Stable Growth and Moderate Risks

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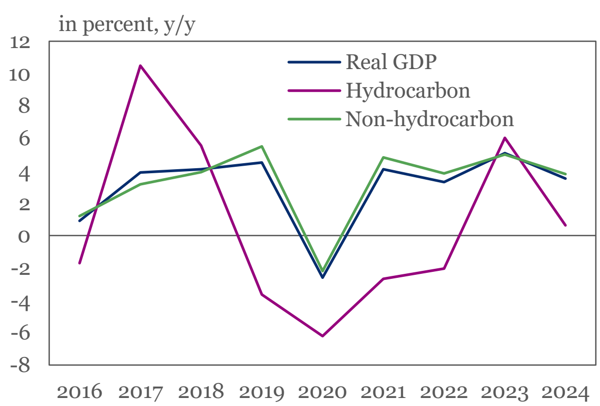
- We expect growth to slow from 5.1% in 2023 to 3.5% in 2024, due to delays in expanding the Tengiz oil field and moderation in private consumption.
- The NBK has maintained tight monetary policy, leading to a steady decline in inflation, from 21% in January 2023…
- …to 9.1% in March 2024. However, utility hikes and the elimination of food subsidies will have inflationary effects.
- Higher oil prices and import compression will narrow the CA deficit to 2.7% of GDP.
- On the fiscal side, we forecast a small deficit in 2024, though public debt will remain low at 22% of GDP.
- Risks remain balanced, with trade diversification and higher oil prices being the primary upside risks…
- …while a potential shutdown of the CPC and secondary sanctions on banks are the main downside risks.

Kazakhstan's economy is estimated to have grown 5.1% in 2023, driven by construction and manufacturing on the production side, and private consumption on the expenditure side. Agriculture was a drag on growth due to a poor summer harvest. Unlike some of its regional neighbors, Kazakhstan has not largely benefited from the migration of Russian skilled labor or relocation of Russian firms caused by the war in Ukraine, rather growth has been driven by robust domestic public and private consumption. We expect this demand to moderate slightly this year, though it will continue to be supported by scheduled minimum wage hikes and pension indexation that will feed consumption, leading to non-hydrocarbon growth coming in at 3.8% in 2024. Meanwhile, hydrocarbon output is expected to grow a modest 0.6%, primarily due to the delay of the Tengiz oil field expansion (which is now scheduled to be finalized in 2025, vs. an initial timeline of 2022H2). As such, authorities estimate that oil production (incl. gas condensates) will reach 90mn tons in 2024, in line with 2023 production. Overall, we forecast the Kazakh economy growing 3.5% in 2024.

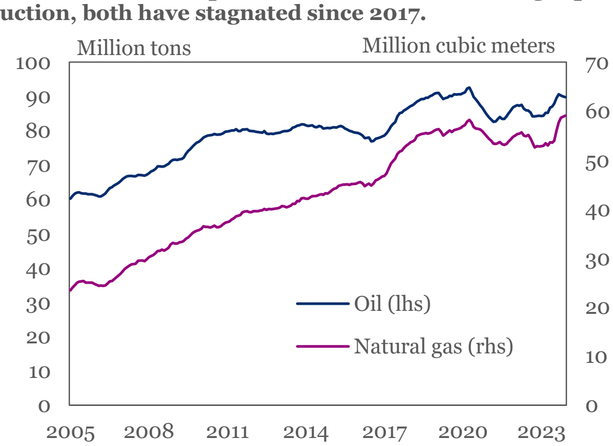
Oil production continues to be an area of particular worry for Kazakhstan. According to the International Energy Agency (IEA), in the first three months of the year Kazakhstan's oil production averaged 1.63 m/bd (excl. condensates), exceeding its OPEC+ quota for 2024H1 (1.47 m/bd) by around 160 k/bd. Kazakh authorities have promised to improve compliance and are likely to curtail production in the summer/fall months in order to compensate for overproduction and as its three main oil fields go through regular maintenance. Furthermore, oil and natural gas production have stagnated in recent years (Exhibit 2). Reliance on aging oil fields, limited export options –80% of all exports goes through the Caspian Pipeline Consortium (CPC)–, and electricity shortages and power outages have all affected production. Therefore, the expansion of the Tengiz oil field, the diversification of export routes, and investment in infrastructure should be top priorities for the government.

Exhibit 1: Robust domestic demand and low hydrocarbon growth will combine for modest RGDP growth this year.



Source: IIF

Exhibit 2: After sharp increases in oil and natural gas production, both have stagnated since 2017.

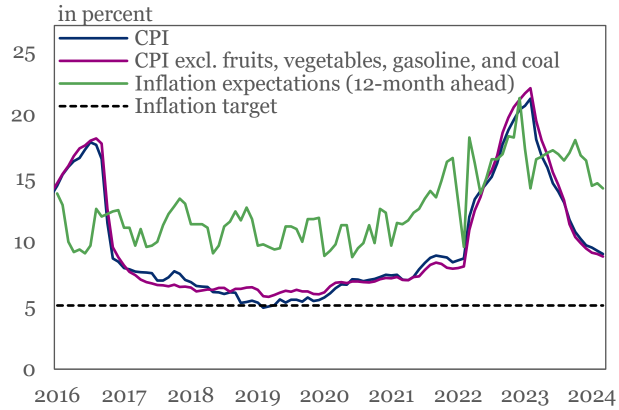


Source: BNS and IIF

The tight monetary stance will be maintained. CPI inflation declined substantially from a peak of 20.7% in January 2023 to 9.1% in March, which is still well above the target of 5%. The sharp fall in inflation is attributed to tight monetary policy, lower commodity prices, and the strong performance of the Tenge. Nevertheless, inflation is forecasted to remain elevated in 2024, averaging 9% for the year. Month-over-month inflation remains volatile but has grown at an average pace of 0.8% over the last 6 months. Energy and utility tariff hikes, high trading partner inflation (most notably in Russia), minimum wage hikes, and the removal of price caps on food staples will all put upward pressure on inflation in the coming months. In recent communications the National Bank of Kazakhstan (NBK) has stated its concern for these developments, and we therefore expect monetary policy to remain tight for the remainder of the year. However, political pressures may yet prove to have a sway on the NBK, as witnessed by the recent 50bps rate cut in February.

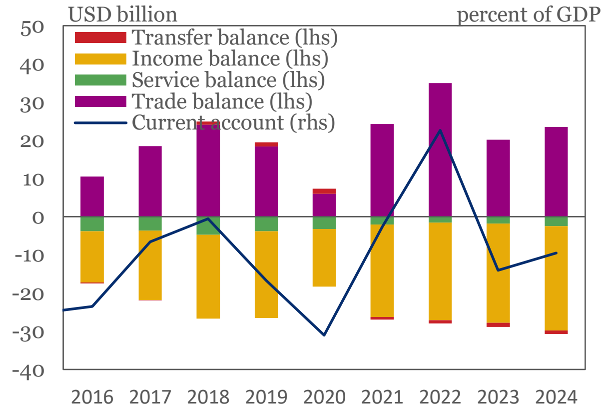
We expect the current account deficit to narrow. A current account deficit of 3.4% of GDP is estimated for 2023. Lower oil prices affected exports, which fell 7% y/y, while strong domestic demand and currency appreciation led to a close to 18% y/y increase in imports. For 2024 we expect some of these developments to revert and forecast the deficit narrowing to 2.7% of GDP (Exhibit 4). On the export side, higher oil prices will be supportive of hydrocarbon exports, a recovery in agriculture will boost wheat production, and higher base metal prices, most notably copper, will further bolster non-hydrocarbon exports. On the import side, moderating demand and currency stability will lead to a small fall from 2023 levels. The deficit will primarily be financed by FDI, as GCC countries invest in exploration and extraction projects as well as renewable energy facilities (Kazakhstan has the goal to raise the share of renewable energy from 6% in 2023 to 15% in 2030), the authorities continue to attract FDI for infrastructure, and as Kazakhstan begins to expand its critical mineral production. Consequently, we expect Kazakhstan's gradual reserve accumulation to continue.

Exhibit 3: While inflation has been trending lower, inflation expectations remain high.



Source: BNS and IIF

Exhibit 4: Weaker import demand will lead to a small contraction in the CA deficit in 2024.

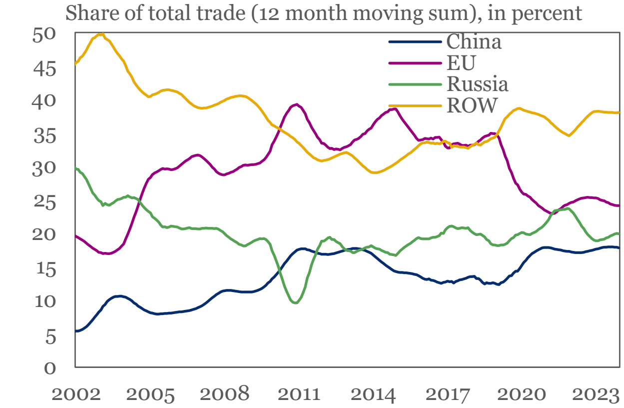


Source: NBK and IIF

On the fiscal side, we expect the consolidated budget to post a deficit of 0.2% of GDP in 2024, compared to a surplus of 0.6% in 2023. Total revenues are expected to increase 10% y/y, aided by increased tax revenue from oil production. However, the failure to enact a proposed VAT tax hike (from 12% to 16%) will hurt revenues, as this VAT hike was intended to compensate for lower transfers from the sovereign wealth fund over the medium term. The increase in revenues will be outweighed by a 15% y/y increase in expenditure. With a higher wage bill (caused by the increase in the minimum wage which will affect 350,000 civil servants) and higher social spending, in line with President Tokayev's social welfare agenda, leading the increase. Debt-to-GDP is expected to remain low and stable, at around 22% of GDP, leading to a positive debt outlook over the medium term.

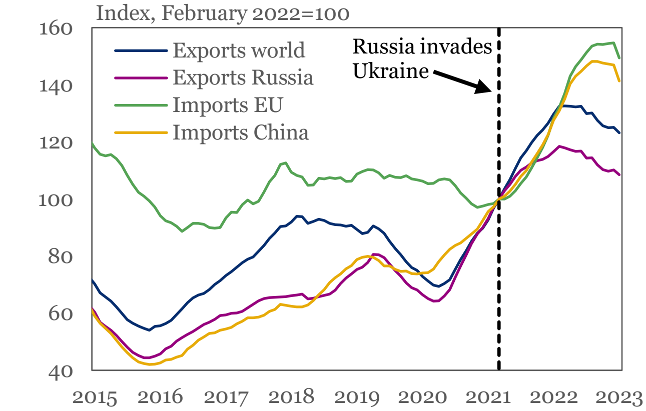
Risks to our outlook are balanced. On the upside, higher oil prices (above the average of $85/b in our baseline) bode well for both the CA and fiscal deficits. Kazakhstan, like the rest of the region, has also pushed to diversify away from Russia. Currently, the EU is the country's single biggest trading block while China's total share is quickly catching up to Russia's (Exhibit 5). Furthermore, a regional initiative with the EU to develop the Trans-Caspian International Transport Route (aka Middle Corridor), which is a trade route between Europe and Asia that will bypass Russia, will help expand trade with Europe and Asia while also bringing in valuable infrastructure investment. Nevertheless, downside risks remain. The most evident of which relate to developments in the war in Ukraine. Kazakhstan remains highly vulnerable to a potential Russia shutdown of the CPC. Regardless of

Exhibit 5: China's share of total trade with Kazakhstan has increased steadily, and is now close to Russia's.



Source: IMF BOP and IIF

Exhibit 6: A large increase in imports from the EU and China points to potential sanctions evasion.



Source: IMF BOP and IIF

whether such a shutdown happens because of a direct confrontation between Kazakhstan and Russia or because of the latter's retaliation against the West, with 80% of all Kazakh oil exports running through the CPC, the effects could be dire. Furthermore, secondary sanctions are an ongoing threat, especially for Kazakh banks. Though Kazakh authorities have done a good job at avoiding such sanctions so far, with the latest example of this being the banning of Russia's Mir payment system, any escalation of the war and consequent expansion of Russian sanctions could indirectly impact Kazakhstan. This is especially true considering that Kazakhstan, like other countries in the region, have significantly increased trade with Russia since the war in Ukraine began. Potentially pointing to sanctioned goods moving from Europe and China to Russia via Kazakhstan (Exhibit 6).

Exhibit 7: Kazakhstan's Main Macroeconomic Indicators

	2020	2021	2022	2023	2024
Oil production, mbd	1.80	1.80	1.77	1.89	1.89
Gas production, mbde	0.53	0.46	0.45	0.46	0.48
Nominal GDP, $bn	171.1	197.1	225.3	256.1	280.7
Real GDP, % change	-2.6	4.1	3.3	5.1	3.5
Hydrocarbon	-6.2	-2.7	-2.0	6.0	0.6
Non-hydrocarbon	-2.2	4.8	3.8	5.0	3.8
Inflation rate, avg., %	6.8	8.0	15.0	14.5	9.1
Policy rate, eop, %	9.0	9.8	16.8	15.8	13.0
Exch. rate avg., Tenge/$	413	426	460	456	468
Current account, % GDP	-6.4	-1.4	3.1	-3.4	-2.7
Hydrocarbon exports, % total exports	59.5	50.6	58.2	54.3	53.3
Public foreign assets*, $bn	92.9	101.5	110.4	110.8	111.9
Fiscal balance, % GDP	-8.0	-4.8	2.3	0.6	-0.2
External debt, % GDP	95.8	83.3	71.3	63.5	60.9

Source: Authorities through 2022; IIF forecasts for 2023-2024
**Includes official reserves and the sovereign wealth fund.*