

December 25, 2020

## Dependence of the replenishment of Kazakhstan's state budget on transfers from the NFRK has peaked

# Despite the record transfer in 2020, the NFRK continues to be a reliable buffer for the budget of Kazakhstan and has a positive effect on the country's rating

## Kazakhstan's budget policy

The main thing that is different about 2020 in terms of budget policy is the fact that the transfer from the National Fund of the Republic of Kazakhstan (NFRK) to the state budget of the Republic of Kazakhstan will hit an all-time high in absolute terms. However, despite the substantial inflow of money from the fund to the budget of the country this year, the share of transferred NFRK assets will not exceed the averages of the past decade.

In 2020, the NFRK's share in the state budget revenue will amount to a record 42% (Fig. 1). This is due to budget expenditures exceeding the target at the start of 2020 in order to soften the economic impact of the quarantine measures imposed to fight against COVID-19 and the shortfall in budget revenue resulting from the expected decline in Kazakhstan's GDP in 2020. It is noteworthy that over the past 12 years, the second largest transfer from the NFRK was made in 2017 when budget expenditures spiked due to considerable expenses on recapitalizing the Kazakh banking system.

Figure 1. Transfers from the NFRK, % of state budget



Sources: Ministry of Finance of the Republic of Kazakhstan, ACRA's calculations and forecast

The fund performs a stabilizing function via an annual transfer to the country's budget. The stabilizing function of the NFRK is to reduce the impact of unfavorable external factors on the national economy and consolidated budget.

For example, in 2017, amid growth in Kazakhstan's GDP and a favorable foreign economic environment, the NFRK was required to perform a stabilizing function in order to support the banking sector. This support was provided using a targeted transfer (the decision on the allocation of which is made when necessary) in addition to the guaranteed part of the transfer, which is determined three years in advance.

Over the past ten years, the average total annual transfer has amounted to about 18% of the fund's assets (Fig. 2). It is interesting that despite the unprecedentedly

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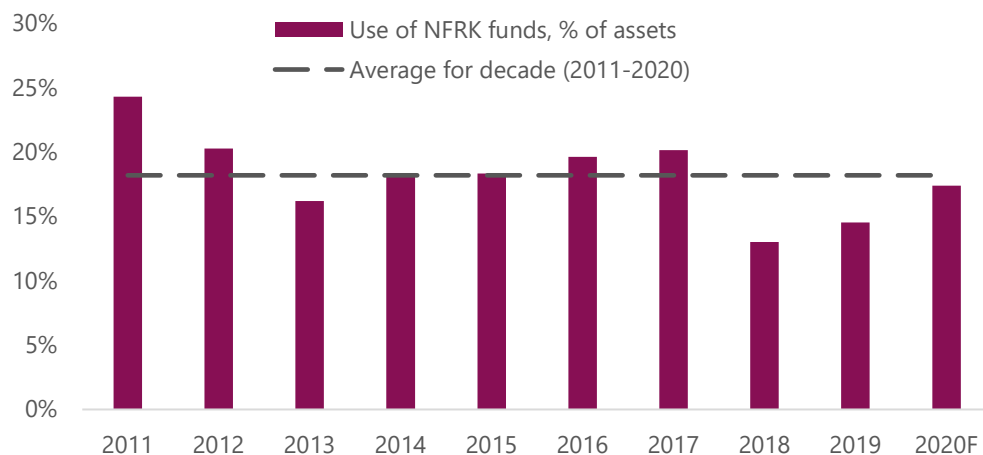
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high size of the transfer in relation to the budget revenues of Kazakhstan in 2020, it is not a record if measured as a percentage of the assets of the NFRK. Fig. 2 shows that the share of the fund's assets spent this year does not exceed the average payment to the budget made over the past ten years.

**Figure 2. Use of NFRK funds, % of assets**

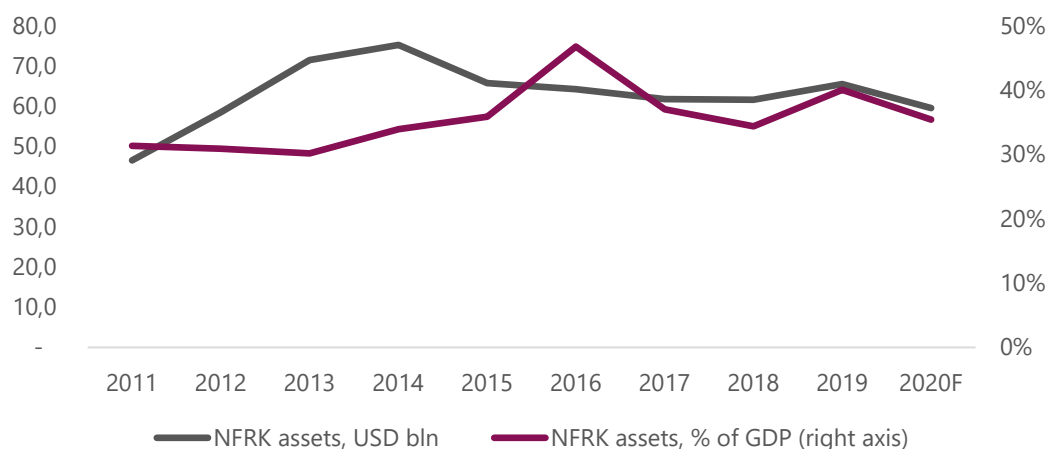


Sources: Ministry of Finance of the Republic of Kazakhstan, ACRA's calculations and forecast

This is because transfers from the fund to the budget are performed in tenge, the exchange rate of which is sensitive to oil prices dynamics. As the tenge depreciates due to falling oil prices and a flexible exchange rate, the country's budget sees an increase in the tenge denominated transfer from the fund. Importantly, transfers expressed in tenge may even increase amid a slight decrease in their currency equivalents.

As for NFRK assets, despite a minor decline in their US dollar value in the period from 2014 to 2019, their value in tenge increased, and the size of the fund's assets ranged from 36% to 47% of Kazakhstan's GDP. Taking into account the transfer from the NFRK to the state budget, ACRA estimates that the fund's assets will amount to around 35% of GDP as of the end of 2020, compared to about 40% of GDP at the end of 2019 (Fig. 3).

**Figure 3. NFRK assets to Kazakhstan's GDP, %**

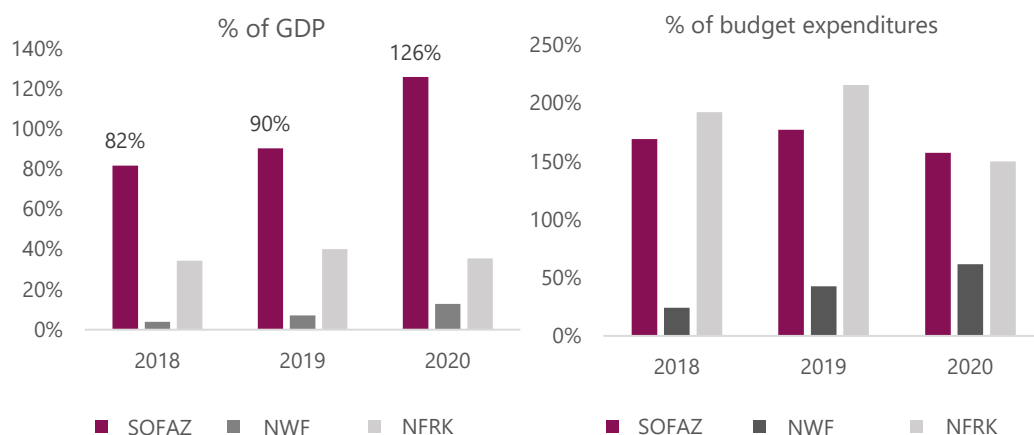


Sources: Ministry of Finance of the Republic of Kazakhstan, ACRA's calculation and forecast

When compared with other CIS countries exporting hydrocarbons (only three out of six countries have established sovereign funds, which accumulate surplus

revenues from commodity exports) Kazakhstan is second after Azerbaijan and ahead of Russia in terms of the size of its sovereign wealth fund in relation to the size of the economy (*Fig. 4*). In 2020<sup>1</sup>, the assets of Russia's National Wealth Fund (NWF) accounted for about 62% of the country's annual budget expenditures<sup>2</sup>, while the assets of Kazakhstan's NFRK were at 150%, and the assets of the State Oil Fund of the Republic of Azerbaijan (SOFAZ) were as high as 157%.

**Figure 4. Sovereign wealth funds of Kazakhstan, Russia and Azerbaijan**



Sources: Ministry of Finance of the Republic of Azerbaijan, SOFAZ, Ministry of Finance of the Republic of Kazakhstan, Ministry of Finance of the Russian Federation<sup>3</sup>

However, it should be noted that the sources of income (and expenses) of the three sovereign funds differ. For example, Kazakhstan's NFRK is replenished from direct taxes paid by oil and gas companies, including corporate tax, excess profit tax, rental tax on exports, production sharing, bonuses, additional charges from subsoil users (except for taxes paid to local budgets), as well as other receipts from operations (fines, non-tax payments from entities in the oil and gas sector), revenues from privatization, sale of land plots, investment income and return of transfers to the budget. All oil revenues go to the NFRK first, and then they can be transferred to the country's budget. This replenishing procedure ensures that the fund receives income even in an unfavorable oil market situation, like that seen in 2020 (*Fig. 5*).

The income sources for Azerbaijan's SOFAZ include proceeds from the sale of hydrocarbons, auction fees for the use of contract areas of hydrocarbon resources, revenues from transporting oil and gas across the country, revenues from fund asset management, and bonuses from investors. The fund replenishing procedure in Azerbaijan is similar to that in Kazakhstan. The fund is used for supporting the country's budget via transfers, constructing and reconstructing infrastructure, maintaining strategically important facilities, and covering urgent national economic needs.

In Russia, the NWF's revenues are made of a certain portion of proceeds from annual mineral extraction tax and energy resource export duties. The amount of federal budget transfers to the fund depends on the actual and base oil price (or cut-off price) set in 2017 at USD 40/bbl for Urals oil and annually increased by 2%

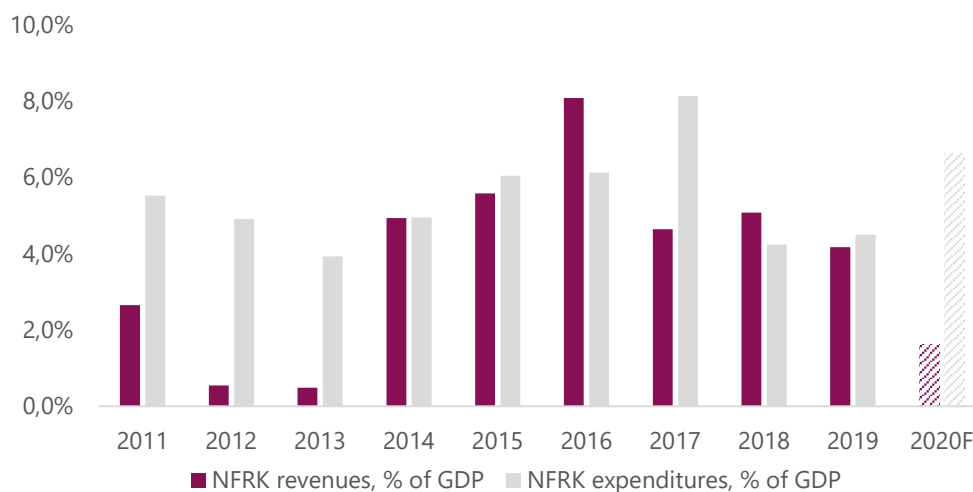
<sup>1</sup> The latest available country data for 2020 (see footnote below).

<sup>2</sup> The calculations take into account the federal budget of Russia, the state budget of Kazakhstan, and the central government budget of Azerbaijan.

<sup>3</sup> The calculations for 2020 are based on the budget forecasts by the corresponding governments, sovereign fund assets are estimated as follows: NWF — as of November 30, 2020; SOFAZ— as of September 30, 2020; NFRK— ACRA's estimates as of the end of 2020.

(in 2020, the cutoff price was USD 42.4/bbl). The fund's main item of expenditure is to compensate for the shortfall in oil and gas revenues to the federal budget when oil prices fall below the cut-off price.

**Figure 5. NFRK proceeds over the past ten years**



Source: Ministry of Finance of the Republic of Kazakhstan, ACRA's calculations and forecast

Over the past ten years, NFRK expenditures exceeded revenues by an average of about 1.7% of GDP<sup>4</sup>. Revenues were highly volatile, mainly due to the cyclical nature of the economy and, accordingly, tax revenues from the oil and gas sector, and, to a lesser extent, due to the volatility of investment income. If the current spending rate of NFRK funds remains unchanged, then, by 2022, the size of the fund will be 26%–27% of GDP (compared to 35% at the end of 2020), which is a reliable buffer for the economy of Kazakhstan. The risk for this scenario is a slow recovery in oil prices and the average oil price in 2021–2022 lower than the past 10-year average.

<sup>4</sup> The difference between median revenues and median expenditures for the past 10 years is 0.8% of GDP.

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