



CAREC Institute Research Workshop

21-24 October 2009, Almaty, Kazakhstan

Ministry of Economy and Budget Planning

JSC “Economic Research Institute”

“Macroeconomic policy issues in Kazakhstan”



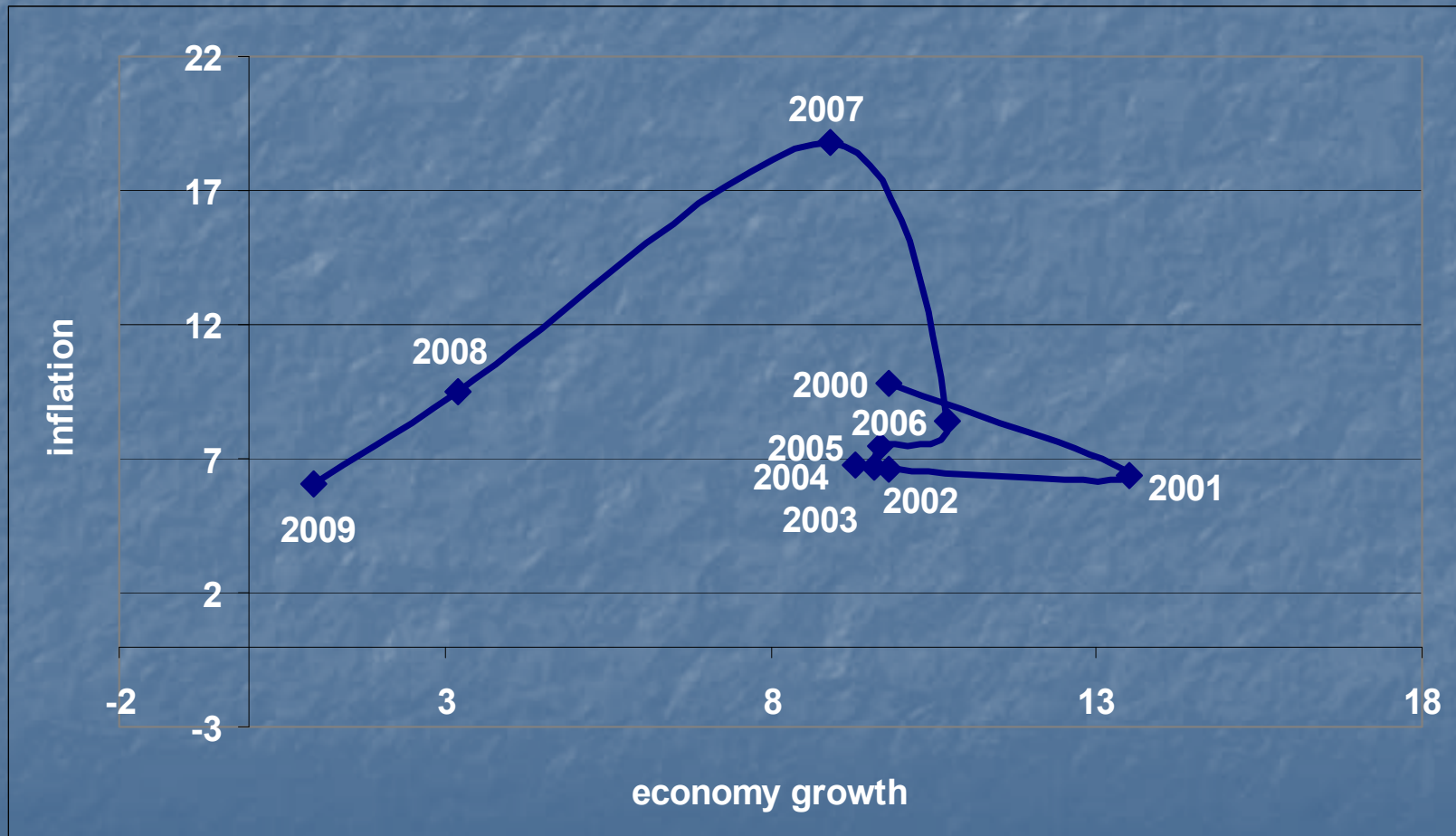


- Summary of macroeconomic indicators
- Trade and external performance
- External debt problem
- Financial situation summary
- Labor market
- Inflation targeting
- Macroeconomic problems and risks
- Solutions: employment strategy
- Solutions: skills development



Economy is turning to the low inflation and growth pattern

Passing through the early post-transition period and experiencing the boom, Kazakh economy is prone to high inflation



*-2009 forecasts

Kazakhstan: current economic indicators summary



<i>Indicators</i>	2008	2009 (est.)	2010 (forecast)
Nominal GDP, KZT trillion	16.0	15.0*	14.9
<i>in US dollars, bln.</i>	132.8	99.3*	100.2
GDP per capita, US dollars	8502.9	6268.9*	6301.2
Real GDP growth, %	3.3	-1.0*	2.2
Inflation, annual average, %	9.5	8.4*	11.2
Unemployment rate, %	6.6	8.5	7.5
Trade balance, US dollars, bln.	33.5	7.4*	16.7
Exports, USD billion	72.0	40.7*	41.6
Imports, USD billion	38.5	33.3*	24.9

Source: BTA Analytics, * - ERI estimates

Kazakhstan: current economic indicators summary



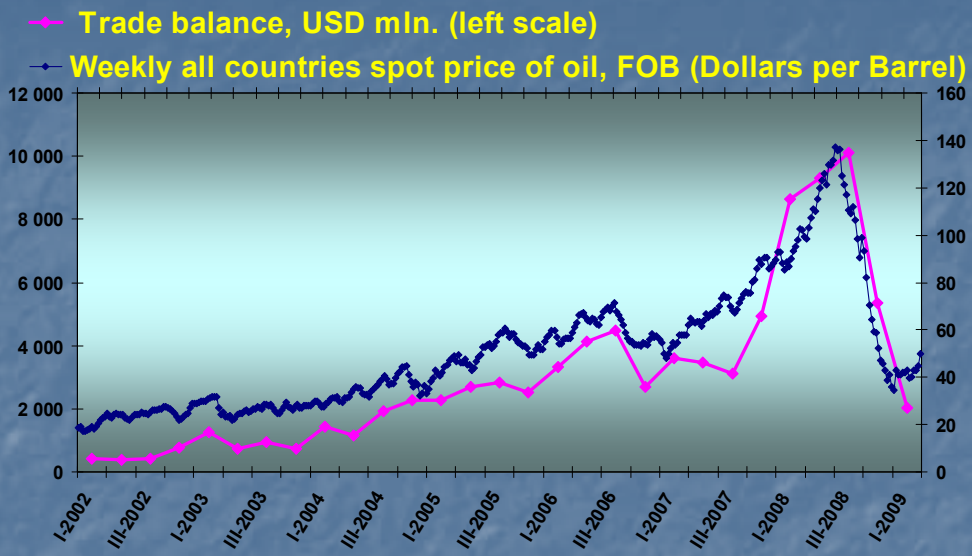
<i>Indicators</i>	2008	2009 (est.)	2010 (forecast)
Current Account, USD billion	7.0	-0.9	-1.3
Foreign direct investments, USD billion	14.5	11.1*	8.5
Budget deficit, USD billion	-2.2	-2.18	-1.01
Budget deficit as % of GDP	-2.1	-2.3	-1.0
Gross external debt, USD billion, end of per	107.8	83.8	67.6
International reserves, USD billion	19.4	21.1	23
Banking system assets, USD billion	98.5	95.0	91
Refinancing rate, %	10.5	7.0*	9
Exchange rate, annual average, KZT/USD	120.6	147.0	149

Source: BTA Analytics, * - ERI estimates

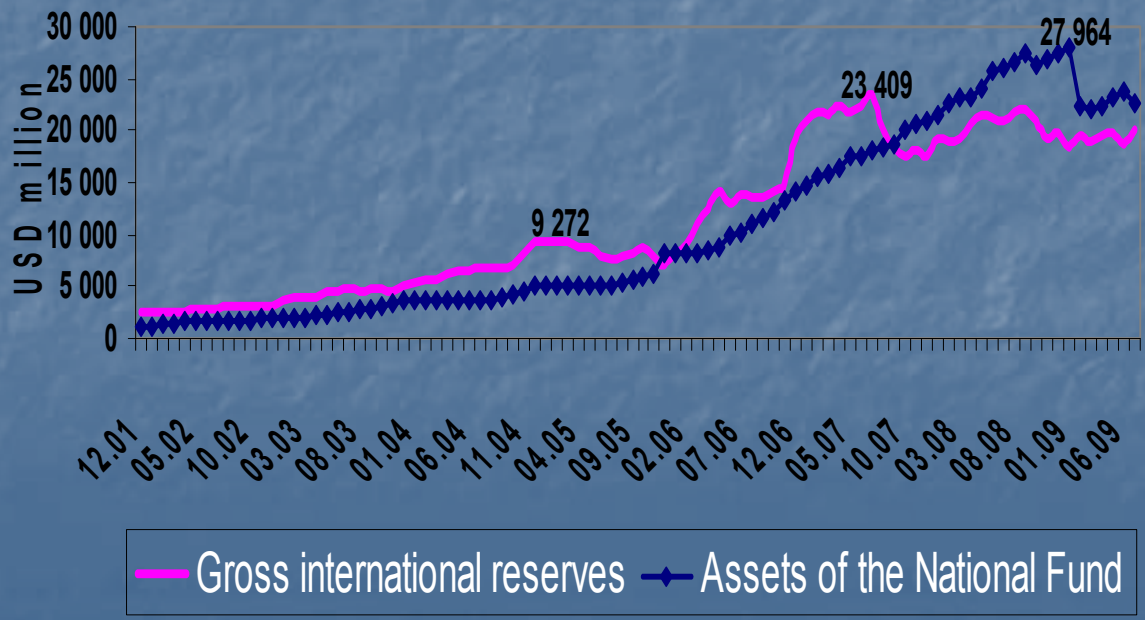


Economy of Kazakhstan is still dominated by the dependence on commodity exports

Oil and gas sector composes 21.8% of GDP (2008) and grew 9.6%.
72% of exports consist of mineral products.



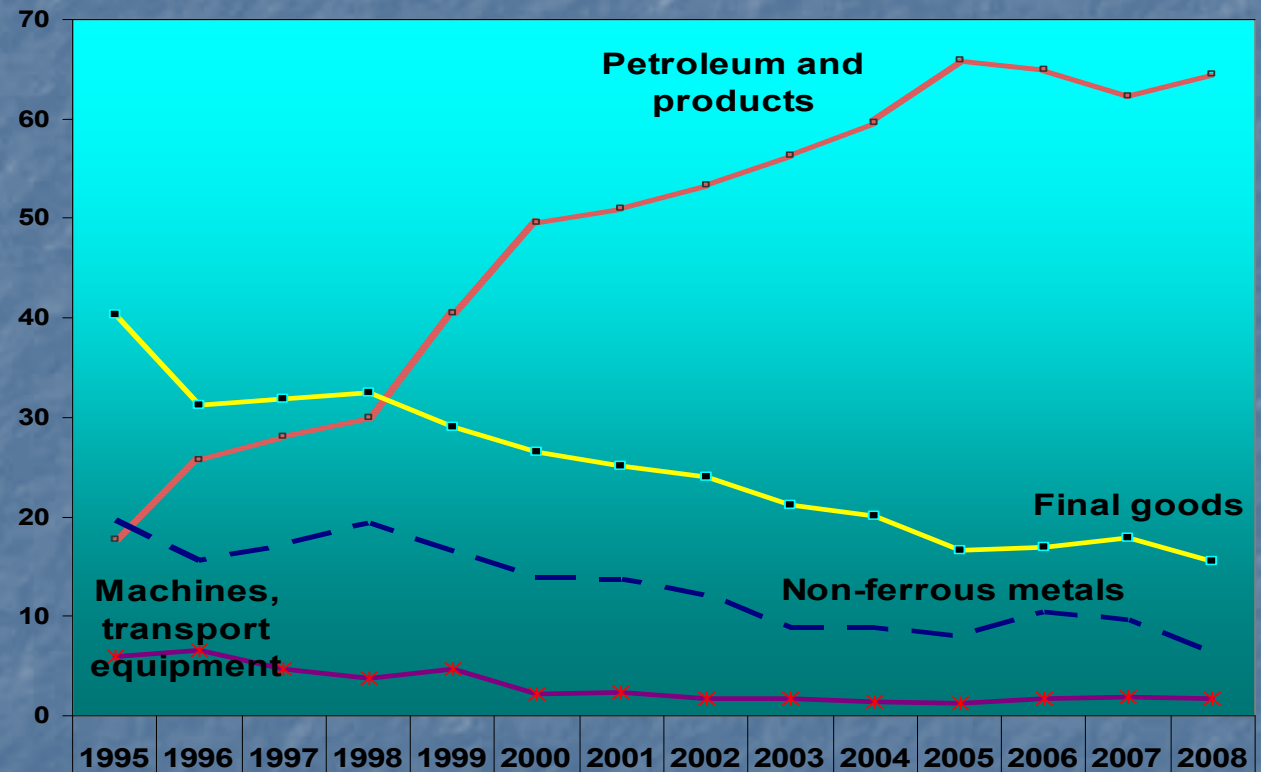
Source: NBRK



Commodity boom allowed to accumulate huge reserves. However, abrupt fall in prices in 2008 revealed the vulnerabilities.



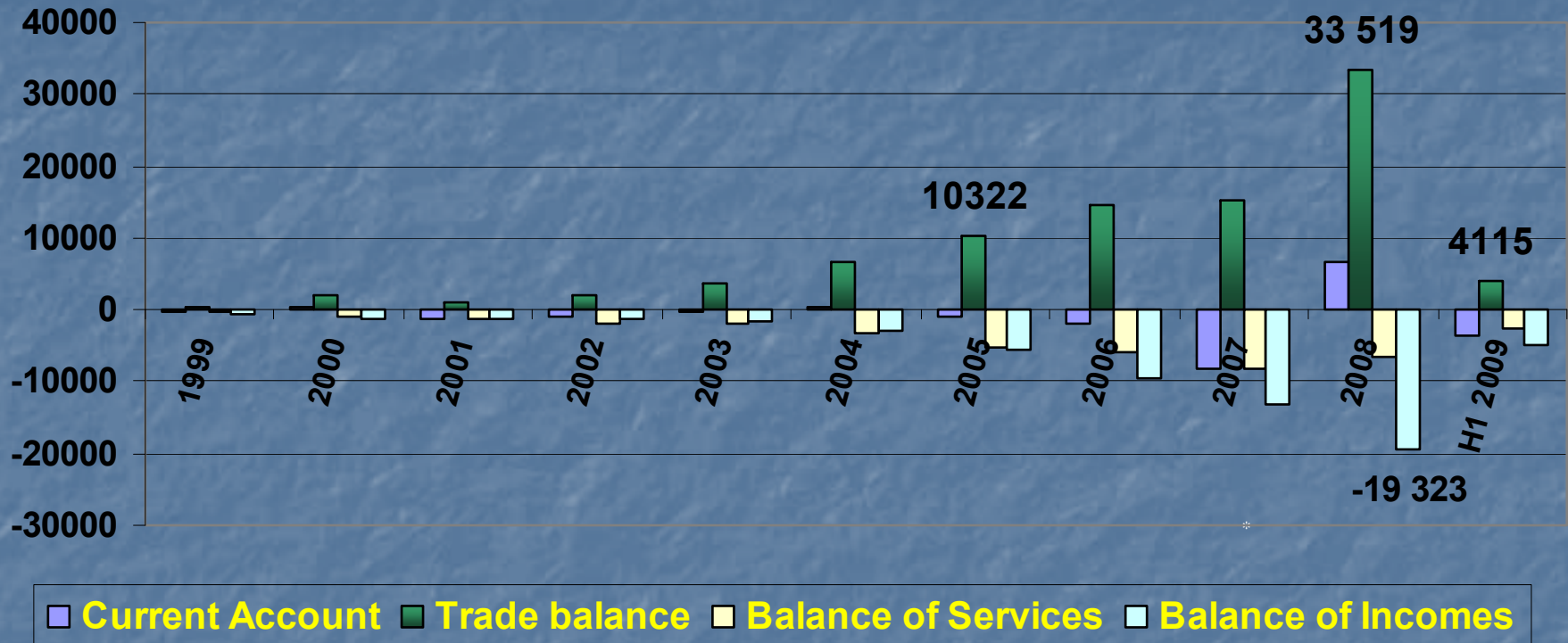
Declining share of non-oil tradables in exports signs a progressing Dutch Disease case



—□— Petroleum and products	17,8	25,8	28,1	30	40,5	49,6	51,1	53,4	56,3	59,6	65,9	65	62,36	64,58
— Non-ferrous metals	19,6	15,5	17,1	19,3	16,5	13,9	13,6	12,1	8,82	8,79	8,05	10,4	9,50	6,33
—■— Final goods	40,4	31,2	31,8	32,5	29,1	26,5	25,1	23,9	21,2	20,1	16,7	16,9	17,92	15,54
—×— Machines, transport equipment	5,96	6,63	4,66	3,83	4,78	2,12	2,32	1,7	1,78	1,36	1,2	1,71	1,92	1,75



Kazakhstan: Balance of Payments



BOP positions are worsening, but no protracted deficits so far.
The dragging-down items are balance of services (imported labor) and incomes (investment return).
Improving quality of the labor force (training, education) and re-investment incentives could help improve long-term stance of the BOP.

Kazakhstan's role in the world trade



Goods with comparative advantages

	2008 imports, USD million	Exports, USD million	Lafay index
Petroleum oils & oils obt. from bituminous mins., crude	2 772.87	43 507.92	16.427
Refined copper cathodes and sections	0.00	2 428.05	1.202
Ferro-chromium, cont. by wt. >4% of carbon	0.00	2 086.73	1.033
Wheat other than durum wheat; meslin	0.00	1 370.44	0.679
Natural uranium & its comps.; alloys, dispersions	0.00	1 279.98	0.634
Wheat/meslin flour	0.00	849.23	0.421
Iron ores and concentrates	0.00	795.38	0.394
Propane, liquefied	0.00	627.88	0.311

Adding value to the commodities prevailing in total exports is the urgent task for the nearest prospects of development.



Kazakhstan's role in the world trade

Goods with comparative disadvantages

	2008 imports, \$ million	Exports, \$ million	Lafay index
Vehicles designed for the tpt. of persons	727.04	0.00	-1.342
Light petroleum oils & preparations	748.34	102.18	-1.331
Line pipe of a kind used for oil/gas pipelines, longitudinally submerged arc welded	696.38	155.31	-1.209
Structures & parts of structures of iron/steel	560.59	0.00	-1.035
Line pipe of a kind used for oil/gas pipelines, diam>406mm	525.91	0.00	-0.971
Taps, cocks, valves & sim. appls. for pipes/boiler shells/tanks	485.37	0.00	-0.896
Medicaments consisting of mixed/unmixed prods	464.63	0.00	-0.858
Aeroplanes & oth. aircraft, of an unladen wt. >15000kg	637.27	687.40	-0.836

Many items on the strong import side could be substituted but due to the lack of technologies and skills the progress is slow.



External indebtedness contains the growth

Foreign debt, USD bln.	2004	2005	2006	2007	2008	31.03.2009
TOTAL	32.7	43.4	74.0	96.9	107.8	105.1
Short-term	3.9	8.2	12.7	12.0	10.6	9.0
Long-term	28.8	35.3	61.4	85.0	97.2	96.1
General Government	2.5	1.5	1.5	1.5	1.6	1.6
Banks	7.7	15.3	33.3	45.9	39.2	34.1
Short-term	2.3	6.3	7.5	6.1	3.1	2.3
Long-term	5.4	9.0	25.9	39.8	36.1	31.8
Other Sectors	22.5	26.5	38.1	49.4	66.9	69.5
Memo items: Intercompany debt	16.7	19.2	25.5	30.1	36.9	38.2
1. Gross external debt excl. intercompany loans per capita (USD)	1 064	1 590	3 151	4 293	4 494	4 226
2. Gross external debt incl. intercompany loans to GDP ratio , %	76	76	91	92	82	82
3. International reserves to a short- term debt on an original maturity basis, %	235	87	151	147	187	210

Debt to GDP ratio is exceeding the safe levels.
The most alarming situation is in the banking system.

Situation in the financial sector



The biggest banks are in trouble. External markets are closed, the growth of deposits under question, non-performing loans have reached 30% of credit portfolio and the losses are growing fast.

There is a high risk of defaults in the system-making banks.

Banking sector capital adequacy	January 2009	April 2009
Tier one capital to total assets (k1)	0,12	0,10
Total capital to total risk-weighted assets and contingent liabilities (k2)	0,15	0,13
Total capital to loan portfolio	0,21	0,19
Total capital to established provisions	1,90	1,23
Total capital to doubtful loans	0,40	0,32
Total capital to loss loans	4,84	2,80

The amount of provisions established as of April 1, 2009 has constituted KZT1560,8 bln. or 15,2% of tier two banks' loan portfolio. Year-to-date provisions have increased by KZT535,2 bln. or 52,2 %. The percentage of doubted loans has increased from 52,6% to 57,8%.

High concentration in the banking sector remains, with assets, liabilities and other indicators of top three banks reaching 60% of total.



Financial liberalization: money supply and the coefficient of monetization

The monetization level of the economy on individual monetary aggregates (%) and GNI per capita, average for 1995-2005 . *

GNI per capita	M1/GNI	M2/GNI	M3/GNI	Number countries in the group
Up to 1 000\$	14.8	29.0	32.4	39
1 000–3 000\$	17.3	43.7	48.7	15
3000–8 000\$	16.3	50.8	55.1	25
8000–15 000\$.	26.6	82.6	86.0	8
Over 15 000\$.	27.6	89.6	95.2	6

Source: World Bank, World Development Indicators - 2007

Coefficient of monetization in the Republic of Kazakhstan for 2004-2008.

	2004	2005	2006	2007	2008
Money Supply (annual average), M3, billion tenge	1 241,8	1 844,1	2 765,0	4 265,9	5 365,0
GDP (billion tenge)	5 870,1	7 590,6	10 213,7	12 850,0	15 936,0
Coefficient of monetization, M3 / GDP	21,2	24,3	27,1	33,2	33,7

Source: National Bank of Kazakhstan

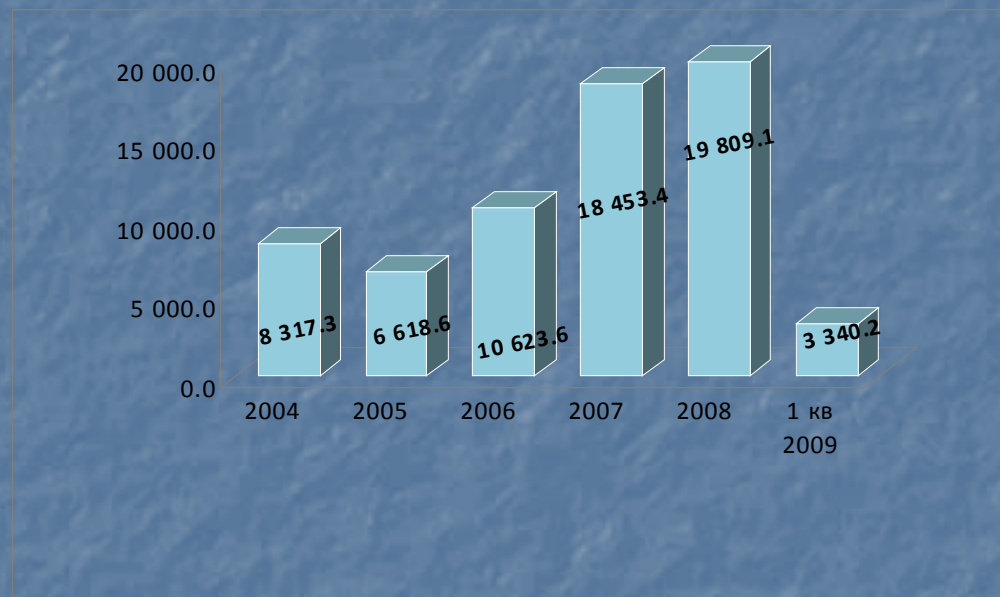
* EM Sandoyan, LM Hakobyan. "Non-inflationary monetization of the economy AS A FACTOR OF ECONOMIC DEVELOPMENT". Journal of the Nizhny Novgorod University. NI Lobachevsky, 2008, № 6, pp. 204-207

- According to modern economic literature, the coefficient of M3 rate to GDP has become a standard measure of development of financial markets and an level indicator of the financial intermediation.
- Kazakhstan enters the group of countries with per capita income of 3 to 8 thousand dollars
- For these countries the average level of monetization on M3 is 55.1%.
- The level of monetization in Kazakhstan is 33,7%. in 2008
- As a result, there is a need to further increase the monetization ratio mainly through increasing the volume of cashless payments



Financial liberalization: foreign direct investment in the economy of Kazakhstan

USD, mln.



Liberalization of capital movements enabled Kazakhstan to attract significant investment to the economy.

Source: NBRK

Financial liberalization can provide as more dynamic economic growth so create significant risks. Removing restrictions on capital movement creates the following risks:

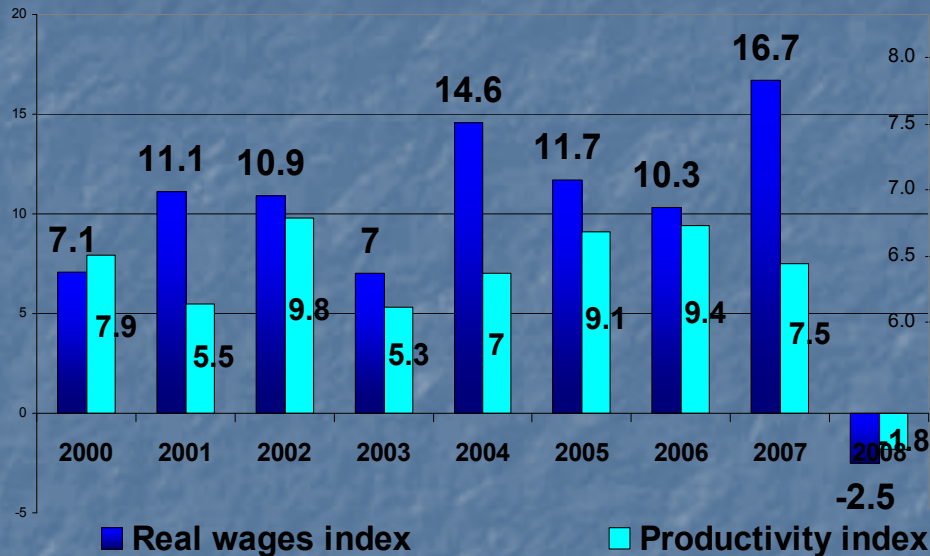
Probable capital outflow from country;

- substantial inflow of capital over a short period of time;
- sudden outflow of capital generated of loss of confidence to market.

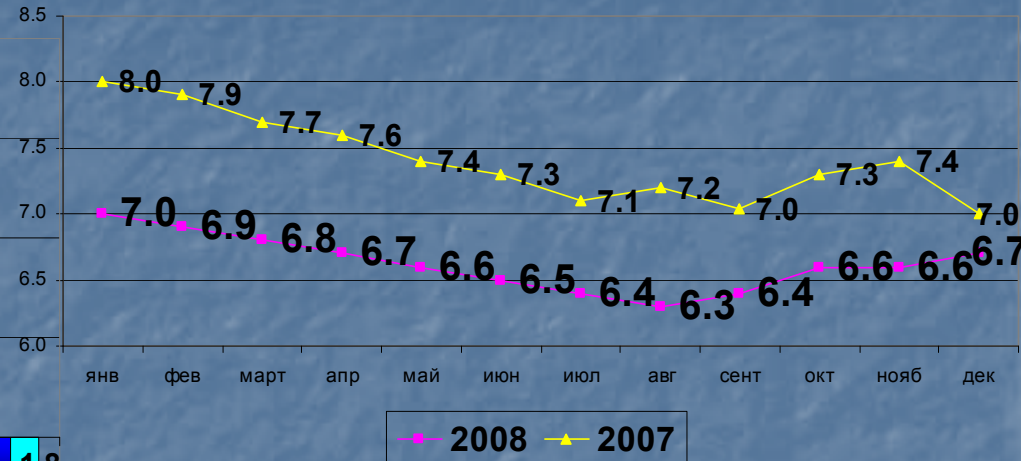


Labor market: results of the overheating

Labor productivity dynamics and real wage
(growth rate, %)



Unemployment levels, %



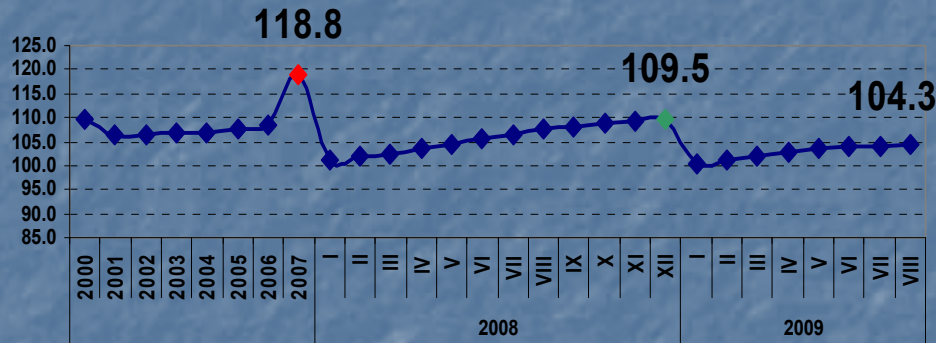
The issue of real wages growing faster than productivity becomes a long-term factor of inflation

Unemployment is contained at relatively safe levels



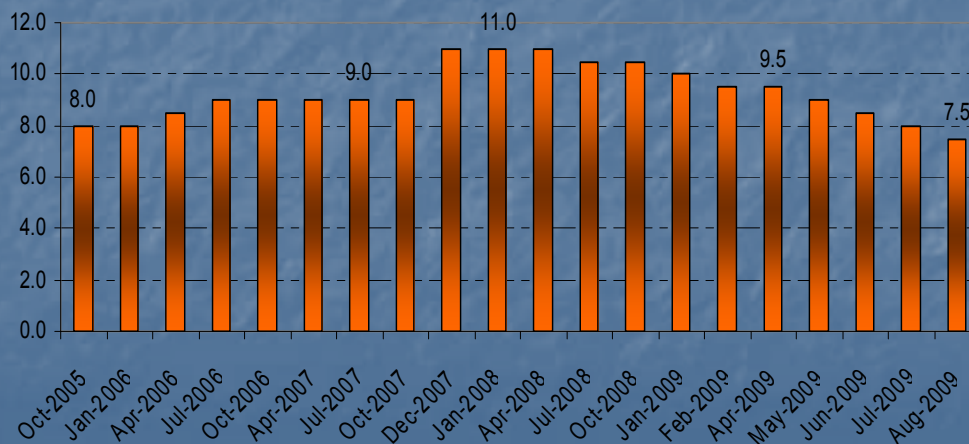
Inflation targeting: pros and cons

Consumer price indices, as % to
December prev. year



Given liberalized capital flows, the National (Central) Bank is to choose between either price or exchange rate stability

National Bank refinancing rate, %

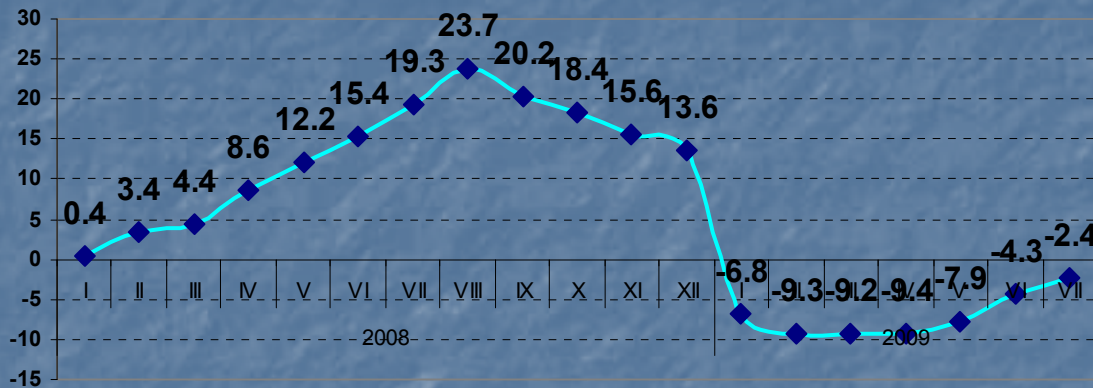


Following historically low rates of inflation, the National Bank is loosening the grip of policy tools



Inflation targeting: pros and cons

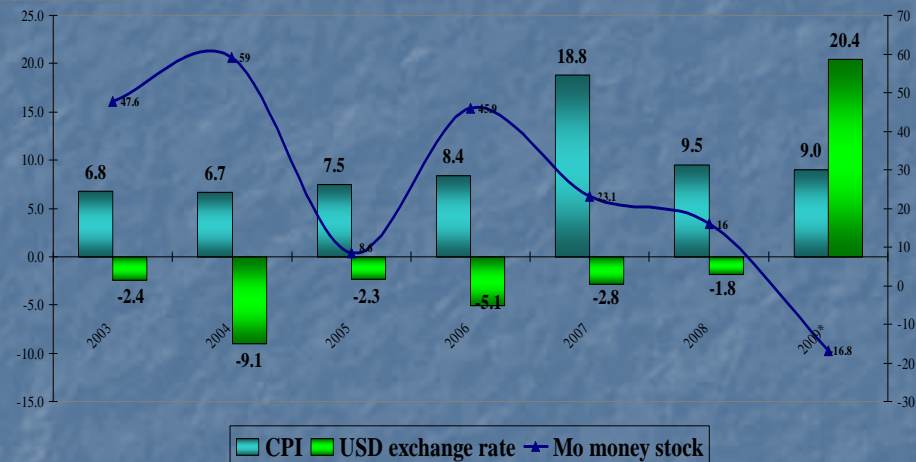
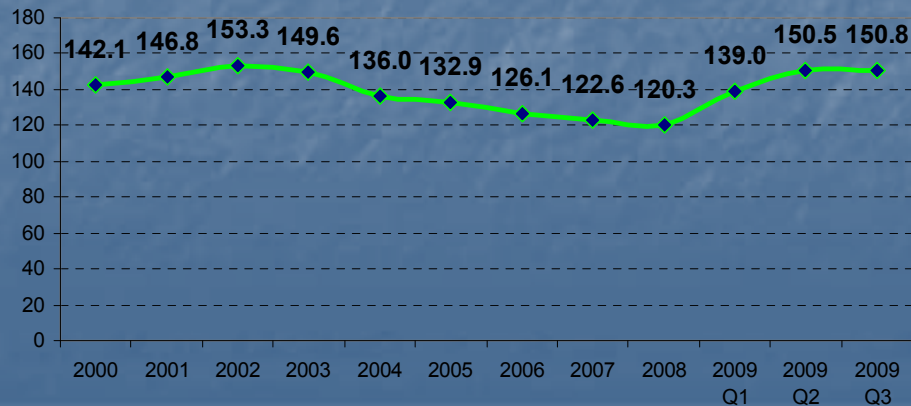
Overall imports price changes, as % to December prev.year



Import prices - the important inflation factor are falling thus deterring the growth in overall price levels

Considering high inflation in trade partners, the risks increase

KZT/USD exchange rate, tenge per 1 US dollar



The pass-through to inflation from the February 2009 18% devaluation was unexpectedly low

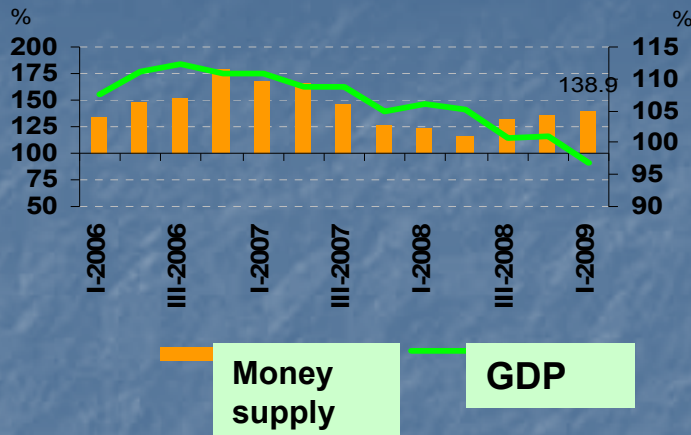


Inflation targeting: pros and cons

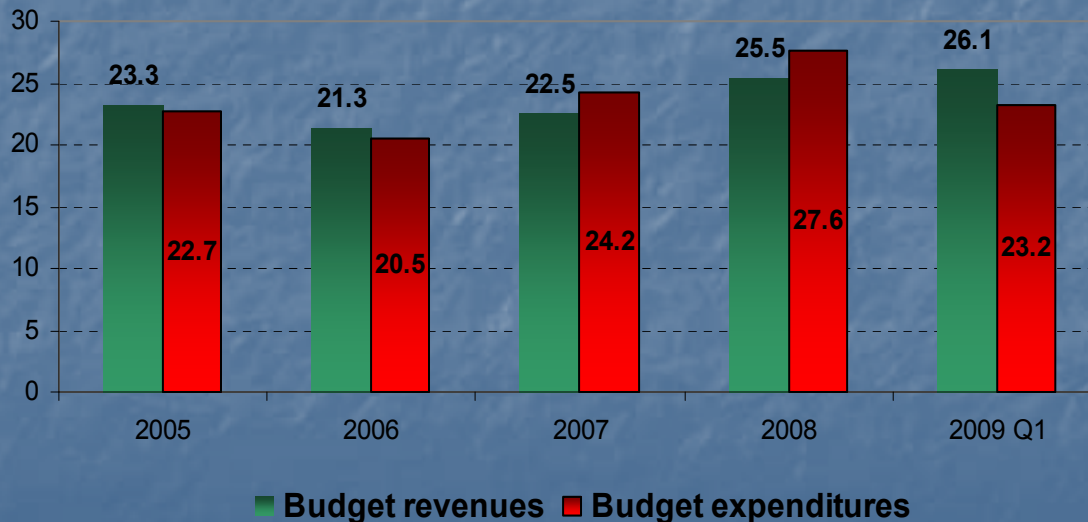
In the long run, inflation risks remain sound.

Before the crisis, public spending was growing, making inflation targets difficult to achieve.

Money growth (left scale) and GDP



Fiscal balance, % of GDP



Since financial stability and the discretionary decision-making by the National Bank are not yet there, the process of introducing inflation targeting is put off.



- 1. High dependence on mining industries – issue of economy diversification.**
- 2. Deteriorating Balance of Payments situation.**
- 3. There are phenomena of the Dutch Disease**
- 4. The country does not fully enjoy its comparative advantages.**
- 5. Proper management of the National Fund: its size, investment policy, and effective distribution of resources to be settled.**
- 6. The mounting external debt deters the development.**
- 7. The banks are not fully supporting the economy due to high external obligations, liquidity shortage, loan quality, and asset deterioration. High risk of defaults.**
- 8. Lack of technological breakthrough contains the development, local labor skills are low.**

Macroeconomic risks assessment in the context of the global financial crisis.



- **Downside risk of the GDP growth.** During the period of January to March, there was a decrease of short-term economic indices for this month last year (-4.1%), that reflects the downside risk of economic growth and the transition to the negative region.
- **Preservation risk of current level of oil prices.** Under present circumstances, the world goods market and primary market, taking into account the calculations of international organizations and agencies (the International Energy Agency expects the decline of world oil demand in 2009, to 570 000.barr. / day, Goldman Sachs - on 1,6 million), with the growth of commercial stocks in the U.S. ,the risk of low oil prices is preserving.
- **Downside risk of bank lending.** During eight months in 2009 the lending of economy by banks of the second level by 22,3% to 2,974.3 billion tenge decreased compared with the last year (3,825.9 billion tenge) in the context of limited external funding.
- **Overrun risk of the safe level of gross external debt .** The level of GDI to GDP will amount 100%according to the results in 2009 year, while by world standard safety is the ratio below 80%. taking into account the devaluation of tenge. There is a risk that the ratio of GDI / GDP will be above the safe level.
- **Default risk of systemic banks.** Major banks were in the ring of problems: external market borrowings are not available, growth in deposits has come under question, the quality of credits is worsening, the damages are growing. Moreover, the position is worsening by the outflow of resources for extinction and servicing of external and internal borrowing, raised earlier.

Macroeconomic risks assessment in the context of the global financial crisis.



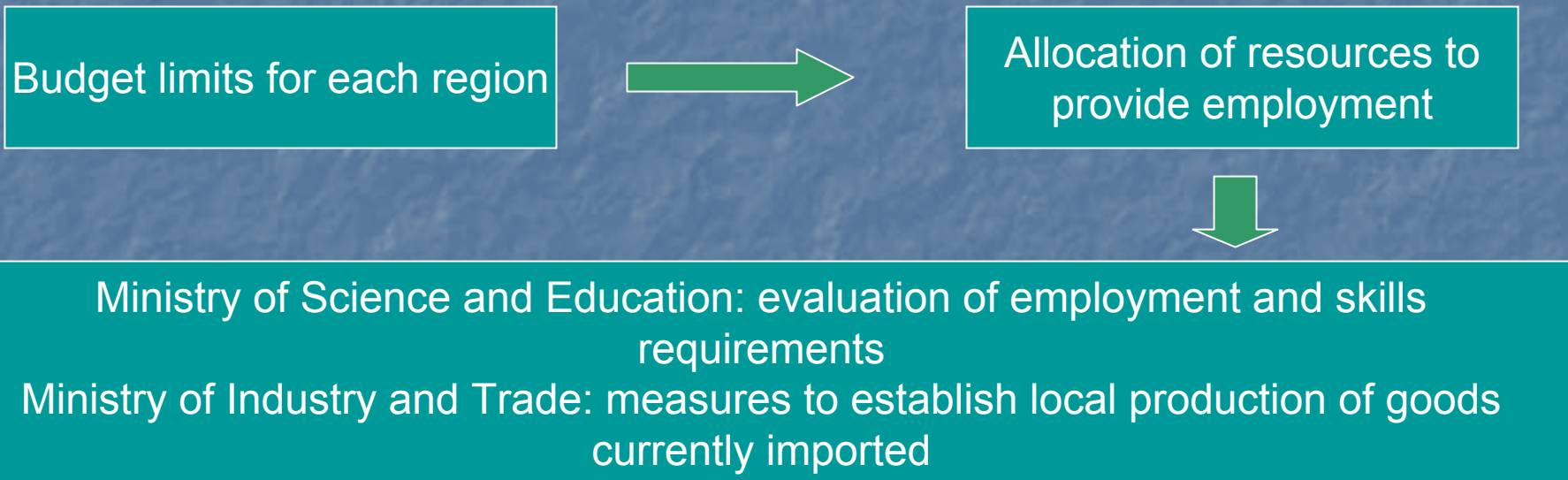
- **Risk of imbalance Budget** . There is a risk of increasing the budget deficit in relation with decrease of entries to the government budget. According to the calculations of the Ministry of Economy and Budget Planning of RK, the deficit of budget will amount 4,6% of GDP (771.4 billion tenge) in 2009.
- **Risk of limited source of state budget.** Taking into account the reduction of the National Fund, the limited internal and closing of the external markets there is a risk borrow limited sources of financing the budget deficit.
- **Macroeconomic trap "running in place"** when the growth of government flow rate leads to an increase in nominal rather than real parameters of economy (i.e the economy "runs" on the place, but with inflationary pursiness).
- **Risk of falling out of state budget** as a result of compression of the economy and reduce tax rates. In the first year of the tax reform (in 2009), the falling government gains of **state budget** are estimating at 2,1% of GDP.
- **The risk of termination of replenishment of the National Fund.** During eight months in 2009, the income structure of the state budget of Kazakhstan 36,4% are transfers from National Fund, instead 20,4% in last year. On the 1 of september in 2009 year, the usage of resource of the National Fund (transfers / income for the period) was more than 58,6% instead 38,5% in 2008.

“Roadmap”: Regional employment strategy in Kazakhstan



- Primary goals of the Roadmap: secure employment and create conditions for the sustainable post-crisis development.
- The Strategy envisages creation of 347.2 thousand jobs, including 278.5 thousand for road reconstruction.
- Financial resources:
 - Total budget of the employment and training strategy is KZT193.4 bln. with KZT140 bln. from the consolidated budget and the rest by local authorities.

Stages of the Strategy



Directions of the Employment Strategy



Housing communications development



Social projects in cities, towns, villages



School, hospital repair



Road repair and construction



Social jobs and internship



Personnel training

- Training and re-training program will cover up to 146.5 thousand persons on 179 branches and professions.

3 directions include:

1. Preparing of specialists involved in the projects under the Strategy – 100 thousand people.
2. Preparing the specialists for export-focused production in macroregions – 23.5 thousand people (KZT4,093 mln.
3. Substitution for foreign workforce – 23 thousand specialists (KZT3,000 mln).

Regional Employment Map



- Laid-off workers skills and professions
- Available newcomers (graduate students)
- Particularities of the region

Source: Ministry of Labor and Social Security

Evaluating the efficiency of the regional employment map

Quantitative efficiency: repaired roads, schools, hospitals, local content purchases etc

Qualitative efficiency: created jobs, trained personnel etc.



Strategy of professional skills development in the Republic of Kazakhstan

System of school education

Usual schools

Technical specialization

Specialized schools

Humanitarian trend

Gives general literacy, basic knowledge of mathematics, physics, chemistry and so on. Social adaptation.
Basic computer skills, languages, etc.

The system of occupational education and training

vocational school

colleges

Coverage of technical and occupational education is an average of 5,8% for the Republic at the vocational school and 14,7% - at the colleges.

Develops professional skills and knowledges, continue the general education component of education

centres of staff Training and Retraining

Incompany Training Centers

Departmental Centers

Consulting firms



Strategy of professional skills development in the Republic of Kazakhstan

Reasons:

Lack of feedback between the system of vocational education / training and employers (employers' requests and standards of educational services are not coordinated, there are no bases of practice in enterprises);
depreciation of technical basis of vocational training;
weak training of teachers, masters of industrial training for the vocational training system;
low quality of educational services in secondary vocational educational link, low coverage of the population.



Problems connected with lack of professional skills:

- imbalance of demand and supply on specialization and level of staff qualification;
- low labour capacity of domestic staff;
- disparities of educational levels (per 10 thousand population of students are studying at vocational high schools - 66 people, in colleges -162, in universities - 439);



Results:

- increase of imports of labor, the loss of income from the country in the form of wages of non-residents (in 2005, the balance of pay was = - 728,4 million dollars in 2008 = - 1452.0 million. the United States, that is, 3 years increased by 2 times);
- Availability of outstanding vacancies on the labor market, skills shortages in the presence of unemployment among young people (lack of experience and skills) among low-skilled labor



Strategy of professional skills development in the Republic of Kazakhstan

- 1. It's necessary to conduct monitoring of labor import in the Republic of Kazakhstan (oil and gas sector, construction, consulting services) for:
- - Possible replacement of its own staff through training our abroad competitors (the ratio of training costs with the costs of attracting non-residents) - depends on whether the work is occasional or regular basis are available on an ongoing basis;
- -competitive abilities on price and quality of domestic pretenders , search for opportunities to strengthen the competitive position of domestic bidders (for example, benefits or advantages to enterprises employing residents).
- 2. It's necessary to organize the relation of professional training systems, with enterprises-employers, to organize the base of production practices.
- 3. It's necessary to develop the system of independent evaluation of staff and their certification.
- 4. It's necessary to organize work on the methodology, teaching materials, visual materials, educational stands and technical base of education for improve the system of vocational education inclusive of current trends in the development of skills and requirements of employers.

Thank you for your attention!