State budget of Kazakhstan in 1H2019

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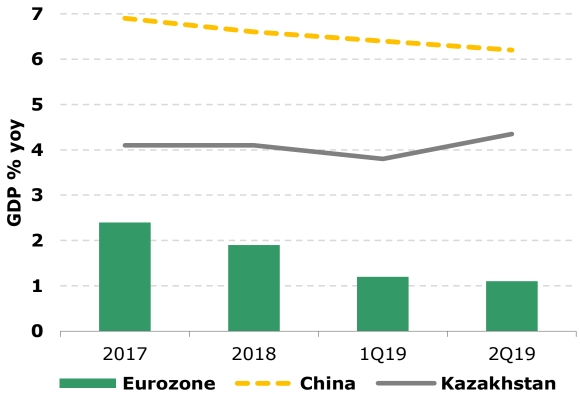
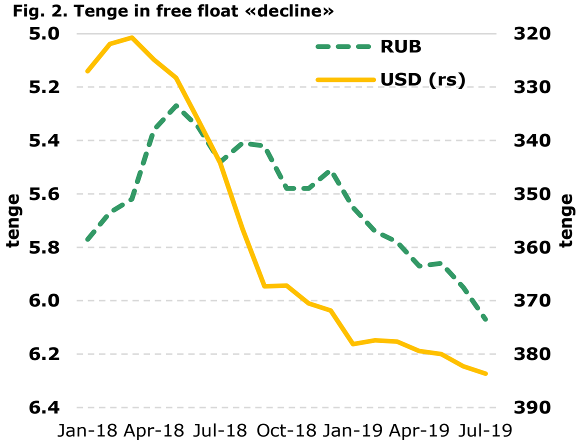
Fig. 1. Despite negative external headwinds, Kazakhstan GDP on the rise



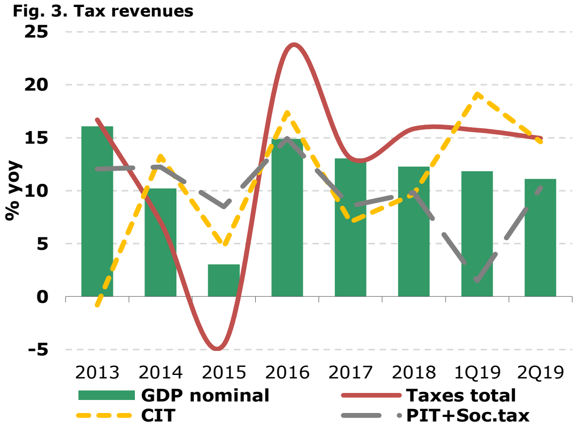
Source: Minfin RK, CS MNE stat agencies

Fig. 2. Tenge in free float «decline»



Source: NBRK

Fig. 3. Tax revenues



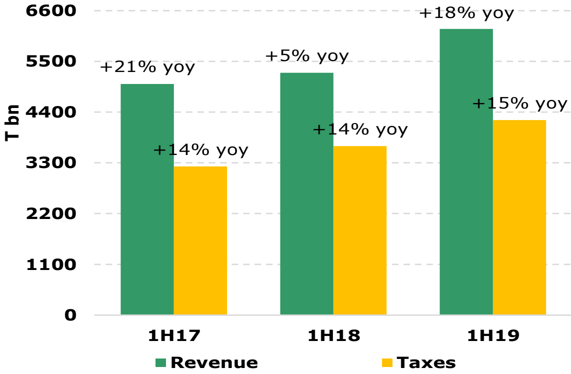
Source: Minfin RK, CS MNE

Despite precarious economic and geopolitical situation in the world, when the largest economies are slowing down, the Kazakhstan economy has shown stability and even accelerated slightly in the second quarter to 4.4% yoy. For example, China's GDP in the second quarter showed an increase of only 6.2% yoy (Fig. 1), which is the weakest indicator in almost 30 years, which is affected by the trade war with the USA, sluggish external demand, accumulated internal imbalances and an attempt by the government to de-lever companies in controlled fashion. According to preliminary data, the Eurozone economy in the second quarter showed growth of just over 1% in annual terms, while the Russian economy expanded by less than 1%.

Against relatively favorable background of the positive dynamics of the economy, the tenge exchange rate remains a weak and vulnerable spot (Fig. 2). So in the first half of this year, the tenge fell against the dollar by 14% yoy, by 5% yoy versus the ruble, while oil fell by 7% yoy. As a result, inflationary pressures continue to accumulate against the backdrop of strong inflationary expectations, the annual level of growth in consumer prices amounted to 5.4% in June.

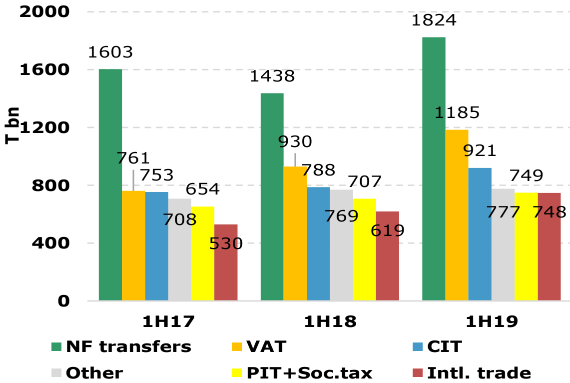
Situation with the state budget in the first half of 2019 reflects a positive change in the dynamics of the main indicators - double-digit investment growth, expansion of trade turnover, low and declining unemployment with a relatively steady economic growth of more than 4% since 2017. It is important to mention the extraordinary presidential elections held in the first half of this year, it is quite logical that such an event is accompanied by a large-scale expansion of government spending, especially those aimed at improving the welfare of the population, which stimulates domestic consumption. The total size of the additional package of economic stimulus spanning three years exceeds T2.3 trillion, or almost 4% of 2018 GDP.

Fig. 4. State budget revenues on the rise



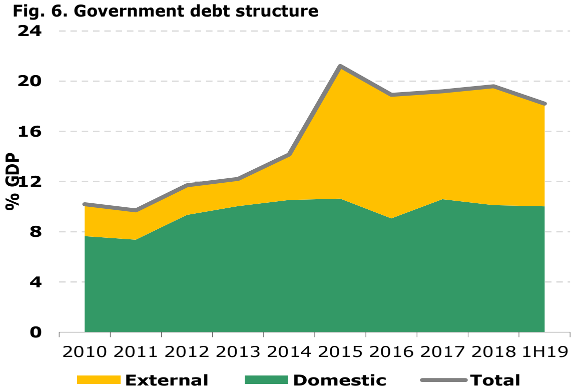
Source: Minfin RK, CS MNE

Fig. 5. Budget revenues by source



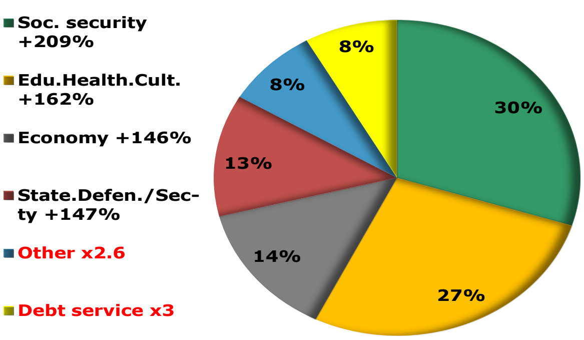
Source: Minfin RK, CS MNE

Fig. 6. Government debt structure



Source: Minfin RK, CS MNE

Fig. 7. State budget outlays 2019 to 2014, contribution to growth, %



Source: Minfin RK, CS MNE

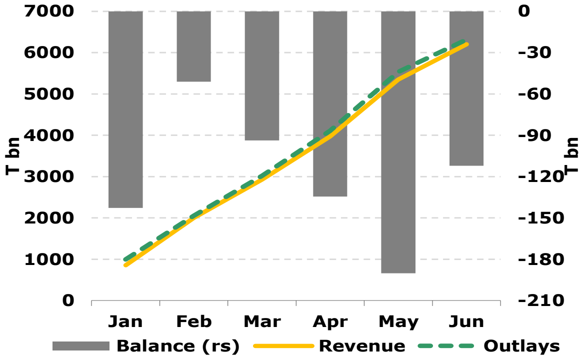
As a result of the social support measures, in particular, the reduction of PIT for people with low salaries, it led to a slight decrease in the revenues from this tax at the beginning of this year (Fig. 3), which improved in the second quarter, while income from taxes on corporate sector incomes are noticeably increased, and the overall collection of taxes progress within the framework of generally positive economic dynamics. Note that the weakening of the national currency also played a positive role for public finances with a high share of income from external operations and a still low share of external liabilities.

State budget revenues in the second quarter of 2019 slightly slowed down in comparison with the first quarter. So, if in the first quarter tax revenues grew by 16% yoy, then in the second quarter by 15% yoy, which occurred as a result of improved inflow from household incomes, but some deterioration in corporate income. In general, tax revenues in the first half of this year show slightly worse dynamics – tax collection amounted to 46.7% of the annual plan, against 48.3% and 47.6% in the corresponding period of 2017 and 2018. Recall that the fiscal authorities, as part of the expansion of budget spending, planned to cover part of the costs by improving tax administration. Nevertheless, as we believe in the second half of the year, tax collection compensates for the slight lag in the first half of the year, so according to the latest reports of the Ministry of Finance, the revenue plan for 7 months was exceeded by 3.6%.

The expenditure part of the state budget in the first half of the year followed the revenue part, showing an increase of about 17% yoy. Breakdown by items show - the sphere of social security with a growth of 24% yoy and debt servicing with an increase of 28% yoy that are traditionally stand out. As we have already noted, debt servicing costs are constantly growing, both due to the total debt and the foreign exchange component (Fig. 6), and at present, the cost of debt servicing in its scope exceeds the outlays on defense or corresponds to half of the cost of health care. Despite the fact that over the past 5 years social security expenses accounted for 30% of the increase in expenses (Fig. 7), other expenses increased stronger - 2.6 times, including such items as bank saving costs, EXPO2017, AIFC and other international image projects. The components of fiscal stimulation this year have been expanded due to tax breaks for low-income people, amnesty tax for SMEs and the public, rise in salaries, measures to reduce spending on utility bills and fuel by population, and write-offs of bad loans.

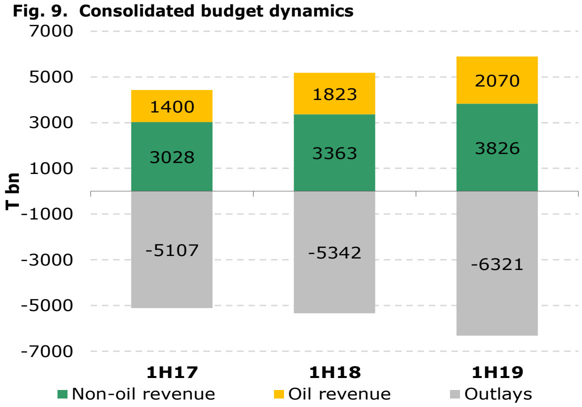
The balance of the state budget in each individual month of 1H2019 was in dedicit, varying from -T50 billion to -T190 billion (Fig. 8), at the end of June it was equal to -T112 billion, although at the end of the year it was planned at -T1.4 trillion or 2% of GDP. Note that with the planned deficit of -T1.4 trillion, transfers from the National Fund this year are more than twice the size of the deficit and

Fig. 8. Budget dynamics



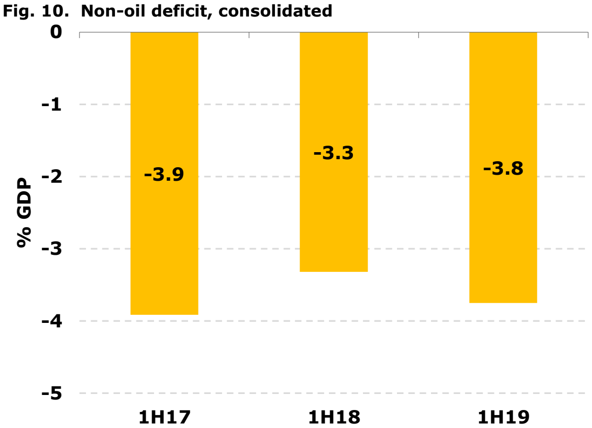
Source: Minfin RK, CS MNE

Fig. 9. Consolidated budget dynamics



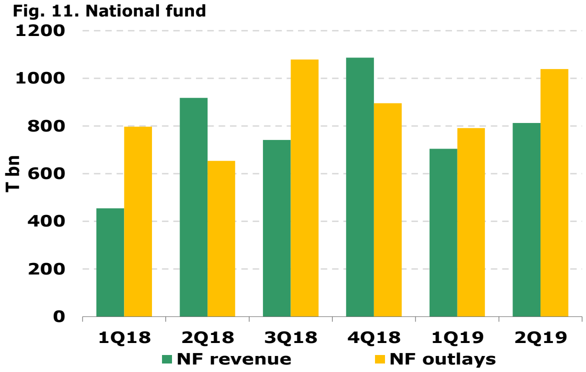
Source: Minfin RK, CS MNE

Fig. 10. Non-oil deficit, consolidated



Source: Minfin RK, CS MNE

Fig. 11. National fund



Source: Minfin RK, CS MNE

equal to T3.1 trillion, thus it is obvious that with the current high costs, the potential budget deficit is huge, as evidenced by non-oil deficit of about -10% of GDP on average since 2008.

Amid falling oil price quotations by 7% yoy, oil revenues in the first half of 2019 increased by a modest 13% compared with a 30% increase in the same period last year, which was offset by a 14% yoy decrease in tenge vs. US dollar. As a result, the share of oil revenues in consolidated budget revenues (including the operations of the National Fund) did not change, remaining at 35% in 1H2019. Non-oil revenues increased slightly more by 14% yoy compared to 11% in 1H2018. The flow of funds to the National Fund for the first half of the year amounted to T1.5 trillion, while expenses were higher by T313 billion.

The non-oil deficit in the first half of 2019 increased to -3.8% of GDP from -3.3% in 1H2018 (Fig. 10). The fall in oil prices has not yet led to a significant reassessment of approaches to reducing the dependence of the budget on commodity revenues. In 2018, due to an increase in the cost of oil to over $70 per barrel, the non-oil deficit fell to -7.4% of GDP from -12.8% in 2017, but this year, according to our estimate, it may increase again to -8,4% of GDP. Thus, the urgent issue of achieving a balanced budget is once again postponed, and the activities of state bodies in this matter indicate the absence of a clear strategy aimed at the result. As a result, investor confidence in the national currency is undermined, and the devaluation expectations prevail among the population. For comparison, according to Fitch, Russia's non-oil budget deficit in 2018 fell to -6% of GDP from -9.4% in 2013, while in Kazakhstan it is planned to achieve this level only in 2021.

The situation with the state budget in the first half of the year is developing within the planned framework. Due to a significant increase in government spending, we are seeing an increase in domestic demand, accompanied by an increase in business activity. Given these positive changes, we believe that the acceleration of economic growth in the current and next year is highly likely, which will help to maintain the sustainability of public finances. At the same time, the assets of the National Fund are likely to drop to 39% of GDP from 43% of GDP in 2018, foreign exchange assets may slightly increase to about 34% of GDP, because GDP in dollar terms may remain at the level of last year at $173 billion as tenge depreciated. In context with the expressed opinion by the head of the National Bank about a possible tightening of monetary policy, which could lead to the strengthening of the national currency, the effect of fiscal stimulus on this background may increase further due to the stability of tenge, higher consumer confidence and the growth of economic activity.

Our opinion

Economic growth accelerated in the second quarter to 4.4% yoy from 3.8% yoy in the first quarter, receiving recharge from a powerful fiscal stimulus and a rapid increase in investment, which ultimately translates into double-digit growth of tax revenues. The state budget deficit in the first half of 2019 was slightly higher than the same period last year, however, given the expansion of expenditures by about T2 trillion this year, the budget situation is developing within controlled limits. Non-oil revenues slightly outstripped oil revenues at 14% yoy vs. 13% yoy in the first half of this year for the first time in the last three years and, in addition, were higher than their previous values, which confirms the thesis about improving state of the economy. Nevertheless, the share of oil revenues has not yet changed and corresponds to 35% of total budget revenues. In the wake of increasing budget spending on anti-crisis and image projects, the state budget spending on debt servicing is growing at a faster pace, showing a threefold increase over the past five years (1.8 times faster than other state budget spending), which was facilitated by reliance on foreign exchange loans and a continuous weakening of tenge from the second quarter of 2018. Efforts to reduce the non-oil deficit have so far failed, in the current year, according to our estimate, its size may again increase to 8.4% of GDP from 7.4% in 2018. The problem seems to be that the state, trying to increase the role of the non-primary sector, increases government spending for these purposes without due attention to the effectiveness of these spending, as a result, the structure of the economy does not change, and accordingly the budget remains deeply unbalanced, spending huge sums of the National Fund, including through quasi -government sector.

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