June 2006
IMF Country Report No. 06/244

Republic of Kazakhstan: 2006 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2006 Article IV consultation with the Republic of Kazakhstan, the following documents have been released and are included in this package:

- the staff report for the 2006 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 11, 2006, with the officials of the Republic of Kazakhstan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on May 17, 2006. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its June 14, 2006 discussion of the staff report that concluded the Article IV consultation.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

Copies of this report are available to the public from

International Monetary Fund • Publication Services
700 19th Street, N.W. • Washington, D.C. 20431
Telephone: (202) 623-7430 • Telefax: (202) 623-7201
E-mail: publications@imf.org • Internet: http://www.imf.org

Price: $15.00 a copy

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

Staff Report for the 2006 Article IV Consultation

Prepared by the Staff Representatives for the
2006 Consultation with the Republic of Kazakhstan

Approved by David Owen and Scott Brown

May 17, 2006

- Article IV consultation discussions were held in Astana and Almaty during March 30–April 11, 2006. The mission met with Deputy Prime Minister Massimov, National Bank of Kazakhstan Governor Saidenov, Minister of Economy and Budget Planning Kelimbetov, Minister of Finance Korzhova, Financial Supervision Agency Chairman Dunayev, other government officials, parliamentarians, and the private sector. The staff team comprised Messrs. Husain (head), Davoodi, Henne, Sumlinski, and Ms. Ter-Martirosyan (all MCD), and Mr. Gasha (MFD). Mr. Saudabaev (OED) joined the discussions.
- Kazakhstan accepted the obligations of Article VIII, Sections 2, 3, and 4 in 1996 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The exchange rate regime is a managed float with limited de facto flexibility against the dollar, although flexibility has increased in recent months. The authorities subscribe to the SDDS and the provision of data is adequate for surveillance purposes.
- In previous consultations, the Fund has praised the authorities' prudent macroeconomic policies, which have been critical in achieving rapid growth and improved social indicators. In particular, the Fund has supported the easing of the fiscal stance and the authorities' steps to address emerging risks in the banking sector. The Fund has also called for increased upward flexibility of the exchange rate and an acceleration of structural reform to enhance the investment climate. Progress in these areas has been mixed. The Public Information Notice for the 2005 Article IV consultation is available at: http://www.imf.org/external/np/sec/pn/2005/pn0587.htm.

Contents Page

EXECUTIVE SUMMARY

Economic activity remains very strong in Kazakhstan, with 2005 marking the sixth consecutive year of real GDP growth in excess of 9 percent. High oil prices and rapid growth in non-oil revenues permitted a further substantial expansion in budgetary expenditures and, at the same time, a sizable increase in the overall fiscal surplus. Activity is expected to remain buoyant in 2006, although non-oil growth will likely slow from the heady pace of 2005.

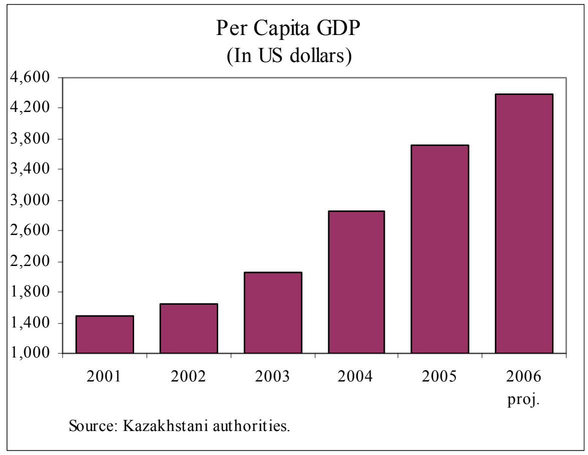
The key policy challenge relates to mounting risks in the banking sector and the marked pickup in inflation in recent months. Credit growth has risen to an annual rate of over 70 percent, financed in part by a surge in banks' external borrowing—$4.5 billion (8 percent of GDP) in the fourth quarter of 2005 alone. As a result, banks' vulnerability to a tightening of international financing conditions, which could lead to a sharp slowdown in credit expansion and deterioration in the quality of loan portfolios, has increased. Inflation, which picked up to near 9 percent in February–April, is projected to stay near or above 8 percent through mid-2007.

Monetary tightening and further prudential measures are needed. Staff recommended early action to raise policy interest rates, broaden the coverage of reserve requirements, and allow more exchange rate appreciation. Additional regulatory measures and intensified supervision will also help contain risks in the banking sector.

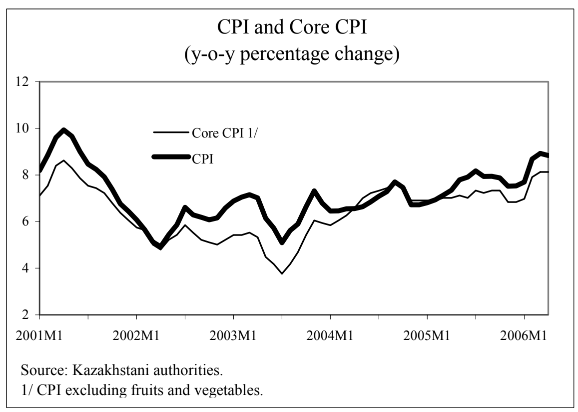
Adequate tightening on the monetary and regulatory side will facilitate the implementation of fiscal policy plans, which envisage significant spending increases and tax cuts in 2007–08. An acceleration of structural reform will help sustain economic performance over the longer term.

I. BACKGROUND

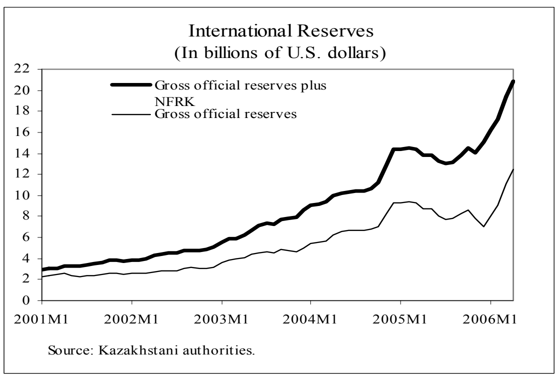
1. **Kazakhstan's economic performance over the past half decade has been impressive.** A rapid expansion in hydrocarbon production, supported by a prudent macroeconomic policy framework, has led to major gains in economic and social indicators. Real GDP has grown by 10 percent a year on average, per capita income has risen sharply, unemployment has declined steadily, inflation has moderated to single digits, and confidence in the banking system has strengthened. Public spending has also expanded rapidly, with a sizable share going to social services. At the same time, increased government revenues, especially from oil, have kept the overall fiscal position in surplus and substantial assets have been accumulated in the National Fund of the Republic of Kazakhstan (NFRK).

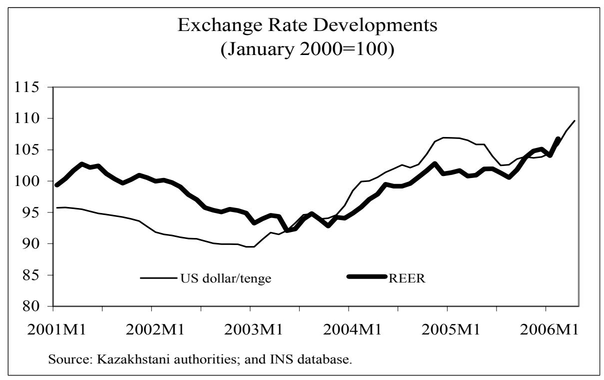


2. **Macroeconomic conditions were buoyant in 2005 and early 2006.** Real GDP grew 9.4 percent in 2005 and by an estimated 7.7 percent (year-on-year) in the first quarter of 2006. While hydrocarbon output decelerated, the income and wealth effects associated with high oil prices lifted non-oil output growth to 11 percent in 2005 (Table 1). Construction and financial services output expanded particularly rapidly (by 40 percent each in real terms). The unemployment rate declined further to 8.1 percent (8.4 percent in 2004). However, inflation picked up from 6.9 percent in 2004 to 7.6 percent in 2005 (period averages) and jumped to almost 9 percent in February–April 2006 (year-on-year) as credit growth accelerated to over 70 percent and external borrowing by banks surged. A 30 percent increase in pensions and public sector salaries (implemented in mid-2005) also contributed to inflationary pressure.



3. **The current account edged into a small deficit in 2005.** A sharp increase in oil exports (by $6 billion;10.7 percent of GDP) was more than offset by higher income remittances to foreign direct investors and a sharp increase in goods and services imports, including FDI-financed imports by the oil sector (Table 2).[1] Banks borrowed heavily from abroad but also increased their holdings of foreign assets, while amortization of FDI liabilities picked up, reflecting the stronger cash position of oil companies.[2] With net outflows increasing, official reserves declined in 2005, albeit by less than the increase in foreign asset accumulation in the NFRK, and the tenge depreciated by 3 percent against the dollar (Table 3). In early 2006, however, official reserves recovered sharply, including on account of continued rapid bank borrowing abroad, and the tenge appreciated by 10 percent against the dollar. In real effective terms, the tenge has appreciated by about 5 percent since end-2004 and 13 percent since end-2003, with little apparent consequence for the non-oil sector's competitiveness (Box 1).





II. Policy Discussions

4. **The focus of the discussions was on mounting risks in the banking system and the marked pickup in inflation in recent months.** The discussions centered around the needed steps to tighten monetary conditions, curb banks' external borrowing, and reduce banks' vulnerability to a sharp deterioration in the quality of loan portfolios. Discussions also covered the authorities' plans to use the considerable fiscal space available over the medium term, and their plans for structural reforms to diversify the economy.

---

[1] Data disaggregating imports by sector are not available. However, the authorities estimate that FDI-financed enterprises accounted for over 90 percent of the increase in services imports in 2005.

[2] The bulk of FDI in the oil sector is recorded in official data as debt. These obligations, however, do not have fixed repayment schedules or prespecified interest rates.

A. Outlook

5. **Economic activity is expected to remain strong in 2006.** Although non-oil growth will likely slow from the heady pace of 2005 and only modest expansion in oil output is anticipated, real GDP is expected to grow by about 8 percent. However, inflation is projected to stay near or above 8 percent through mid-2007, including on account of a further large civil service wage increase (30 percent on average) that is planned for January 2007. The current account is projected to register a small surplus, with continued growth in imports and income outflows to direct investors more than offset by a further increase in oil export receipts. Oil sector FDI is expected to remain large, although tighter monetary conditions domestically and abroad should curb banks' inflows later in the year.

6. **The baseline medium-term scenario is favorable.** Growth is projected to remain brisk, notwithstanding some moderation in non-oil sector growth to its estimated longer-term trend.[3] The external position should remain strong, with broad balance in the current account and continued substantial inflows of FDI, including in connection with the projected increase in oil production, as well as other capital. The main risks to the outlook relate to a decline in global oil prices and the possibility of a sudden stop in the availability of foreign financing at attractive terms to Kazakhstani banks.

7. **Debt sustainability analysis indicates that external debt—almost all of which is private—should remain manageable, even under standard stress tests.** Continued rapid economic growth and tenge appreciation in an environment of sustained high oil prices are expected to reduce external debt ratios substantially under the baseline scenario (Table 4 and Figure 1). While a sharp depreciation of the tenge and/or a very steep decline in oil prices would result in a large increase in the external debt ratio, the overall external debt position excluding intracompany obligations—the relevant measure for vulnerability analysis[4]—would remain manageable. Nevertheless, continued rapid external borrowing by banks is raising their vulnerability to a sharp tightening in the availability of external financing and a rapid deterioration in the quality of loan portfolios.

---

[3] As noted in Chapter I in *Republic of Kazakhstan—Selected Issues* (Country Report No. 05/240), various analytical techniques suggest that real non-oil sector growth of 6–8 percent can be maintained over the medium term.

[4] A large share (about 45 percent) of external debt comprises intra-company obligations (mainly in the oil sector) without a fixed repayment schedule. Public debt sustainability analysis was not undertaken in view of the very low level of public debt.

Medium-Term Macroeconomic Indicators, 2005–11

	Prel.	Projections					
	2005	2006	2007	2008	2009	2010	2011
	(Annual changes in percent)						
CPI (p.a)	7.6	8.5	7.9	7.3	7.0	6.4	6.0
Real GDP growth	9.4	8.3	7.7	7.6	7.6	6.8	8.3
Crude oil and gas condensate production	4.3	0.9	2.4	9.4	12.9	7.7	19.0
	(In percent of GDP)						
General government balance	6.0	5.6	3.3	2.6	2.6	2.7	2.3
Non-oil balance	-4.8	-4.8	-5.8	-6.1	-5.9	-5.8	-5.4
Revenues and grants	28.6	28.3	27.4	26.5	26.3	26.3	25.4
Of which: oil revenue 1/	10.8	10.4	9.1	8.7	8.5	8.5	7.7
Expenditures and net lending	22.6	22.6	24.0	23.9	23.7	23.7	23.1
Allocated to NFRK (-=increase)	-5.4	-5.8	-3.8	-3.5	-3.6	-3.7	-3.1
External current account balance	-0.9	1.1	-0.2	-0.4	0.1	-0.6	2.3
FDI, net	3.1	3.2	2.7	2.3	2.2	1.9	1.3
	(In billions of U.S. dollars)						
NBK gross reserves	7.1	12.4	13.5	14.9	16.4	16.8	20.0
NFRK	8.0	12.5	16.3	19.8	23.7	28.2	32.6
External debt (excluding intracompany debt)	22.9	30.0	33.6	37.1	40.5	44.0	47.6
of which: Public and publicly guaranteed debt	2.4	2.2	1.9	2.0	2.0	2.1	2.1
Memorandum items:							
Nominal GDP (in billions of U.S. dollars)	56.1	70.7	82.8	93.8	106.4	118.6	135.7
Oil price (in U.S. dollars per barrel)	53.4	68.0	71.0	69.5	68.3	67.0	66.0

Sources: Kazakhstani authorities; and Fund Staff estimates and projections.

1/ Includes one-off payments, such as discovery bonuses.

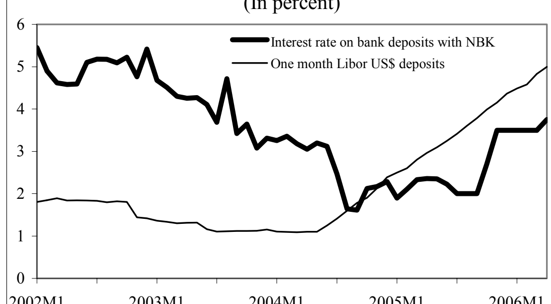
B. Monetary and Exchange Rate Policy

8. **The monetary policy stance has been accommodative.**

- **Money growth remained high in 2005**, despite a substantial contraction in net foreign assets (Table 5). In early 2006, with net foreign inflows rebounding, broad money growth accelerated to 34 percent at end-March (year-on-year).

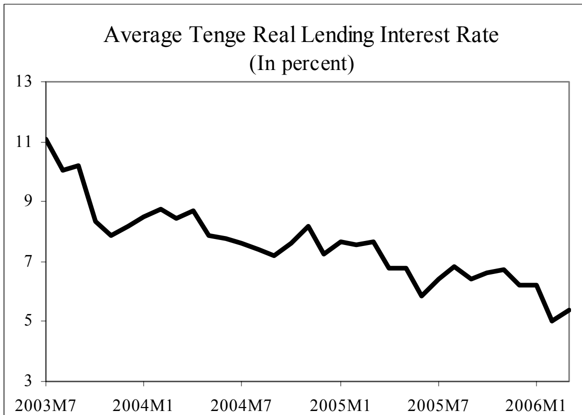
- **Policy interest rates are low.** Although the interest rate paid by the National Bank of Kazakhstan (NBK) on commercial bank deposits—the principal tool for soaking up liquidity—was raised late in 2005 and early 2006, the increase has been well short of the rise in international short-term rates.

Interest Rates
(In percent)



Sources: Kazakhstani authorities, and IFS.

- **The coverage of reserve requirements remains narrow.** To enhance its ability to manage liquidity, the NBK broadened the coverage to include net foreign liabilities from October 2005. However, liabilities of remaining maturity exceeding two months and interbank borrowing—including syndicated loans from abroad—remain outside the coverage, foreign liabilities are covered only on a net basis, and the required rate remains relatively low at 6 percent.



Sources: Kazakhstani authorities; and Fund staff estimates.

- **Banks' lending rates have declined markedly in real terms,** further fueling credit demand. The average real interest rate—measured as the nominal interest rate less actual inflation over the previous 12 months—on tenge-denominated loans was 5 percent in February 2006, compared with 7.3 percent at end-2004.

9. **The authorities agreed that a tighter monetary stance is needed to limit vulnerabilities in the banking sector and keep inflation from rising further.**

- **The NBK plans to raise its deposit interest rate further.** The authorities noted, however, that raising domestic policy rates significantly above international rates could attract even more capital inflows.

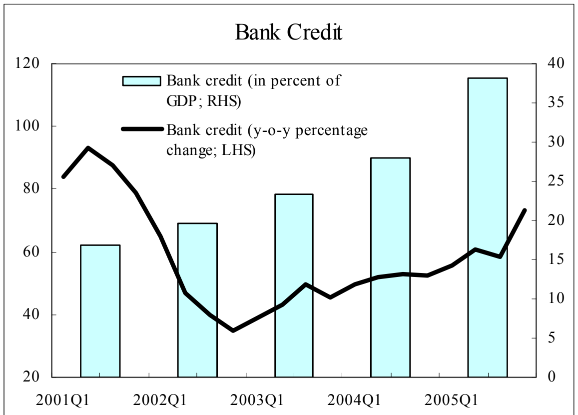
- **Broader reserve requirements are under consideration.** A working group is drawing up a menu of possible options. It is likely that all liabilities, except domestic interbank liabilities, will be covered. Changes to the requirements will be implemented in a phased manner to allow banks to adjust their balance sheets without undue disruption.

- **The NBK will scale back its exchange market intervention and allow greater tenge appreciation,** which will help to restrain inflation. An informal NBK survey indicated that non-oil exporters do not view the nominal exchange rate as a major determinant of competitiveness. Nevertheless, the authorities believe that large and rapid nominal appreciation could prove disruptive, and continued occasional intervention will likely still be needed, especially for lumpy transactions. Since mid-April, the tenge has appreciated by 5 percent against the dollar.

- **The NBK's ability to conduct monetary policy has been strengthened.** An amendment to the Budget Code enacted in mid-2005 envisages capital injections to the NBK to cover losses related to monetary operations, including interest expenses for sterilization operations and revaluation losses resulting from tenge appreciation.[5]

C. Banking Sector Policies

10. **Credit is booming, funded in part by a surge in external borrowing.**



Source: Kazakhstani authorities; and Fund staff calculations.

- **The financial deepening process is continuing, but at an unusually rapid pace.** Credit growth in Kazakhstan has been substantially higher than in other transition countries and credit-to-GDP is now broadly in line with that in several Emerging European economies (Box 2).

- **Property and consumer lending have expanded especially rapidly.** Mortgages and construction loans almost doubled in 2005, while consumer credit grew even faster. Property prices have escalated sharply in major urban areas and a large share of property purchases has reportedly been for speculative investment rather than own-use purposes.

- **Banks are funding their lending partly by external borrowing.** External liabilities of the banking sector more than doubled to $15 billion (27 percent of GDP) at end-2005, from $7.7 billion at end-2004.[6]

- **Banks' external assets also grew sharply in 2005.** The banking system's foreign assets rose to $9 billion ($4 billion at end-2004), with particularly high growth in deposits and securities. Cross-border lending—mainly to enterprises in Russia and other CIS countries—expanded 50 percent; banks also stepped up lending through their foreign subsidiaries and branches.

---

[5] The NBK incurred substantial sterilization costs and unrealized revaluation losses in 2004, experiencing a net loss of about T 60 billion (about 1 percent of GDP and 70 percent of its combined capital and reserves at end-2004). In 2005, the NBK registered net profits of T 9 billion, which were transferred to reserves. Its capital and reserves amounted to 15 percent of reserve money at end-2005.

[6] At end-2005, about one half of banks' liabilities was external.

- **Significant gaps in the maturity composition data on banks' external debt complicate risk assessment.**[7] Moreover, systematic monitoring of the banking system's debt repayment profile, with a view to identifying lumpy payments and the associated rollover risk, is not yet in place.

- **Financial soundness indicators have remained broadly stable, but partly on account of the very favorable macroeconomic environment.** The banking system's capital adequacy ratio eased slightly in 2005, but remains well above the required minimum. However, the stock of nonperforming loans (NPLs) increased by 36 percent in 2005—despite a small decline in the NPL ratio (to 9.6 percent at end-2005) due to the very rapid growth in loans—possibly indicating deficiencies in banks' credit risk management practices (Table 6). Dollarization remains relatively high; about one half of bank loans and over 40 percent of deposits are foreign-currency denominated.

11. **The authorities are concerned about banking sector risks and have taken a number of measures to mitigate them.**[8]

- **Prudential regulations have been tightened.** Banks' open foreign currency limits were reduced in early 2005 and capital adequacy requirements for market and operational risks have been introduced. The risk weight for high-value property loans has been raised and the scoring system used by banks for loan classification has been toughened. To mitigate risks related to cross-border lending, the risk weight for loans to nonresident entities—excluding loans through foreign branches and subsidiaries—has been increased from 100 percent to 150 percent for subinvestment-grade borrowers.

- **Supervision has also been strengthened.** On-site inspections have been intensified. Larger banks are inspected at least once a year; other banks are inspected at least once every two years. Occasional unscheduled special topic inspections are also conducted. In addition, off-site supervision has been strengthened and, since early 2006, banks have been required to submit additional information on their assets, contingent liabilities, and related party and holding operations. Banks are required to regularly submit stress test results—covering liquidity, credit, interest rate, exchange rate, and oil and real estate price shocks—and currency gap analysis to the FSA.

---

[7] The NBK's external debt data are compiled on an original-maturity rather than remaining-maturity basis, and obligations under which creditors may exercise early repayment options are not classified as short term. Separate data compiled by the Financial Supervision Agency (FSA) are on a remaining-maturity basis, but their coverage does not match that of the NBK. According to NBK external debt data, 38 percent of banks' foreign liabilities at end-2005 was short term.

[8] The measures are broadly in line with the 2004 FSAP update recommendations.

- **Risks associated with related-party lending are being addressed.** New legislation adopted in early 2006 introduced consolidated supervision over banking-industrial conglomerates.

12. **Further regulatory measures are also under consideration.**

- **To address risks related to external borrowing,** the authorities are considering further reducing net open position limits, introducing liquidity requirements by currency, and/or introducing limits related to bank capital on external borrowing, especially short-term obligations. A higher reserve requirement for external liabilities than domestic liabilities is also being considered.

- **To mitigate risks on the assets side of banks' balance sheets,** the authorities are considering tightening loan classification rules for property loans by streamlining the treatment of collateral and introducing stricter loan-to-value ratios. Tougher classification rules for foreign currency loans to borrowers without foreign currency earnings, as well as exposure limits for construction loans and mortgages, are also under consideration.

- **Additional regulatory tightening will be implemented at a measured pace** to avoid unnecessary transition difficulties for banks. The authorities were also cognizant of the need for beefing up supervisory resources at the FSA, where the availability of qualified personnel is already being stretched.

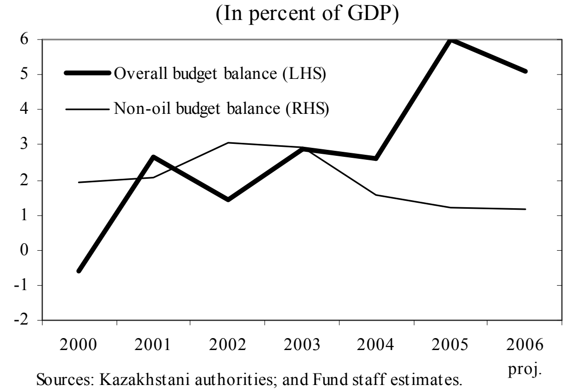
D. Fiscal Policy

13. **Strong expansion in oil and non-oil receipts in 2005 permitted continued rapid spending growth within a sharply increasing surplus position of the overall budget.**

- **The overall fiscal surplus widened to 6 percent of GDP in 2005** (Table 7). The non-oil deficit increased to 4.8 percent of GDP (from 4.4 percent in 2004), well within the sustainable level given the outlook for oil prices and Kazakhstan's oil production (Box 3).

- **Expenditures grew by over 20 percent in real terms,** with social spending and civil service salaries increasing even more rapidly.

Fiscal Developments
(In percent of GDP)



Sources: Kazakhstani authorities; and Fund staff estimates.

- **Non-oil revenues expanded at a faster pace than non-oil GDP** on account of the brisk economic conditions and improvements in tax administration, including the implementation of an electronic tracking system for the VAT.

- **Savings in the NFRK rose sharply.** With oil revenue nearly doubling—due to record high oil prices as well as one-off receipts[9]—assets of the NFRK rose by about \$3 billion to \$8 billion (14 percent of GDP). Public external debt was also paid down, with the outstanding stock falling by \$1 billion to \$2.4 billion (4 percent of GDP).

- **For 2006, budgetary plans envisage a broadly unchanged non-oil deficit in relation to GDP,** with expenditure and non-oil revenue both growing in line with nominal GDP. The overall fiscal surplus will narrow slightly to 5.6 percent of GDP.

14. **The authorities recognize that rapid spending growth warrants intensified scrutiny over spending quality and enhanced budget transparency.**

- **New rules that will fully integrate the NFRK with the budget are to be implemented from July.** Under the new rules, all oil revenue will accrue to the NFRK, which will transfer funds to the budget to cover development spending.[10] The authorities believe that the new rules—which will be incorporated in the medium-term budget framework—will help rationalize future spending growth and link the use of oil revenue to the development of the country's physical and human capital. Full implementation of the new rules will commence from 2007, with the next budget cycle.

- **Kazakhstan has joined the Extractive Industries Transparency Initiative (EITI).** A memorandum of understanding has been signed by the government, a number of resource companies, and NGOs. Audited accounts are to be published this year.

- **Legislation presently with parliament aims to improve the quality of budgetary expenditure.** Draft amendments to the budget code envisage the introduction of explicit cost-benefit analysis for proposed programs, tightening of the rules governing program selection and control over program execution, and allowing the transfer of unutilized funding to the next budget year to ensure project completion.

---

[9] One-off payments accounted for almost 20 percent (\$1.1 billion) of oil revenue in 2005, including advance royalties, bonus payments, and receipts arising from a project ownership transfer between oil companies.

[10] The coverage of expenditure under the development budget is somewhat broader than capital spending and includes a number of health and education programs that are designed to develop human capital.

15. **The authorities agreed that there is considerable room to loosen the fiscal stance without compromising sustainability.**

- **Spending will rise further through 2007,** mainly on account of the announced public sector wage increase (estimated at 1.5 percent of GDP), which will be accompanied by reform of the wage and civil service structure. Thereafter, spending will decline in relation to GDP, which should help ensure expenditure efficiency.

- **From 2007, the focus of the fiscal strategy will shift to reducing the tax burden.** The aim is to diversify the economy by enhancing the private non-oil sector's growth prospects.

16. **Significant tax cuts have already been announced.**[11]

- **The VAT rate will be reduced by 1 percentage point to 14 percent from 2007.** The authorities plan to gradually reduce the rate further, possibly to 12 percent by 2010.

- **A flat 10 percent personal income tax will be introduced, also from 2007.** This will replace the existing 5–20 percent progressive rate structure. The minimum taxable threshold will be raised.

- **From 2008, social (payroll) taxes will be reduced by 30 percent to a range of 5–13 percent.** Social taxes covering foreign and domestic employees will be harmonized.

- **New tax concessions are to be introduced** for high value-added industries and for projects in certain locations, including the Free Economic Zones.

17. **The authorities emphasized that the fiscal position is expected to remain in surplus, even under conservative assumptions on the impact of the tax cuts.**

- **Their estimates indicate that the impact on tax revenue will be about 0.5 percent of GDP in 2007 and under 2 percent of GDP in 2008.** These estimates assume no widening of the tax base, although the authorities expect a significant expansion in practice.

- **They also expect to achieve further gains in tax administration,** including by introducing information tracking systems for other taxes (as was done recently for the VAT).

[11] The authorities are receiving technical assistance from the World Bank in tax policy and administration.

E. Structural Reform and Other Issues

18. **The authorities recognize that structural reforms to enhance the investment climate are critical for sustaining the non-oil sector's growth prospects.** While acknowledging that some business climate surveys suggest mixed progress on structural reforms (Box 4), the authorities noted that a multi-pronged strategy is now in place to make Kazakhstan one of the world's 50 most competitive economies (under the World Economic Forum's rankings). They are implementing institutional, administrative, and legal reform of the business licensing and registration system, strengthening anti-monopoly and competition policies, and have launched a project to improve assessment of the investment climate with a view to promoting investment.[12] A major investment program to upgrade the country's transportation system has also been launched. WTO accession negotiations are proceeding, and significant steps to align the legal framework with WTO requirements have been taken. In addition, the "clusters" initiative is supporting the non-oil sector through labor training, infrastructure provision, and some tax concessions. Funding for development institutions has also been increased in order to enhance the non-oil sector's access to long-term financing.

19. **The authorities expressed appreciation for the Fund's technical assistance to improve the quality of statistics.** The recent STA mission's recommendations are being implemented, with the aim of improving the quality of national accounts and balance of payments data, including better disaggregation of the oil and non-oil sectors. On AML/CFT, the authorities indicated that draft legislation is being considered by parliament.

III. Staff Appraisal

20. **Economic activity remains very strong in Kazakhstan and the baseline outlook is favorable.** However, banks' vulnerability to a tightening of international financing conditions and/or a sharp slowdown in credit expansion—which would lead to a deterioration in the quality of loan portfolios—has increased and inflation has picked up markedly. To sustain strong economic performance, policies will need to be geared to mitigating risks in the banking sector and bringing inflation down.

21. **A marked tightening of the monetary policy stance is needed.** The NBK will need to move quickly to soak up liquidity to slow the pace of credit expansion and contain inflationary pressures. This can be achieved by increasing policy interest rates and by broadening the coverage of reserve requirements to include all liabilities, which should also help slow external borrowing. In addition, consideration should be given to a moderate and temporary increase in reserve requirements to aid in mopping up liquidity. It is expected that banks will pass on the higher policy interest rates and tighter reserve requirements to their customers in the form of higher lending rates. That would be a welcome development which would help curb credit demand.

---

[12] These initiatives are being supported with technical assistance from the European Union.

22. **Nominal appreciation of the tenge will also help curb inflationary pressure and stem capital inflows.** Indeed, underlying economic fundamentals and the major improvement in Kazakhstan's terms of trade on account of high oil prices suggest that significant real appreciation is inevitable over the longer term. Limiting nominal appreciation of the tenge in these circumstances will lead to higher inflation that could be difficult to reverse and ultimately prove more disruptive to the economy. The authorities' decision to allow increased tenge appreciation since mid-April is welcome.

23. **Tighter monetary conditions will affect the NBK's balance sheet, which will eventually need to be replenished from the budget.** Legislation passed in 2005 that envisages capital replenishment in response to revaluation losses and sterilization costs is a welcome step. In current circumstances, an early capital injection into the NBK would send a convincing signal to markets that monetary policy can shoulder the burden of combating inflation squarely and will not be constrained by profit and loss considerations.

24. **A number of welcome prudential regulations have been adopted over the past year to contain risks associated with banks' loan portfolios,** including on related-party lending, real estate exposures, and cross-border loans. In light of the ongoing rapid escalation of property prices and continued surge in mortgage and construction lending, a further tightening of loan-to-value ratios and the credit scoring system for loan classification may need to be considered, especially if credit growth decelerates more slowly than desired in response to tighter monetary conditions. Moreover, consideration should also be given to tightening prudential regulations on banks' foreign lending and investment activities.

25. **Early implementation of further prudential measures to contain external funding is also needed.** The staff strongly supports measures under consideration to tighten liquidity requirements for foreign liabilities, a further reduction in net open position limits, and the introduction of limits on short-term external borrowing—including longer-term borrowing with an early repayment option—related to bank capital. These could be supported by higher reserve requirements on external liabilities than domestic liabilities on a temporary basis. In addition, data on the maturity structure of banks' external obligations need to be improved and systematic monitoring of the future debt repayment profile should be developed. This will aid in assessing rollover risk for the banking system as a whole.

26. **The regulatory measures will have to be supported by vigorous supervision to ensure banks' compliance.** A further increase in the frequency and depth of on-site inspections, especially unscheduled special topic inspections, will be an important component of an intensified supervisory effort and will support recent steps to enhance off-site stress testing and monitoring of banks' liquidity models and maturity gap analysis. Enhanced supervision of banks' cross-border activities is also needed. Maintaining the FSA's independence will be critical for its credibility and effectiveness. In addition, an increase in supervisory resources at the FSA will likely be required. In view of the mounting risks, the FSA will need to stand ready to deal with any violations of prudential regulations expeditiously and, should difficulties emerge, to intervene and resolve the situation before any spillover effects develop.

27. **Adequate monetary tightening should facilitate implementation of the authorities' fiscal plans,** which aim to address social and infrastructure needs and help diversify the economy. With oil revenue projected to rise further and with non-oil revenue expected to remain strong, there is significant room to expand spending and reduce taxes—along the lines envisaged by the authorities—without compromising fiscal sustainability. Under the spending plans currently in place, government expenditure will continue to rise in relation to GDP through 2007. This underscores the importance of intensified scrutiny over expenditure efficiency, especially the project approval and ex-post evaluation mechanisms. In addition, strengthening of procurement processes is a priority. On the revenue side, the staff cautions against tax incentives that are distortive or erode the tax base, and against excessive reliance on tax cuts to effect increased tax compliance, including from the shadow economy.

28. **The authorities have taken important steps to enhance the investment climate and economic governance.** The staff welcomes the authorities' decision to join the EITI. Expeditious implementation, including the publication of audited reports, will mark an important gain in transparency. Transparency will also be enhanced by the implementation of the new mechanism governing the NFRK. The mechanism will clearly identify the scale of oil revenue and its use, and will help in the design and implementation of the medium-term budget strategy. However, the new mechanism will not automatically instill budget discipline, and the authorities' prudent fiscal approach will need to be retained. The staff also welcomes the implementation of the information system for the VAT, which has led to a marked improvement in VAT administration as evidenced by sizable revenue gains.

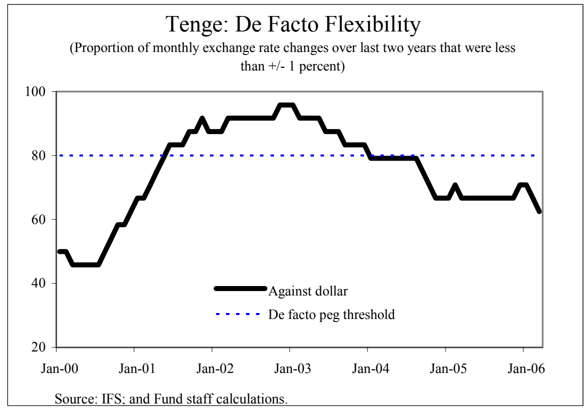
29. **An acceleration of structural reforms is needed to sustain the non-oil sector's growth prospects.** Significant gains in productivity will be required to offset the impact of the inevitable trend real exchange rate appreciation on the non-oil sector's competitiveness over the medium term. Early WTO accession, customs administration reform (supported by a World Bank Modernization Loan), and further progress in enhancing regional trade—including by streamlining procedures that raise the cost of cross-border trading—will help secure these gains. In addition, reforms to address weaknesses identified in business climate surveys—such as telecommunications infrastructure, excessive inspections and business documentation and licensing requirements, as well as anti-competitive practices—will boost growth prospects.

30. **Better disaggregation of national accounts and balance of payments data into the oil and non-oil sectors will facilitate the assessment of macroeconomic conditions.** The staff welcomes the authorities' intention to enhance data compilation. Close cooperation between the Ministry of Finance (Customs Control Committee), the NBK, the Agency on Statistics, and the Ministry of Economy and Budget Planning will be needed.

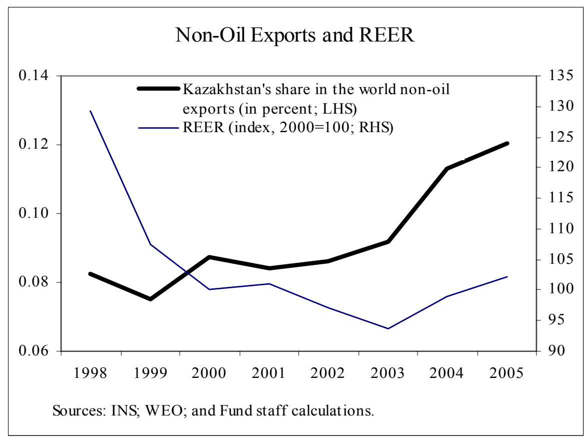
31. It is proposed that the next Article IV consultation with Kazakhstan take place on the standard 12-month cycle.

Box 1. Exchange Rate Regime and Competitiveness

The de facto flexibility of the tenge increased in 2003–04, but reversed significantly in 2005. With more than 80 percent of monthly exchange rate changes over the previous two years falling within the +/- 1 percent range, the tenge was tightly managed against the dollar until 2003. During 2003–04, monthly fluctuations increased, but the pattern reversed in late 2004 and 2005.[1] Flexibility has increased again in 2006, especially since mid April.



The real appreciation of the tenge in recent years appears not to have affected the competitiveness of non-oil exports. Kazakhstan's share in nonfuel world exports has increased steadily, although part of the recent rise is due to the buoyancy of nonfuel commodity prices. In addition, Kazakhstan's ranking as an exporter improved or stayed broadly unchanged across all product groups during 1998–2004.



That said, significant further real appreciation is likely over the medium term. Staff estimates indicate that, based on purchasing power parity comparisons, the tenge was undervalued by 66 percent against the dollar in real terms in 2000.[2] Taking account of the terms of trade improvement due to higher oil prices and relative productivity differentials—which have likely appreciated the tenge's equilibrium real exchange rate—and actual exchange rate developments since then, the real undervaluation of the tenge against the dollar in 2005 is estimated to have remained very large.

Kazakhstan's Export Rank [1/]

	1998	2001	2003	2004
Food & live animals	69	66	61	58
Beverages and tobacco	75	85	78	76
Crude mater.ex food/fuel	52	45	42	37
Mineral fuel/lubricants	31	27	23	18
Animal/veg oil	104	94	81	71
Chemicals/products	60	67	67	57
Manufactured goods	48	46	46	43
Machinery/transp equipmt	64	68	69	58
Misc manufactures	91	108	102	90
Commodities	41	55	48	44
Total Trade	61	60	53	46

[1/] Kazakhstan's global rank among exporting countries.

Source: COMTRADE.

---

[1] See Reinhart and Rogoff (2004) for details on their methodology for measuring de facto flexibility. By that measure, the tenge was de facto pegged to the dollar during 2001–03.

[2] See Chapter IV in *Republic of Kazakhstan—Selected Issues (Country Report No. 05/240)* for details on the estimates and methodology.

Box 2. Credit Growth and Financial Soundness Indicators

Kazakhstan has experienced especially rapid growth in bank credit over the past half decade, even in comparison with other Central Asia and Emerging Europe (CAEE) economies.[1] Although credit growth in the region has taken place against a backdrop of generally shallow financial markets, and credit-to-GDP ratios remain relatively low in many countries, financial deepening—as measured by the change in the credit-to-GDP ratio—appears to have proceeded more quickly in Kazakhstan than elsewhere.

Credit Growth and Financial Deepening

(In percent)

	Credit Growth Ave. 2001–05	Credit to GDP 2001	Credit to GDP 2005
Kazakhstan	56.9	16.8	38.1
Armenia	13.8	7.8	8.6
Azerbaijan	33.8	5.0	9.1
Bulgaria	41.0	14.9	45.0
Czech Republic	1.7	39.6	36.6
Georgia	34.8	7.5	14.7
Hungary	21.5	33.5	51.6
Kyrgyz Republic	26.7	3.8	7.8
Romania	42.5	7.7	11.7
Russia	43.6	16.5	26.0
Turkey	34.7	19.6	19.8
Ukraine	47.7	12.9	33.6

Sources: MFD's Financial Systems Trends, IFS, and Kazakhstanti authorities.

Under favorable macroeconomic conditions, Kazakhstan's financial soundness indicators have remained broadly stable. Bank capitalization has edged down in recent years as assets have expanded, although a similar trend has been evident in many other CAEE countries. By contrast, the slight decline in the Kazakhstan banking system's nonperforming loans ratio, in an environment of particularly rapid loan growth, has been more limited than in most other CAEE countries.

Financial Soundness Indicators

	Regulatory Capital (In percent of risk-weighted assets)					Nonperforming Loans (In percent of total loans)				
	2001	2002	2003	2004	2005	2001	2002	2003	2004	2005
Kazakhstan	18.6	17.2	16.9	15.9	15.0	...	11.9	13.1	11.9	9.6
Armenia	13.6	30.5	33.8	32.3	33.9	24.4	12.5	9.9	6.9	...
Azerbaijan	...	...	10.9	19.9	19.6	28.0	21.5	15.1	9.5	7.2
Bulgaria	31.1	25.2	22.4	16.6	15.4	13.1	8.6	7.3	7.1	6.5
Czech Republic	15.0	14.2	14.5	12.6	12.7	13.7	10.6	4.9	4.1	4.8
Georgia	33.1	21.9	20.3	18.8	16.9	11.6	7.9	7.5	6.2	3.6
Hungary	13.9	13.0	11.8	11.2	...	2.7	2.9	2.6	2.7	...
Kyrgyz Republic	52.8	36.4	35.3	23.0	...	13.4	13.3	11.2	6.4	...
Romania	28.8	25.0	20.0	18.8	19.1	...	...	8.3	8.1	8.8
Russia	20.3	19.1	19.1	17.0	17.6	6.2	5.6	5	3.8	3.7
Turkey	15.3	25.1	30.9	28.8	...	29.3	17.6	11.5	6	...
Ukraine	20.7	18.0	15.2	16.8	17.1	25.1	21.9	28.3	30	25.3

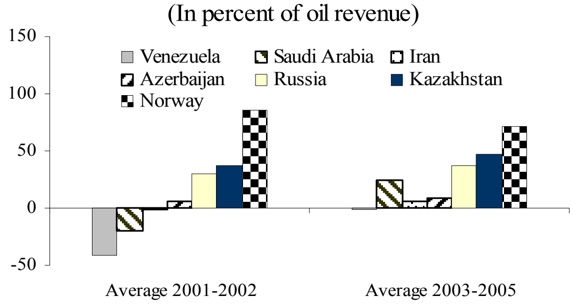
Sources: MFD's Financial Systems Trends, IFS, and Kazakhstani authorities.

[1] See Chapter III of *Republic of Kazakhstan—Selected Issues (Country Report No. 05/240)* for an analysis of bank credit growth through 2004.

Box 3. How is Oil Revenue Being Used?

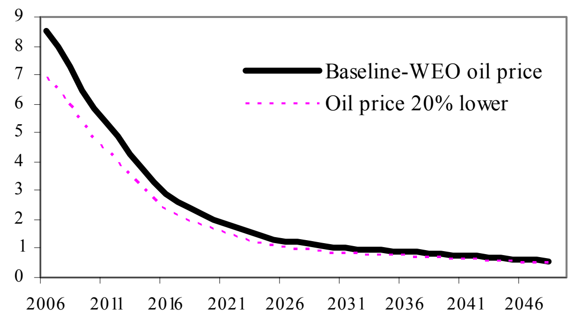
Kazakhstan's saving from its current oil revenue has been higher than in many other oil-producing countries. The ratio of the overall fiscal surplus to oil revenue—the share of oil revenue saved—was over one-half in 2005. In view of the expected substantial increase in oil production over the next decade, staff estimates indicate that a significantly wider non-oil deficit in the near term (up to 8 percent of GDP—and 6½ percent of GDP under 20 percent lower oil prices—compared with an actual non-oil deficit of under 5 percent in 2005) would still be consistent with maintaining real per capita oil wealth at the present level.[1]

Overall Balance
(In percent of oil revenue)



Sources: National authorities; and Fund staff estimates.

Sustainable Non-oil Deficit 1/
(in percent of GDP)



Source: Fund staff estimates.
1/ Non-oil deficit that would maintain oil wealth in real per capita terms.

Even the relatively conservative fiscal position has permitted a rapid increase in real public spending—by an average of almost 20 percent a year since 2003. Spending on housing and agriculture exhibited the fastest rates of growth, followed by spending on the social sector and transport and communications.

Government Spending

	2003	2004	2005 Prel.	2006 Proj.	2006 Proj.
	Annual percentage change; in real terms				Percent of total
Housing	34	93	81	36	9
Agriculture	64	46	17	12	5
Transport and Communication	60	20	10	30	8
Social expenditures	15	17	25	20	50
Education	17	21	27	23	17
Health	20	39	34	24	12
Social assistance	12	7	19	15	21
Total expenditure	24	18	23	12	100
Memo items (nominal; in percent of GDP)					
Total expenditure	22	22	23	23	...
Oil revenue	6	7	11	10	...

Sources: Kazakhstani authorities; and Fund staff estimates.

[1] See Chapter II of *Republic of Kazakhstan—Selected Issues (Country Report No. 05/240)* for details on the methodology. The underlying assumptions have been updated. The authorities expect oil production to increase from 62 million metric tons (MMT) in 2005 to 84 MMT in 2010, and 145 MMT in 2015.

Box 4. Structural Reform and Investment Climate Indicators

Recent surveys and indicators point to mixed progress in the structural and business climate areas.

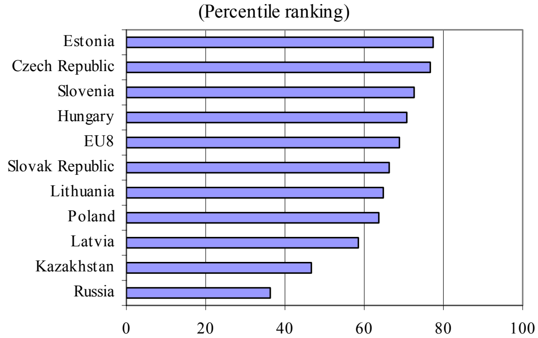
- The World Economic Forum's business competitiveness index ranks Kazakhstan 62 out of 117 countries. Kazakhstan received high marks in macroeconomic stability and effectiveness of law-making bodies, but relatively weak scores in foreign ownership restrictions, quality of public institutions, and telecommunications infrastructure.

- The World Bank-EBRD Business Environment and Enterprise Performance (BEEPS) survey suggests that problems encountered by businesses in the areas of tax administration and customs and trade regulations have declined since 2002, but difficulties in obtaining permits and licenses and the extent of anticompetitive practices have increased. Nevertheless, Kazakhstan compares favorably against the EU accession countries and Russia in most of these areas.

- The latest EBRD transition indicators continue to show limited recent progress in structural reform, especially in the areas of enterprise restructuring and competition policy.

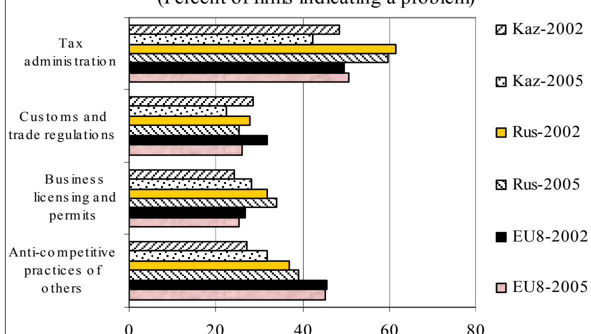
- The World Bank Doing Business in 2006 survey indicates that Kazakhstan is among the 10 countries (out of 155) with the most difficult environment for trade.

Business Competitiveness Index
(Percentile ranking)



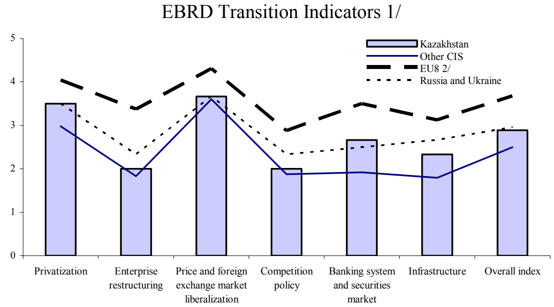
Source: Global Competitiveness Report 2005-06, World Economic Forum.

Problems in Doing Business over time
(Percent of firms indicating a problem)



Source: EBRD-World Bank BEEPS 2005.

EBRD Transition Indicators 1/



Source: Transition Report (EBRD, 2005).
1/ Higher values represent more progress.
2/ EU8 consists of Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, and Slovenia.

Cost of Trading Across Borders, 2005

	Number of documents		Number of signatures		Number of days	
	Exports	Imports	Exports	Imports	Exports	Imports
Kazakhstan	14	18	15	17	93	87
Russia	8	8	8	10	29	35
Estonia	5	5	2	5	12	14
Ukraine	6	10	9	10	34	46
EU8	7	9	5	7	17	21

Source: World Bank, Doing Business in 2006

Table 1. Kazakhstan: Selected Economic Indicators, 2002–11

				Prel.	Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
(Annual percent change; unless otherwise indicated)										
National accounts and prices										
Real GDP	9.8	9.3	9.6	9.4	8.3	7.7	7.6	7.6	6.8	8.3
Real oil	22.4	11.6	15.4	2.3	2.9	2.2	9.8	11.9	7.9	18.0
Real non-oil	7.6	8.9	8.4	11.0	9.4	8.8	7.2	6.8	6.6	6.4
Crude oil and gas condensate production	17.9	8.8	15.4	4.3	0.9	2.4	9.4	12.9	7.7	19.0
Consumer price index (eop)	6.6	6.8	6.7	7.5	8.2	7.8	7.4	6.8	6.2	6.0
Consumer price index (p.a)	5.9	6.4	6.9	7.6	8.5	7.9	7.3	7.0	6.4	6.0
Exchange rate (tenge per U.S. dollars; eop)	3.3	-8.0	-9.3	2.9	...	...	...	...	...	...
Exchange rate (tenge per Russian rubles; eop)	-2.2	0.1	-4.3	-0.4	...	...	...	...	...	...
Real effective exchange rate (p.a) 1/	-3.8	-3.6	5.8	3.1	...	...	...	...	...	...
(In percent of GDP; unless otherwise indicated)										
General government fiscal accounts										
Revenues and grants	22.5	25.4	24.6	28.6	28.3	27.4	26.5	26.3	26.3	25.4
Of which: oil revenues	4.4	6.0	7.0	10.8	10.4	9.1	8.7	8.5	8.5	7.7
Expenditures and net lending	21.0	22.5	22.0	22.6	22.6	24.0	23.9	23.7	23.7	23.1
Overall fiscal balance	1.4	2.9	2.6	6.0	5.6	3.3	2.6	2.6	2.7	2.3
Statistical discrepancy	-0.4	0.2	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-1.8	-2.7	-2.7	-6.1	-5.6	-3.3	-2.6	-2.6	-2.7	-2.3
Domestic financing, net	1.7	1.6	0.7	1.0	0.6	0.9	0.9	1.0	0.9	0.7
Foreign financing, net	-1.5	0.2	-0.8	-1.7	-0.3	-0.3	0.1	0.0	0.2	0.2
Privatization receipts	0.5	1.3	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0
National Fund of the Republic of Kazakhstan (NFRK)	-2.5	-5.5	-2.6	-5.4	-5.8	-3.8	-3.5	-3.6	-3.7	-3.1
Other capital operations	0.0	-0.2	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Non-oil fiscal balance	-3.0	-3.1	-4.4	-4.8	-4.8	-5.8	-6.1	-5.9	-5.8	-5.4
Non-oil fiscal balance (percent of non-oil GDP)	-3.6	-4.0	-6.3	-7.5	-7.5	-8.8	-8.9	-8.5	-8.2	-7.7
Expenditures (percent change)	6.3	30.5	24.4	30.7	20.5	18.5	11.3	11.7	10.5	11.3
(Annual percent change; unless otherwise indicated)										
Monetary accounts										
Reserve money	19.1	52.2	82.3	14.7	...	...	...	...	...	...
Broad money	34.1	27.0	69.8	25.2	...	...	...	...	...	...
Broad money velocity (annual average)	5.7	5.3	4.5	4.0	...	...	...	...	...	...
Credit to the economy	34.9	45.6	52.4	73.2	...	...	...	...	...	...
Credit to the economy (in percent of GDP)	19.6	23.3	27.9	38.1	...	...	...	...	...	...
Interest rate on bank deposits with NBK (p.a)	5.0	4.0	2.6	2.4	...	...	...	...	...	...
Interest rate on NBK notes (eop; percent)	5.9	5.2	4.0	2.2	...	...	...	...	...	...
(In billions of U.S. dollars; unless otherwise indicated)										
External accounts										
Current account balance (in percent of GDP)	-4.2	-0.9	1.1	-0.9	1.1	-0.2	-0.4	0.1	-0.6	2.3
Exports of goods and services	11.6	14.9	22.6	30.6	38.1	41.2	44.3	48.1	50.1	56.8
Oil and gas condensate	5.0	7.0	11.4	17.4	23.3	24.8	26.8	29.6	30.6	36.1
Imports of goods and services	11.6	13.3	18.8	25.4	30.5	34.2	37.2	39.9	42.4	45.1
Foreign direct investments (net, in percent of GDP)	8.8	7.2	12.5	3.1	3.2	2.7	2.3	2.2	1.9	1.3
NBK gross reserves (eop) 2/	3.1	5.0	9.3	7.1	12.4	13.5	14.9	16.4	16.8	20.0
In months of imports of goods and services	3.3	4.5	5.9	3.3	4.9	4.7	4.8	4.9	4.8	5.3
NFRK (eop) 3/	1.9	3.7	5.1	8.0	12.5	16.3	19.8	23.7	28.2	32.6
Public and publicly guaranteed external debt (in percent of GDP)	14.3	11.8	7.8	4.2	3.2	2.3	2.1	1.9	1.8	1.6
Total external debt (in percent of GDP)	74.2	74.3	74.0	74.0	69.4	63.9	60.3	56.5	53.5	49.0
(In percent of GDP)										
Final consumption	72.4	68.3	65.0	64.5	63.6	65.6	66.5	66.5	67.6	66.9
Net exports of goods and non-factor services	0.9	6.1	9.0	9.1	10.7	8.5	7.6	7.7	6.5	8.6
Gross capital formation = gross savings	26.7	25.6	26.3	26.4	25.6	25.9	25.9	25.8	25.9	24.5
Domestic savings	22.5	24.8	27.4	25.6	26.7	25.7	25.5	25.9	25.4	26.8
Government	5.3	8.8	8.3	11.0	10.0	7.8	7.0	7.1	6.8	6.1
Private sector	17.3	16.0	19.1	14.5	16.7	18.0	18.4	18.8	18.6	20.7
External savings	4.1	0.9	-1.1	0.9	-1.1	0.2	0.4	-0.1	0.6	-2.3
Memorandum items:										
Nominal GDP (in billions of tenge)	3,776	4,612	5,870	7,453	8,974	10,016	11,210	12,604	13,970	15,914
Nominal GDP (in millions of U.S. dollars)	24,599	30,860	43,152	56,088	70,664	82,779	93,806	106,365	118,644	135,723
Crude oil and gas condensate production										
(in millions of barrels per day) 4/	0.97	1.06	1.22	1.27	1.28	1.32	1.44	1.62	1.75	2.08
Oil price (in U.S. dollars per barrel)	24.9	28.9	37.8	53.4	68.0	71.0	69.5	68.3	67.0	66.0

Sources: Kazakhstani authorities; and Fund staff estimates and projections.

1/ A positive sign indicates a real appreciation.
2/ Excludes deposits of the National Fund.
3/ Excludes transitory domestic currency deposits.
4/ Based on a conversion factor of 7.5 barrels of oil per ton.

Table 2. Kazakhstan: Balance of Payments, 2002–11

(In millions of U.S. dollars, unless otherwise indicated)

					Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Current account	-1,024	-273	455	-486	768	-141	-415	104	-656	3,082
Trade balance	1,987	3,679	6,785	10,322	13,467	13,472	14,148	15,722	15,597	19,880
Exports (f.o.b.)	10,027	13,233	20,603	28,301	35,625	38,489	41,270	44,782	46,543	52,900
Oil and gas condensate	5,028	7,023	11,417	17,395	23,304	24,818	26,779	29,566	30,566	36,124
Non-oil exports	4,999	6,209	9,186	10,906	12,321	13,671	14,492	15,216	15,977	16,776
Imports (f.o.b.)	-8,040	-9,554	-13,818	-17,979	-22,158	-25,017	-27,122	-29,060	-30,946	-33,020
Services and income balance	-3,125	-3,787	-5,842	-10,395	-12,266	-13,158	-14,086	-15,117	-15,726	-16,245
Services, net	-1,998	-2,040	-3,027	-5,215	-5,882	-6,455	-7,034	-7,562	-7,905	-8,190
Income, net	-1,127	-1,747	-2,815	-5,180	-6,384	-6,703	-7,052	-7,555	-7,821	-8,055
Of which: Income to direct investors	-1,015	-1,448	-2,332	-4,611	-5,674	-6,060	-6,445	-7,131	-7,616	-8,002
Current transfers	114	-165	-488	-412	-433	-455	-477	-501	-526	-553
Capital and financial account	1,239	2,738	4,489	532	4,532	1,266	1,790	1,446	1,056	118
Capital transfers, net	-120	-28	-20	14	15	15	16	17	18	19
Foreign direct investment	2,164	2,213	5,392	1,721	2,281	2,235	2,167	2,300	2,203	1,825
Amortization of intracompany liabilities	-1,518	-2,266	-4,223	-4,449	-3,567	-3,634	-3,764	-3,921	-3,982	-4,483
Portfolio investment, net	-1,247	-1,891	-418	-4,044	-1,789	-3,221	-2,684	-3,044	-3,365	-2,953
Of which: National Fund	-739	-1,716	-1,189	-2,971	-4,041	-3,021	-2,447	-2,740	-3,069	-2,653
Other investment	442	2,428	-418	2,953	4,026	2,237	2,291	2,172	2,200	1,227
Medium- and long-term loans and credits, net	758	2,188	1,948	2,187	3,350	1,700	1,700	1,600	1,600	1,300
Short-term and other capital, net	-316	239	-2,366	766	676	537	591	572	600	-73
Errors and omissions	320	-932	-945	-1,991	0	0	0	0	0	0
Overall balance	535	1,534	3,999	-1,945	5,300	1,125	1,375	1,550	400	3,200
Financing	-535	-1,534	-3,999	1,945	-5,300	-1,125	-1,375	-1,550	-400	-3,200
Net international reserves of the NBK (increase -)	-535	-1,534	-3,999	1,945	-5,300	-1,125	-1,375	-1,550	-400	-3,200
Memorandum items: 1/										
Current account (in percent of annual GDP)	-4.2	-0.9	1.1	-0.9	1.1	-0.2	-0.4	0.1	-0.6	2.3
Exports in percent of GDP	40.8	42.9	47.7	50.5	50.4	46.5	44.0	42.1	39.2	39.0
Of which: Oil exports	20.4	22.8	26.5	31.0	33.0	30.0	28.5	27.8	25.8	26.6
Imports in percent of GDP	32.7	31.0	32.0	32.1	31.4	30.2	28.9	27.3	26.1	24.3
Annual growth rate (in percent)										
Exports	9.9	32.0	55.7	37.4	25.9	8.0	7.2	8.5	3.9	13.7
Non-oil exports	7.3	24.2	47.9	18.7	13.0	11.0	6.0	5.0	5.0	5.0
Imports	1.2	18.8	44.6	30.1	23.2	12.9	8.4	7.1	6.5	6.7
Exports of crude oil and gas condensate (in millions of tons)	39.3	44.3	52.4	52.4	55.1	56.2	62.0	69.7	73.4	88.0
NBK gross international reserves (in millions of U.S. dollars)	3,141	4,962	9,280	7,070	12,370	13,495	14,870	16,420	16,820	20,020
In months of imports of goods and nonfactor services	3.3	4.5	5.9	3.3	4.9	4.7	4.8	4.9	4.8	5.3
National Fund (including interest), end of period stock	1,915	3,663	5,131	8,015	12,541	16,329	19,776	23,725	28,246	32,626
External debt in percent of GDP	74.2	74.3	74.0	74.0	69.4	63.9	60.3	56.5	53.5	49.0
excluding intra-company loans	30.7	35.5	35.5	40.9	42.5	40.6	39.6	38.1	37.1	35.0
Public external debt service in percent of exports of gnfs	7.9	3.2	3.3	4.1	1.2	1.3	0.4	0.4	0.4	0.3
World oil price (U.S. dollars per barrel)	24.9	28.9	37.8	53.4	68.0	71.0	69.5	68.3	67.0	66.0

Sources: Kazakhstani authorities; and Fund staff estimates.

1/ Estimates and projections are based on GDP at market exchange rates. Import data have been revised for the period 2000–04 in light of revisions to NBK's cif coefficients in March 2005.

Table 3. Kazakhstan: Indicators of Vulnerability, 2002–05

(In percent of GDP unless otherwise indicated)

	2002	2003	2004	Est. 2005
Financial indicators				
Broad money, M3 (annual percentage change)	34.1	27.0	69.8	25.2
Private sector credit (annual percentage change)	34.9	45.6	52.4	73.2
Refinance rate (period average, in percent)	8.1	7.3	7.0	7.7
External indicators				
Competitiveness-related				
Merchandise exports (annual percentage change, US$)	9.9	32.0	55.7	37.4
Of which: Non-oil exports (annual percentage change)	7.3	24.2	47.9	18.7
Imports (annual percentage change, US$)	1.2	18.8	44.6	30.1
Terms of trade (annual percentage change)	-0.1	2.0	12.1	17.3
Current account balance	-4.2	-0.9	1.1	-0.9
Capital and financial account balance	5.0	8.9	10.4	0.9
Of which : Foreign direct investment, net (in millions of US$)	2,164	2,213	5,392	1,721
Exchange rate (per US$, period average)	153.5	149.5	136.0	132.9
REER appreciation (+) (eop, CPI-based)	-5.6	-0.9	7.5	4.4
Annual REER appreciation (+) (CPI-based, p.a.)	-3.8	-3.6	5.8	3.1
Reserves-related				
Gross official reserves				
- In millions of US$	3,141	4,962	9,280	7,070
- In months of imports	3.3	4.5	5.9	3.3
- In percent of short-term external debt	170.5	176.4	285.7	101.4
- In percent of total external debt	17.2	21.6	29.1	17.0
- Excluding intra-company loans	41.6	45.4	60.6	30.8
Gross official reserves/broad money (M3)	0.6	0.7	0.7	0.5
Gross official reserves/reserve money	2.3	2.2	2.1	1.4
Debt-related				
Central bank short-term foreign liabilities (in millions of US$)	0.6	0.9	1.0	2.0
Short-term external debt				
- In millions of US$	1,842	2,813	3,249	6,972
- In percent of GDP	7.5	9.1	7.5	12.4
- In percent of total external debt	10.1	12.3	10.2	16.8
Total external debt				
- In millions of US$	18,252	22,920	31,941	41,516
- Excluding intra-company loans	7,542	10,937	15,325	22,926
- In percent of GDP	74.2	74.3	74.0	74.0
- Excluding intra-company loans	30.7	35.5	35.5	40.9
- In percent of exports of goods and services	157.8	153.4	141.3	135.9
- Excluding intra-company loans	65.2	73.2	67.8	75.0
Public external interest payments (in percent of exports of good and services)	2.0	1.3	0.8	0.5
Public external amortization payments (in percent of exports of good and services)	5.9	1.9	2.5	3.7
Net public external debt (in millions of US$) 1/	-1,548	-4,994	-11,045	-12,716
National Fund (NFRK) assets (in millions of US$) 2/	1,915	3,663	5,131	8,015
Financial market indicators				
Foreign currency debt rating				
Moody's	Baa3	Baa3	Baa3	Baa3
Standard and Poor's	BB+	BBB-	BBB-	BBB-
Spread over benchmark bonds (basis points, period average) 3/	175.5	113	57.7	51.1

Sources: The Kazakhstan authorities, and Fund staff estimates.

1/ Total external public debt minus gross official reserves, and minus NFRK assets.
2/ Excludes transitory domestic currency deposits.
3/ Kazakhstan eurobonds are mostly held by domestic investors who have limited investment opportunities abroad. Therefore, bond spreads of Kazakhstan are not comparable to those of other countries and do not fully reflect country risks.

Table 4. External Debt Sustainability Framework, 2002–11

(In percent of GDP, unless otherwise indicated)

	Actual						Projections						
	2002	2003	2004	2005			2006	2007	2008	2009	2010	2011	
							I. Baseline Projections						**Debt-stabilizing noninterest current account 6/**
1 **External debt, excluding intracompany debt**	30.7	35.5	35.5	40.9			**42.5**	**40.6**	**39.6**	**38.1**	**37.1**	**35.0**	**-5.2**
2 Change in external debt	2.3	4.8	0.1	5.4			1.6	-1.8	-1.1	-1.4	-1.0	-2.0	
3 Identified external debt-creating flows (4+8+9)	1.3	-9.4	-13.2	-8.0			-12.4	-8.6	-6.7	-7.0	-5.5	-8.9	
4 Current account deficit, excluding interest payments	2.6	-0.5	-2.4	-1.1			-2.6	-1.2	-0.9	-1.4	-0.7	-3.5	
5 Deficit in balance of goods and services	0.0	-5.3	-8.7	-9.1			-10.7	-8.5	-7.6	-7.7	-6.5	-8.6	
6 Exports	47.0	48.4	52.4	54.5			53.9	49.8	47.2	45.2	42.3	41.9	
7 Imports	47.1	43.1	43.7	45.4			43.2	41.3	39.6	37.5	35.8	33.2	
8 Net nondebt creating capital inflows (negative)	-1.4	-4.0	-2.0	-0.7			-2.9	-2.6	-2.3	-2.2	-2.1	-1.9	
9 Automatic debt dynamics 1/	0.2	-4.8	-8.8	-6.2			-6.9	-4.9	-3.5	-3.4	-2.7	-3.5	
10 Contribution from nominal interest rate	1.7	1.4	1.4	2.0			1.5	1.3	1.3	1.3	1.3	1.2	
11 Contribution from real GDP growth	-2.6	-2.3	-2.4	-2.6			-2.7	-2.8	-2.7	-2.7	-2.3	-2.7	
12 Contribution from price and exchange rate changes 2/	1.1	-3.9	-7.7	-5.6			-5.7	-3.4	-2.1	-2.0	-1.6	-2.0	
13 Residual, including change in gross foreign assets (2–3)	1.0	14.1	13.3	13.4			14.0	6.8	5.6	5.6	4.5	6.8	
External debt-to-exports ratio (in percent)	65.2	73.2	67.8	75.0			78.8	81.6	83.8	84.3	87.8	83.7	
Gross external financing need (in billions of U.S. dollars) 3/	4.4	4.2	5.2	8.2			7.8	10.5	11.5	11.9	13.6	10.7	
in percent of GDP	17.8	13.6	12.0	14.7			11.1	12.7	12.2	11.2	11.4	7.9	
Key Macroeconomic Assumptions					10-Year Historical Average	10-Year Standard Deviation							Projected Average
Real GDP growth (in percent)	9.8	9.3	9.6	9.4	6.4	5.2	8.3	7.7	7.6	7.6	6.8	8.3	7.6
GDP deflator in U.S. dollars (change in percent)	-3.8	14.7	27.6	18.8	6.8	15.6	16.3	8.8	5.3	5.4	4.4	5.6	5.9
Nominal external interest rate (in percent)	6.2	5.7	5.3	7.4	4.8	1.9	4.6	3.7	3.7	3.7	3.7	3.7	3.7
Growth of exports (U.S. dollar terms, in percent)	11.4	29.2	51.2	35.2	20.0	21.2	24.7	8.2	7.4	8.6	4.3	13.3	8.4
Growth of imports (U.S. dollar terms, in percent)	9.4	14.9	41.6	35.0	16.5	17.6	19.9	12.1	8.6	7.4	6.3	6.3	8.2
Current account balance, excluding interest payments	-2.6	0.5	2.4	1.1	-0.7	3.1	2.6	1.2	0.9	1.4	0.7	3.5	1.5
Net nondebt creating capital inflows	1.4	4.0	2.0	0.7	2.8	1.4	2.9	2.6	2.3	2.2	2.1	1.9	2.2
							II. Stress Tests for External Debt Ratio						**Debt-stabilizing noninterest current account 6/**
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2006–10 4/							**49.5**	**51.2**	**51.4**	**51.6**	**50.4**	**51.9**	**-6.9**
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation							**42.8**	**41.2**	**40.5**	**39.3**	**38.5**	**36.6**	**-5.0**
B2. Real GDP growth is at baseline minus one-half standard deviations							**43.3**	**42.5**	**42.5**	**42.1**	**42.1**	**41.3**	**-5.2**
B3. Non-interest current account is at baseline minus one-half standard deviations							**44.0**	**43.6**	**43.8**	**43.5**	**43.7**	**42.6**	**-5.9**
B4. Combination of B1-B3 using 1/4 standard deviation shocks							**43.8**	**43.4**	**43.6**	**43.4**	**43.6**	**42.8**	**-5.4**
B5. One time 30 percent real depreciation in 2006							**68.9**	**67.3**	**66.5**	**65.3**	**64.3**	**63.5**	**-9.4**
B6. Permanent drop in oil price to $20 pb in 2006							**46.0**	**47.7**	**50.7**	**50.5**	**52.2**	**53.6**	

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in U.S. dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

4/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both noninterest current account and nondebt inflows in percent of GDP.

5/ The implied change in other key variables under this scenario is discussed in the text.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and nondebt inflows in percent of GDP) remain at their levels of the last projection year.

Table 4. Kazakhstan: External Debt Sustainability Framework, 2002–11 1/ (concluded)

(Percent of GDP unless otherwise indicated)

	Actual				Projections					
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
A. External debt, excluding intracompany debt										
Baseline	30.7	35.5	35.5	40.9	42.5	40.6	39.6	38.1	37.1	35.0
Stress tests:										
1. Real GDP growth, nominal interest rate, dollar deflator, noninterest current account, and nondebt inflows are at historical average in 2006–11					49.5	51.2	51.4	51.6	50.4	51.9
2. Nominal interest rate is at historical average plus one-half standard deviation					42.8	41.2	40.5	39.3	38.5	36.6
3. Real GDP growth is at historical average minus one-half standard deviations					43.3	42.5	42.5	42.1	42.1	41.3
4. Non-interest current account is at historical average minus one-half standard deviations					44.0	43.6	43.8	43.5	43.7	42.6
5. Combination of 2–4 using 1/4 standard deviation shocks					43.8	43.4	43.6	43.4	43.6	42.8
6. One time 30 percent real depreciation in 2006					68.9	67.3	66.5	65.3	64.3	63.5
7. Permanent drop in oil price to $20 pb in 2006					46.0	47.7	50.7	50.5	52.2	53.6
B. Total external debt outstanding at year-end										
Baseline	74.2	74.3	74.0	74.0	69.4	63.9	60.3	56.5	53.5	49.0
Stress tests:										
1. Real GDP growth, nominal interest rate, dollar deflator, noninterest current account, and nondebt inflows are at historical average in 2006–11					79.4	77.9	75.0	72.2	68.0	66.5
2. Nominal interest rate is at historical average plus one-half standard deviation					69.7	64.6	61.3	57.8	55.0	50.7
3. Real GDP growth is at historical average minus one-half standard deviations					70.9	67.0	64.9	62.6	60.9	57.7
4. Non-interest current account is at historical average minus one-half standard deviations					71.1	67.2	65.0	62.6	60.9	57.4
5. Combination of 2–4 using 1/4 standard deviation shocks					71.2	67.5	65.5	63.2	61.7	58.4
6. One time 30 percent real depreciation in 2006					117.1	109.8	105.0	100.1	95.9	90.7
7. Permanent drop in oil price to $20 pb in 2006					74.9	73.5	74.4	71.9	72.6	73.0

Source: Data provided by the Kazakhstani authorities; and staff estimates.

Table 5. Kazakhstan: Monetary Survey, 2002–06

(In billions of tenge; end-period stocks unless otherwise indicated)

	2002	2003				2004				2005				2006
	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep	Dec	Mar.
National Bank of Kazakhstan														
Net foreign assets	489.2	595.3	664.5	733.3	715.3	789.7	905.0	918.2	1,205.6	1,228.8	1,083.1	1,111.8	945.5	1,422.2
Net domestic assets	-280.9	-388.9	-409.0	-436.0	-398.2	-460.9	-516.4	-514.0	-515.3	-601.5	-525.3	-461.8	-272.0	-370.7
Domestic credit	-111.4	-231.4	-264.7	-279.7	-245.8	-342.0	-446.2	-435.9	-444.8	-532.1	-448.2	-383.3	-188.4	-312.4
Net credit to government	-54.1	-120.3	-85.6	-74.4	-49.6	-75.1	-132.3	-138.1	-71.7	-146.4	-182.9	-202.4	-42.7	-134.2
Credit to banks	-24.6	-62.3	-107.7	-99.8	-88.6	-146.2	-156.1	-144.5	-187.8	-237.8	-166.2	-106.8	-82.6	-76.5
Credit to the rest of the economy	-32.7	-48.9	-71.5	-105.5	-107.6	-120.8	-157.8	-153.4	-185.3	-147.9	-99.2	-74.1	-63.1	-101.7
Other items (net)	-169.5	-157.5	-144.3	-156.3	-152.4	-118.9	-70.2	-78.0	-70.5	-69.3	-77.1	-78.5	-83.7	-58.4
Reserve money	208.3	206.4	255.5	297.2	317.0	325.6	388.5	404.2	577.8	546.1	550.6	642.3	663.0	1,040.4
Currency outside NBK	177.9	175.8	206.1	238.6	262.1	265.0	303.2	338.6	410.9	394.1	425.5	452.1	458.5	480.3
Deposits with NBK	30.4	30.6	49.4	58.6	54.9	60.6	85.3	65.6	166.9	152.0	125.2	190.3	204.5	560.1
Banking system														
Net foreign assets	402.8	476.7	480.5	519.4	426.5	471.6	539.7	518.8	734.5	743.2	579.3	639.9	116.2	404.4
Net domestic assets	398.9	369.2	487.4	576.6	658.7	709.9	846.5	971.5	1,108.5	1,155.9	1,359.5	1,464.1	2,027.4	2,034.8
Domestic credit	781.2	756.4	876.9	1,017.0	1,133.9	1,189.6	1,307.7	1,497.0	1,695.3	1,779.3	2,058.2	2,261.5	2,927.5	2,997.1
Net credit to government	40.6	-15.2	13.0	49.3	55.2	39.1	-0.7	21.0	53.1	-7.9	-42.6	-74.4	86.4	0.7
Credit to the economy	738.8	767.2	858.0	963.4	1,075.7	1,146.4	1,304.9	1,472.4	1,638.8	1,783.7	2,097.5	2,333.1	2,838.4	2,993.7
Claims on local government	1.8	4.4	5.9	4.2	3.0	4.1	3.5	3.7	3.4	3.5	3.4	2.8	2.7	2.6
Capital accounts and other items net	-382.3	-387.2	-389.5	-440.4	-475.2	-479.8	-461.2	-525.6	-586.7	-623.5	-698.7	-797.4	-900.1	-962.3
Broad money	765.0	793.0	892.3	984.9	971.2	1,053.5	1,220.3	1,329.1	1,649.3	1,745.6	1,832.7	2,015.5	2,065.0	2,332.6
Currency in circulation	161.7	159.2	190.0	218.0	238.7	244.9	281.5	312.2	379.4	365.0	389.5	414.9	412.0	436.7
Deposits	603.3	633.8	702.3	766.9	732.5	808.5	938.7	1,016.9	1,269.9	1,380.6	1,443.1	1,600.7	1,653.0	1,895.9
Tenge deposits	241.7	283.6	363.7	387.3	387.1	440.9	499.3	556.1	720.5	771.0	846.7	902.5	960.3	1,178.7
Foreign exchange deposits	361.6	350.1	338.6	379.6	345.4	367.6	439.4	460.7	549.4	609.6	596.4	698.2	692.8	717.2
NBK notes outside the banking system	36.8	53.0	75.5	111.2	114.0	127.9	165.9	161.2	193.8	153.4	106.1	88.4	78.6	106.6
Memorandum items:														
Net international reserves (in millions of U.S. dollars)	3,140	3,923	4,493	4,929	4,961	5,688	6,635	6,828	9,276	9,272	8,011	8,309	7,058	11,073
NFRK (in millions of U.S. dollars) 1/	1,915	1,999	2,688	2,774	3,663	3,745	3,701	3,884	5,131	5,158	5,214	5,551	8,015	8,326
Annual growth rates (in percent)														
Broad money	34.1	42.2	44.9	46.6	27.0	32.8	36.8	34.9	69.8	65.7	50.2	51.7	25.2	33.6
Currency in circulation	23.3	28.5	40.8	54.2	47.6	53.8	48.1	43.2	58.9	49.0	38.4	32.9	8.6	19.6
Reserve money	19.1	32.5	45.2	60.2	52.2	57.7	52.0	36.0	82.3	67.7	41.7	58.9	14.7	90.5
Credit to the economy	34.9	38.9	43.1	49.6	45.6	49.4	52.1	52.8	52.4	55.6	60.7	58.5	73.2	67.8

Source: National Bank of Kazakhstan.

1/ Transitory deposits in tenge not included.

Table 6. Kazakhstan: Selected Prudential Indicators of the Banking Sector, 2002–05

	2002	2003	2004	2005
Percent, unless otherwise indicated				
Capital adequacy ratio (K2)	17.2	16.9	15.9	15.0
Tier I capital (K1, percent of assets)	9.0	9.0	8.0	8.0
Growth in banks' total assets	40.2	46.4	60.4	68.0
Off-balance sheet items (percent of total assets)	56.8	60.8	69.1	63.6
Growth in banks' loans 1/	37.3	45.5	51.7	74.7
Growth of claims on private non-financial institutions 1/	33.7	39.5	37.8	63.0
Growth of claims on households 1/	90.2	107.8	149.7	120.0
Classified assets to total assets 2/	18.5	25.9	30.0	28.5
Classified loans to total loans 2/	26.7	39.3	43.8	41.8
Nonperforming loans (percent of total loans)	11.9	13.1	11.9	9.6
Loans classified as loss ("unattended," percent of total loans) 2/	2.0	2.1	2.9	2.2
Loan loss provisions (percent of total sum of loans) 2/	5.9	6.2	6.7	5.6
Net foreign assets (percent of total assets)	6.1	1.7	-3.1	-0.9
Net open position in foreign exchange (percent of Tier I+II)	7.7	4.5	12.8	1.4
Share of deposits denominated in foreign exchange 3/	59.9	47.1	43.0	41.9
Share of loans denominated in foreign exchange 4/	68.5	55.5	51.9	51.5
Securities (percent of total assets)	17.0	19.6	17.3	14.4
Liquidity ratio (K4)	0.9	0.9	1.1	1.0
Loan to deposit ratio, excluding deposits of nonresidents	111.5	133.4	118.2	156.1
Loan to deposit ratio, excluding deposits of nonresident legal entities	109.4	131.2	115.6	155.2
FX loan to FX deposit ratio, excluding deposits of nonresidents	127.4	157.1	169.3	192.9
Return on assets, before tax (percent of assets end of period)	2.0	2.0	1.4	1.8
Return on equity, before tax (percent of equity)	13.8	14.2	11.2	14.1

Sources: NBK reports various issues, FSA, FSAP, and staff calculations.

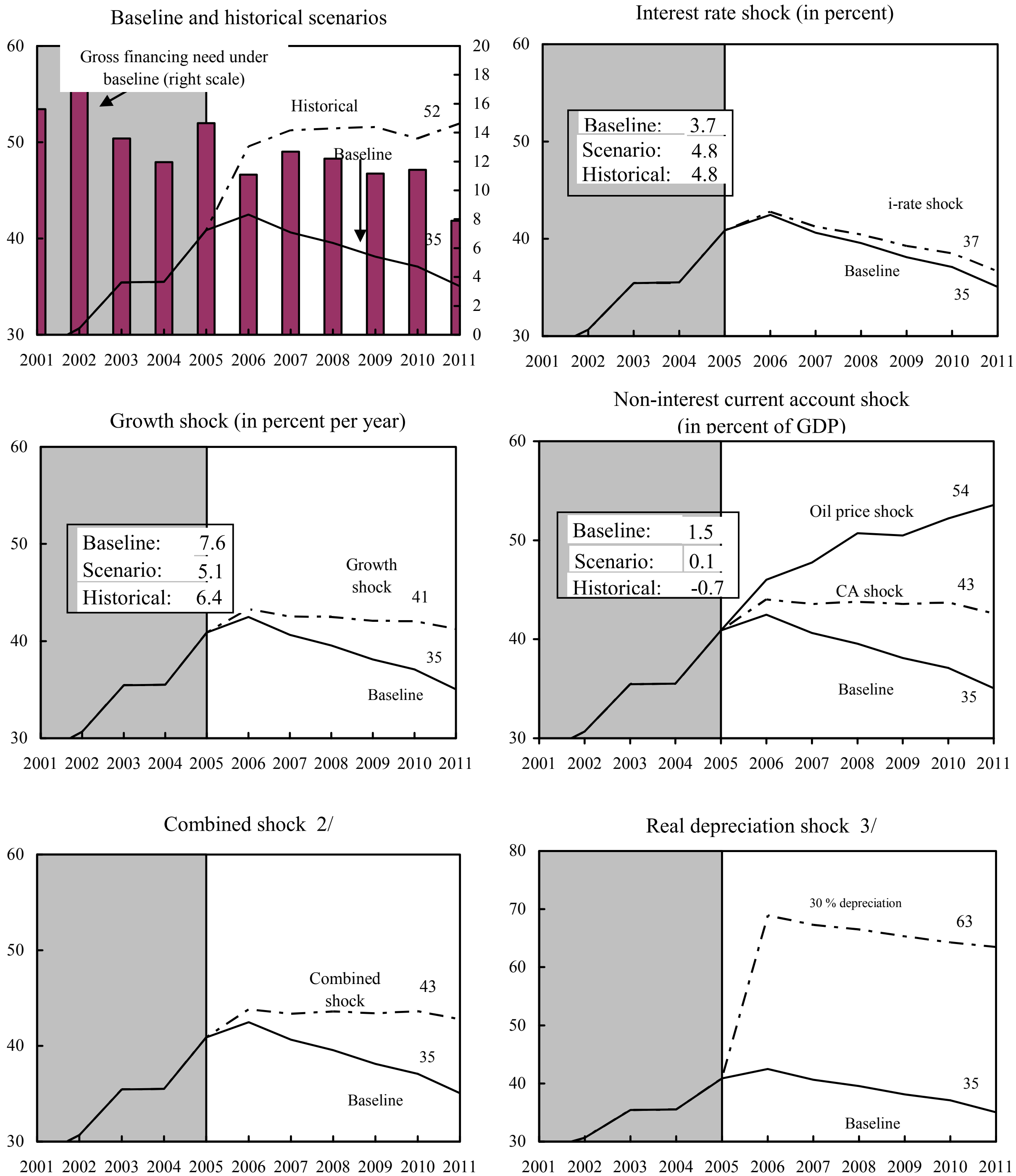
1/ Loans of second tier banks.
2/ New classification scheme introduced in early 2003. It is, thus, difficult to compare over time the level of classified assets, but both the FSA and banks are of the opinion that the new policy is stricter.
3/ Deposits in the banking system.
4/ Commercial bank loans.

Table 7. Kazakhstan: General Government Fiscal Operations, 2002–11

	2002	2003	2004	Prel. 2005	Proj. 2006	Proj. 2007	Proj. 2008	Proj. 2009	Proj. 2010	Proj. 2011
				(In percent of GDP)						
Total revenue and grants	22.5	25.4	24.6	28.6	28.3	27.4	26.5	26.3	26.3	25.4
Total revenue	22.5	25.4	24.6	28.6	28.3	27.4	26.5	26.3	26.3	25.4
Oil revenue	4.4	6.0	7.0	10.8	10.4	9.1	8.7	8.5	8.5	7.7
Non-oil revenue	18.1	19.4	17.5	17.8	17.9	18.2	17.8	17.8	17.8	17.7
Current revenue	22.2	25.1	24.2	28.2	27.8	27.0	26.1	25.9	25.9	25.0
Capital revenue	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Tax revenue	21.0	23.2	22.3	26.8	26.7	25.6	24.6	24.4	24.3	23.4
Non-oil tax revenue	16.6	17.6	15.5	16.0	16.4	16.5	15.9	15.9	15.9	15.7
Nontax revenue	1.2	1.9	1.9	1.4	1.1	1.3	1.5	1.5	1.6	1.6
Income from capital transactions	0.3	0.3	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	21.0	22.5	22.0	22.6	22.6	24.0	23.9	23.7	23.7	23.1
Total expenditure and net lending	21.0	22.5	22.0	22.6	22.6	24.0	23.9	23.7	23.7	23.1
Total expenditure	20.5	21.4	21.6	22.5	22.4	23.9	23.5	23.4	23.3	22.8
Current expenditure	17.2	16.6	16.3	17.6	17.5	19.2	18.8	18.6	18.6	18.2
Capital expenditure	3.3	4.8	5.3	4.9	4.9	4.7	4.7	4.8	4.7	4.5
Net lending	0.5	1.1	0.4	0.1	0.3	0.2	0.4	0.4	0.4	0.3
Extension of credits	0.8	1.5	0.7	0.2	0.4	0.3	0.5	0.5	0.5	0.5
Repayment of credits	0.4	0.4	0.3	0.2	0.2	0.2	0.2	0.1	0.2	0.1
Overall budget balance	1.4	2.9	2.6	6.0	5.6	3.3	2.6	2.6	2.7	2.3
Statistical discrepancy	-0.4	0.2	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-1.8	-2.7	-2.7	-6.1	-5.6	-3.3	-2.6	-2.6	-2.7	-2.3
Domestic financing (net)	1.7	1.6	0.7	1.0	0.6	0.9	0.9	1.0	0.9	0.7
Foreign financing, net	-1.5	0.2	-0.8	-1.7	-0.3	-0.3	0.1	0.0	0.2	0.2
Privatization receipts	0.5	1.3	0.1	0.2	0.1	0.0	0.0	0.0	0.0	0.0
National Fund of the Republic of Kazakhstan	-2.5	-5.5	-2.6	-5.4	-5.8	-3.8	-3.5	-3.6	-3.7	-3.1
Other capital operations	0.0	-0.2	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1
Memorandum items:										
Non-oil balance (in billions of tenge)	-111.7	-141.9	-260.8	-356.4	-426.7	-582.3	-680.4	-745.3	-811.4	-856.2
(in percent of GDP)	-3.0	-3.1	-4.4	-4.8	-4.8	-5.8	-6.1	-5.9	-5.8	-5.4
Non-oil revenues to non-oil GDP	23.6	26.0	25.0	27.9	28.4	27.5	26.2	25.8	25.2	25.3
Oil price (US$ pb)	25.0	28.9	37.8	53.4	68.0	71.0	69.5	68.3	67.0	66.0

Sources: Kazakhstani authorities; and Fund staff estimates and projections.

Figure 1. Kazakhstan: External Debt Sustainability: Bound Tests 1/
(External debt, excluding intra-company debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data including estimates for 2005. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2006.

Kazakhstan—Relations with the Fund

(As of March 31, 2006)

I. Membership Status: Joined: 07/15/92; Article VIII

II. General Resources Account

	SDR Million	Percent of Quota
Quota	365.70	100.0
Fund holdings of currency	365.70	100.0
Reserve position in the Fund	0.01	0.0

III. SDR Department

	SDR Million	Percent of Allocation
Holdings	0.81	n.a.

IV. Outstanding Purchases and Loans **None**

V. Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	12/13/99	3/19/02	329.10	0.00
EFF	7/17/96	7/16/99	309.40	154.70
Stand-by	6/05/95	6/04/96	185.60	185.60

VI. Projected Obligations to the Fund

None

VII. Safeguards Assessments

The safeguards assessment procedures are not applicable to the National Bank of Kazakhstan (NBK) at this time.

VIII. Exchange Rate Arrangements

The currency of Kazakhstan is the tenge, which was introduced in November 1993. The official exchange rate is determined on the basis of foreign exchange auctions that are held daily. Auctions are held for U.S. dollars, euros, and Russian rubles, and official rates are quoted for over 30 other currencies on the basis of cross-rates. Since late 1999, the exchange rate regime has been a managed float with no pre-announced path, although there has been limited de facto flexibility against the dollar and the ruble in recent years. On March 2, 2006, the rate was T 130.17 per U.S. dollar. The exchange rates at numerous exchange bureaus are very close to the auction rate, and the spread between buying and selling rates is very small. The exchange system is free from restrictions on payments and transfers for current international transactions.

IX. Article IV Consultation

Kazakhstan is on the standard 12-month consultation cycle. The last consultation was concluded on July 1, 2005 (see IMF Country Report No. 05/244).

X. FSAP Participation and ROSCS

Kazakhstan participated in the Financial Sector Assessment Program (FSAP) in 2000. The staff report on the Financial Sector Stability Assessment (FSSA) was issued on November 27, 2000 (FO/DIS/00/142). The FSSA included the following ROSC modules: Basel Core Principles for Effective Banking Supervision, Core Principles for Systemically Important Payment Systems, Code of Good Practices on Transparency in Monetary and Financial Policies, IOSCO Objectives and Principles of Securities Regulation, and IAIS Insurance Core Principles. An FSAP update mission took place in February 2004. The fiscal transparency module was completed in October 2002 and the final report published in April 2003. A data module mission took place in April/May 2002, and its final report was published in March 2003.

XI. Technical Assistance

Kazakhstan has received considerable technical assistance and training by the Fund in virtually every area of economic policy, including through about 75 technical assistance missions provided during 1993–2003 by FAD, LEG, MFD, STA, and the IMF Institute. In addition to short-term missions, the Fund has provided resident advisors to the National Bank of Kazakhstan, to the Agency of Statistics of the Republic of Kazakhstan, and to the ministry of finance. Other international agencies and governments, including the World Bank, EU TACIS, EBRD, UNDP, and OECD, also are providing a wide variety of technical assistance.

The following list summarizes the technical assistance provided by the Fund to Kazakhstan since 2002.

Monetary and Financial Systems

Technical assistance has enabled steady progress to be made in a number of arrears related to monetary and exchange affairs, including banking legislation, central bank accounting, payments system reform, central bank organization and management, foreign operations and reserve management, banking supervision, monetary statistics, currency issuance, monetary operations, and money-market development.

1. December 2002: Sequencing of Capital Account Liberalization and Financial Sector Supervision
2. January 2003: Assessment of the CPSS Core Principles for Systematically Important Payment Systems and Transparency of Payment System Oversight
3. September 2004: Bringing Banking Prudential Regulation up to EU Standards
4. September 2004: Implementing Inflation Targeting: Next Steps

Fiscal Affairs

The Fiscal Affairs Department of the IMF has given comprehensive advice to Kazakhstan in the areas of tax and expenditure administration, the establishment of a treasury system, and the introduction of a social safety net.

1. April 2003: Customs Administration
2. 1997–2004 Treasury Modernization
3. September 2004: Treasury Reform Process

Statistics

The Fund's technical assistance program in statistics has focused on the development of the institutional framework appropriate to the needs of a market economy. The assistance has concentrated on establishing procedures for collecting and compiling monetary, government finance, balance of payments (including external trade), and national accounts.

1. November 2002: International Reserves Template
2. January 2006: Real Sector and Balance of Payments Statistics

Legal Department

December 2003: Draft Law on Mandatory Reporting on Certain Financial Transactions

IMF Institute

Kazakh officials have participated in courses in Washington and at the Vienna Institute in the areas of macroeconomic management, expenditure control, financial programming, taxation, statistics, and other areas. In addition, the Fund's Institute has conducted courses in the region. Seminars and training sessions have also been conducted by MAE and STA technical assistance missions.

XII. Resident Representatives

Position terminated in August 2003.

Kazakhstan—Relations with the World Bank Group

(As of April 30, 2006)

Kazakhstan became a member of the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) in July 1992 and of the International Finance Corporation (IFC) in September 1993. The Bank's lending program has been curtailed in recent years as a result of the country's reduced borrowing needs, but the program of economic research has expanded and in FY06 it amounts to $2 million of which half is directly financed by the authorities. The research undertaken under this umbrella focuses on issues of overall competitiveness, fiscal and expenditure management, human development, infrastructure and environment.

At present, there are ten active projects (nine IBRD loans and one Global Environmental Facility (GEF) grant) with a total commitment of $648 million, of which $325 million have been disbursed. In the active portfolio, there are five old loans (Uzen Oil Field Rehabilitation, Road Transport Restructuring, Electricity Transmission Rehabilitation, Syr Darya Control and Northern Aral Sea Phase I, and Nura River Clean-Up) with a commitment of $454 million, one old GEF grant (Drylands Management) of $5 million, and four new loans which went to the board this FY (Agricultural Post-Privatization Assistance II, Agricultural Competitiveness, Forest Protection and Reforestation, and North-South Electricity Transmission) with a commitment of $189 million.

The Bank is also preparing four new loans (Technology and Competitiveness, Customs Modernization, Irrigation and Drainage II, and Ust-Kamenogorsk Environment Remediation) with an expected financing envelope of about $235 million, and one new GEF grant (Irrigated Ecosystem Management) of $6 million.

Kazakhstan is IFC's largest client in Central Asia. The current IFC net committed projects in Kazakhstan amount to $277 million for its own account plus $75 million in syndicated loans and are concentrated primarily in the oil, gas and mining and financial sector. To date $252 million have been disbursed. IFC has also been active in promotion of small and medium enterprises and leasing sector, and provision of Technical Assistance in the areas of corporate governance, housing market, leasing, and SMEs.

The Bank is assisting the government in attracting grants from the Global Environmental Facility, the International Fund for Agricultural Development, and, together with UNAIDS, the Global Fund to Fight AIDS, Malaria, and TB.

Kazakhstan—Relations with the EBRD

(As of February 1, 2006)

The EBRD is the largest investor outside the oil and gas sector in Kazakhstan. As of end-January, 2006, the EBRD's gross cumulative disbursements amounted to EUR 875.1 million. The current portfolio is composed of 87 projects with a total value of EUR 2.9 billion, of which EUR 1.4 billion are financed by the EBRD. The Bank expects to sign new project agreements in Kazakhstan on the order of EUR 200–250 million per year. Operations in Kazakhstan are focused on building earning assets in the oil and gas sector and the development of the small and medium-sized enterprise (SME) sector. There are also well established and effective relationships between the Bank and the government for financings in the transport and general industry sectors. About 70 percent of all investments are now in the private sector.

Strategic priorities

The latest country strategy, approved in November 2004, outlines the following strategic priorities:

- Enterprise Sector: Support economic diversification and promote new capital investment, including FDI inflows. The Kazakhstan Small Business Programme (KSBP) will remain the centrepiece of SME operations; the Trade Facilitation Programme (TFP) will further expand Kazakh enterprises' access to international markets. Support for the domestic agribusiness sector will be provided primarily through the Grain Warehouse Receipts Programme (GWRP). EBRD continues to seek opportunities to finance projects directly in the manufacturing sector. New financing structures will also be considered.

- Infrastructure: Promoting commercial principles, ensuring open, nondiscriminatory access to infrastructure as well as supporting regional cooperation will remain key priorities. Lending operations in the transport, power and communication sectors will be undertaken in conjunction with appropriate regulatory and institutional reform, and will stress the need for more regional cooperation where appropriate.

- Financial Sector: Focus on diversifying financial services, including the provision of longer tenor and more sophisticated products. Further promote higher corporate governance standards through equity investments. Support local competition and the expansion strategy of selected banks in CIS countries where feasible. Extend activities to nonbank financial institutions in sectors such as pensions, mortgages and leasing. Develop suitable funding structures for local currency lending.

The Bank's activities will continue to be guided by the existing country strategy until a new country strategy is approved by the Board, scheduled in October 2006.

Main trends in the portfolio over the past year

During 2005, the total business volume was EUR 290.7 million with all but one of the new operations representing the private sector.

In the telecommunications sector, the Bank financed a EUR 83.3 million loan to a private mobile phone operator Kar-Tel (K-mobile). In the energy sector, a EUR 44 million loan was provided to KEGOC for the completion of a new transmission line. It provides power to the more populated South of the country and assists to eliminate seasonal imbalances.

In the general industry sector, EUR 29.1 million loan was provided to Karcement, an affiliate of Central Asia Cement, for the expansion and modernisation of the cement plant in Karaganda. This loan represents the first major investment in the cement industry in 15 years, helping to satisfy the demand for cement, and support the construction sector, and thereby diversification of the Kazakhstani economy.

Investments in financial institutions remained an important part of the portfolio, with continued support of the Trade Facilitation (five loans). During 2005, the investments into the FIs sector amounted to EUR 84 million. The EBRD places paramount importance on supporting development of MSE/SME. Under the Kazakh Small Business Program (KSBP), which is channelled through 7 Kazakh banks in 45 cities (more than 210 banking outlets participate), approximately 4,000 loans are disbursed per month totalling $43 million, resulting in an average loan size of about $11,000. Since inception of the KSBP in 1998, the cumulative number of loans disbursed is 168,500 for a total volume of $1.1 billion. The EBRD increases its efforts to support nonbank financial sector such as insurance, leasing, and mortgages. In February 2005, it signed a $10 million loan to BTA Ipoteka to finance residential mortgages.

The agricultural sector benefited from continued implementation of the Grain Warehouse Receipt Programme (GWRP). With three loans of EUR 20 million each under the GWRP, the EBRD continues working with agribusiness companies, grain traders and banks on a risk sharing approach. A EUR 13.3 million loan was granted to a sun flower oil producer Turkuaz in Aktobe, and a further EUR 10 million loan to financing for agricultural equipment in cooperation with Kazkommertsbank. Under the project, the Bank offer a scheme for risk sharing in lending/leasing of agricultural equipment machines, primarily combine harvesters and tractors.

The EBRD continued to conduct policy dialogue on the investment climate, mainly through the Foreign Investors Council (FIC), and bilateral discussions. Coordination in terms of policy dialogue and regional cooperation will be reinforced, in particular with the Asian Development Bank, the International Monetary Fund, the World Bank, and key bilateral donors. EBRD will also continue to link its provision of funding for investment activities to enhancements in transparency, integrity, corporate governance and effective regulation.

Kazakhstan—Relations with the Asian Development Bank

(As of January 31, 2006)

Kazakhstan became a member of the Asian Development Bank (ADB) in 1994. As of January 2006, total loan commitments amounted to $483 million, covering 14 loans in agriculture and natural resources, education, finance, transport and communications, and water supply, sanitation and waste management.

At end-December 2005, total loan disbursements amounted to $434.4 million. Current Country Strategy and Program (CSP) was formulated in 2003 for 2004–06 and is being updated annually. The CSP is anchored to Millennium Development Goals and aimed to help Kazakhstan's long-term developmental objective of diversifying resource-based economy. The CSP has four key pillars: (a) private sector development, (b) human development, (c) environmental sustainability; and (d) regional cooperation. Knowledge transfer is a the basis of collaboration, using both technical assistance (TA) and loans. CSPU for 2006–08, approved in 2005, retained essentially the same strategy and approaches, but sharpened its focus on areas of rural support (e.g., rural development, rural water supply, water resources management) and sectors of regional impact (e.g., finance, transport). Kazakhstan is no longer eligible for concessional resources from the Asian Development Fund.

Private sector operations, which commenced in 2005, will be at the forefront of future ADB operations in the country. Such operations will gradually expand over time and focus on SME support, infrastructure, water, power, and the financial sector. This new thrust towards private sector operations will be supported by public sector technical assistance and investments to create an enabling environment for the private sector and selected public lending programs in rural water supply and water resources management aimed at improving livelihood in rural areas and reducing urban-rural gap.

The ADB has provided Kazakhstan with TA grants in several sectors, including agriculture, education, finance, pension reform, transportation, energy, water supply and sanitation, aid coordination and management, public investment programming, and poverty reduction planning and implementation. As of December 31, 2005, total ADB's TA program since l994 has reached 62 technical assistance projects with a total of $26.4 million.

Kazakhstan—Statistical Issues

The quality and coverage of Kazakhstan's economic statistics are generally adequate for surveillance. The April 2002 data ROSC mission found that international standards for methodological soundness, accuracy and reliability of data are either fully observed or largely observed. Nevertheless, there were shortcomings in some statistical practices that could detract from accurate and timely analysis of economic and financial developments and the formulation of appropriate policies.[1]

Kazakhstan has made considerable progress since the 2002 data ROSC mission. On March 24, 2003 Kazakhstan became the 53rd subscriber to the Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system. It is the first country to graduate from the General Data Dissemination System to the SDDS, and the second country of the Commonwealth of Independent States to subscribe to the SDDS. Measures have been taken to address delays in disseminating SDDS prescribed data for different data categories, including the official reserve assets and government finance statistics.

Building on the progress achieved since 2002, an IMF multitopic statistics mission visited Kazakhstan during 20–24 February, 2006 to help develop a more analytically rigorous disaggregation of national accounts and balance of payments statistics into the oil and non-oil sectors of the economy, in order to allow a better assessment of macroeconomic developments and policy formulation. The mission also provided recommendations for improving their quarterly national accounts (QNA).

Sector specific issues

In the area of **national accounts,** several weaknesses remain in both the quality of GDP estimates by sector produced by the National Statistical Agency and the quality and timeliness of GDP estimates by expenditures. First, the quality of **GDP estimates by industry** is affected by the poor coverage of production and financial statistics, particularly concerning small enterprises and informal activities. Second, while some progress has been made in making **GDP estimates by final expenditure** consistent with output-based measures, there remain substantial shortcomings, particularly in the estimation of fixed capital formation. Quarterly GDP series are compiled both on a cumulative and discrete basis, but the former are not in accordance with the concepts and definitions of the *Quarterly National Accounts Manual (QNA Manual)*. The 2006 multitopic mission found deficiencies, however, and proposed that only the discrete series be compiled. Also, the mission made recommendations in a number of areas, including: the deflators used; data sources for intermediate consumption and inventories; adjustments for holding gains for intermediate consumption; methods for deriving constant price estimates of changes in inventories, taxes and subsidies, and retail trade; and methods for recording work in progress.

---

[1] IMF Country Report No. 03/78.

As a result of extensive technical assistance, the quality of **fiscal data has improved**, in particular following the **consolidation, in 1999, of most extrabudgetary and social security funds** into the fiscal accounts and the provision of more **detailed expenditure data** on a quarterly basis. However, the coverage of oil revenues, particularly royalties, is not transparent and may be significantly undervalued. Progress has also been made in the establishment of a **classification of the fiscal accounts** consistent with the Fund's *Government Finance Statistics Manual 2001* (*GFSM 2001*) methodology. However, as a result of the reorganization of the public sector, including the redefinition of budgetary units, difficulties have arisen with regard to the **recording and reporting of expenditure arrears**. Since 1997, the authorities have reported detailed data for publication in the *GFS Yearbook.* The latest data reported for publication cover consolidated general government and are presented using the new template consistent with the *GFSM 2001*. The ministry of finance also provides monthly indicators covering the general government for publication in *International Financial Statistics (IFS).*

The existing framework for compiling **monetary statistics** generally conforms to recommended Fund methodology, and data are compiled on a timely basis. Steps are being taken by the NBK to further improve the quality and coverage of data. In particular, **the chart of accounts for commercial banks** has been revised to enable the NBK to distinguish sectors and financial instruments in accordance with the *Monetary and Financial Statistics Manual*. The NBK has extended **institutional coverage** to compile a financial sector survey that includes the Development Bank. The authorities have started implementing the recommendations of past money and banking statistics missions regarding the use of residency criteria as defined in the *Balance of Payments Manual*, fifth edition (*BPM5*), including changing the data base where foreign branches and foreign companies' representatives should be classified as resident. However, there are inconsistencies among banks in recording **syndicated lending** which can distort the measure of net foreign assets and credit to the domestic economy. Also, **data revisions** in the monetary statistics are not synchronized with those for the International Investment Position and balance of payments statistics. MCD and STA staff are working with the authorities to harmonize the presentation of monetary statistics.

There are also significant shortcomings in **external debt statistics**. First, public and publicly-guaranteed debt does not include external debt of public enterprises and development institutions, which is instead included in private debt. Second, external debt data are compiled and reported on an original-maturity rather than remaining-maturity basis. Third, there are substantial discrepancies in the maturity composition of banks' external liabilities reported in the monetary statistics and the external debt statistics.

In the area of balance of payments, the overall quality and timeliness of data are satisfactory. Considerable progress has been made in implementing the Fund technical assistance recommendations. In particular, the coverage of trade data has been improved through a survey to determine the volume of shuttle trade and travel expenses. The NBK has also worked closely with relevant agencies, including the STA staff, to update the ratios used for adjusting c.i.f. imports to an f.o.b. basis, which was implemented in March 2005 and resulted in revision of import data from 2000 to 2004. Compilation of export and import price indices has been initiated, and historical data are also now available. However, some work remains to be done to address certain deficiencies.

First, the timeliness of trade data remains an issue; improvements can be expected with the continuing computerization of the customs administration. In addition, separation of import data into those related to the oil sector would aid in macroeconomic analysis and assessment of the policy stance. Second, foreign direct investment statistics are not fully in line with the standards set forth in *BPM5*, as local branch offices of foreign companies operating in the construction sector are considered as nonresident entities. This leads to an inconsistency with national accounts statistics where this activity is treated as domestic production. Finally, the Data ROSC mission in 2002 also noted that commercial banks define nonresidents on a legal basis rather than on the *BPM5* principle, affecting the data reported by these banks for balance of payments purposes.

Kazakhstan: Table of Common Indicators Required for Surveillance

(As of May 3, 2006)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality- Methodological soundness[7]	Memo Items: Data Quality- Accuracy and reliability[8]
Exchange Rates	04/2006	05/03/060	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	03/31/06	05/02/06	W	W	M		
Reserve/Base Money	04/2006	05/03/06	M	M	M	O, O, LO, LO	LO, O, O, O, O
Broad Money	02/2006	04/06/06	M	M	M		
Central Bank Balance Sheet	04/2006	05/03/06	M	M	M		
Consolidated Balance Sheet of the Banking System	02/2006	04/06/06	M	M	M		
Interest Rates[2]	04/2006	05/03/06	W	W	M		
Consumer Price Index	03/31/06	04/18/06	M	M	M	O, LO, O, O	O, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3]—General Government[4]	Q4/2005	01/31/06	M	M	M	O, LNO, LO, O	O, O, O, LO, LO
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	Q4/2005	01/31/06	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q4/2005	01/31/06	M	M	M		
External Current Account Balance	Q4/2005	04/12/06	Q	Q	Q	O, LO, O, O	LO, O, O, O ,O
Exports and Imports of Goods and Services	Q4/2005	04/12/06	Q	Q	Q		
GDP/GNP	Q4/2005	02/13/06	Q	Q	Q	O, LO, O, LO	LO, LO, LO, LO, O
Gross External Debt	Q4/2005	01/31/06	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); NA: Not Available.
[7] Reflects the assessment provided in the data ROSC published on March 18, 2003, and based on the findings of the mission that took place during April 16–May 3, 2002 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
8 Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

Public Information Notice (PIN) No. 06/70
FOR IMMEDIATE RELEASE
June 27, 2006

IMF Concludes 2006 Article IV Consultation with the Republic of Kazakhstan

On June 14, 2006, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Kazakhstan.[1]

Background

Macroeconomic conditions were buoyant in 2005 and early 2006. Real GDP grew 9.4 percent in 2005. While hydrocarbon output decelerated, the income and wealth effects associated with high oil prices lifted non-oil output growth to 11 percent, with construction and financial services output expanding particularly rapidly. The unemployment rate declined further to 8.1 percent. However, inflation picked up to 7.6 percent in 2005 (period average) and jumped to almost 9 percent in February–April 2006 (year-on-year). A 30 percent increase in pensions and public sector salaries contributed to inflationary pressure.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. This PIN summarizes the views of the Executive Board as expressed during the June 14, 2006 Executive Board discussion based on the staff report.

The current account edged into a small deficit in 2005. A sharp increase in oil exports (by $6 billion;10.7 percent of GDP) was more than offset by higher income remittances to foreign direct investors and a sharp increase in goods and services imports, including FDI-financed imports by the oil sector. Banks borrowed heavily from abroad but also increased their holdings of foreign assets and securities, while amortization of FDI liabilities picked up, reflecting the stronger cash position of oil companies. With net outflows increasing, official reserves declined in 2005, albeit by less than the increase in foreign asset accumulation in the National Fund of the Republic of Kazakhstan (NFRK), and the tenge depreciated by 3 percent against the dollar. In early 2006, however, official reserves recovered sharply, including on account of continued rapid bank borrowing abroad, and the tenge appreciated by 8 percent against the dollar. In real effective terms, the tenge has appreciated by 5½ percent since end-2004 and by about 13 percent since end-2003, with little apparent consequence for the non-oil sector's competitiveness.

Monetary policy was accommodative and bank credit boomed, fueled in part by bank borrowing abroad. Money growth remained high and policy interest rates were flat for much of 2005. Credit growth accelerated to over 70 percent (year-on-year) in late 2005 and early 2006 as banks' lending interest rates declined in real terms. Banks funded their lending partly with a surge in external borrowing—banks' external liabilities rose to $15 billion (27 percent of GDP) at end-2005, from $7.7 billion at end-2004. On the fiscal side, policy remained prudent. The overall fiscal surplus rose to 6 percent of GDP, with surging oil revenue permitting a further rapid expansion in public spending (by over 20 percent in real terms).

Executive Board Assessment

Executive Directors commended the authorities' prudent macroeconomic framework, which helped Kazakhstan achieve an impressive economic performance over the past five years, including in the non-oil sectors of the economy. Looking forward, Directors welcomed the continued favorable outlook, but cautioned that mounting inflationary pressures and risks in the banking sector needed to be addressed.

Most Directors encouraged the authorities to tighten the monetary policy stance further. While they welcomed the recently announced broadening of the coverage of reserve requirements, they recommended further increases in policy interest rates. Directors also welcomed the nominal appreciation of the tenge in recent months and supported more exchange rate flexibility to allow greater appreciation of the tenge to help absorb liquidity and curb inflation. They pointed out that tighter monetary conditions would affect the National Bank Kazakhstan's (NBK) balance sheet and recommended an early capital injection into the NBK to send a convincing signal to markets that monetary policy will not be constrained by profit and loss considerations.

Directors welcomed the adoption of a number of prudential regulations over the past year to help contain risks associated with banks' loan portfolios. They urged the authorities to consider further prudential measures, particularly for real estate-related and foreign currency lending, and for investment activities. Directors also considered the need for an early tightening of prudential regulations to contain external bank funding and strongly supported measures recently announced by the authorities, including tougher liquidity requirements and net open position limits. In addition, they urged the authorities to improve monitoring of the maturity structure of banks' external obligations and debt repayment profiles to better assess the rollover risks.

Directors emphasized that regulatory measures would have to be supported by vigorous supervision to ensure banks' compliance. They recommended increased on-site inspections and enhanced supervision of banks' cross-border activities. They also underscored the importance of maintaining the Financial Supervision Agency's (FSA) independence and stressed that the FSA should deal expeditiously with any violation of prudential regulations.

Directors considered that an adequate monetary tightening would facilitate implementation of the authorities' fiscal plans, which aim at addressing social and infrastructure needs, and helping diversify the economy. They noted that there remains significant room to raise spending and cut taxes without compromising fiscal sustainability. However, in light of the continued rise in government expenditure, Directors underscored the importance of intensified scrutiny over expenditure efficiency. They also cautioned against distortive tax incentives that would erode the tax base.

Directors welcomed the important steps taken by the authorities to improve the investment climate and economic governance. They noted that transparency would be enhanced with the expeditious implementation of the Extractive Industries Transparency Initiative and the new design of the National Fund of the Republic of Kazakhstan.

Directors noted that the growth prospects and competitiveness of the non-oil sector would benefit from an acceleration of structural reforms. They pointed in particular to the need for early WTO accession, continued reform of customs administration, and further progress in enhancing regional trade, including by streamlining procedures that lower the cost of cross-border trading. Directors also urged reforms to address weaknesses identified in business climate surveys.

Directors welcomed the authorities' efforts to improve data disaggregation into the oil and non-oil sectors of the economy. In this context, they called for closer cooperation between various agencies involved in compiling and analyzing the relevant data.

Kazakhstan Selected Economic Indicators

	2000	2001	2002	2003	2004	Prel. 2005	Proj. 1/ 2006
			(Changes in percent)				
Real economy							
Real GDP	9.8	13.5	9.8	9.3	9.6	9.4	8.3
CPI (end-of-period)	9.8	6.4	6.6	6.8	6.7	7.5	8.2
			(In percent of GDP)				
Public finance							
Government revenue and grants	21.9	25.7	22.5	25.4	24.6	28.6	28.3
Government expenditures	22.5	23.0	21.0	22.5	22.0	22.6	22.6
General government balance 2/	-0.6	2.7	1.4	2.9	2.6	6.0	5.6
General government non-oil balance	-3.9	-3.9	-3.0	-3.1	-4.4	-4.8	-4.8
General government debt (end-of-period) 3/	24.8	19.7	17.4	15.5	11.9	8.2	7.2
			(Changes in percent)				
Money and credit							
Base money	5.3	30.9	19.1	52.2	82.3	14.7	...
Broad money	45.9	42.8	34.1	27.0	69.8	25.2	...
Banking sector credit to the economy	81.0	78.9	34.9	45.6	52.4	73.2	...
Interest rate on NBK notes (end of period)	7.9	5.8	5.9	5.2	4.0	2.2	...
			(In percent of GDP)				
Balance of payments							
Trade balance 4/	12.9	5.3	8.1	11.9	15.7	18.4	19.1
Current account balance 4/	3.0	-5.4	-4.2	-0.9	1.1	-0.9	1.1
External debt	69.4	68.5	74.2	74.3	74.0	74.0	69.4
Gross international reserves							
In billions of U.S. dollars, end of period	2.1	2.5	3.1	5.0	9.3	7.1	12.4
In months of imports of goods and nonfactor services	2.8	2.8	3.3	4.5	5.9	3.3	4.9
			(Changes in percent)				
Exchange rate							
Tenge per U.S. dollar (end of period)	5.2	3.8	3.3	-8.0	-9.3	2.9	...
Tenge per Russian ruble (end of period)	0.8	-3.0	-2.2	0.1	-4.3	-0.4	...
Real effective exchange rate (p.a) 5/	-7.0	0.9	-3.8	-3.6	5.8	3.1	...

Sources: Kazakhstani authorities; and Fund staff estimates and projections.

1/ Staff projections.
2/ Under this definition of the general government balance, privatization revenue is treated as a financing item and measured from below-the-line financing, which includes a statistical discrepancy.
3/ Gross domestic and external debt, including government guaranteed debt.
4/ Reported figures for 2000-2001 have been adjusted for staff estimates of the underinvoicing of exports.
5/ A positive sign indicates appreciation.