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Kazakhstan:

“The recent dramatic contraction of the world economy has been a sharp reminder of how interrelated are the economies, nations and peoples of the world.” Robert MT Jutson, Managing Director of Griffin Capital.



ROBERT MT JUTSON
Managing Director of Griffin Capital

Mr. Jutson founded Griffin Capital in 1985 to acquire corporate real estate and arrange finance for strategic assets and for early- and growth-stage enterprises.

Russian and CIS clients include the Tbilisi Marriott Hotel, MTV Ukraine, KazakhstanEnergO, Moscow CableCom Corp., Sakhalin Telecom (Golden Telecom) and NTV Plus.

Mr. Jutson served as a Director of Dal Telecom International (1999-2002), the largest GSM operator in Far Eastern Russia (Vimpelcom). He was previously a limited partner of Fieldstone Private Capital Group, L.P., a spinoff of Bankers Trust Company, a Vice President of Eastdil Realty, Inc. and Vice President of Gerald D. Hines Interests. Mr. Jutson graduated Rice University's School of Architecture and attended the Columbia University Graduate School of Business Administration.

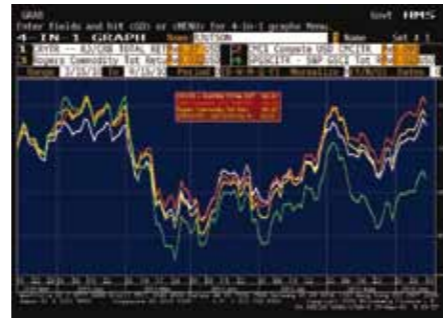
Mr. Jutson has appeared on CNN International regarding current events in Russia and presented to and chaired numerous finance conferences. rmj@griffincap.ch

OVERVIEW

The upcoming summit of the Organization for Security and Cooperation in Europe is the perfect time for Kazakhstan to promote regional collaboration and the benefits of economic interdependence. This moment was all but unimaginable in 1994 when we first served as advisor to KazakhstanEnergO, then the state electric power generating company.

Today, in a world clouded by anxiety and economic uncertainty, where even expert opinions of the future lack conviction, Kazakhstan occupies a unique position as a resource-rich land bridge straddling the markets of Asia and Europe. Its enterprises will benefit as an increasing share of mergers and acquisition deals this year will be in large emerging markets and involve natural resources. Under Kazakhstan's chairmanship, the OSCE summit is expected to emphasize regional economic development and gradual political liberalization while forging new approaches to contemporary security threats. Kazakhstan can expect an attentive audience as it speaks with authority on all these issues.

These broad themes will benefit all OSCE members. But the nature of the macroeconomic risks facing investors in Kazakh enterprises remains worthy of close examination due to the dependence of the nation's economy on global commodity price movements as shown below:



Bloomberg L.P. tracks daily changes in these commodity futures indexes:

- RJ/CRB Commodity Total Return
- CMCI Composite USD Total Return
- Rogers International Total Return
- S&P GSCI Total Return

(Charts show 12-months ending 15 Sep 2010)

AN UNUSUALLY UNCERTAIN WORLD

In spite of what US Federal Reserve Chairman Ben Bernanke called an “unusually uncertain” global economic outlook, some resourceful investment managers have had, until recently, the courage of their convictions. However, extraordinary correlations and pricing anomalies caused by fiscal stimulus and expansive monetary policies have prompted widespread anxiety. A notable example is Stanley Druckenmiller. Since he helped George Soros “break the pound”, Druckenmiller has been ranked among the world's most successful macro hedge fund managers who specifically seek to profit from bets on long-term economic trends and risk assessment.

Druckenmiller's retirement this August, after 30 years running Duquesne Capital Management, and disappointment with his performance during this year's market volatility, signal for many the end of an era. His lack of conviction now pervades the markets as foresight is thin on the ground.

Erratic growth, harsh credit conditions, pronounced market volatility and

Eurasia's land bridge

conflicting views of policymakers and economists about whether leading economies are facing deflation, inflation or even seventies-style “stagflation” make it extremely difficult even for seasoned investors to find a clear way forward. Such conditions create a unique set of opportunities for investment managers willing to make bets on particular emerging markets such as Kazakhstan. One should however heed their cautionary tone, as more macro fund managers make long bets on Asian currencies, emerging market rates and bonds. They can close these bets overnight.

FLAT EXPECTATIONS

A lack of consensus expectations over such basic economic variables as growth and inflation make it unusually difficult for the world's policymakers and businesses to assess risk.

The utility of any economic model is its predictive ability. On this measure alone, conventional models have failed us all, from central bankers to hedge fund managers to homeowners.

The classic bell curve no longer describes the distribution of expected outcomes. Rather, there is a spreading of risk away from the mean and toward the tail ends of the bell curve. While the mean still exists technically, it is widely dispersed – in a word, it's “flatter”.

In this macroeconomic environment, the chance of a policy mistake is significantly increased, with adverse consequences which can continue for a generation. As an example, it's difficult to imagine a well-intentioned policy gone off the rails with worse effect than American policies to promote homeownership as a national birthright. This well-intentioned policy profoundly aggravated the breadth and depth of the current global financial downturn.

Mortgages make good citizens, so

America affords unique tax breaks to homeowners worth \$230 billion per year according to The Financial Times. Most famously, America's quasi-public housing agencies provide de facto “AAA” guarantees for buyers of securitized home mortgages from Beijing to Berlin. American policymakers and millions of aspiring homeowners, lulled by the availability of ever cheaper credit over 30 years of declining interest rates, together sustained the credit binge of 2003-2007 – and the illusion of a consumer Nirvana. False confidence in risk-free refinancing, and the unprecedented consumer demand it stimulated, ultimately betrayed a generation who believed the collateral value of their homes was immune from the laws of gravity.

The use of unusual monetary measures during the crisis, such as printing money (also known as “quantitative easing”) to buy the “AAA” paper of Fannie Mae and Freddie Mac has further obscured the future. As we creep forward, the credibility of unorthodox monetary policies will ultimately depend on the perceived independence of central banks.

Unfortunately, investor anxiety about this credibility is becoming palpable as central banks consider moves to return balance sheets to pre-paper mill levels. Central bank credibility has been severely undermined in the US dollar and Euro zones. This is because of the widespread perception that the US and European central banks are under the direction of finance ministers who've successfully urged the dramatic enlargement of central bank balance sheets.

As for the private enterprise sector, little comfort can be taken from the exceptional cash levels of America's nonfinancial firms – the greatest share of assets since the 1960s. Until fiscal policy is clarified, every finance director knows

there are unquantified and growing tax, insurance and pension liabilities facing their company.

Compounding this uncertainty is the fact that unforeseen regulatory changes have a particularly adverse impact on the ability to plan capital expenditures. This is of acute importance for companies and countries planning large multi-year infrastructure projects to support and sustain growth. According to Richard W. Fisher, a member of the US Federal Reserve Open Market Committee, business leaders “... are increasingly distressed by the lack of consistent direction coming from Washington ... so they are calling time-outs and heading for the sidelines while they wait for the referees to settle the rules of the game.”

The arbitrary and capricious imposition of tolls, tariffs and taxes on such projects represents a significant risk today. Fiscal constraints, perpetual election campaigns and subdued growth are forcing governments to consider such “temporary” assessments. In the current American election year, politicians playing to the crowd proposed retroactive application of increased liability limits on oil companies such as BP operating in America's offshore regions.

Likewise in Europe, politicians retroactively reduced renewable energy subsidies in Germany and Spain. This uncertainty resulted in postponement of many alternative energy projects and 25% decline in the value of Vestas, the world's largest wind power producer.

This policy reversal is remarkably short-sighted. Germany's feed-in tariff regime produced some of the world's leading alternative energy developers and significant export earnings for Siemens, juwi Holding and others. It should be noted that last year, Sinoval of China became the world's third largest wind turbine producer behind Vestas and GE. China's Goldwind and Dongfang also »

entered the ranks of the top 10. Perhaps wind projects from Texas to the North Sea will soon be "Made in China". Kazakhstan needs to take great care to learn from the regulatory missteps outlined above. Kazakhstan is a seasoned and sophisticated player when it comes to treating with international groups. It has cooperated for years with the world's leading energy companies to develop the Tengiz and Kashagan fields and build pipelines for export of production. Its ability to play hardball with fund investors who backed institutions such as Bank BTA has served it well. With a clear eye to its own long-term interests, we're confident that Kazakhstan's leadership will play a strong hand in the rounds ahead.

KAZAKHSTAN: EURASIA'S LAND BRIDGE

In this uncertain world, Kazakhstan is a desirable and increasingly attractive destination for foreign direct investment. Kazakhstan has long recognized its natural strength as a fulcrum for Eurasian cooperation, trade and collaboration. For instance, it supports Russia and the United States to prevent conflict in the one country where these superpowers have military bases - Kyrgyzstan.

In his recent book, Michael Meyer described 1989 as "The Year That Changed the World". In the 20 years which elapsed since the fall of the Berlin wall, Kazakhstan's leadership has set a stable course through uncharted waters. This is true in economic and geopolitical terms, most significantly with its historic program of denuclearization.

As keenly observed by Kazakhstan's Ambassador to the United States, HE Erlan Idrissov, Kazakhstan's consistent pursuit of a multi-vector foreign policy has for decades served it well. So too has its geographic position as a land bridge linking trade and commerce between Asia and Europe.

This land bridge is powerfully manifest in Kazakhstan's network of oil and gas pipelines. Samruk-Kazyna's KazMunaiGas owns 5,071km of oil pipelines and 12,577km of natural gas pipelines. The gas pipeline includes the Central Asia Centre pipeline (transporting gas from Central Asia through Russia to Europe), and a 50% participation in

the Asia Gas Pipeline project designed to connect Turkmenistan and China. As a result, after enduring three years of worldwide economic and financial challenges, Kazakhstan's economy posted 8% growth during its first half of 2010, and can expect growth of 4% overall this year.

Foreign trade totaled \$42.5 billion in the first six months of the year, of which exports totaled \$29.6 billion.

Kazakhstan's main export markets are China, Italy, France and Russia, with imports coming mainly from Russia, China, Germany and Ukraine.

Crude oil, gas and minerals exports were the main exports, accounting for 76.8% of total exports. Significantly, KazMunaiGas exported precisely 77% of the 9 million tons of crude oil it produced in 2009.

In recent years China has been a reliable engine of global growth. Its economy is now the world's second-largest after the US and ahead of Japan. Although the Chinese economy is but one-tenth the size of the U.S. and Europe, its domestic demand, particularly household consumption, is helping to reinforce growth throughout Asia. Investors and executives from Almaty to Sao Paulo and from Tokyo to New York are closely watching regional indicators of demand, not only from China's economy but from countries such as South Korea where more than 40% of exports of electronic goods, machine tools and cars go to Brazil, Russia, India and China.

In the past six to 12 months, imports in almost all Asian economies outstripped exports. Much intraregional trade is of components that find their way into finished goods for Western consumers, but an increasing portion of Asian production serves domestic consumption.

While collaboration is essential to successful trade policies, Kazakhstan naturally pursues the interests of its people. In keeping with this priority, Kazakhstan will not join Russia's recent ban on wheat exports, thereby reaping benefits from dramatically increased global wheat prices in the wake of Russia's devastating fires.

GUARANTOR OF STABILITY AND THE FUTURE

Through the dramatic changes of the

past several decades, Kazakhstan's President Nursultan Nazarbayev is widely perceived within the country as the guarantor of national stability, particularly following recent political and ethnic strife in neighboring Kyrgyzstan. "The main thing [for the public] is that the ruling power in the country should be very strong, one which will provide people with order, calm, peace, and an absence of the upheavals we are observing in the neighboring country," Gulmira Ileuova, head of the Strategy Center of Social and Political Studies, told a news conference in Almaty on 16 August. "So the main thing is that they see the assurance of this calm in the institution of the presidency ... President Nazarbayev is [perceived as] a guarantee of that stability."

Not content to bask in the spotlight of its OSCE chairmanship, Kazakhstan began classes at Nazarbayev University. Its ambitious aim is to provide a world-class education to 20,000 students annually, ending the "Bolashak" (Future) program of sending the country's best and brightest to study abroad.

English will be the sole language of instruction at Nazarbayev University, and initially all of its professors come from abroad. To be admitted to the first class of approximately 500, students must achieve minimum scores on English language tests and pass the same Subject Entrance Tests as applicants to University College, London.

As we predicted in these pages last year, "Within the next decade young men and women [of Kazakhstan] will assume leadership roles throughout the region". There is no better way to ensure the future of Kazakhstan, or any other country for that matter, than an investment in education its people.

Griffin Capital Corp. and affiliates have advised on financings for TOO Telekrona, KazakhstanEnergo, Dal Telecom International (Khabarovsk), Sakhalin Telecom (Cable & Wireless), MoscowCableCom, NTVPlus, MTV Ukraine, the Tbilisi Marriott Hotel and the Renaissance Grand Hotel in Tianjin TEDA, China. We are currently advising on a mining project in Russia, acquiring wind and solar power generators and developing remote sensing technology for critical infrastructure protection and asset management. www.griffincap.com or contact us at: partners@griffincap.ch



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