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EDITORIAL

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# Kazakhstan's economy and its relationship with Central Asian economies, between growth and debt

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Dear Associates,
In recent years, Kazakhstan has faced a number of economic challenges while trying to consolidate its position as a regional power in Central Asia. The country, which is the largest economy in the region and in fact its economic locomotive (60% of the region's GDP), has experienced relatively solid growth, but also growing indebtedness (72% of GDP in 2022 which remains normal for a developing country but the country at the same time is in the political risk ranking with a 5/7 OECD classification) that has put pressure on public finances in conjunction with several climate disasters such as the floods of the last two years.
The analysis of Kazakh economic performance cannot ignore the dynamics of its relations with other countries.

neighbors: Russia, first of all, but also in relation to the active role of President Tokayev in economic policies and in attracting foreign investments, carried out personally.

**Kazakhstan economy trend**

In recent years, Kazakhstan has seen a recovery from economic hardships related to the COVID-19 pandemic and the fall in oil prices, one of the country's main economic resources. According to OECD data, Kazakhstan's GDP growth in 2023 was 4.1%, a relatively positive result but below forecasts compared to many other emerging countries.

This growth is also accompanied, above all, by the closure of Russian markets with the conflict in Ukraine and the commercial logistics adjustment of Kazakhstan as a country that has remained diplomatically neutral between the West and Russia.
However, this growth must also be contextualized with inflation data, which only returned under control in the last year, reaching 8.1% (after reaching peaks of 14.7% in 2023).
However, this growth has been accompanied by both internal and external challenges, including rising geopolitical tensions in the region and continued dependence on the energy sector and its logistics routes and alliances, which effectively delay investment in new oil projects that drive the country's economy.
Oil accounts for more than 45% of export revenues, which means that OPEC+ member Kazakhstan is substantially dependent on the development of oil prices and production.
For example, with the disruptions of the CPC (Caspian Pipeline Consortium) pipeline in 2022, one of the main risks to Kazakhstan's oil export revenues is its heavy dependence on the CPC to transport its oil to Europe, which receives about 80% of production.
This means that oil flows could be disrupted again due to tensions in the Black Sea (CPC terminals are located in the Russian Black Sea port of Novorossiysk), or because Russia could decide to reduce oil flows again as it did in 2022, apparently for technical reasons, but also due to production cuts imposed by OPEC.
To mitigate these concrete risks, the Kazakh authorities – who, as mentioned above, have adopted a neutral position with respect to the war in Ukraine – are trying to develop alternative trade routes to bypass logistical routes other than passing through Russian territory.
The main initiative in the region is the Middle Corridor, a trade route to connect China and Europe through Kazakhstan, Azerbaijan and Georgia, which could generate potential benefits for these countries;
However, to bring it to fruition, huge infrastructural investments and coordination between different nation-states are needed, which will take time and at the moment there are no serious intentions or concrete projects on the part of foreign investors until the geopolitical situation becomes more predictable and under risk control in the medium-long term.
The country's economic growth has been largely supported by increased public and private investment, but also by the resilience of the mining sector and infrastructure. The oil and gas industry remains the main driver of the economy as mentioned, but Kazakhstan is seeking to diversify, including through the development of sectors such as agro-processing and inbound tourism.

**The Relationship with the Economies of Central Asia**

Kazakhstan is the largest trading partner of other countries in the region, such as Kyrgyzstan, Uzbekistan, Turkmenistan, and Tajikistan. The country is also a leader in promoting regional economic integration initiatives, such as the Eurasian Economic Union (EEU), which includes Russia, Belarus, Kyrgyzstan, and the Belt and Road Initiative (BRI) promoted by China. Russia's recent proposal to join BRICS is certainly a geopolitical move that Kazakhstan will most likely decline to remain Kazakhstan will decline to stay out and not

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openly take sides against the US and Europe on the financial markets.

The Kazakh economy has a particularly close relationship with Uzbekistan, the second largest country in Central Asia. Bilateral relations have been strengthened in recent years thanks to increased cooperation in the energy and mining sectors as well as a more consolidated one related to its own food security.

Additionally, the two nations have increased mutual trade and foreign direct investment, with Kazakhstan supplying energy to Uzbekistan, while Uzbekistan offers Kazakhstan access to its expanding markets.

Despite its economic size, Kazakhstan has also had to deal with the growing competitiveness of its neighbors, especially Uzbekistan, which is accelerating its efforts to attract foreign investment through economic reforms and openness policies.

It should be noted that the population of Uzbekistan is almost double that of Kazakhstan with 36.6 million inhabitants with an average age of under 26, a demographic that plays a decisive role in the economic development of a country in the long term.

**Tokayev's Presidential Visits: A Strategy to Attract Investment**

President Tokayev has sought to strengthen Kazakhstan's international standing through a series of diplomatic visits abroad, focusing in particular on economic investment and international cooperation. Since taking office in 2019, Tokayev has visited numerous countries, including Russia, China, Germany, the United Arab Emirates, Qatar, and even the United States, aiming to improve Kazakhstan's access to global markets.

One of Tokayev's main priorities has been the creation of a favorable environment for investment, particularly in the renewable energy sector, the production localization of advanced technologies, and infrastructure.

According to World Bank data, the flow of foreign direct investment (FDI) into the country has seen a significant increase, reaching about $22.5 billion in 2022, a 10% increase compared to the previous year. Attracting investments has allowed Kazakhstan to improve its competitiveness and image as a regional power and to intensify and diversify its economy.

**Economic Growth and Debt: Kazakhstan's Challenge**

However, Kazakhstan's economic growth has been accompanied by growing public debt. Just this month, a sovereign loan of 15 billion euros was taken out with Japan.

Public spending, supported by the need to finance large infrastructure projects and social policies, has led to an increase in sovereign debt.

According to the OECD, Kazakhstan's public debt has increased significantly in recent years, reaching around 26.3% of GDP in 2023, up from 20.8% in 2018. Although the debt-to-GDP ratio is still low compared to other emerging countries, the risk of unsustainable debt is always present, especially in a context of global uncertainties and an economy that is not yet sufficiently diversified.

In recent years, Kazakhstan has resorted to international loans to finance its budget deficit and support its growth policies. The World Bank, the International Monetary Fund (IMF), and the European Bank for Reconstruction and Development (EBRD) have been among the main international creditors. In particular, the Kazakh government has negotiated long-term loans with relatively favorable interest rates, but debt sustainability is an issue that remains under close scrutiny, given the uncertain geopolitical environment and the country's dependence on the natural resources sector.

In 2023, Kazakhstan recorded a budget deficit of around $3 billion, slightly increasing (after the post-Covid containment reached 4.1%) which was covered by external borrowings and an increase in sovereign bond issuance. The government has implemented restrictive fiscal policies to reduce the deficit and improve public finance management, but the pressure on fiscal resources is expected to remain high in the coming years.

An example is the symbolic maneuver of the moratorium on the salaries of high-level public employees including members of parliament frozen since 2022 and still in force.


**Towards Economic Diversification and Prudent Debt Management**

Kazakhstan's economy has shown signs of resilience and growth, but significant challenges remain, particularly regarding debt sustainability and dependence on natural resources. Economic diversification policies, incentivizing sectors such as technology and renewable energy, are crucial to ensuring sustainable growth in the long term.

Kazakhstan will face a delicate challenge in balancing growth and financial stability, trying to avoid excessive indebtedness that could undermine its competitiveness in the global context. In this scenario, cooperation with neighboring countries and deepening regional integrations will be key tools to strengthen Kazakhstan's economic position and establish new synergies with the economies of Central Asia.

All this must be taken into consideration by foreign investors in the country but also by those who are approaching this market, because it demonstrates and extends the caution that the current economic and political circumstances of the country suggest.

It is an extremely decisive transitional moment that is not yet concluded, where we will have to keep our eyes on different fronts that could lead to a cannibalistic twist towards foreign companies in the country, in particular

1)Whether alternative investors to the US and Europe will be able to compete with the Middle East and South East Asia in infrastructure projects

2)If Russia indirectly imposes a political line through economic pressure (for example on projects involving Georgia and Azerbaijan on the Middle Corridor of Oil and Gas routes)

3)If fiscal policies fail and energy and food inefficiency will lead to low inflation and employment levels.