Kazakhstan’s macroeconomic response to the pandemic

Sabit Khakimzhanov
Center for research and analysis
National Bank of Kazakhstan

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Fiscal policy: a countercyclical force

- Accumulated fiscal surpluses could be used in times of need, act as a self-insurance.
- However, in normal times, without checks and balance of mature institutions they also tend underwrite and indemnify statist expansion, which distort the market signals, support failing companies and leave no air for competitive producers, used to bail out of insolvent banks and its creditors, mask regulatory failures, erode institutional development.
- In an resource rich economy, especially where the state controls them, fiscal room stops being an informative indicator of fiscal prudence.
- Fiscal policy should be aware of the Dutch disease and other longer term institutional implications of a lack of spending discipline. Fiscal rules should be designed with a broader set of objectives in mind.
Fiscal policy: how much is too much

- Fiscal austerity of 2017-2018 gave way to expansion in 2019-2020
- Objective metrics of fiscal stance – non-oil and consolidated deficit – reached record levels
- Historically, the twin deficits financed by the sale of government’s foreign assets supported both, aggregate demand and the exchange rate, usually at an unsustainable level, setting up the stage for a subsequent adjustment
- Once the need for fiscal support becomes less acute, the rates of spending growth would have to be brought down in a sustainable manner.
- Fiscal rules could provide the badly needed structure

**Consolidated deficit is at record high**

![Graph showing consolidated deficit over time](image)

**Spending grows faster than GDP cum inflation target**

![Graph showing government spending growth](image)
Fiscal policy: tax relief

- Cash transfers of KZT 42,500 a month to 4 million who lost a job due to lockdown
- Expand the list of free medical services until July 1, 2020
- Food and essentials for 1 million socially vulnerable people
- KZT300bn to fund jobs in infrastructure maintenance
- Tax relief and due date extensions
- Scale up off-budget provision of subsidized credits to SME
- Broaden business eligibility for government support
- Off-take contracts to support agricultural producers with special expedited procurement rules until August 2020
Monetary policy: no room for rate cuts

Dollarization high, sensitive to fx risk

- Dollarization remains high, limiting banks’ ability to direct savings to productive uses.
- Money and deposit market is highly sensitive to fx risk, indicative of economy’s commodity dependence and the history of devaluations under fixed exchange rate.

High inflation limits further rate cuts

- High inflation (6.7%) and low real interest rate (1.0-2.0%) leave no room for a rate cut (policy rate at 9.0±1pp).
- Any further narrowing of the spread is perceived as a weakened commitment to fight inflation and maintain a sufficient premium for holding Tenge.
- Monetary policy is not in a position to provide a countercyclical stimulus due to high inflation of largely fiscal origin.
Regulatory forbearance

Capital adequacy requirements
• Lowered risk weights for
  • SMEs from 75% to 50%
  • FX loans from 200% to 100%
  • syndicated loans from 100% to 50%
• Lowered capital conservation buffer by 1 percentage point
• Effective until Oct 2020, extended to July 2021

Loan loss provisioning
• Deferred payments is not recognized as objective evidence of loan impairment, only applicable for loans in good standing borrower before the lockdown
• Originally effective until Oct 2020, extended to April 2021

Liquidity requirements
• Lowered LCR requirement from 80% to 60%
• Expanded the definition of highly liquid assets
• Effective until Oct 2020
Regulatory forbearance: little room

- **Corporate credit** continues to shrink, aided by bank restructurings.
- Supply remains depressed due CAR pressure from legacy loans and high credit risk on new loans.
- Legacy NPL are mainly due to related party lending. Widespread evergreening, other types of forbearance.
- Retail loans are better quality, grew +27% yoy prior to lockdown.
- Asset Quality Review, ST 2019, Viability Analysis 2020
- **The room for further forbearance is limited by past practices**
- Suspension of judgement until the end of forbearance period
SME: credit absorption capacity limited

- The stock of corporate loan portfolio belies the actual demand
- Most bank loans are on the balances of insolvent SME, mostly to small businesses
- Stock of bank loans issued to solvent SME is at KZT 2.0 trillion
- Given stable leverage ratios, demand for new corporate credit is limited by equity growth
The right tools for the job

• Monetary policy
  – **No room** for monetary stimulus during negative shocks.
  – Rate cuts could jeopardize trust in Tenge, escalate funding risks for banks and lead to the contraction of credit supply

• Prudential regulation
  – **Room for forbearance is limited** for corporate clients due to legacy NPE, related party lending, past abuses of forbearance by banks, weak balance sheets of potential borrowers
  – **Adequate room** for forbearance in consumer lending

• Fiscal policy
  – **Adequate room** for provision of emergency support in the form of income replacement to households, ideally if means / needs based
  – However, the side effects of excessive and protracted fiscal support are highly undesirable and long lasting
  – Could be the main countercyclical factor, but need more discipline, structure, rules to guide fiscal policy during normal ("good") times and during the phase out from emergency support