
Consumer prices (HICP), % p.a.	7.4	6.0	5.3	6.0	6.8	6.4	7.0	5.5	5.0
Producer prices in industry, % p.a.	15.3	19.0	5.1	1.8	-18.6	-8.6	-8.0	5.0	3.0
General governm.budget, nat.def., % of GDP									
Revenues	21.3	17.5	18.3	22.1	28.0	24.9	25.0	22.0	20.0
Expenditures	23.9	18.8	20.2	22.4	33.8	27.7	30.0	26.0	23.0
Deficit (-) / surplus (+)	-2.7	-1.3	-1.8	-0.2	-5.8	-2.8	-5.0	-4.0	-3.0
General gov.gross debt, nat.def., % of GDP	25.7	26.0	24.9	26.6	27.2	27.2	29.0	31.0	31.0
Stock of loans of non-fin.private sector, % p.a.	0.0	3.0	5.9	14.7	7.9	7.9	.	.	.
Non-performing loans (NPL), in %, eop	9.3	7.4	8.1	8.9	9.0	9.0	.	.	.
Central bank policy rate, % p.a., eop 3)	10.25	9.25	9.25	12.00	9.50	9.50	9.00	8.75	8.50
Current account, EUR mn 4)	-4,516	-117	-6,437	2,557	-1,021	1,542	-5,200	-5,100	-5,700
Current account in % of GDP	-3.1	-0.1	-4.0	7.3	-3.5	2.4	-3.5	-3.3	-3.4
Exports of goods, BOP, EUR mn 4)	41,866	50,712	51,953	12,952	10,589	23,546	40,300	46,300	48,600
annual change in %	30.6	21.1	2.4	10.3	-22.3	-7.2	-22.4	14.9	5.0
Imports of goods, BOP, EUR mn 4)	27,060	29,030	35,759	6,483	7,859	14,341	31,300	32,500	33,800
annual change in %	14.2	7.3	23.2	1.5	-14.8	-8.1	-12.5	3.8	4.0
Exports of services, BOP, EUR mn 4)	5,757	6,205	6,952	1,393	998	2,391	5,000	5,900	6,500
annual change in %	4.7	7.8	12.0	-3.8	-40.5	-23.5	-28.1	18.0	10.2
Imports of services, BOP, EUR mn 4)	8,924	10,156	10,244	2,212	1,614	3,827	7,500	8,900	9,300
annual change in %	0.3	13.8	0.9	-1.1	-35.5	-19.2	-26.8	18.7	4.5
FDI liabilities, EUR mn 4)	4,171	71	3,010	911	2,863	3,771	4,400	.	.
FDI assets, EUR mn 4)	847	-3,933	-1,833	-341	950	607	900	.	.
Gross reserves of NB excl. gold, EUR mn 4)	15,505	14,460	9,004	9,137	10,066	10,066	.	.	.
Gross external debt, EUR mn 4)	140,153	139,732	141,600	139,876	141,802	141,802	145,000	147,000	149,000
Gross external debt, % of GDP	94.9	91.9	87.3	94.2	95.5	95.5	98.0	94.0	88.0
Average exchange rate KZT/EUR	368.32	406.66	428.51	429.88	459.91	444.89	473	489	495

1) Preliminary. - 2) Excluding small enterprises, engaged in entrepreneurial activity. - 3) One-day (overnight) repo rate. - 4) Converted from USD.

Source: wiiw Databases incorporating national statistics. Forecasts by wiiw.