Analyses OSW

CENTRE FOR EASTERN STUDIES 26.08.2015 www.osw.waw.pl

Kazakhstan – tough times for the tenge

Aleksandra Jarosiewicz

On 20 August, the Kazakh government announced its decision to liberalise the exchange rate of the country's currency, the tenge. This led to a sudden depreciation (by around 26%). The government's decision to liberalise the exchange rate is an overdue desperate attempt to save the economy in the context of the worsening socio-political situation in Kazakhstan. The monetary policy has been adjusted due to external factors, above all falling prices of crude oil, as Kazakhstan's economy relies heavily on the production of crude.

The depreciation of the tenge – even though basically it will have positive effects – will not resolve the huge socio-economic problems. Since oil prices remain low, Kazakhstan will be unable to avoid an economic crisis, and this will entail a deterioration of living standards. This means that over the coming months there will be a rise in the risk of social unrests (especially in Mangyshlak and Atyrau, the regions which depend on oil) and political tension, which may take the form of a reshuffle inside the government elite as well as some readjustments of the political system.

The devaluation of the tenge – a necessary evil

Since the rapid fall of oil prices last autumn, Kazakhstan has been faced with the risk of a serious economic crisis, which it has been trying to avert by adopting a policy of selective interventions (for example, support for car manufacturers or farmers sustaining losses due to the influx of cheaper Russian goods). However, the scale of the problem has gone beyond the government's expectations and has forced it to radically adjust the country's monetary policy; this was most probably ordered by President Nursultan Nazarbayev personally.

The decision to liberalise the exchange rate is a consequence of economic problems caused by both external factors and errors of the previous economic policy. These include maintaining the predominance of the raw material production sectors in the economy despite attempts made for years to diversify it – oil generated around 66% of income from exports in 2014. Falling oil prices have led to a dramatic deterioration of the country's financial situation: budget expenses have been cut by 10% (the budget for 2015 was adjusted several times; at first it was based on the price of US$80 per barrel in November last year, then it was reduced to US$50 in January and US$30–40 in August), and a depletion of currency reserves (according to Nazarbayev, Kazakhstan has spent US$28 billion on maintaining the tenge exchange rate at the same level over the past two years, and the total reserves of the central bank and oil fund stood at US$96 billion at the end of July this year). The situation became even worse after Kazakh manufacturers lost competitiveness to Russian manufacturers following the devaluation of the Russian rouble

last December. This caused the Kazakh market to be inundated with foreign goods, including Russian cars and food products and caused an outflow of capital from Kazakhstan. One of the factors which has contributed to these negative trends is Kazakhstan's membership in the Eurasian Economic Union. In consequence of this, Astana has been deprived of instruments necessary to protect its market from Russian imports. Last but not least, the devaluation of the Chinese yuan and the fact that oil prices fell below US$50 per barrel (the level assumed in the budget) have probably accelerated the decision to devaluate the tenge.

The devaluation caused panic on the market, which is manifested in the large-scale purchase of foreign currencies and more expensive goods from stores, and also through public dissatisfaction articulated in social networking services. While the need to carry out the devaluation was clear to both the public and the market, the way it was conducted (for example, contradictory messages sent out by the central bank and the government) has undermined the already low public confidence in the government. The head of the central bank has become a symbol of incompetence and dependence in Kazakhstan. The way the devaluation was carried out has laid bare the limitations of the authoritarian system in Kazakhstan and the ineffectiveness of the institutions in charge of monetary and economic policy (hence Nazarbayev decided to intervene personally).

The advantages and the disadvantages of the liberalisation of the tenge exchange rate

The liberalisation of the tenge exchange rate will principally have positive consequences for the economy. Firstly, it will allow both local manufacturers (who now need to handle the inflow of Russian goods) and exporters of mineral raw materials (state-owned companies, e.g. KazMunaiGas, metal producers linked to the elite, e.g. KAZ Minerals, and investors present in the raw materials sector – Chevron, ArcelorMittal) to regain competitiveness. The depreciation of the national currency has also offered the government an argument to demand these firms to maintain the previous employment levels, which will help limit the social costs if it will not actually eliminate them. The liberalisation of the exchange rate will also cushion the blow of the consequences of Kazakhstan joining the World Trade Organisation (WTO) in December this year. In the broadest extent, the weak currency will also contribute to a real economic diversification – business circles in Kazakhstan have complained about the excessive strength of the tenge for years.

One negative consequence of the tenge exchange rate liberalisation is the emergence of inflationary pressure – in the short term, growing prices will result in falling domestic consumption and thus a deterioration of the situation of the small business sector. The depreciation will also complicate the situation in the banking sector through the deterioration of the quality of the credit portfolio of those banks which offered loans in foreign currencies (the borrowers, mainly entrepreneurs, generate their incomes in tenge). The introduction of a market exchange rate also means the emergence of currency risk for potential investors in Kazakhstan, which – given the central bank's inept policy – may discourage them.

The public vs. the government: Is the social contract no longer binding?

However, the most serious problem the government needs to face is the social consequences of the upcoming economic crisis. It is precisely the fear of a sudden reaction from the public which forced the government to delay the devaluation. One negative consequence of this will be a deterioration in living standards in the country. As a result, protest sentiments will become more intense. The government is aware of this and has promised to take a number of measures to alleviate the consequences of the sudden depreciation by, for example, raising wages in the public sector, indexing bank deposits and assistance to borrowers.

However, these are only selective measures and will not resolve public dissatisfaction which has been mounting for months. This is manifested for example in the refusal of the trade unions to participate in the costs of the crisis (their disagreement to any reduction of wages, for example, at ArcelorMittal) and resistance to the reform of the labour code offering more powers to employers (trade unions from the oil region Mangyshlak sent a letter to the government warning it against amendments to the code). In effect, the spectre of redundancies and expense cuts is accompanied by the growing risk of worker strikes in Kazakhstan. According to the director of OzenMunaiGas, a subsidiary of the state-owned company KazMunaiGas, if oil prices fall below US$40 per barrel, redundancies are unavoidable.

It is the memory of the violently suppressed strike of OzenMunaiGas workers in 2011 that has paralysed changes in the oil sector (which has been affected most severely by the low oil prices). The public dislike of the government has also been escalated by the government's image-building policy. It is a commonly shared opinion that the government has burdened the public with the costs of the crisis, and has not withdrawn from projects which are viewed as smacking of profligacy, e.g. the Expo show in 2017.

The political uncertainty

The rivalry for the dwindling incomes and the socio-economic crisis have generated tension inside the government elite and laid bare the ineffectiveness of the existing system of government. Manifestations of this was have included the public debate on the devaluation of the tenge which has been ongoing for a few months and also the mutual accusations of mismanagement between the managements of some state-owned companies, as well as criticism of the indebtedness of state-controlled firms expressed by the parliament, which has no real power in the authoritarian system (reports of this have been published by the media). Therefore, it cannot be ruled out that tension will escalate inside the elite in the future.

Nevertheless, one side effect of the economic crisis is the emergence of elements of political competition within the narrow circle of the government elite: for example, one of the staunchest supporters of devaluation and critics of the central bank received (already after the devaluation) the position of deputy minister at one of the key ministries in charge of incoming investments. However, this will not lead to a democratisation of the system in Kazakhstan, but will only make political rivalry fiercer.

The difficult situation Kazakhstan has found itself in appears to be also a catalyst of change in the country's domestic policy, one consequence of which (as intended by Nazarbayev) will be the adjustment of the previous ineffective model. The emergence of elements of

limited political competition as part of the system and the promotion of young politicians, many of whom have a Western education (for example, the new mayors of Almaty and Shymkent) will escalate conflicts inside the elite and at the same time respond to the needs of its most pro-reform section, who have a negative opinion about the old elite and their 'Soviet-style' model of government. It is symptomatic that Nazarbayev has not made attempts to pacify public dissatisfaction and political tension by tightening the authoritarian grip or making the system more repressive. In this context, it cannot be ruled out that an attempt will be made to change the existing model both through a continuation of the generation exchange and reforms aimed at improving the effectiveness of state institutions. However, it is still an open question whether, despite the threat of possible domestic tension in Kazakhstan, Nazarbayev will still risk holding a (snap) parliamentary election of a partly competitive nature. This would not put Nazarbayev's position at stake, and could mark an introduction to the process of adjusting the political system and the succession of power.