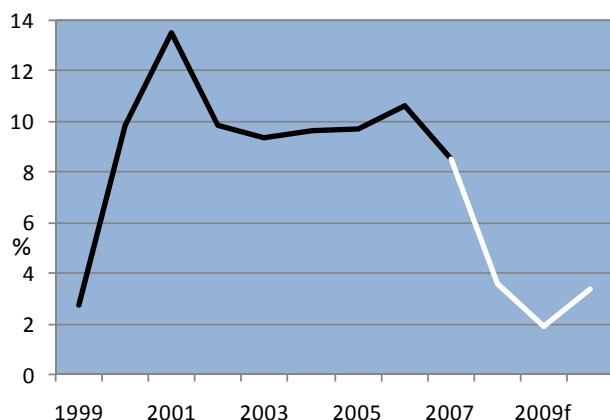


Ilkka Korhonen: Devaluation of the Kazakhstani tenge does not solve economy's structural problems

Kazakhstan's economy has suffered from falling commodity prices over the past months, but the country's economic growth slowed notably already in the latter part of 2007, as several Kazakhstani banks run into difficulties. In 2000–2007 Kazakhstan's gross domestic product grew at an average annual rate of 10%, but growth in 2008 was probably below 4%. Research institutes' average forecast for Kazakhstan's GDP growth in 2009 is 1.9% (Chart 1).

Chart 1. Kazakhstan's GDP growth, 1999–2010



Sources: Kazakhstan's statistical authorities, forecast for 2008–2010 from *Consensus Economics*, January 2009.

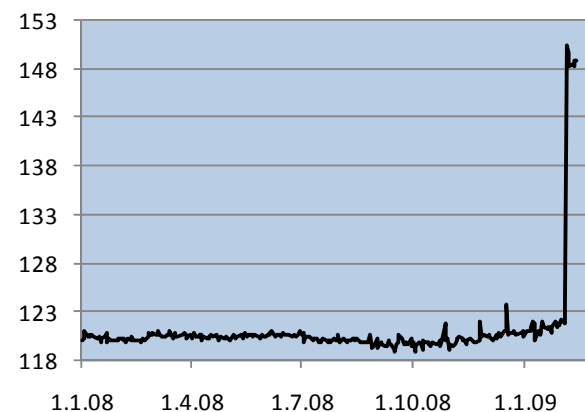
The rapid growth of Kazakhstan's economy resulted from several factors. Kazakhstan's major export products are oil and natural gas, but it also exports substantial amounts of copper and zinc. So, high commodity prices brought export income and increased public sector tax receipts. Due to the growth of global liquidity, Kazakhstani banks and enterprises were able to borrow funds from abroad, which led to rapid growth of the stock of domestic lending. Expanded bank lending fuelled eg the construction boom. When the global financial crisis began in 2007, Kazakhstani banks were highly exposed to the refinancing risk, and foreign borrowing dried up almost completely. At the same time, banks' loan losses increased notably, driven eg by weakening activity in the construction sector. As a result of these factors, in 2008 and in the first weeks of 2009 the state had to take control of several banks. However, the government has emphasised that this is only a

temporary measure and the intention is to sell the banks.

Tenge is a commodity currency

Falling commodity prices have reduced Kazakhstan's export income notably, whereas imports have remained relatively high. The position of Kazakhstani enterprises that compete with imports has been undermined by the fact that Kazakhstan has kept the tenge relatively stable against the US dollar, even as the Russian rouble, for instance, has depreciated substantially. The combination of weaker external competitiveness and the banking crisis forced the National Bank of Kazakhstan to devalue the tenge on 4 February. Prior to devaluation the tenge was slightly over 120 per US dollar, but the current exchange rate is almost 150 tenge per dollar. This represents a weakening of 20% for the Kazakhstani currency (Chart 2). The new central parity is 150 tenge per dollar, and the central bank has announced that it will defend $\pm 3\%$ fluctuation band around the parity. Nevertheless, the devaluation is not eg boosting the volume of exports in the current market situation, because of Kazakhstan's narrow range of export products. Kazakhstan's import-competing industry is gaining at least a temporary competitive edge. On the other hand, Kazakhstan produces very little of its own durable consumer goods, for instance, and so it is difficult to replace these exports.

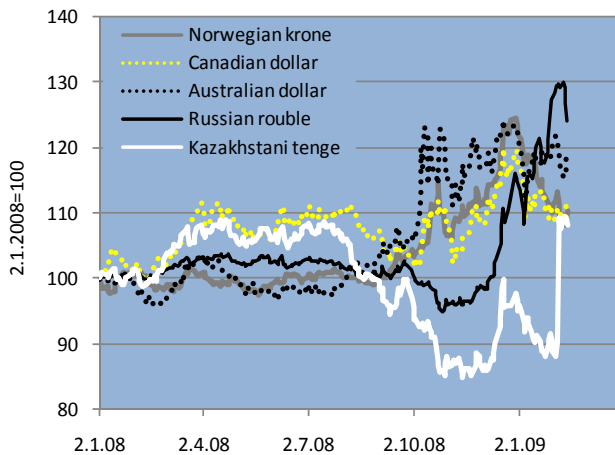
Chart 2. Exchange rate of Kazakhstani tenge vs US dollar, 2 Jan 2008–12 Feb 2009



Source: Reuters

Although the tenge's devaluation percentage is relatively high, it corresponds with the past year's depreciation of currencies of other countries that are dependent on commodity exports. Chart 3 shows the changes in the currencies of Australia, Canada, Kazakhstan, Norway and Russia against the euro from the start of 2008. The external value of these currencies has weakened in line with the falling prices of their major export products. The chart shows that, even after devaluation, the Kazakhstani tenge has maintained its value against the euro better than eg the Russian rouble or Australian dollar. It is therefore possible that the tenge is still under depreciation pressure in the currency markets.

Chart 3. Euro exchange rates of commodity-exporting country currencies, 2 Jan 2008–12 Feb 2009



Source: Reuters

Structural problems in the economy remain

The tenge devaluation helps some of Kazakhstan's enterprises, but it does not totally resolve the export-related problems. Commodity prices are likely to remain at low levels in 2009, and Kazakhstan's exports in processed industrial products are very modest. The cheapening of the tenge has therefore very little impact on exports. Imports are likely to fall slightly, which will reduce the current account deficit for this year. On the other hand, it is doubtful that the country will experience rapid growth in industries that could genuinely compete with products from countries such as China and South Korea. The weakening of the tenge's external value will further dampen activity levels for many banks, since they are in debt to foreign countries. The Kazakhstani government has already taken control of several banks, and it is possible that more rescue measures are in the offing.

Iikka Korhonen is a research supervisor at BOFIT.