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Among CIS oil exporters, only Kazakhstan will evade the risk of slowing down economy

CIS oil economies' growth

- **Over 27 years of post-Soviet transformation, oil-rich CIS economies demonstrated the best growth rates.** Almost all CIS economies have restored after the economic shock in 1990–1995, but the rate of recovery differed by country. For example, the lowest drop in Azerbaijan and Kazakhstan economies in 1995 was compensated subsequently by almost two-fold growth.
- **The growth potential of CIS commodity economies is limited.** Low factor productivity and weak investments into production capital deprive the Azerbaijan economy of stable growth drivers. The only growth driver is recovering oil prices. As to the Russian economy, its growth potential is restricted by a negative demographic trend.
Exception: Kazakhstan. The importance of oil prices for Kazakh GDP is overestimated: for almost 20 years, the key role has been played by the structural growth based on the fundamental sources — labor and production capital.
- **No overheat in the Azerbaijan economy will contribute to lower inflation** that will reach a target corridor of 6–8%.
- **In Kazakhstan, the economy may overheat,** as the resulting growth exceeds the structural one, which will contribute to inflation processes' acceleration.

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In 1990–2017, the economies of Azerbaijan and Kazakhstan have grown more than two-fold

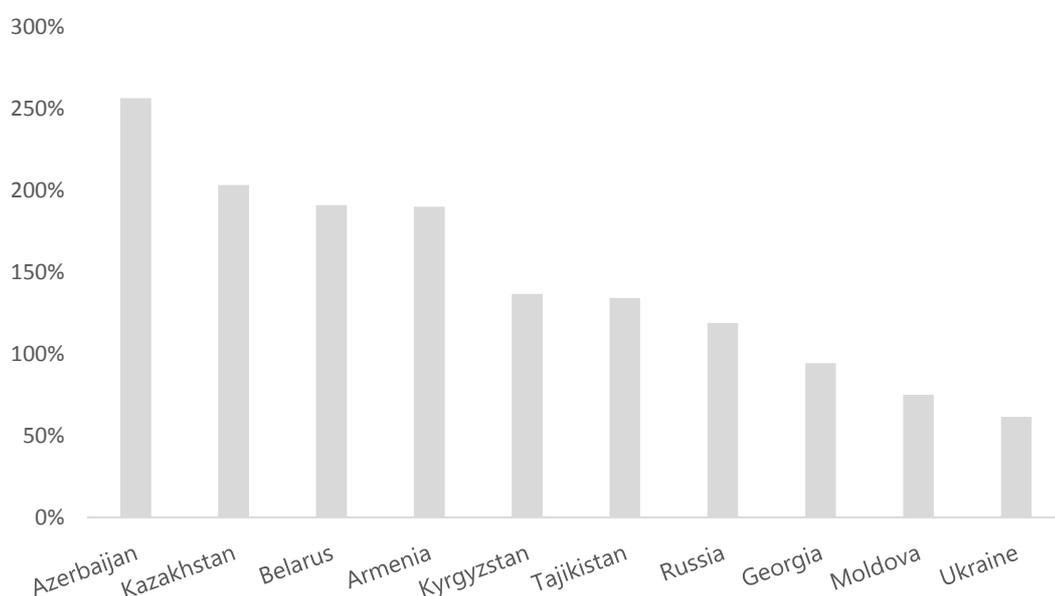
Higher oil prices (Brent at USD 55/bbl in 2017, expected at USD 60/bbl in 2019) and a significant growth in oil production will strengthen the external balances and the exchange rate of the national currency of Azerbaijan.

All CIS countries, including Georgia, faced a plunge in the economic activity after the USSR collapse. The bottom point was reached in 1995, when the average real decline amounted to 48% against 1990. The economies of Armenia and Georgia were first to begin recovering, while Ukraine was the last to show the signs of growth (as late as in 2000).

From 2003 to 2007, most CIS economies reached and exceeded the 1990 level. Tajikistan and Georgia were the last to recover, by 2013 and 2017, respectively. Ukraine and Moldova have not recovered yet.

From 1990 to 2017, only Azerbaijan and Kazakhstan doubled their real GDP: the economic activity have grown there by 2.6 and 2.03, respectively.

Figure 1. Cumulative real GDP growth in the CIS countries in 1990–2017¹



Source: World Bank, ACRA estimates

In 2018–2021, the real GDP growth potential in Russia is limited by 1.5% a year (see ACRA forecast *Six investment drivers in Russia*).

Thus, in the analyzed period, the oil economies of Azerbaijan and Kazakhstan demonstrated the most significant recovery and growth in economic activity. At the same time, the structure of growth drivers in those economies differs sufficiently, therefore, the economic growth in the two countries showed different dynamics in 2016–2017.

See ACRA research [Six investment drivers in Russia](#) of April 4, 2018.

¹ The cumulative growth in Uzbekistan and Turkmenistan amounted to 3.2 and 3.4, respectively (more than three-fold). But, in view of the prolonged period of underestimated foreign exchange rate (which resulted in "black currency markets" in those countries) and doubtful official statistics on foreign exchange rates and price indices, GDPs of those countries were excluded from the peer analysis.

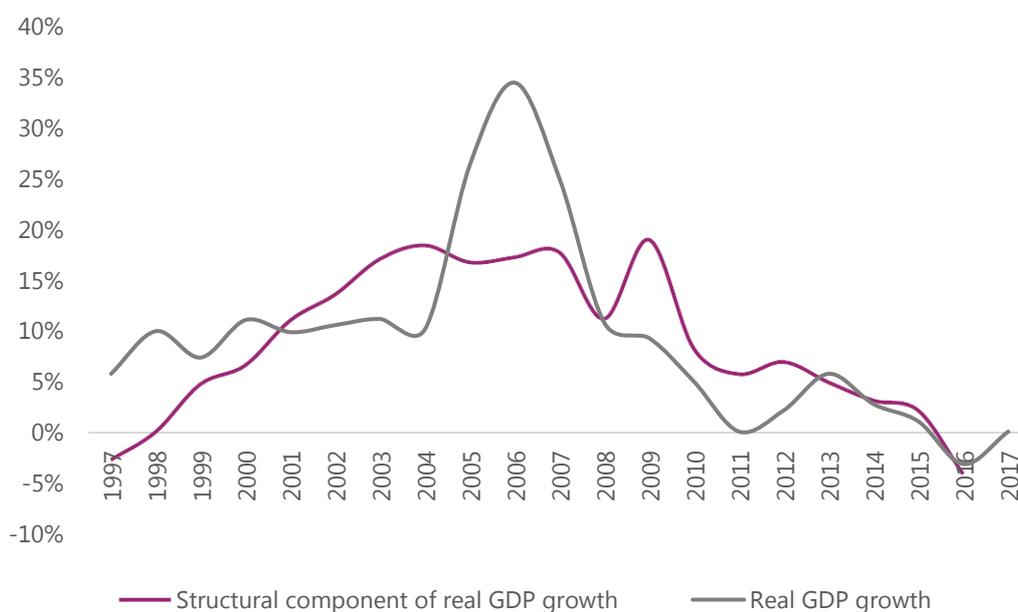
The Azerbaijan's potential GDP growth was based on fixed capital but it ceased to translate into real growth

In 1990–2017, a basic trend in the generation of Azerbaijan's GDP included multiple fixed assets commissioned mainly in the mining industries. Throughout the period (with the exception of 2008 and 2010–2011), the production capacity grew much stronger than labor resources.

Before 2000 (inclusively) and in 2005–2007, the real GDP growth exceeded the potential one. The first excess can be attributed to low depreciation rates and usage of production capacities built in the Soviet era. The strong gap seen in 2005–2007 is a result of the oil boom.

On the contrary, in 2001–2004 and 2008–2012, the growth of the economy was not so intensive relative to its potential, that is, the growth potential of the Azerbaijani economy was actualized not in full.

Figure 2. Structural component of real GDP growth and real GDP growth in Azerbaijan



Source: State Statistics Committee of the Republic of Azerbaijan, ACRA estimates

In the 2000s, a significant inflow of investments (mainly to the oil and gas sector) and a multiplier effect on the non-oil segments, gave the Azerbaijani economy a significant impetus for growth, which weakened by 2015–2016. The economic growth was regularly contributed by fixed assets (from 0.4% to 4% in 2012–2016), but the effect was offset by a negative rate of factor productivity.

Neither the production rate dynamics nor the basic types of resources allow the country's economy to reach the trajectory of sustainable potential growth, which drives the search for new sources of growth.

Azerbaijan: "economy quality" deteriorates

See ACRA research

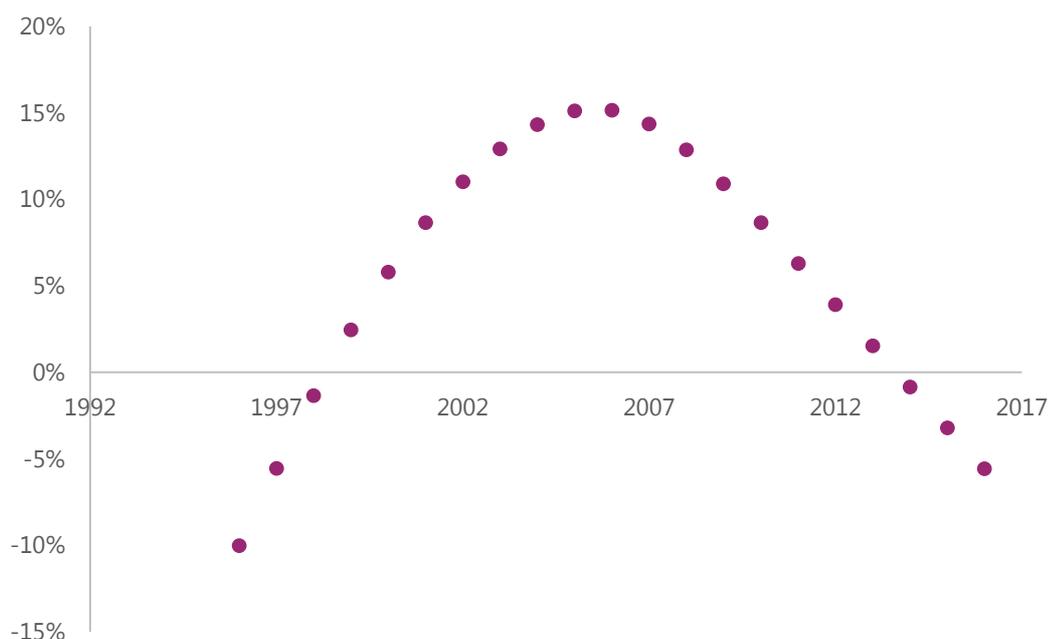
[Russian government to become a net borrower and Kazakhstan government to remain a net creditor in 2018](#) of July 27, 2017.

The "economy quality"² includes multiple factors determining the technological progress: the quality of institutes, market structure. The resulting quantitative assessment (the Total Factor Productivity or TFP) is unstable and changes its sign frequently.

In the period from 1998 to 2013, the TFP was positive, but in 2014, it became negative.³ The negative TFP before 1998 may be attributed to the management and production crisis in the post-Soviet era and the Karabakh conflict, while the negative TFP seen in recent years is a cumulative effect of business cyclicity and short-term factors. The maximum TFP growth rate (peaked in 2000–2011) reflects a multiplicative effect of the oil boom on other sectors of the economy, technological growth and, finally, productivity.

In view of the current negative TFP trend and the limited dynamics of contributions from base sources of growth, the potential growth of Azerbaijani economy stagnates.

Figure 3. Since 2014, TFP has been negative in the Azerbaijani economy (after smoothing)

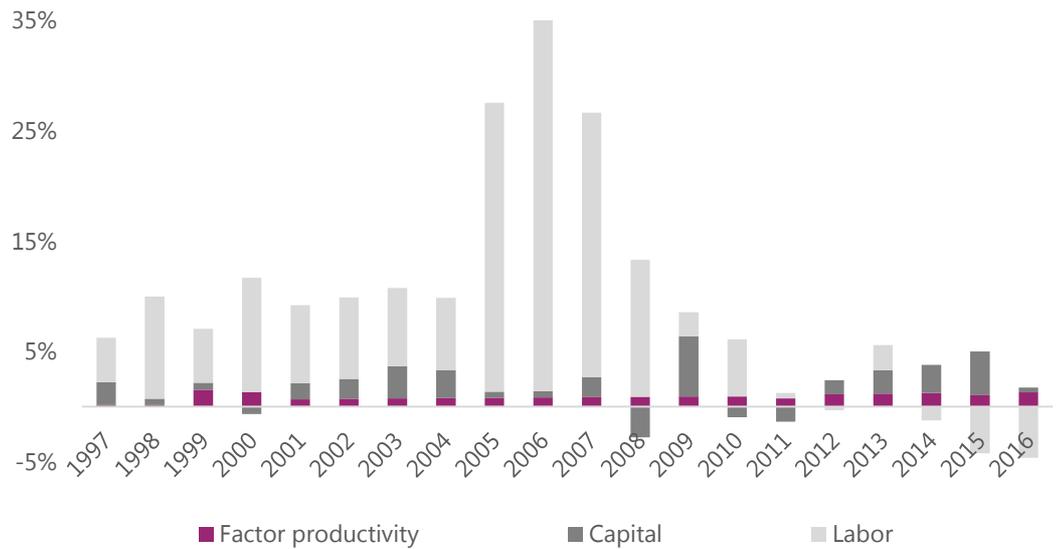


Source: State Statistics Committee of the Republic of Azerbaijan, ACRA estimates

² The term "economy quality" is used as an aggregate indicator of economy's ability to develop and grow based on the internal structure/architecture, which may include the institutional development level, the degree of competition in the economy, capacity to reproduce assets etc.

³ The TFP was not calculated for 2017, as certain data has not been published officially. It is assumed that the 2017 TFP calculations will be made later.

Figure 4. In 2014–2016, the TFP contributed negatively into the Azerbaijani GRP



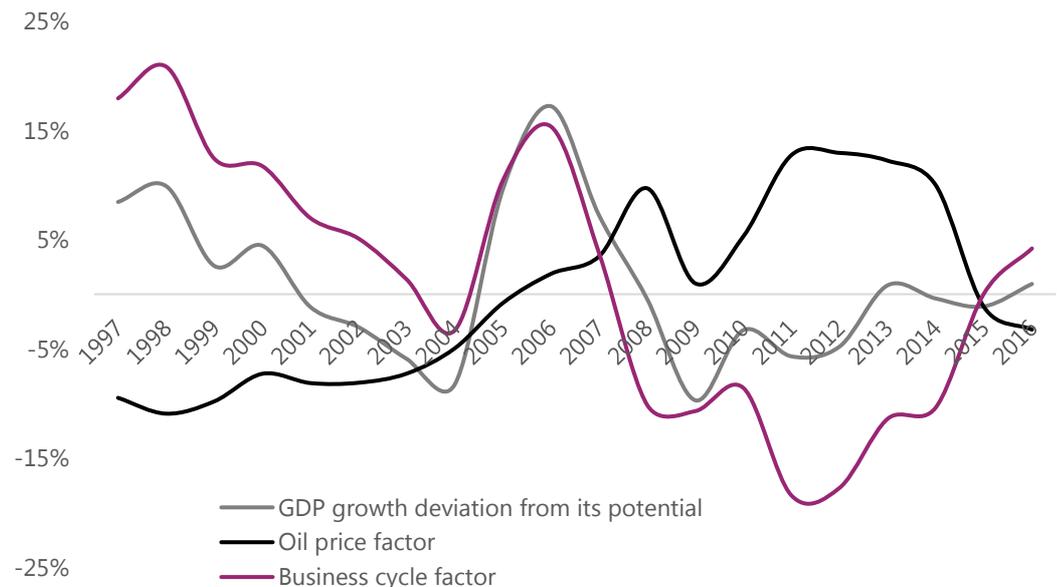
Source: State Statistics Committee of the Republic of Azerbaijan, ACRA estimates

Declining economic potential and oil prices triggered a recession in Azerbaijan in 2016

Real GDP growth in Azerbaijan was negative until 2005 (caused by crude oil market environment). The positive dynamics of 2006-2014 was followed by a stagnation.

An element of the external environment represents the effect of global oil price fluctuations, where the price of Brent is used as a proxy, and the relative position of the current price is calculated versus the 40-year average.⁴

Figure 5. Business cycle and crude oil price factors in the Azerbaijan GDP profile



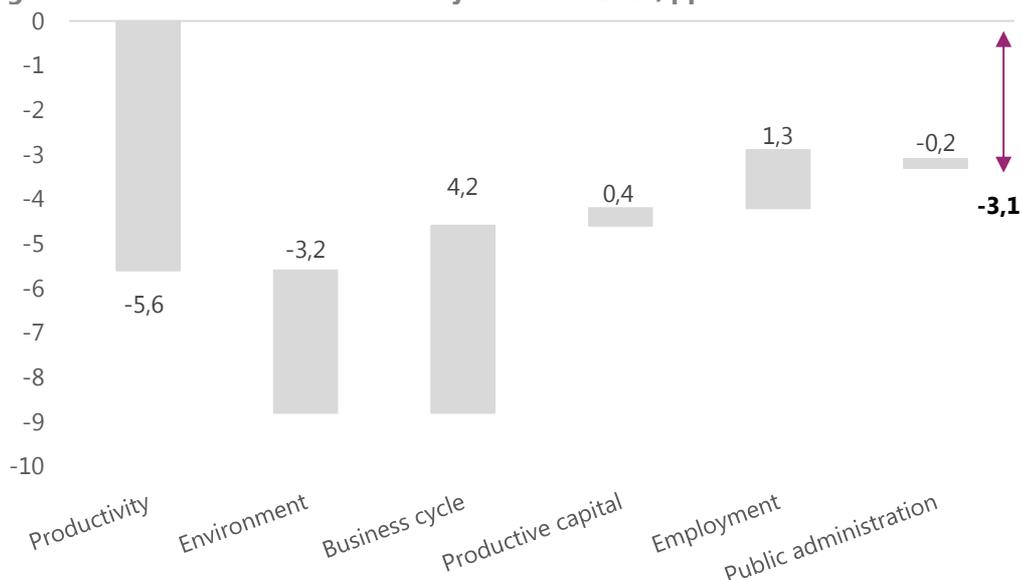
Source: State Statistics Committee of the Republic of Azerbaijan, ACRA estimates

Please see ACRA research titled [Low inflation in Russia to force the government and businesses to seek new forms of flexibility](#), published on October 9, 2017.

Please see ACRA research titled [Higher share of short-term borrowings has not increased financial instability in Kazakhstan](#), published on March 19, 2018.

⁴ In the majority of similar studies, the average crude price was calculated for the period of 10 years, which is seen as extremely short for incorporation of sufficient information to present the long-term price behavior pattern in this sector.

Figure 6. Growth structure of Azerbaijan GDP in 2016, pps



Source: State Statistics Committee of the Republic of Azerbaijan, ACRA estimates

Starting in 2010 (even considering that oil prices remained fairly high during most of that period) the actual GDP growth in Azerbaijan demonstrated minor deviations from its potential. The recession in 2016 was driven by both the oil price factor and the economy's potential dynamics (in 2015-2016, the trend of relative oil prices became a negative factor). At the same time, owing only to the business cycle factor the economy did not slip into a deeper recession, which may be attributed to the domestic currency devaluation and subsequent tight monetary policy of the authorities.

In 2017, non-oil GDP grew by 2.7% in real terms, which demonstrates a positive contribution of the business cycle component.

Oil prices were rather a constraint in 2017 as GDP demonstrated a nominal gain of 0.1%. GDP of Azerbaijan is set to take a foothold in the green zone in view of fairly positive expectations crude oil prices (according to ACRA projections, Brent crude oil prices would average 58 and 60 USD per barrel in 2018 and 2019, respectively). However, due to lack of major growth drivers the growth rates would be limited to their potential.

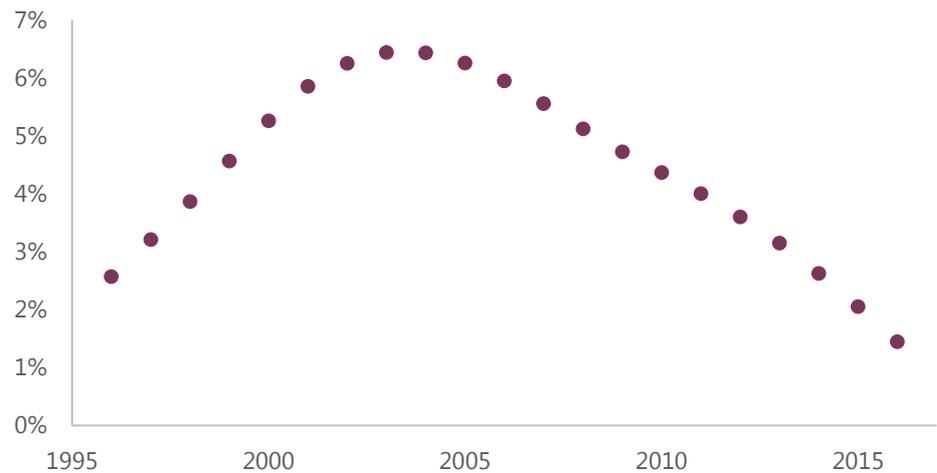
As a result, the country's economy is unlikely to overheat, which mitigates the risks of a consistent inflation slowdown and the annual average inflation reaching the range of 6%-8% in 2018-2019 targeted by the Central Bank of Azerbaijan.

The "economy quality" of Kazakhstan remains high

The dynamics of Kazakhstan's smoothed factor productivity rate (as a proxy for quality of the country's economy) was in the growth stage through 2003 (the indicator value declined by 6.4% as at the end of the period) and decreased to 1.4% in 2016. This fits into the general understanding of the process and indicates to improvement of the comparison base as well as to the weakening of the multiplication effect from the oil production boom of 2000-2007.

At the same time, the factor productivity dynamics remains positive, i.e. the country's economy is still capable of reinforcing returns on basic production resources (labor and capital).

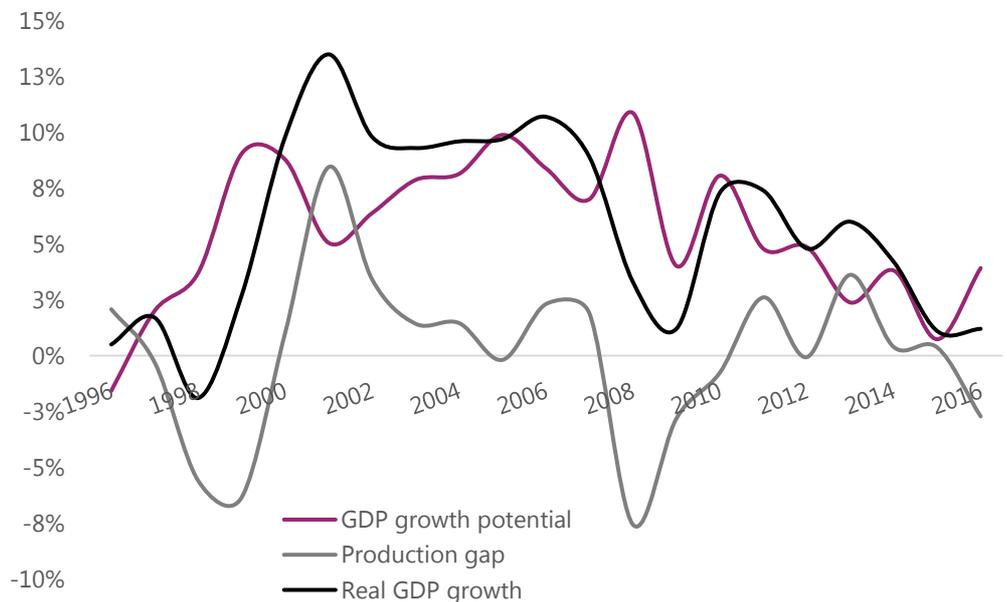
Figure 7. Kazakhstan's factor productivity remains positive



Source: Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan, ACRA estimates

The potential growth of Kazakhstan's economy largely matches the actual growth. The gap between the above two indicators was virtually non-existent after 2014, and the figures stay around zero on average.

Figure 8. Kazakhstan's economy growth potential was materialized almost completely



Source: Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan, ACRA estimates

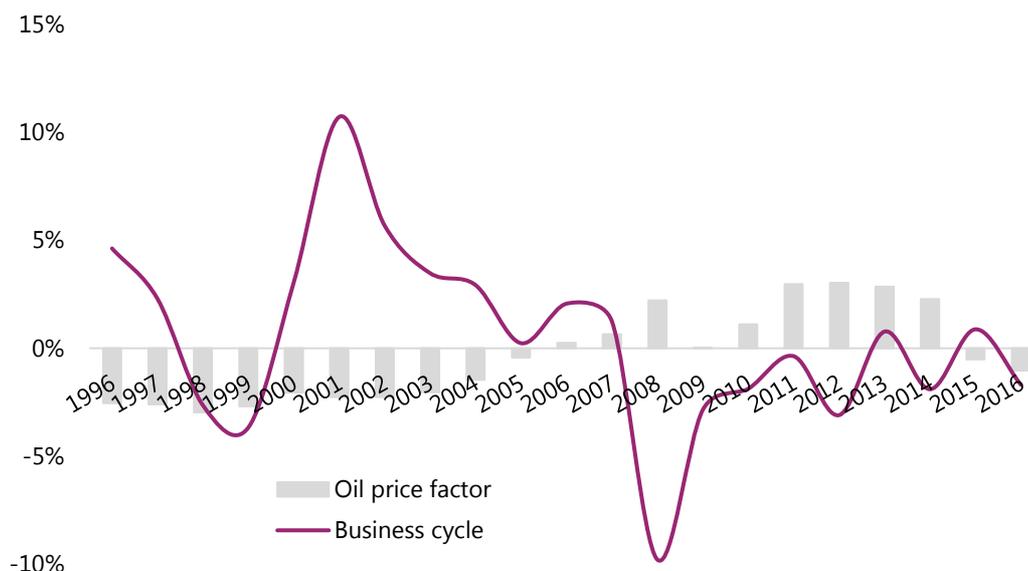
The business cycle in the Kazakhstan's economy is two years

Micro cycles of business activity in Kazakhstan have been following a wave-like development path since 2011. In addition, micro cycles are short: two years from peak to peak (as opposed to three to four years in the economic theory). According to ACRA's forecast, the positive business cycle dynamics seen in 2017 would turn negative in 2018.

Please see ACRA research titled [Kazakhstan's financial system is becoming more stable but imbalances remain](#), published on December 20, 2017

The overall trend of business activity cycles is positive: local minimums⁵ are less negative from cycle to cycle, while peaks are more positive. Understanding the role of micro cycles in generating GDP of Kazakhstan becomes a new tool using which sustained crisis conditions may be identified. For instance, the weak economic dynamics of 2015 resulted from two factors: the business cycle and the oil market environment, with both of them being of mutually compensating nature; the 2016 economic performance was the result of a negative cycle stage and business environment effects.

Figure 9. Business cycles in Kazakh economy



Source: Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan, ACRA estimates

Rather than oil prices, the economic growth potential helped overcome stagnation in Kazakhstan

Kazakhstan's economy that was close to stagnation just a year ago demonstrated a strong rebound in 2016. It was fostered by the structural GDP growth rate⁶ (resulting from utilization of fixed capital and labor resources accumulated in the previous periods). For the most part, the structural growth was the key driver of economic development in Kazakhstan over the entire period of new economic history (with 2013 and 2015 constituting exceptions), which empirically disproves the common notion of oil prices being the crucial factor.

The final growth rate in real terms in 2016 was the combination of a positive contributions by the structural growth (including employment, productive capital and productivity) and by the public sector, and adverse effects from the business cycle and crude oil prices.

ACRA expects the 2017 data to demonstrate a slight decline of the structural growth share. The external environment would rise in importance, which is attributable to higher crude oil prices (40% above the average level).

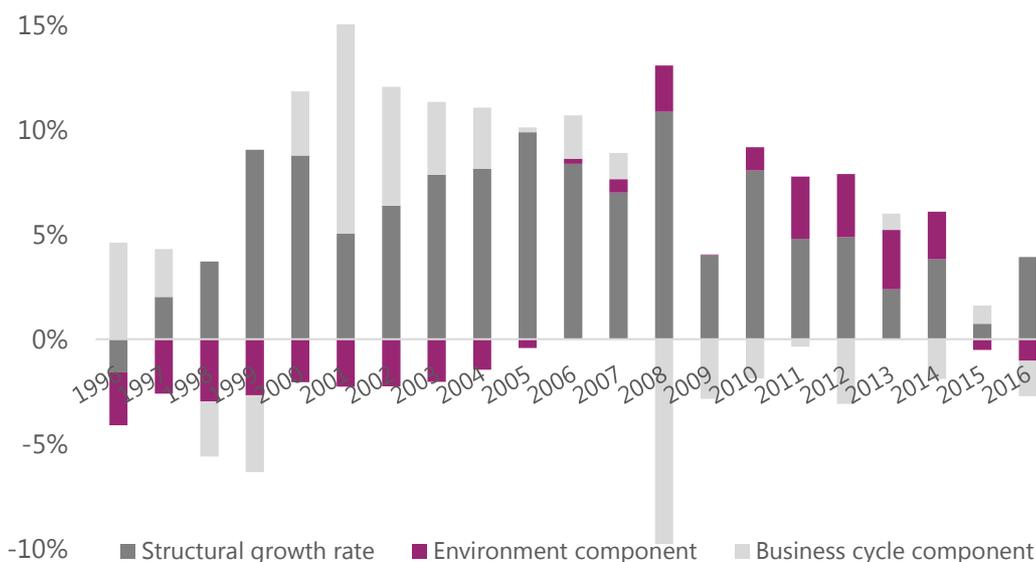
⁵ A local minimum is the lowest point in the time series within a single cycle.

⁶ Structural growth does not factor in the commodity prices which constitute a separate component in the GDP growth but includes commodity production increase (the latter is regarded as utilization of capital expenditures of the previous periods).

In 2018-2019, the business cycle of the economy will be the only near-neutral factor. As the actual GDP growth rate exceeds the potential rate the risk of overheating in the economy emerges, which might accelerate inflation.

In February 2018, the CPI on a year-on-year basis (6.5%) was within the target range set by the macro-regulator for 2018 (5%-7%). However, the inflationary developments supported by a potential overheat in the economy may represent a risk for meeting the inflation target and require additional measures from the regulator to cut excess liquidity.

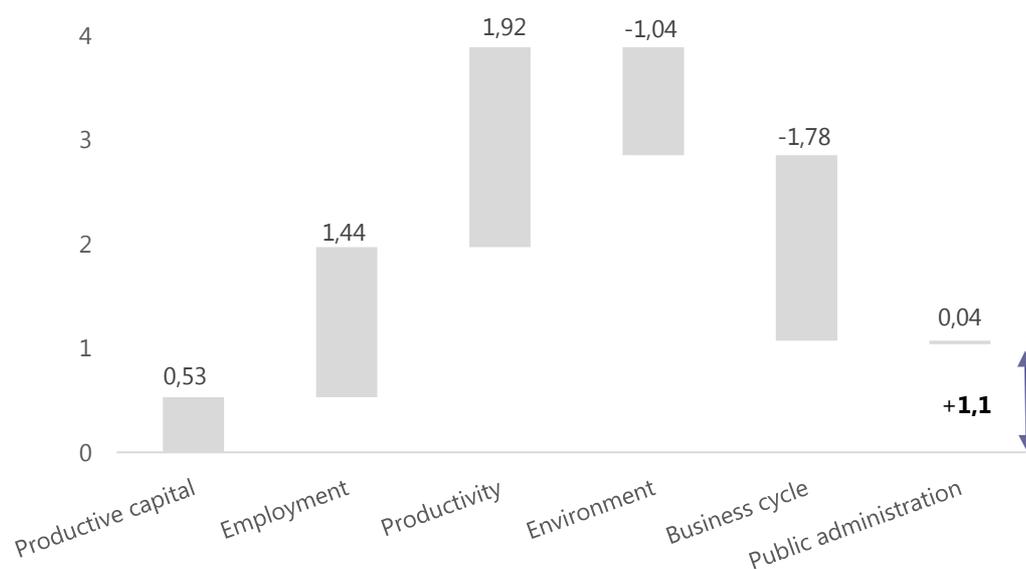
Figure 10. Structural GDP growth rate⁷ in Kazakhstan is the key driver of the country's economic growth



Source: Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan, National Bank of the Republic of Kazakhstan, ACRA estimates

Please see ACRA comment titled [Higher share of short-term borrowings has not increased financial instability in Kazakhstan](#), published on March 19, 2018.

Figure 11. Kazakhstan's GDP profile in 2016 by growth drivers



Source: Committee on Statistics of the Ministry of National Economy of the Republic of Kazakhstan, National Bank of the Republic of Kazakhstan, ACRA estimates

⁷ Structural growth rate of the economy is a growth rate at which the economy reaches its potential growth rate.

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