



### **Summary**

Kazakhstan's banking sector remains one of the country's major weaknesses, with the share of non-performing loans worrying high at 35-40% of total loans in 2011. In early 2012, BTA Bank defaulted for the second time, after the bank and three other banks defaulted in the global recession of 2009. The default is not only negative for the bank itself, but also for the banking sector as a whole, as it undermines investor confidence in Kazakh lenders, and thereby has a negative impact on foreign investment in the country. The image of Kazakhstan was further affected by severe riots in the oil town of Zhanaozen in December 2011, killing at least 16 people and wounding many more people. The authorities took firm measures to restore social stability and in one go, the government cracked down on the opposition and political activists, which allegedly had incited the unrest. Social stability was restored and the likelihood of contagion to other regions is small. However, the crackdown showed that the authorities are increasingly intolerant of oppositional voices. New government measures, created in response to the social unrest, aim to reduce social and labor tensions in the future. As a consequence, companies may come under increased pressure to accept wage demands.

### **Things to watch:**

- Recovery of the banking sector
- Social and political unrest

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Kazakhstan			
<b>National facts</b>		<b>Social and governance indicators</b> rank / total	
Type of government	Republic	Human Development Index (rank)	68 / 187
Capital	Astana	Ease of doing business (rank)	47 / 183
Surface area (thousand sq km)	2,724	Economic freedom index (rank)	65 / 179
Population (millions)	16.4	Corruption perceptions index (rank)	120 / 183
Main languages	Russian (95%) Kazakh (64%)	Press freedom index (rank)	154 / 178
Main religions	Muslim (47%) Russian orthodox (44%) Protestant (2%)	Gini index (income distribution)	30.9
Head of State (president)	Nursultan A. Nazarbayev	Population below \$1.25 per day (PPP)	0.1%
Head of Government (prime-minister)	Kamir Masimov	<b>Foreign trade</b> 2011	
Monetary unit	tenge (KZT)	<i>Main export partners (%)</i>	<i>Main import partners (%)</i>
<b>Economy</b> 2011		China	18
<i>Economic size</i> bn USD % world total		Italy	17
Nominal GDP	176 0.25	Russia	9
Nominal GDP at PPP	215 0.27	France	6
Export value of goods and services	70 0.32	<i>Main export products (%)</i>	
IMF quatum (in mln SDR)	366 0.17	Mineral products	78
<i>Economic structure</i> 2011 5-year av.		Metals	13
Real GDP growth	6.9 6.3	Chemicals	4
Agriculture (% of GDP)	6 6	Food products	2
Industry (% of GDP)	34 33	<i>Main import products (%)</i>	
Services (% of GDP)	56 56	Machinery & equipment	41
<i>Standards of living</i> USD % world av.		Mineral products	14
Nominal GDP per head	10543 98	Chemicals	13
Nominal GDP per head at PPP	12882 104	Metals	10
Real GDP per head	4953 61	<i>Openness of the economy</i>	
		Export value of G&S (% of GDP)	40
		Import value of G&S (% of GDP)	25
		Inward FDI (% of GDP)	7.3

Source: EIU, CIA World Factbook, UN, Heritage Foundation, Transparency International, Reporters Without Borders, World Bank.

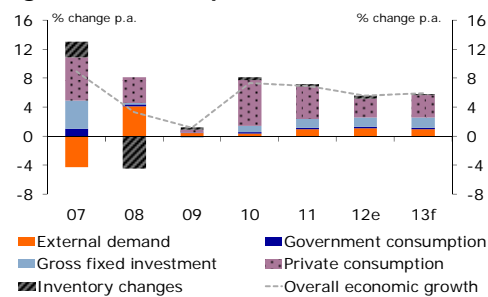
### Introduction and update

Kazakhstan is a central-Asian country that is authoritarian ruled by the 71-year old president Nursultan Nazarbayev. Nazarbayev's rule is expected to continue in the medium term, supported by relatively strong economic growth and the fact that little room is left for the opposition. Until January 2012, Kazakhstan was ruled by one party, Nazarbayev's Nur-Otan (Fatherland-Light). However, Nazarbayev organized snap elections this January, as he concluded it was necessary for Kazakhstan to get a multi-party parliament in light of the ongoing modernization of the country. In the elections, two opposition parties, AK Zhol (Bright Path) and the Communist People's Party of Kazakhstan (KNPK), just managed to pass the threshold of 7% of votes and received seats in Parliament. However, Nazarbayev's party remains the largest party, with about 80% of the votes, and the two opposition parties are pro-government parties, which are not expected to bring any changes to the country's policy.

Kazakhstan's economy grew nearly 6% in 2011, with the oil and gas industries as the main contributors. Also in 2012, economic growth is expected to come in at around 6%, underpinned by oil prices that remain high. Downside risks relate to uncertainty in the external demand, due to the global slowdown, and the problems in the domestic banking sector (see below). Kazakhstan's external position appears to be relatively healthy with foreign exchange reserves amounting to USD 25bn or 14% of GDP by end-2011, plus another USD 44bn or 25% of GDP in the country's

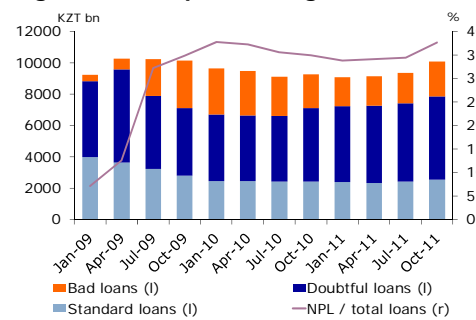
national oil fund by end-2011. Although foreign debt has declined substantially, from about 100% of GDP in 2009 to 70% of GDP last year, it remains very high. Most of the debt is medium or long term private sector debt. Due to the country's large reserves, Kazakhstan's external position is no immediate reason for concern. Most pressing issues are the health of the banking sector and the actions of the government after unrest in Zhanaozen, which will be discussed more extensively below.

Figure 1: Growth performance



Source: EIU

Figure 2: Non-performing loans



Source: National Bank of Kazakhstan

### Banking sector still not healthy?

In January 2012, BTA Bank, Kazakhstan's third-largest bank and until 2009 the country's largest bank, defaulted for the second time in three years. The new default of BTA Bank not only suggests that Kazakhstan's banking sector has not been cleaned up yet, but also that there may be other factors that play a part in the default. BTA Bank is majority owned by the government's sovereign wealth fund Samruk-Kazyna, which is financially fairly healthy. This has led to some speculation of political incentives in the default. The willingness to pay seems a larger issue than the bank's ability to pay.

The first time that BTA Bank defaulted was in 2009, when the whole sector was hit by tighter global credit conditions as well as lower oil prices, which together led to a burst in lending and real estate bubbles. In 2009, BTA Bank and three other banks (Alliance Bank, Astana Finance and Temirbank) suspended debt repayments and were restructured. Since 2009, restructuring of the problem banks had seemingly improved most prudential indicators, as the regulatory capital adequacy requirement of at least 12% was initially met by all commercial banks and external indebtedness of the banks was halved.

However, the biggest concern for the financial sector is the amount of non-performing loans (NPLs), which have yet come down. As of July 2011, recognized NPLs amounted to USD 23bn, which is about 15% of GDP or 35% of total loans. However, according to unofficial estimates, NPLs could be twice as high. About half of the loans are situated within the problem banks BTA Bank, Alliance Bank and Astana Finance. In response to the unresolved NPLs, banks have set aside a lot of capital (about one third of their portfolio), which obstructs them from granting credit.

Since 2011, the government has introduced several plans to make the banking sector healthier. For example, the government started developing a Distressed Asset Fund (DAF2) that may help the banks to put up their bad assets. Thereby, it would increase the transparency about the government's contingent liabilities, as the government is expected to guarantee the bad debt, and prevent the banks from becoming zombie banks, which do not have the capability to issue new loans. However, the fund will only be ready in the second half of 2012 and its capacity will be

limited to just 10% of NPLs in the system. Therefore, it is not expected to be enough to fully clean up the banking sector and reduce the amount of NPLs. Other plans of the government include the design of special purpose vehicles within the intervened banks, but these plans are just in development stage.

Overall, the second default of BTA Bank is not only negative for the bank itself, but also for the whole banking sector, as it undermines investor confidence in Kazakh lenders, and thereby has a negative impact on foreign investment in the country. The persistent high NPL ratio suggests that new problems in the banking sector cannot be excluded and it is likely to subdue credit growth in the coming year. If the government has to take action again, this could increase the government's liabilities, and thereby weaken the government's debt position.

### **Tighter control after Zhanaozen unrest**

In December 2011, violent unrest erupted in the remote oil town of Zhanaozen, in Kazakhstan's western Manghystau region, after oil workers clashed with the police. The oil workers had been on strike since May 2011, demanding better work conditions and higher wages. Officially, in the clashes, 16 people were killed, 86 people were wounded and many public and private buildings were destroyed. However, other sources suggest that the truth might be far worse. The riots prompted the authorities to declare a state of emergency and a curfew in the city for six weeks. Since then, social stability has been restored, accompanied by a political crackdown by the authorities against the opposition and political activists, which – according to the authorities – had incited the unrest. A few political activists face a prison sentence of up to 12 years for inciting social discord in Zhanaozen, while several opposition leaders were given short prison terms for holding protests without permission in Kazakhstan's main financial hub, Almaty. As the authorities have localized and contained the protests in Zhanaozen, the likelihood of contagion to other regions in the country is small. However, the crackdown shows that the authorities are becoming more and more intolerant of oppositional voices and the elections as mentioned in the introduction were mostly window-dressing.

In addition, the government has taken measures for closer supervision of companies in its energy sector and a stronger social agenda in that same sector to further reinforce social and political stability, as well as support the government's new more resource nationalist stance. The moderately resource nationalist stance arose end-2011, underpinned by the deal of state company KazMunaiGas to get a 10% stake in an energy project. Kazakhstan now has a stake in each of the country's three major energy projects - Tengiz, Kashagan and Karachaganak. A moderate risk is that other direct investors may face pressures to renegotiate the terms of their projects. The additional supervision and measures around the social agenda of the government seem to implicate that foreign investors will be expected to prevent social and labor tensions in the future. The investors could come under increased pressure from the government to accept wage demands. Also, energy companies come under pressure to locate their head offices and key staff at the project locations, instead of kilometers away in the capital, as is common practice until now. Thereby, the measures may deteriorate Kazakhstan's investor climate.

Kazakhstan							
Selection of economic indicators	2007	2008	2009	2010	2011	2012e	2013f
<i>Key country risk indicators</i>							
GDP (% real change pa)	8.9	3.3	1.2	7.3	6.9	5.6	5.9
Consumer prices (average % change pa)	10.8	17.1	7.3	7.1	8.4	5.5	5.3
Current account balance (% of GDP)	-8.0	4.9	-3.8	3.1	4.4	4.7	2.8
Total foreign exchange reserves (mln USD)	15777	17872	20720	25223	25440	30260	30500
<i>Economic growth</i>							
GDP (% real change pa)	8.9	3.3	1.2	7.3	6.9	5.6	5.9
Gross fixed investment (% real change pa)	17.4	1.0	-0.8	3.8	5.5	5.9	6.4
Private consumption (real % change pa)	10.9	6.3	0.6	10.9	7.5	4.3	5.3
Government consumption (% real change pa)	14.6	3.5	1.0	2.6	3.0	3.3	3.4
Exports of G&S (% real change pa)	9.0	0.7	-11.6	1.9	4.4	4.1	4.4
Imports of G&S (% real change pa)	25.9	-11.5	-16.0	0.9	1.5	0.4	1.2
<i>Economic policy</i>							
Budget balance (% of GDP)	-1.7	-2.0	-3.0	-2.5	-2.2	-2.5	-1.5
Public debt (% of GDP)	8	9	13	15	13	16	18
Money market interest rate (%)	6.0	6.5	2.4	1.4	1.5	1.8	2.0
M2 growth (% change pa)	24	29	19	24	20	12	12
Consumer prices (average % change pa)	10.8	17.1	7.3	7.1	8.4	5.5	5.3
Exchange rate LCU to USD (average)	122.6	120.6	147.5	147.4	146.6	147.3	143.7
Recorded unemployment (%)	7.3	6.6	6.6	5.8	5.3	5.8	5.6
<i>Balance of payments (mln USD)</i>							
Current account balance	-8226	6596	-4221	4319	7694	8950	5900
Trade balance	15091	33519	14969	28881	33202	34130	31030
Export value of goods	48351	71971	43931	60838	65616	66430	64040
Import value of goods	33260	38452	28962	31957	32414	32290	33010
Services balance	-8072	-6616	-5778	-7053	-6912	-6750	-6760
Income balance	-13086	-19323	-12729	-17075	-18143	-18000	-17930
Transfer balance	-2160	-985	-683	-435	-452	-430	-440
Net direct investment flows	7968	13118	10653	2155	10350	11500	12750
Net portfolio investment flows	-14827	-9013	5084	10271	9488	9510	7800
Net debt flows	21434	11057	3389	13090	10793	2690	5320
Other capital flows (negative is flight)	-7846	-19515	-11557	-24780	-37276	-27630	-31520
Change in international reserves	-1498	2243	3348	5054	1049	5020	250
<i>External position (mln USD)</i>							
Total foreign debt	95542	107278	109873	108510	122944	123520	126760
Short-term debt	11154	10321	8676	4033	4446	4390	4290
Total debt service due, incl. short-term debt	38044	44580	51007	30011	32989	36470	36600
Total foreign exchange reserves	15777	17872	20720	25223	25440	30260	30500
International investment position	-44317	-38842	-42637	-33854	n.a.	n.a.	n.a.
Total assets	77611	92786	97443	117823	n.a.	n.a.	n.a.
Total liabilities	121928	131628	140080	151677	n.a.	n.a.	n.a.
<i>Key ratios for balance of payments, external solvency and external liquidity</i>							
Trade balance (% of GDP)	14.6	24.8	13.4	20.4	18.9	17.9	14.6
Current account balance (% of GDP)	-8.0	4.9	-3.8	3.1	4.4	4.7	2.8
Inward FDI (% of GDP)	10.8	10.6	12.4	7.0	7.3	7.1	7.0
Foreign debt (% of GDP)	93	80	99	77	70	65	59
Foreign debt (% of XGSIT)	170	133	212	159	169	168	178
International investment position (% of GDP)	-43.0	-28.8	-38.3	-23.9	n.a.	n.a.	n.a.
Debt service ratio (% of XGSIT)	68	55	99	44	45	50	51
Interest service ratio incl. arrears (% of XGSIT)	6	5	8	5	3	3	2
FX-reserves import cover (months)	4.2	4.3	6.4	7.0	7.0	8.4	8.3
FX-reserves debt service cover (%)	41	40	41	84	77	83	83
Liquidity ratio	96	108	94	126	124	127	125

Source: EIU

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