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Weekly analysis

IMPLEMENTATION OF THE FISCAL POLICY IN THE ECONOMY OF KAZAKHSTAN IN 2015

Kazakhstan, like the other Eurasian countries, has been hit by large external shocks such as low oil prices and slowdown in Russian and Chinese economies. Kazakhstan's real GDP growth rate reduced from 6% (five-year average) to 1.5% due to reduced domestic demand in 2015. Besides, after the 2009 and 2014 devaluations, the risk of dollarization occurred in the economy of the country. Tenge has appreciated by 71% in January 2015 and by 33% in May 2015. Kazakhstan tried to stabilize exchange rates and to keep the exchange rate within the floating corridor. Facing these problems, the Central Bank of Kazakhstan (CBK) has tried to keep tenge-dollar rate within the 1 dollar = 185 tenge (+3 tenge -15 tenge) corridor but had to extend this corridor by (170-198) in July 2015. However, in August 2015 the CBK had to accept the floating exchange rate regime. Since then, dollarization in the Kazakh economy has increased and is still expected to remain a risk for the future.

The downfall in the oil and gas prices in the second half of 2014 had a negative impact on the fiscal revenues of the government which declined by 18% to 7,287 billion tenge in 2014 from 8,911 billion tenge in 2013. The main reason for this negative impact is that in the Kazakh economy, oil revenues constitute a significant amount of the fiscal revenues (11.3% of GDP in 2014 and 8.1% in the first half of 2015). Regarding the fiscal revenues, there certainly seems to be a need to ensure fiscal sustainability.

Total fiscal revenues have declined from 23.8% of GDP in 2014 to 19.8% of GDP in the first half of 2015 and are expected to increase only to 20.8% in 2016. The non-oil fiscal deficit rose to 11.4% of GDP in the first half of 2015 from 9.6% of GDP in 2014, and is expected to decline to 10.4% of GDP in 2016. Overall, the fiscal balance reduced from 1.7% of GDP in 2014 to -3.2% in the first half of 2015. This sharp decline shows the strong dependence of Kazakhstan on the oil and gas taxation.

In these circumstances, the government has been implementing an expansionary fiscal policy to support the economic growth. Here, an economic support package has been used as a fiscal stimulus. Immediately after the tenge devaluation by almost 20% in 2014, the government launched a 3–5 year Economic Support Package including a $12 billion (5.8% of GDP) allocation from the National Fund of the Republic of Kazakhstan (NFRK) and $7 billion (2.9% of GDP) in loans from the Multinational Development Banks (MDBs). The purpose of the package is to modernize the infrastructure and to promote Small and Medium Sized Enterprises (SMEs) to lend via quasi-fiscal development institutions.

Despite the costs of the package (higher current account deficit and lower reserves in the oil fund), it is supported by the government due to its growth-enhancing, countercyclical and structural nature. The package also helps to ensure transparency and high quality of the government expenditures. In this sense, the 2015 government budget is rebalanced by cutting nonproductive expenditures and by scaling up those expenditures that stimulate growth.

The debt load of the Kazakh government remains at tolerable levels. The gross government debt (5,199 billion tenge in the first half of 2015) poses no significant risk to the Kazakh economy as it represents 13% of GDP. The public debt is expected to rise in the medium term, with an increase of international loans, but overall levels would remain relatively low.

In order to help to finance the fiscal deficit, the government has requested a $2 billion Development Policy Loan from the World Bank and a $1 billion Countercyclical Support Facility from the Asian Development Bank. The general external debt of the government is expected to rise from 3.8% of GDP in the first half of 2015 to 6.4% of GDP by 2020. In addition, the total government debt is projected to increase from 13% in the first half of 2015 to 30.7% in 2020

The government has developed a new budget policy aimed to strengthen the public financial management (PFM) system. This budget policy is aimed to enhance budget efficiency during 2014–17 and to improve fiscal sustainability during 2018–20. The enhancement of the budget efficiency includes implementation of various reforms such as shaping current expenditures by ensuring financial sustainability of the pension system, increasing per capita expenditures in education and health, reforming the public service pay system and improving the social assistance programs.

The government also hopes to achieve better capital expenditure efficiency by improving the public investment system, by developing new public-private partnership (PPP) mechanisms for infrastructural development and by setting public monitoring. The government plans to improve the equity and the neutrality of the tax system and to increase the efficiency of the transfers from the Oil Fund. Improving fiscal sustainability includes expanding the PPP implementation, increasing efficiency of local governments and improving the public audit system.

High dependence on oil and gas prices as well as high dependence on the Russian economy had a significant negative impact on the economy of Kazakhstan. Depreciation of tenge is still causing the risk of dollarization. Despite the low government debt, reduction in government revenues causes a risk for the future repayments and for the debt issuance. In this sense, fiscal consolidation becomes an essential component for the success of fiscal sustainability.

Fiscal consolidation includes improvements in tax administration, expenditure cuts (equivalent to 5% of GDP over the three year period) and measures to increase low fiscal revenues such as strengthening the enforcement of tax collection, reducing tax exemptions and making income tax rates more progressive. Obviously, it is necessary to strengthen these policies with structural reforms to ensure transparency and sustainability of the economy of Kazakhstan.

Politics, Foreign Affairs and Security

- The Council of Foreign Ministers of the Commonwealth of Independent States (CIS), which was held in Astana, adopted a draft concept of the CIS military cooperation up to 2020 and a draft statement of the CIS leaders concerning the fight against international terrorism.
- Gaining 177 votes Ukraine was elected as a non-permanent member of the United Nations Security Council for 2016-2017 along with Egypt, Senegal, Uruguay and Japan.
- In accordance with the Minsk agreements, the military service of the self-proclaimed Luhansk People's Republic has begun the withdrawal of mortars with a caliber of less than 120 mm from the contact line.
- During the official visit to Kazakhstan, the Minister of Defense of China, Chang Wanquan, and the Minister of Defense of Kazakhstan, Imangali Tasmagambetov, signed an agreement on the free of charge technical assistance by China to the Army of Kazakhstan.
- The German Foreign Military Operations Command spokesman, Dominik Wullers, announce the closing of the air base in Termez, Uzbekistan, which has been providing support for German and NATO forces in Afghanistan since 2001. The base is to be fully closed down by the end of the year.
- The Iranian flotilla in the Caspian Sea started its second voyage to the Caspian port of Russia. After Russia the flotilla will berth at the Baku port. The voyage that will last for over two weeks is aimed to strengthen the communication in order to preserve the security in the Caspian Sea.
- The Ministry of Defense of Kazakhstan announced the reaching of an agreement with Ukraine on bilateral supply of military equipment, which is a part of the Aviation Sector Cooperation Agreement between the Kazakhstan Aviation Industry LLP and the Ukrainian Special Export company.

Economy, Finance and Energy

- The meeting of the Coordination Committee for the development of the Trans-Caspian International Transport Route (TITR) was held in Baku, Azerbaijan. The parties agreed to create a Consortium on TIRT and signed the Collaboration Technology Agreement between their transport companies in order to launch the transit container service "NomadExpress" along the China - Kazakhstan - Azerbaijan - Georgia - Turkey route.
- During the meeting of the Supreme Eurasian Economic Council held in Astana, the Eurasian Economic Union (EAEU) member states decided to implement new tariffs for over a thousand items in the EAEU. This decision was made in connection with Kazakhstan's accession to the WTO.
- The President of Russia, Vladimir Putin, and the President of Kazakhstan, Nursultan Nazarbayev, signed a Protocol on amendments to the Agreement on the delimitation of the northern part of the Caspian Sea dated July, 1998. The Protocol will allow the companies of the two countries to begin the development of a large hydrocarbon field, namely, the "Tsentralnaya" structure.
- The Russian oil and gas company, Lukoil, discovered large gas fields in the Lira offshore structure located at the Trident block in the Romanian Black Sea Continental Shelf. According to the seismic data, reserves can exceed 30 billion cubic meters of gas.
- Kazakhstan's KazTransOil company adopted a decision to liquidate its subsidiary Batumi Terminals Limited, the owner of Batumi Oil Terminal on Georgia's Black Sea coast.
- According to the Chinese General Administration of Customs, the trade turnover between China and Russia amounted to $50 billion in January-September 2015, which is 29.3% less than that in the first three quarters of the last year.
- New production facilities worth about $534 million were put into operation in Turkmenbashi complex of oil refineries with the support of the South Korean companies LG International Corp. and Hyundai Engineering Co., Ltd. In total, the production facilities are designed to receive two million tons of fuel oil per year processing 250 thousand tons of liquefied gas and 230 thousand tons of low-octane gasoline.
- According to the data of the Statistics Committee of the Ministry of National Economy of Kazakhstan, the state produced 49.929 million tons of oil and 2.129 million tons of gasoline in January-September 2015, which is 1% and 5.3% less, respectively, than in the same period of 2014.
- According to the Ministry of Oil and Gas Industry and Mineral Resources of Turkmenistan, the oil production in the country was at 9.76 million tons in the first nine months of 2015, or almost 600,000 tons or 6.7% more than that in the same period of 2014. The total volume of investments spent since the beginning of 2015 in the energy sector of Turkmenistan totaled to over 6.726 billion manats, which is 42.3% more than that during the first nine months of 2014.
- According to the State Statistical Committee of Azerbaijan, the volume of investments made in Azerbaijan's oil sector stood at 5.35 billion manats in January-September 2015, or 21.3% more than that in the same period of 2014.
- The GM Uzbekistan, the former UzDaewooAuto, sold 15,498 cars in Russia in January-September 2015, which is 50.5% less than that in the same period of 2014.
- According to the Ministry of Economy and Development of Turkmenistan, the growth rate of GDP decreased to 8.3% in January-September 2015 from 10.3% in the same period of 2014.
- Production of precious metals in Kyrgyzstan grew by 39.2% and industrial production output amounted to 126.6 billion soms in January-September 2015.

Society and Culture

- The European Union and Turkey have agreed to cooperate on the migration issue. The sides agreed on a joint action plan aimed at stemming the flow of refugees into Europe.
- Civil servants in Tajikistan were banned from attending Friday prayers. The Tajik authorities had already banned all children under the age of 18 from attending Friday prayers four years ago.
- The President of Kazakhstan, Nursultan Nazarbayev, signed a decree to award cosmonaut Aidyn Aimbetov a title of the People's Hero.

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