



European Bank
for Reconstruction and Development



Kazakhstan and wider Central Asia region: heightened risks

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“Black Swans”: Central Asia is not immune

- **A NUMBER OF IDENTIFIABLE GLOBAL RISKS:**

- risk of escalation of Russia/Ukraine crisis
- potentially unruly unravelling in China
- regional tension between Saudi Arabia and Iran
- terrorism related security situation globally
- risk of re-emergence of Greek crisis
- etc.

ALTHOUGH LIKELIHOOD OF WORST OUTCOMES IS SMALL: IF THEY WERE TO MATERIALISE, GLOBAL ECONOMIC IMPACT COULD BE SIGNIFICANT

- **SPECIFIC CENTRAL ASIA UNCERTAINTY IS HIGH**

- countries facing significant risks

- **ALL THIS SET AGAINST HEIGHTENED ANXIETY (GOVERNMENTS, BUSINESS COMMUNITY, ETC.)**

- path of growth in Kazakhstan and other Central Asian countries can be very different depending if any of these risks materialise, effects can be non-linear

- **REFORMS CARRIED OUT IN THE LARGEST CENTRAL ASIAN COUNTRY, KAZAKHSTAN, OVER LAST 2 YEARS IN PARTICULAR HAVE INCREASED RESILIENCE**

- but work needs to continue

Kazakhstan and wider Central Asia region is facing difficult external environment, new economic realities

DIFFICULT EXTERNAL ENVIRONMENT:

- OIL AND OTHER COMMODITY PRICES ARE DECLINING AND REMAIN CLOSE TO (RECENT) HISTORIC LOWS
- DIFFICULT ECONOMIC OUTLOOK IN RUSSIA
 - continued recession
 - collapsing Rouble
- CHALLENGES IN CHINA
 - slowdown of growth, currency weakening, stock market volatility
 - structural challenges

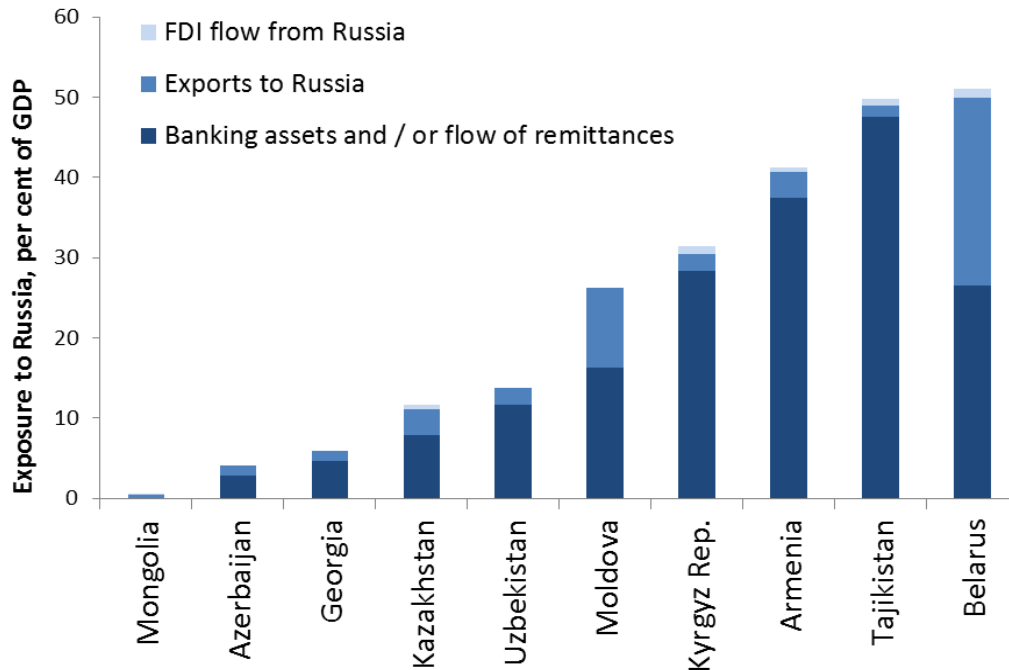
> *INTERNAL VULNERABILITIES*

NEW ECONOMIC REALITIES:

- NEW SILK ROAD ECONOMIC BELT, INCREASING CHINESE FDI
- EURASIAN ECONOMIC UNION
 - impact of common economic zone and financial support provided by Russia
 - expected slow recovery in Russia
- *SLOW* RECOVERY OF OIL AND OTHER COMMODITY PRICES CAN BE EXPECTED

What do economic problems in Russia mean for the region?

- **LOWER REMITTANCES, LOWER EXPORT DEMAND, LOWER INVESTMENT, REDUCED AVAILABILITY OF CREDIT FROM RUSSIAN BANKS**

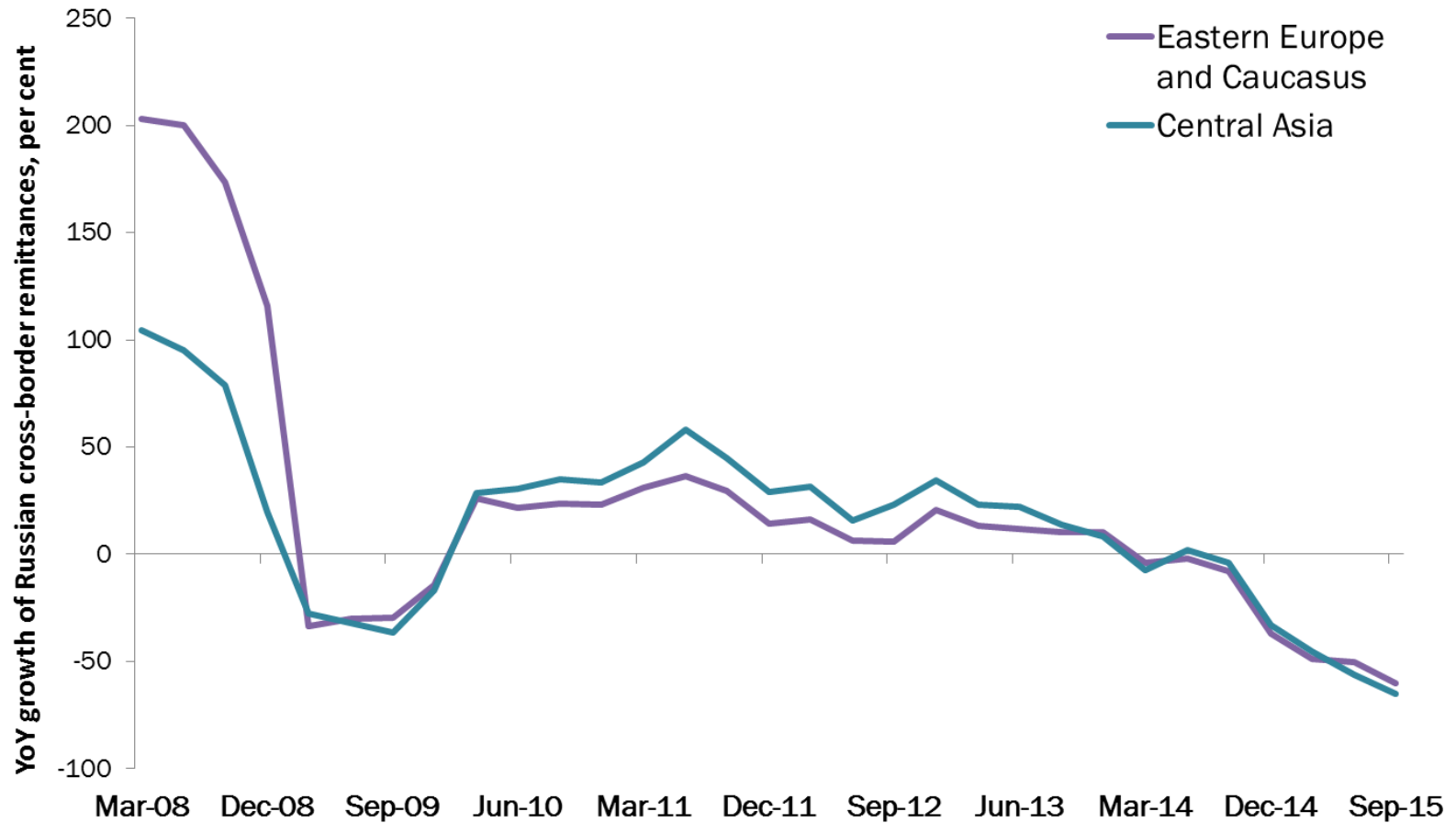


Indirect impacts:
PRESSURE ON LOCAL CURRENCIES
NEGATIVE INVESTOR SENTIMENT

Source: National Sources, CEIC, Bankscope

- **EXPOSURE TO CHINA ALSO A FACTOR**
- **Mongolia exports to China are 42% of GDP, other countries in the region also affected**

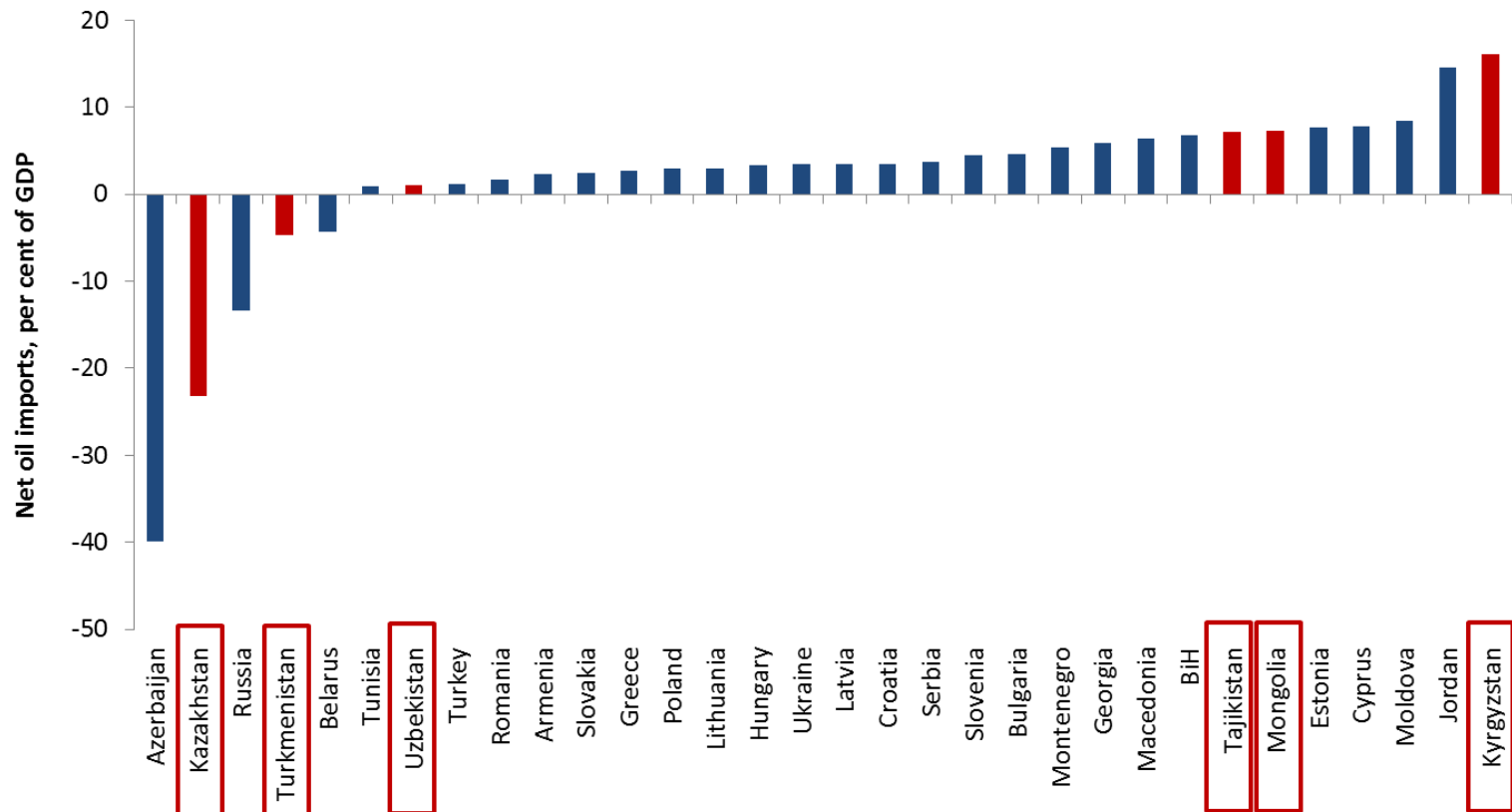
Remittances from Russia declining



Source: Central Bank of Russia

Exposure to drop in oil prices

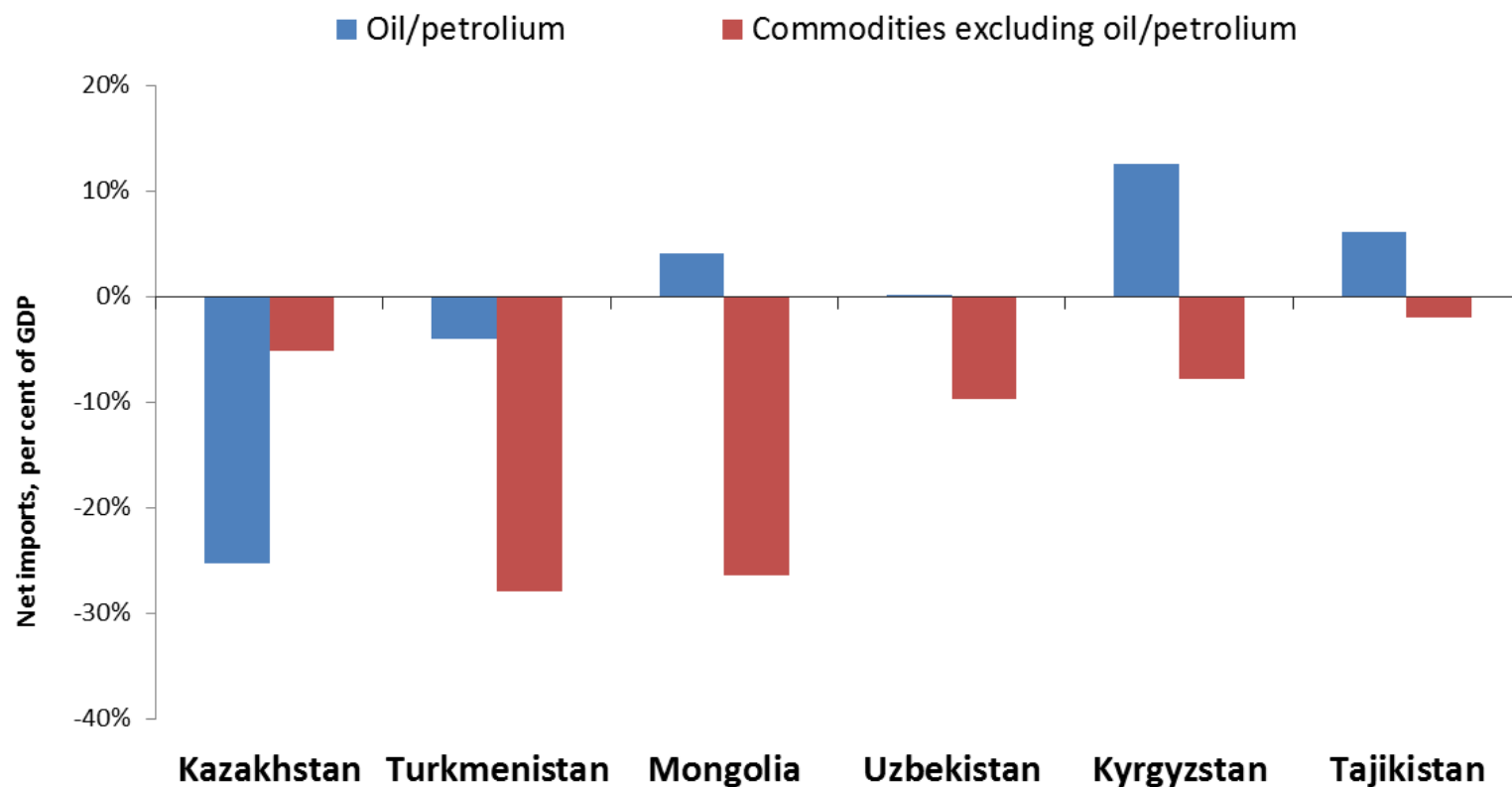
- EXPORTERS HIT HARD FROM LOWER GOVERNMENT REVENUES, LOWER ENERGY IMPORT BILLS SUPPORTING OIL IMPORTERS



Source: UNCTAD, IMF WEO

Exposure to drop in oil and non-oil commodity prices

- CENTRAL ASIAN COUNTRIES ARE SIGNIFICANTLY EXPOSED TO DROP IN NON-OIL COMMODITY PRICES**

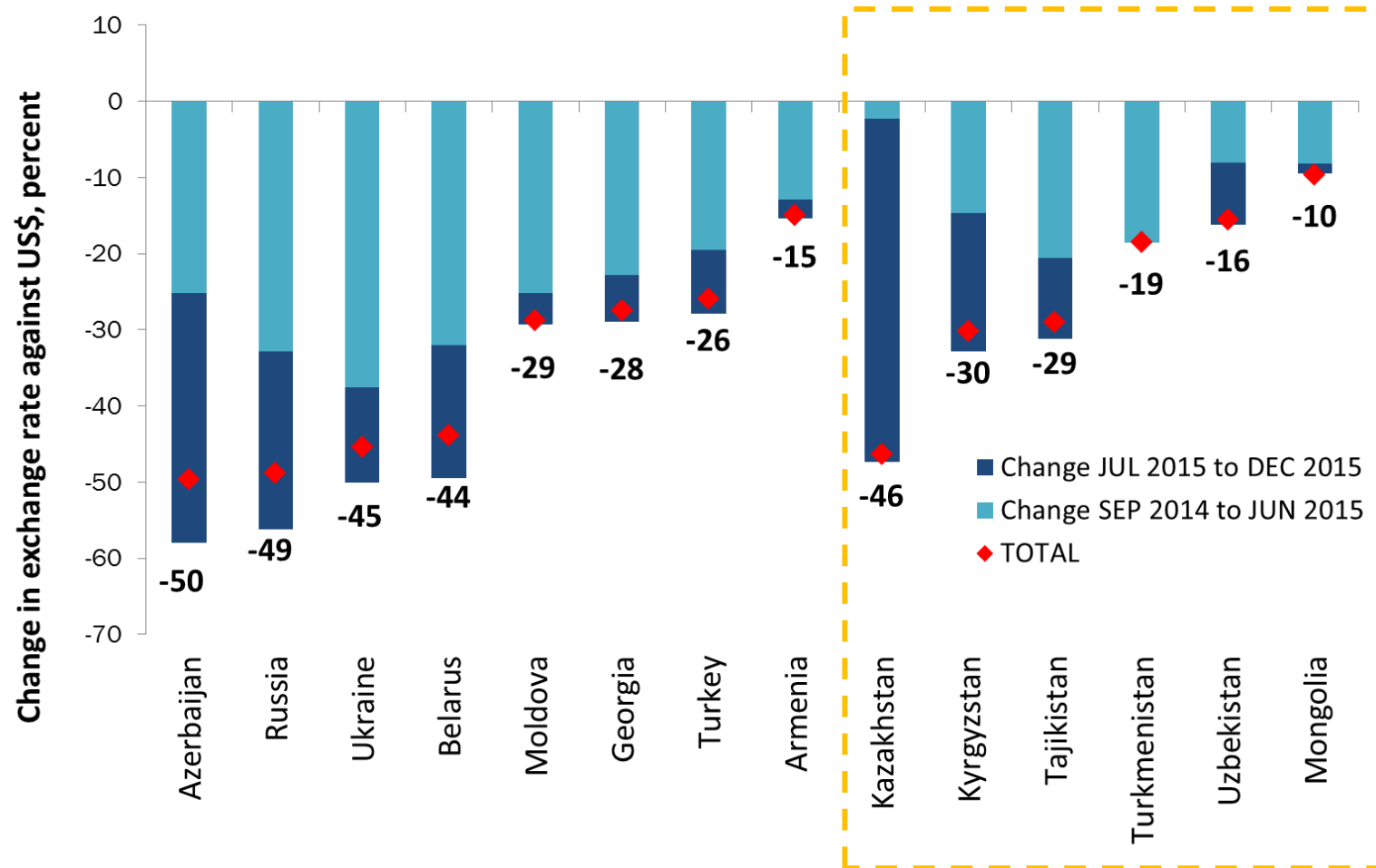


Source: UNCTAD, IMF WEO, National sources

Internal vulnerabilities in Central Asia being exposed

- **CURRENCY VULNERABILITIES**
 - high dollarization
- **UNDERDEVELOPED FINANCIAL SECTOR**
- **UNCERTAINTY SURROUNDING OPERATIONS OF LARGE EXTRACTIVE PROJECTS**
 - Kumtor (Kyrgyz Republic)
- **SIGNIFICANT RELIANCE ON EXTRACTIVE SECTORS**
- **IMPROVING, BUT STILL CHALLENGING BUSINESS ENVIRONMENT**

Regional currencies have been under pressure



Source: Central Banks

Growth in Central Asia has been affected, risks are heightened

- EBRD GROWTH FORECAST (%):**

Net oil/commodity exporters	Current forecast 2016	2014	Difference
Kazakhstan	1.5	4.3	-2.8
Mongolia	5.0	7.8	-2.8
Turkmenistan	8.5	10.3	-1.8

Countries with exposure to Russia	Current forecast 2016	2014	Difference
Kyrgyz Republic	3.9	3.6	0.3
Tajikistan	4.5	6.7	-2.2
Uzbekistan	7.2	8.1	-0.9

“New Normal”: how can Kazakhstan and wider Central Asia respond?

- NEW REALITIES:

- | | |
|--|--|
| <ul style="list-style-type: none">• sluggish growth in Russia• low oil prices• challenges in China | <ul style="list-style-type: none">• New Silk Road Economic Belt, increasing Chinese FDI, establishment of AIIB• Eurasian Economic Union• slow gradual recovery in commodity prices |
|--|--|

- HOW CAN REGION RESPOND?

- KEY IS TO ENSURE BETTER POSITIONING AT THE TIME WHEN IMPROVEMENTS IN EXTERNAL ANCHORS MATERIALIZE

- 1) continued focus on structural reforms, delivery
- 2) improvement in infrastructure, logistics
- 3) innovation in high-tech and low-tech sectors

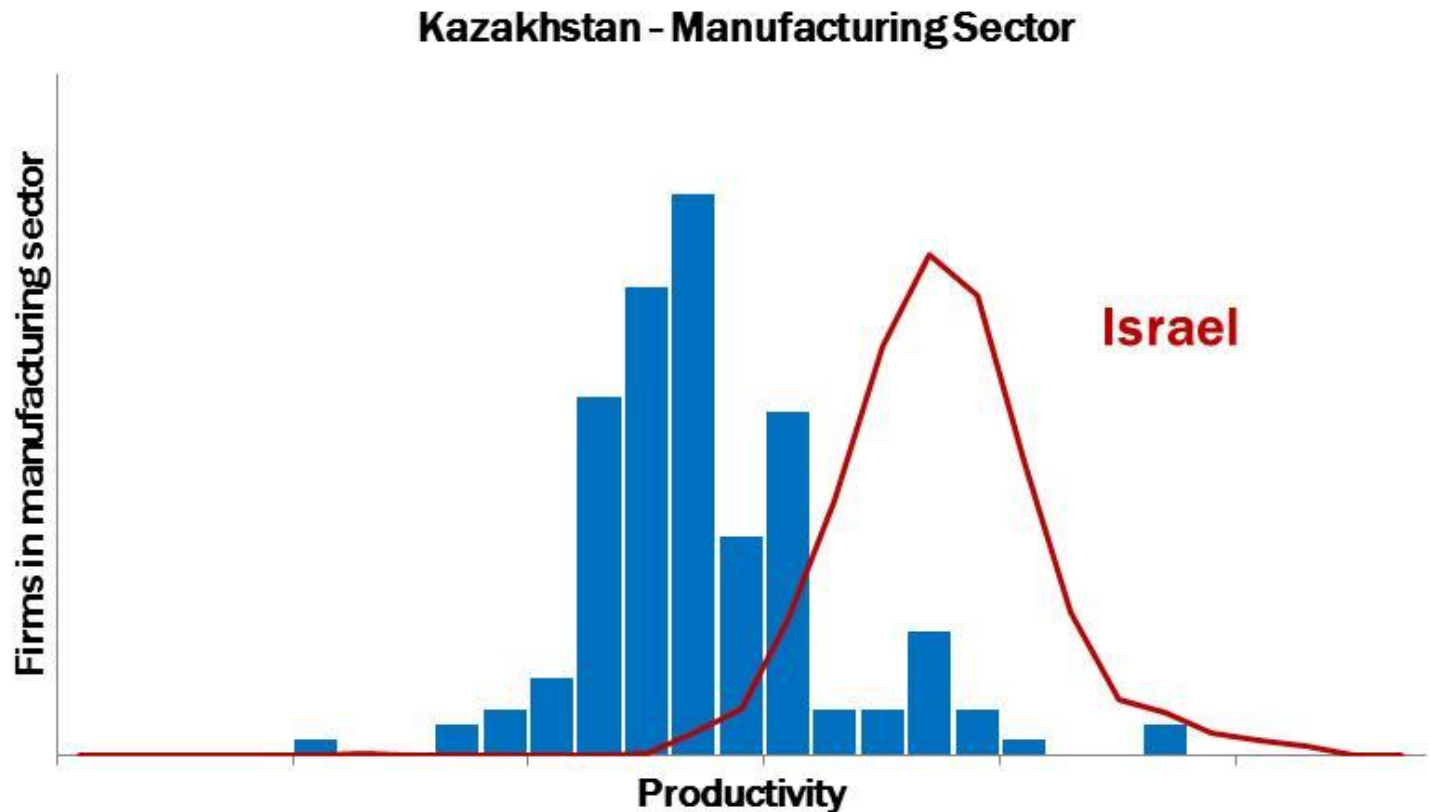
➤ improvements in external anchors are needed (increased Chinese investment, recovery of commodity prices, etc.)

More innovation

- **IMPORTANT TO INCREASE INNOVATION BOTH IN HIGH-TECH AND LOW-TECH SECTORS**
- **BASIC INNOVATION IN LOW-TECH SECTORS CAN BE PARTICULARLY BENEFICIAL IN SHORT-RUN**
- **help improve competitiveness of non-extractive sectors, ensure broad-based growth**
- **LOW-TECH SECTORS:**
- **(i) horizontal policies, including improvements in business environment;**
- **(ii) liberalisation and increased market pressures to facilitate improved productivity;**
- **(iii) closer international integration, including technology transfers**
- **HIGH-TECH SECTOR DEVELOPMENT:**
- **developing VC/innovation ecosystem; vertical policies, including establishment of clusters**

Innovation is not just about high-tech: productivity and innovation in manufacturing sector

- KAZAKHSTAN COMPANIES ARE LAGGING INNOVATION LEADERS...

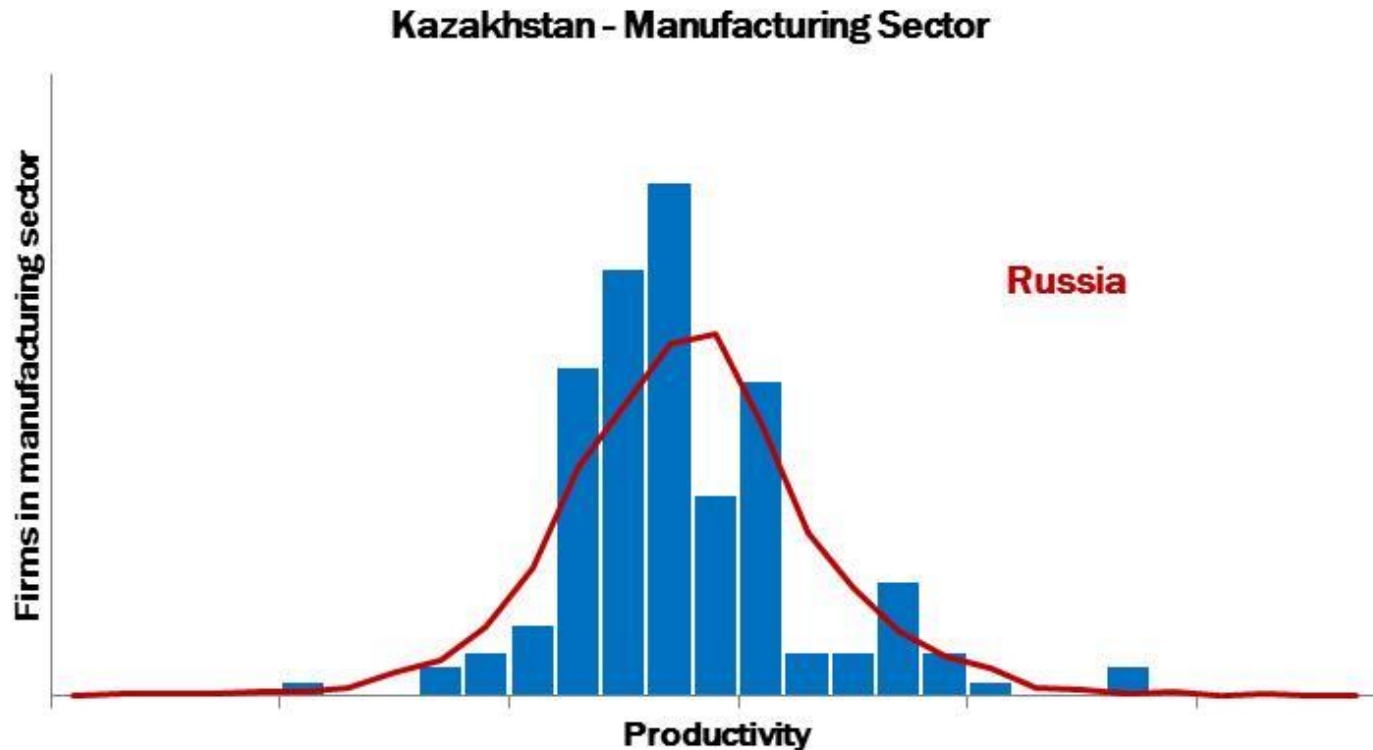


Source: BEEPS V, MENA ES and authors' calculations.

Note: Fitted distribution for Israel. Firm-level labour productivity is measured in logs and defined as sales per employee.

Innovation is not just about high-tech: productivity and innovation in manufacturing sector (2)

- ...BUT VERY SIMILAR TO SUCH MARKETS AS RUSSIA
- scope to push forward productivity with innovation: new products, processes, technology and more (and more sophisticated) financing
- it is key to attract foreign firms and investors



Source: BEEPS V, MENA ES and authors' calculations.

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