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REPUBLIC OF KAZAKHSTAN

2012 ARTICLE IV CONSULTATION

June 2012

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 2012 Article IV consultation with the Republic of Kazakhstan, the following documents have been released and are included in this package:

- **Staff Report** for the 2012 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 8, 2012, 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 31, 2012. 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.

- **Public Information Notice** (PIN) summarizing the views of the Executive Board as expressed during its June 18, 2012 discussion of the staff report that concluded the Article IV consultation.

- **Statement by the Executive Director** for the Republic of Kazakhstan.

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

May 31, 2012

KEY ISSUES

Near-term growth outlook. Led by high commodity prices, economic performance continues to be strong, and growth has become more broad-based. Staff projects robust growth in 2012–13, with a continued rebound in non-oil activity.

External stability. The external position has strengthened further, with the current account surplus reaching record high levels. Combined oil fund resources and central bank international reserves provide an ample external buffer.

Financial stability. Restoring the health of the banking system remains a key short-term policy priority. The new mechanism adopted by the authorities is insufficient to resolve problem loans. Success depends on the willingness of banks to accept realistic asset valuation and recognize losses, and on the readiness of the regulatory authorities to enforce proper provisioning and adequate bank capitalization.

Interconnectedness and risks. A protracted global slowdown, in particular if it affects China and Russia and is combined with a decline in commodity prices, could hurt Kazakhstan through trade, finance, and investment channels. The weak domestic banking system and the changing socio-political environment are other sources of vulnerability.

Recent macroeconomic policies. Consistent with the recommendations of the 2011 Article IV Consultation, the authorities have achieved a reduction in the non-oil fiscal deficit, and allowed some more flexibility of the tenge. However, action to forcefully resolve banks' problem assets has not been taken.

Recommended policies. A return to potential growth calls for continued fiscal adjustment and control of inflation. Premature or excessive reaction to shocks could unnecessarily invigorate demand and result in overheating. Greater exchange rate flexibility and healthier banks would be key complements to the existing buffers.

Medium-term prospects. The authorities' plans rightly focus on diversification. Success would require further enhancements in competitiveness, governance, and the quality of institutions. The key challenge is to ensure that the oil wealth benefits the whole economy, and to promote job-creating and inclusive growth.

Approved By
Juha Kähkönen and David D. Marston

The Article IV Consultation Discussions were held on April 26 through May 8, 2012 in Almaty and Astana.
Staff Team: A.L. Coronel (head), D. Rozhkov, G. Minasyan and K. Kirabaeva (all MCD), M. Saito (SPR), and N. Saker (MCM). K. Sazanov (OED) joined some discussions.

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CONTEXT

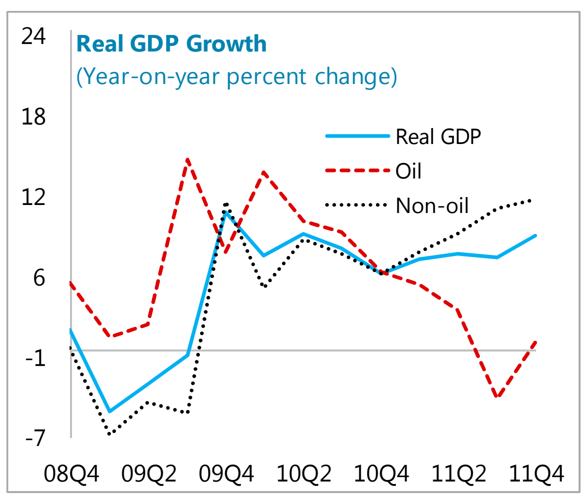
1. **Ample savings from the oil boom helped limit the impact of the 2007–09 crisis on the real and financial sectors, but banking sector weaknesses and vulnerabilities persist.** A sudden stop of foreign exchange inflows in 2007 resulted in an abrupt halt of the unsustainable credit boom and a bursting of the property bubble, exacerbated by a large devaluation of the tenge. Four overleveraged financial institutions, including the largest bank at the time, BTA, defaulted on their external obligations, were forced to restructure their debt, and were de facto nationalized. The authorities responded with substantial support to the banking sector and the real economy that helped lessen the impact of the crisis on incomes and employment. More recently, with high commodity prices, the external buffer has been rebuilt and the economy has recovered rapidly, but the rebound has not helped to restore the quality of the banks' portfolio. Furthermore, the credit-to-GDP ratio continues to fall.

2. **The socio-political situation presents challenges**. Two early electoral processes—a presidential election in April 2011 and a parliamentary one in January 2012—resulted in overwhelming victories for the president and the ruling party. Social stability was affected, however, by unprecedented and violent labor disputes in the oil industry in late 2011 that spread to other areas, signaling underlying discontent. Against this backdrop, the government has announced increased social spending, large investment projects in non-oil sectors, and creation of employment programs.

RECENT DEVELOPMENTS

A. High Oil Prices Have Driven Favorable Macroeconomic Developments

3. **The economic rebound has been impressive**. Real GDP expanded above estimated potential during the last two years, reaching 7½ percent. While growth of oil production slowed, high commodity prices helped spur domestic demand and activity in transport and communications. Agriculture recovered from a severe drought, but activity in construction and real estate, the sectors to which the banks are highly exposed, remained flat. Official statistics show that the unemployment rate, at 5¼ percent, continued to be unaffected by real growth, as was the case at the time of the slowdown.



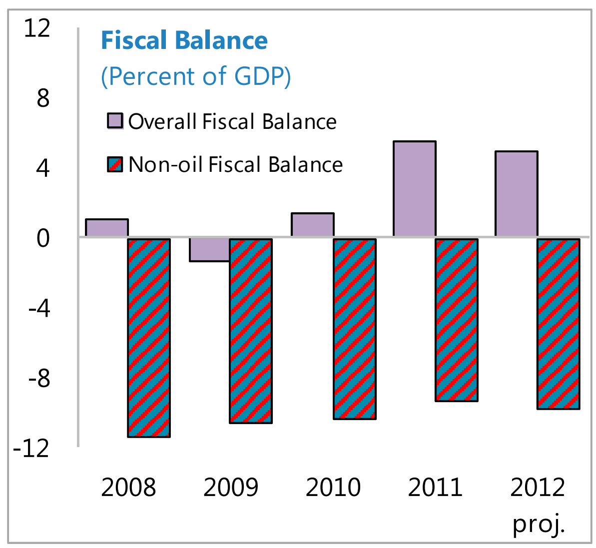
4. **A combination of external factors and administrative measures helped to ease inflation pressures in recent months**. Driven by rising global food prices and large increases in public sector wages, inflation peaked at 9 percent in mid-2011, exceeding the official objective

range of 6–8 percent. More recently, however, slowing international food prices, an exceptionally high harvest, and the use of administrative measures to limit food and fuel price increases helped to bring inflation below 5 percent.[1] Core inflation, which excludes energy and food, remains subdued.

5. With high export prices, the external position strengthened further. The current account surplus rose to 7½ percent of GDP, the highest level in recent years, as robust exports outpaced the demand-driven rebound in imports. Commodities-related FDI picked up, while portfolio flows fluctuated with market sentiment and showed a net outflow during the year. CDS spreads remained at 150–200 bps, with some volatility in reaction to uncertainty in the Russian and global markets. Assets in the National Fund of the Republic of Kazakhstan (NFRK) rose rapidly, and together with National Bank of Kazakhstan's (NBK) international reserves, reached a comfortable level equivalent to 17 months of imports and 110 percent of broad money.

B. The Policy Stance Adapted to the Economic Recovery

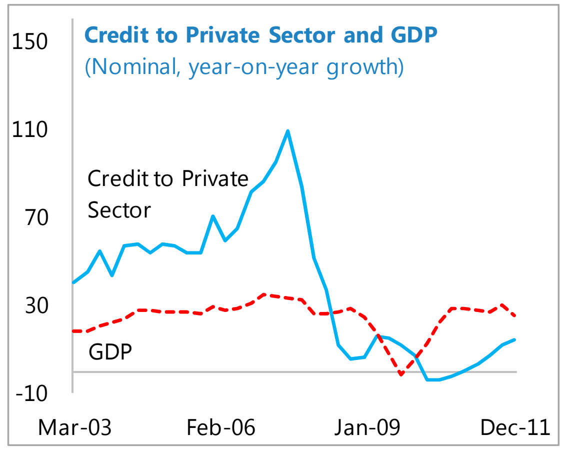
6. While assessing the underlying fiscal stance is not straightforward as some spending is conducted off budget, the fiscal tightening trend continued in 2011. An expansion of non-oil revenues from improved tax collection combined with expenditure restraint resulted in a fall in the non-oil deficit from 10¼ to 9¼ percent of GDP (a decline of 0.9 percent of GDP if cyclically adjusted). The non-oil deficit, however, was still higher than the staff-estimated long-term sustainable level of 6–6½ percent of GDP.[2] Moreover, some of the revenue gains reflect recovery of old tax debt. The overall fiscal surplus improved significantly, and the bulk of oil revenues was saved. Transfers from the NFRK to the budget remained capped at $8 billion, but were supplemented by proceeds from a new customs duty on oil exports. The government borrowing needs of 1½ percent of GDP were fully covered in the domestic market. Quasi-fiscal expenditure (such as subsidized credit support funded by large-scale public sector deposits in banks) and borrowing by state-owned entities are not included in the fiscal accounts.



[1] In addition to limits on price increases for staple food items, the periodic adjustment of utility tariffs was postponed until July 2012, after the parliamentary election.

[2] The authorities' estimated level of sustainable non-oil deficit of 3 percent of GDP is consistent with staff's estimate, which excludes all oil-related revenues (including export duties) from the non-oil balance.

7. Reflecting weak money demand, monetary and credit indicators continued to grow at a slower rate than the economy. Bank credit—still partially supported by public sector funding and subsidies—grew by 15 percent year-on-year at end–2011, after having been sluggish for three years. Although some medium-sized banks have extended new loans, overall excess liquidity remains high, reflecting banks' risk aversion, the underdeveloped interbank market, and the lack of projects as traditional borrowers in the non-oil sector such as real estate and construction companies remain weak. This is adversely affecting profitability as deposits are placed at the NBK at zero remuneration. As inflation pressures subsided, the NBK signaled a more accommodative monetary policy stance earlier this year by cutting its policy rate twice in three months by a total of 100 bps to a level of 6½ percent, reversing the increase in the rate implemented a year before, when inflation was rising.



8. The tenge has started to show some more flexibility. During the year, market sentiment toward the currency shifted repeatedly—in line with exchange rate movements in neighboring Russia. The NBK continued to intervene to avoid large exchange rate movements in either direction. The real effective exchange rate appreciated by 3½ percent year-on-year, and staff's preliminary assessment finds, on balance, no evidence of significant deviation from the long-run equilibrium (Appendix 1).

C. The Return to Strong Growth Did Not Restore Banks' Credit Quality

9. Notwithstanding the rebound in economic growth, the banking sector continues to be fragile. Banks have generally not benefited from the upturn given that the most dynamic sectors rely little on bank funding. The legacy of past poor lending, particularly to real estate and construction, has burdened banks, especially some of the large ones, with high and increasing nonperforming loans (NPLs). The system's total NPLs amount to 11 percent of GDP, the NPL ratio reached nearly 32 percent of total loans in March (21 percent excluding the especially hard-hit BTA), and banks are reluctant to write bad debts off to avoid recording losses (Box 1). Reported capital adequacy ratios remain strong, aggregate liquidity is ample, and provisioning of overdue loans is still relatively high (although decreasing). However, capital adequacy and provisioning ratios may be overstated by doubtful recoveries of already restructured loans and possible under-recognition of NPLs. Several banks, in particular those that underwent restructuring in 2009, may require additional capital. Profitability is undermined by the negative carry from excess liquidity and low levels of lending, limiting the ability to replenish capital and support new lending activity.

Box 1. Banking Sector Indicators Before and After the Crisis

The crisis has forced banks to implement significant changes in the structure of their balance sheets.

A fundamental fall in external liabilities now limits banks' exposure to shocks. As funding from foreign banks became unavailable or prohibitively expensive, reliance on it decreased significantly, while the share of retail deposits and issued securities went up. This helped banks to reduce the vulnerabilities that were exposed by the crisis. At the same time, however, the quality of assets deteriorated sharply.

Structure of the Aggregate Balance Sheet of the Banking System

(Excluding restructured banks)

	2007	2008	2009	2010	2011	Mar-12
	(In percent of total assets)					
Total assets	100.0	100.0	100.0	100.0	100.0	100.0
Correspondent accounts	7.5	6.9	8.8	5.7	10.3	11.2
Claims on NBK	0.1	0.4	5.5	4.4	0.8	3.1
Deposits in other banks	7.3	6.2	5.8	6.1	4.8	5.7
Claims on clients	67.8	66.1	57.2	54.9	58.1	55.6
Accumulated interest income	2.2	3.5	6.1	7.3	7.1	6.8
Total liabilities	89.2	83.8	88.5	88.4	85.9	86.2
Loans from other banks	11.7	8.2	6.0	4.0	2.8	2.4
Clients' liabilities	58.1	61.7	65.5	63.1	64.4	66.1
Issued securities	4.5	3.8	5.3	10.1	8.9	8.0
Total capital	10.8	10.8	11.5	11.6	14.1	13.8
Memo items						
Interest income to average assets	14.1	12.2	12.1	9.2	8.3	...
Interest margin (all banks)	2.8	3.3	6.1	4.5	4.6	4.6
Return on assets	1.8	0.0	0.1	-1.4	1.0	...
NPL ratio (90-day basis)	...	5.4	16.2	17.4	18.6	19.1
NPL ratio (90-day basis, all banks)	...	5.2	21.2	23.8	30.8	31.9
Total assets (in billions of U.S. dollars)	62.5	63.4	59.8	63.5	70.4	90.0

Source: Financial Supervision Committee, National Bank of Kazakhstan.

These changes were reflected in the structure of the balance sheet:

- An increase in provisioning and reduced willingness to take risks led to a fall in the share of net loans.
- Excess liquidity was reflected in an increase in claims on the NBK and correspondent accounts.
- Interest income and profitability declined following limited lending activity, although interest margins remained relatively stable.
- Notably, accrued but not received interest increased from 2 to 7 percent of total assets even for non-restructured banks (for restructured banks, this share increased from 3 to 17 percent), suggesting that the underlying NPL ratio may be higher than the one reported.

Banking Sector Vulnerability Indicators 1/

	2007	2008	2009	2010	2011	2012*	Trend	Impact
			(In percent)					
Assets to GDP	90.9	74.1	68.0	62.3	46.9	47.2	↓	Positive
Assets to Capital (ratio) 1/	8.2	8.2	na	9.1	9.8	11.4	↑	Negative
Capital Adequacy	14.2	14.9	-8.2	17.9	17.4	18.2	↑	Positive
Loans to Deposits	89.6	201.5	160.5	132.8	134.3	126.9	↓	Positive
Foreign Borrowing to Deposits	140.3	102.2	70.1	37.5	29.1	26.8	↓	Positive
NPLs (90-day) to total loans	–	5.2	21.2	23.8	30.8	31.9	↑	Negative
Accrued interest to regulatory capital 1/	–	27.2	na	57.8	59.0	56.4	↑	Negative
Loan write-offs to total loans	0.8	1.1	4.0	15.4	5.1	–	↓	Negative
Provisioning coverage/NPLs	–	213.5	178.0	130.1	104.2	97.5	↓	Negative

Sources: Financial Supervision Committee, and Fund staff estimates.

* End March 2012.

1/ Reported capital was negative during 2009.

10. BTA's post-restructuring business plan has proved unsuccessful. The bank is now the third largest in the system, accounting for about 11 percent of total gross assets and 8 percent of deposits, and is majority owned by Samruk Kazyna (SK), the state investment holding company, as a result of the intervention during the crisis. Continuing problems in dealing with bad assets—both domestic and external—have driven NPLs to 80 percent. Persistent losses have further eroded the bank's capital position, and the shortfall is estimated at around $5 billion (2½ percent of GDP). BTA defaulted again on its external obligations in January 2012 and has started difficult negotiations on a second debt restructuring requesting external creditors to accept another significant haircut. A number of aggravating factors derived from BTA's first debt restructuring, such as complex legal issues related to creditor rights, limit the ability to undertake more comprehensive action, including closure. The bank still operates with a full license, but remains dependent on public sector funding and on regulatory forbearance.

11. Action taken to reduce bad debts has been insufficient. Hopes that economic recovery and government-funded support would generate loan recovery, and on the other hand concerns about loan valuation and management of collateral, have hampered swift resolution of the NPL problem. Repeated attempts to solve it including by creating a distressed asset fund in 2009 (that was later diverted to other uses) and removing tax disincentives to write off bad debt have been unsuccessful. In the end, restoring the banking systems' health requires recapitalizing viable banks and restructuring or closing unviable ones. Capital shortfalls represent public contingent liabilities, given the need to protect depositors and the fact that SK is the biggest shareholder in several large banks.

OUTLOOK AND RISKS

12. Favorable commodity prices underpin a positive economic outlook for 2012 and beyond. Staff projects real GDP growth of 6 percent in 2012, with a continued rebound in non-oil activity. Oil output is expected to grow only slightly as existing fields are close to full capacity, and the first phase of Kashagan, a large hydrocarbon extraction project, has been postponed to 2013. The external current account would continue to benefit from favorable commodity prices, but non-oil export prices are set to decline. Possible upward revisions in administered prices and demand pressures could reignite inflation later in the year, but it is expected to remain within the authorities' objective range. Over the medium term, growth is expected to converge to the estimated potential of 6 to 6½ percent. The authorities shared staff views of near-term prospects, but expected growth to stabilize at over 7 percent in the medium term.

Selected Economic Indicators, 2011–17

		Projections					
	2011	2012	2013	2014	2015	2016	2017
Real GDP (percent, year-on-year)	7.5	5.9	6.0	6.2	6.3	6.3	6.4
Consumer price inflation (percent, p.a)	8.3	5.6	7.2	6.6	6.3	6.0	6.0
Overall fiscal balance (percent of GDP)	5.5	4.9	4.5	4.1	3.9	3.7	3.6
Credit to the economy (growth, in percent)	14.9	15.5	15.2	13.0	12.9	11.3	11.9
Current account balance (percent of GDP)	7.6	7.1	5.3	4.0	3.3	2.9	3.0
NBK gross reserves (eop) 1/ 2/	29.3	35.3	38.4	42.8	44.8	48.5	54.2
NFRK assets (eop) 2/	43.7	54.9	64.6	73.0	82.5	91.4	101.2
Nominal GDP 2/	186.2	206.4	227.5	252.5	282.5	316.2	355.2

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

1/ Does not include NFRK.

2/ In billions of U.S. dollars.

13. Risks to the economic outlook are mainly on the downside and come from external shocks and domestic vulnerabilities (Appendix 2). A prolonged global slowdown, particularly if it affects market conditions in Russia and China, is the main risk to the outlook. Spillovers through trade, finance, and investment channels would hit the external position and growth prospects. If deteriorated global conditions result in a decline in oil prices, further downward risks to the outlook would be expected (Box 2). The fragile situation of the banking system, and, in particular, the delicate BTA negotiations in uncertain times, brings additional confidence-related risks that may limit capital inflows and trade financing. In the context of continued deleveraging, directed and subsidized lending may further weaken banks' balance sheets. Moreover, any misalignment between political incentives and economic priorities may hinder effective policymaking and affect macroeconomic and social stability. The authorities broadly agreed with the staff assessment of risks. They expected external conditions to deteriorate in late 2012, and were prepared to use part of the accumulated buffers to withstand the shock without a sharp deceleration of growth.

Box 2. Possible Spillovers from a Prolonged Global Slowdown

Inward Spillovers

Given the economy's international integration, Kazakhstan is subject to spillovers from deteriorating global conditions. The extent of these spillovers depends on the nature and magnitude of the shocks. Four illustrative scenarios can be considered (based on the April 2012 IMF World Economic Outlook).

1. Re-escalation of the euro area crisis leading to a moderate decline in oil prices:
Growth in Europe would slow by 2½ percent and result in a decline of 17 percent in the real price of oil (deflated by the U.S. CPI), compared to an 8 percent increase in the baseline scenario.

- Growth in Kazakhstan would fall by 1¾ percent. One percent would be explained by structural co-movements between real GDP and the real price of oil, if the bulk of oil revenues would continue to be saved. Lower exports to Europe (now 20 percent of GDP) would explain the difference (¾ percent).
- Financial spillovers would lead to lower availability and higher costs of credit, though banks' rollover needs on external loans are now significantly lower than at the time of the 2007–09 crisis. Foreign investment and portfolio flows would also be affected.

2. Slowdown affecting EMEs and involving a larger decline in oil prices:
Banks and authorities in EMEs would tighten lending standards to clean up the legacy of the extended credit boom, lowering global demand by 2¼ percent and generating a fall in oil prices of 25 percent.

- The downturn would lower Kazakhstan's growth by 2¼ percent. This estimate is underpinned by 1) the higher decline in oil prices; 2) larger trade spillovers from Russia and China (two important trading partners with combined exports of 15 percent of GDP); and 3) financing needs forcing a higher-than-currently-envisaged use of oil savings.
- Global risk aversion could lead to increased sovereign risk (in line with possible developments in Russia), adverse impacts on FDI and portfolio inflows, and depreciation pressures.

3. Faster than anticipated recovery in the euro area and a mild fall in oil prices:
A recovery in the euro area would result in easing of credit conditions.

- The impact on growth would be likely negligible as the effect of a faster global recovery would offset the mild fall in oil prices.
- Lower risk aversion, however, may imply inflow flight to buoyant emerging economies, including Kazakhstan, creating policy challenges related to currency appreciation and overheating.

4. Adverse supply shock triggered by geopolitical tension in the Middle East:
Renewed tensions in the Middle East would lead to a 50 percent rise in oil prices.

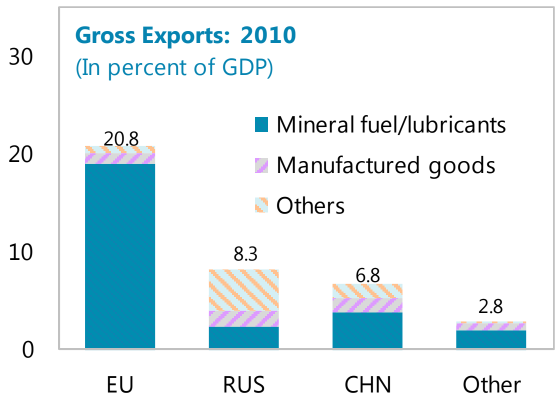
- The impact on growth would be uncertain and likely negative even if Kazakhstan is a large oil exporter.
- In principle, growth would be higher by 3 percentage points from spillovers to the domestic economy even though most windfall revenue would be saved.
- Nonetheless, the increase in oil price would depress global demand and financial markets, with large adverse spillovers to Kazakhstan's real and financial sectors.

Outward Spillovers

Deteriorated conditions in Kazakhstan would be transmitted to neighboring countries via trade, remittances and capital flows. The most serious impact is likely to be on trade with the Kyrgyz Republic (imports from Kazakhstan are 10 percent of GDP), and remittances to Tajikistan (2 percent of GDP). In addition, subsidiaries of Kazakhstani banks are present in these countries.

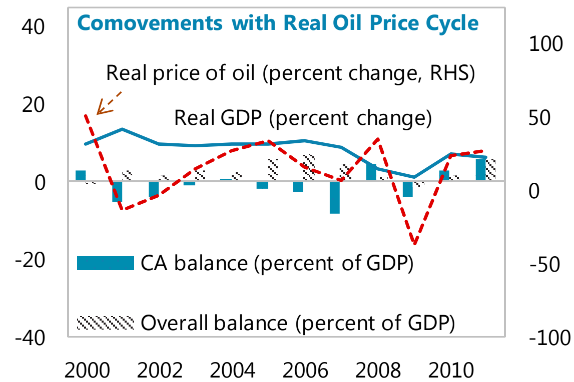
Kazakhstan: External Spillovers

External spillovers to Kazakhstan would come from trade links with Europe, Russia, and China...



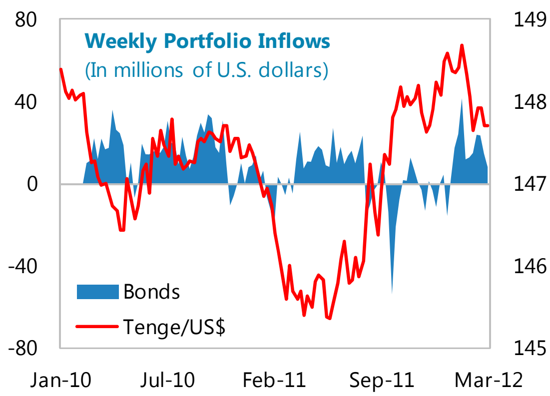
Sources: UN COMTRADE, MEDT, and Fund staff estimates.

...fluctuations in the real price of oil, with which Kazakhstan's real GDP is correlated...



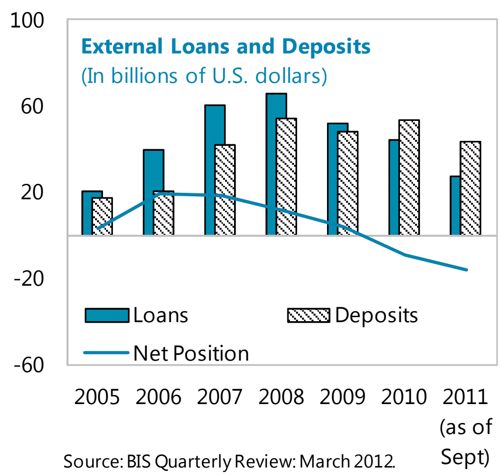
Sources: WEO, and Fund staff estimates.

...and capital flows, which are sensitive to risk indicators of Russia...



Sources: National Bank of Kazakhstan, and EPFR Global.

...though rollover risks of external loans have become smaller since the crisis.



Source: BIS Quarterly Review: March 2012.

Downside and upside risks would have spillovers to Kazakhstan's growth outlook ...

Size of External Spillover Effects

	Escalation in the euro area crisis	Adverse supply shock	Slowdown in EMEs	Better prospects in EA
	(In percent)			
WEO estimates				
Trading partner's demand (weighted by export shares)	-2.6	-1.2	-2.7	1.8
Real price of oil	-17	50	-25	-10
Spillovers on Kazakhstan				
Short-run effect on real GDP	-1.8	2.9	-2.3	-0.1
via change in oil export (volume)	-0.7	-0.3	-0.7	0.5
via change in oil price (real)	-1.1	3.3	-1.6	-0.7
Long-run effect on real GDP	-4.4	7.0	-5.7	-0.4

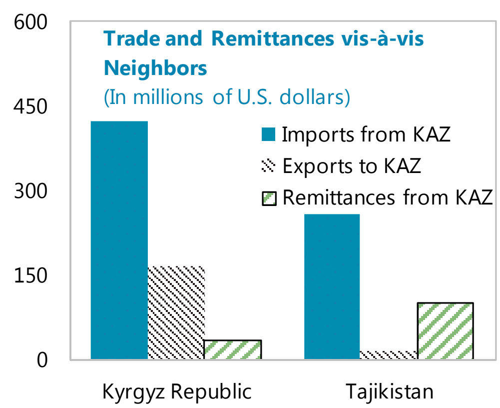
Sources: WEO April 2012, and Fund staff estimates.

Note: The estimates are based on:

$$\ln y_t = \underset{(0.25)}{1.43} + \underset{(0.03)}{0.07}{*}\ln p^{oil}_t + \underset{(0.05)}{0.27}{*}\ln q^{oil}_t + \underset{(0.07)}{0.58}{*}\ln y_{t-1} \quad [R^2 = 0.997]$$

where $\ln y_t$, $\ln p^{oil}_t$, and $\ln q^{oil}_t$ are log of real GDP, real price of oil, and the volume of oil production at t = 1998–2011, respectively. The volume of oil production is a proxy for trading partners' demand.

...and an impact on the neighbors.



Sources: UN COMTRADE, WB Migration and Remittances Factbook 2011, country desk data, and Fund staff estimates.

POLICY DISCUSSIONS

D. Financial Sector: Resolving Bank Asset Weaknesses

14. **The authorities have developed a new mechanism to deal with impaired bank loans, but its implementation has been slow**. The strategy combines a centralized problem loans fund established and funded by the NBK and other investors (including pension funds and banks) and bank-run Special Purpose Vehicles (SPVs). The centralized fund is expected to deal with a small fraction of NPLs (up to $2 billion compared to $22 billion) and to exclude real estate loans where the bulk of the problem is concentrated. Loans to real estate and construction are to be addressed by individual banks through the SPVs. The SPVs are separate accounting entities that seek to allow better management of troubled assets and collateral by banks, and will have preferential provisioning requirements. The strategy was announced in early 2011, but the enabling legislation was adopted only at the end of the year, and the mechanism is now expected to begin operating in the second half of 2012.

Six Largest Banks: Key Ratios and Vulnerabilities 1/
(End-March 2012)

	KKB	Halyk	BTA 2/	BCC	ATF	Alliance
			(In percent)			
Systemic importance (assets in percent of total banks' assets; gross)	18.4	18.7	10.8	8.1	7.5	4.0
Systemic importance (deposits in percent of total banks' deposits)	16.5	21.7	7.6	8.4	6.6	3.6
Capital adequacy ratio (percent of risk weighted assets)	17.1	17.3	19.0	14.4	12.1	14.5
Contingent liabilities (percent of total assets)	30.7	74.8	98.5	49.9	132.3	60.6
Loan-to-Deposit Ratio	168.6	74.3	324.8	114.5	151.7	177.1
Foreign borrowing to Capital 3/	117.0	101.2	168.4	112.7	275.9	223.7
Real estate loans (including mortgages) as share of loans	9.4	37.5	28.2	61.5	42.8	54.9
Loans to mining and quarrying industry	2.7	0.9	2.5	1.8	1.3	6.1
Accrued interest to capital	88.7	39.0	87.2	46.2	66.7	105.3
NPLs (90 days basis) as share of total gross loans	24.4	19.0	76.2	9.2	38.9	52.2
Provisions as share of total gross loans	36.4	24.8	56.5	16.5	21.4	46.0
Provisioning ratio (Provisioning/NPLs)	149.4	130.3	74.1	179.7	55.1	88.2

Sources: FSC, and IMF staff estimates.
1/ According to Kazakhstani accounting standards.
2/ Undergoing the second restructuring.
3/ K-9 ratio (calculated as foreign liabilities to regulatory capital).

15. **Staff cautioned the authorities about the insufficiency of this approach**. The NBK will need to ensure that the centralized fund manages bad loans efficiently, as their further deterioration would result in losses for the NBK and other investors. In addition, banks should actively seek to resolve NPLs by writing them off or selling them at market prices with the help of professional managers and specialists, rather than simply moving them off the banks' unconsolidated balance sheets into the SPVs. Furthermore, provisioning rules for SPVs should not be different from those for the banks, to eliminate the incentives to window-dress the balance sheets instead of pursuing true resolution. Staff also noted the need to make permanent the removal of tax disincentives for banks to write off NPLs, eliminate tax liabilities for potential purchasers of bad loans at a discount, and give banks the possibility of sharing the upside gains if assets become performing. Ultimately, successful resolution of problem loans will depend critically on the willingness of banks to accept realistic asset valuation and recognize losses. Neither the centralized fund nor the bank-run SPVs solve the valuation problem.

16. The NBK saw no urgency to take additional action based on the belief that economic recovery is bound to encourage lending and improve bank profitability. The authorities acknowledged that the combination of strong economic growth, recovery in bank lending, and the newly created mechanism are not sufficient to immediately resolve the problem of impaired assets. The NBK also felt, however, that reporting requirements, in particular those related to NPLs and provisioning, are more stringent in Kazakhstan than in most other countries, and thus the soundness indicators reflect reality more accurately. They saw no need for an additional diagnostic assessment, noting that in many advanced economies and other emerging markets, banking sector problems had been resolved through more interventionist support operations and forbearance.

17. Staff stressed the need to strictly enforce regulations, ensuring proper valuation and adequate provisioning of loans, as well as recognition of bank losses. An independent, forward-looking and comprehensive assessment of asset quality and capital adequacy would be crucial. Rapid action should then be taken to replenish bank capital where needed, ideally from existing shareholders and other private investors. If these funds are insufficient, the use of budgetary funds may be required. Otherwise, banks will remain risk averse and not supportive of the government's objectives of growth and diversification. In parallel, the NBK, as the banks' regulator and supervisor, should strictly enforce existing regulations, refrain from forbearance, and ensure that banks adopt and implement better practices in governance, accountability, and risk management. While a cohesive framework for crisis management and bank resolution exists, the NBK should make full use of its mandate to conduct effective supervision. Following the recent incorporation of the supervisory agency into the NBK, supervisory responsibilities need to be fully integrated with monetary and regulatory functions. It is also crucial that supervisory staff has the necessary training and budgetary resources to credibly perform its role.

18. To mitigate further risks, a quick and definitive solution to the BTA problem is a key priority. Staff noted that continuing to allow BTA to operate while violating many prudential norms creates costs and distortions. The bank has a large negative interest margin, resulting in growing losses and contingent liabilities to the public sector. Furthermore, with an implicit government guarantee, continuing to offer high deposit rates creates moral hazard and may distort the market. Substantial funds of state companies are deposited at BTA, tying up their working capital or imposing liquidity risks. Protracted negotiations to share costs of the needed recapitalization with external creditors could involve risks of confidence loss, making trade finance and foreign loans more difficult to obtain.

19. On a more positive note, the NBK is interested in strengthening macroprudential policy tools to support monetary and financial stability. Following the crisis, regulations to contain systemic risks were introduced, discouraging cross-border borrowing and foreign currency lending, increasing minimum capital requirements, and requiring better governance and transparency practices, including stricter limits on related parties' activities. In the context of moving to the proposed Basel III framework, the NBK is considering additional countercyclical measures focused on instruments that are conditional on aggregate events and limit the impact on banks of excessive financial cycles, such as dynamic capital and provisioning requirements. Staff supported this intention, emphasizing that these tools should be useful to prevent a renewed expansion of low-quality credit. However, it is important that such measures are openly discussed with the banks and implemented in a consistent and time bound manner.

E. Monetary and Exchange Rate Policies: Refining the Policy Instruments

20. As the financial crisis has evolved, the NBK has adapted its monetary policy to changing conditions. At the peak of the crisis, monetary policy was focused on financial stability considerations, including providing liquidity support to banks and promoting exchange rate stability to avoid the impact of devaluation on weak banks. Given the weak demand for credit and risk aversion by banks, liquidity has been de facto sterilized by the NBK with no inflationary impact, since movements in international food and fuel prices have been the main drivers of inflation. As conditions improved, the NBK first abandoned the temporary exchange rate peg by transitioning to a trading band, then widened the band, and finally moved to managed float in 2011. While more flexibility has been observed, NBK's interventions in the market have kept fluctuations within a narrow range. At the same time, high dollarization, limited interbank transactions, and shallow money and credit markets have impaired the impact of the policy rate on either monetary developments or inflation.

21. With the worst of the liquidity problems behind, it would be important for the NBK to prioritize the inflation objective and allow greater exchange rate flexibility. The authorities noted that monetary policy will continue to aim at preventing sharp fluctuations of the exchange rate, while keeping inflation within the 6–8 percent objective. Staff pointed out that greater two-way flexibility would help the economy adjust to external shocks, reduce reliance on fiscal policy that is relatively inflexible in the short term, and avoid excessive speculative inflows. A full rehabilitation of banks would be a prerequisite to improve the efficiency of the monetary transmission mechanism by strengthening the credit channel. Staff also recommended developing money and foreign exchange markets, promoting long-term tenge liquidity, facilitating risk management and hedging practices, and refining the policy tools to control inflation. At the same time, the use of administrative measures to control price increases should be avoided. The authorities indicated that while they have abandoned plans to formally introduce inflation targeting, they continuously assess the efficacy of their policy instruments in controlling inflation.

Key Interest Rates

	2007	2008	2009	2010	2011	2012 Q1
	(Annual average; in percent)					
NBK refinancing rate	9.5	10.8	8.6	7.0	7.4	7.0
Tenge Deposit rates						
Deposits of legal entities	5.1	5.3	4.7	3.1	2.8	2.5
Deposits of individuals						
Demand deposits	1.0	0.8	0.2	0.0	0.0	0.0
Time deposits	10.5	11.2	9.3	9.7	8.5	8.2
Tenge Lending rates						
Loans to legal entities	13.6	16.1	15.0	13.8	12.1	11.2
Loans to individuals	17.9	19.4	18.9	20.0	20.3	20.9
Average CPI inflation	10.8	17.1	7.3	7.1	8.3	5.6

Source: NBK.

22. In the short term, the NBK should keep its options open, given the uncertainties, and tighten policies if demand pressures arise. The NBK has signaled its readiness to further cut the indicative policy rate should inflation remain low after the forthcoming increases in utility tariffs. Staff argued that, given the economy's position in the cycle, implementation of the announced fiscal spending plans could cause demand pressures. This possibility would call for postponing any further monetary easing until the weakening of inflation pressures becomes evident, or it would even warrant tightening policies through more active open market operations and increased reserve requirements, should demand pressures arise. Given the changing external conditions, however, it is also possible that spillovers from a deeper global slowdown would call for domestic monetary support.

F. Fiscal Policy: Rebuilding the Fiscal Buffer to Deal with Uncertainty

23. The authorities' medium-term fiscal plans envisage gradual consolidation. The authorities remain committed to reducing the non-oil deficit to the medium-term sustainable level, primarily through expenditure reduction, to rebuild their fiscal buffer and ensure intergenerational equity. Staff supported this approach, but stressed the need for a well-defined fiscal strategy to achieve the target. In this regard, broadening the tax base, making the personal income tax more progressive, limiting the use of tax exemptions, and increasing the relatively low VAT rate, would bring efficiency gains over the medium term. These measures would also make the attainment of the medium-term target more credible, and help reduce the budget's dependence on oil, thereby mitigating the economic risks related to a potentially prolonged decline in oil prices.

24. In the near term, however, a planned fiscal expansion would likely shift the path away from the sustainable goal. Based on budgetary plans, staff estimates that the non-oil fiscal balance would deteriorate by some ½ percent of GDP in 2012 and improve only marginally in 2013. Given global uncertainty and the anticipated modest slowdown in growth, the authorities feel that a fiscal expansion is consistent with the needed counter-cyclicality. Non-oil revenue is expected to decline somewhat, reversing part of the one-off increase last year, and the annual transfer from the NFRK is set to increase by 15 percent as a result of amended legislation. While wages and pensions are to remain constant in real terms, higher capital outlays in line with the diversification and industrialization strategy have been announced.[3] Staff cautioned against fiscal policy loosening, as it would shift the non-oil position from the desirable path and risk unduly stimulating demand, and urged the authorities to treat the spending plans as contingent. After two years of strong economic expansion, the projected return to potential growth calls for gradual but continued fiscal consolidation.

25. While supporting flexibility in the use of oil resources, staff urged proper integration of the NFRK into the fiscal framework. The authorities see the disconnection of the NFRK from the fiscal accounts as an important tool to safeguard oil savings from increasing spending demands.

[3] These estimates do not include any possible capital injections to banks.

However, any use of NFRK resources that is not aligned with the medium-term fiscal objectives could complicate policy coordination and macroeconomic management. In line with the recommendations of the technical assistance mission on Public Financial Management, staff advised to fully integrate the NFRK into the budget, and anchor the budget process on clear and credible medium-term targets for the non-oil deficit.

26. With the large role of public enterprises in the economy, transparent reporting of their activities is essential for fiscal planning. Since the crisis, the government has shown preference for large quasi-fiscal operations channeled off budget through state enterprises, in particular, SK and its subsidiaries. Information on the extent of these operations is not fully available. While the bulk of them occurred in 2009, the authorities indicated that they have plans for outlays of 1¼ percent of GDP in 2012–13. Staff noted the benefits of incorporating state enterprises into the fiscal accounts for the authorities' own analysis of the fiscal stance. Transparency of public sector statistics, in the form of a consolidated balance sheet, would also eliminate the asymmetry of information among government agencies. The authorities have formed an interagency committee to work on reporting the fiscal positions of state owned enterprises and have started collecting debt data for enterprises with more than 50 percent state ownership.

G. Diversifying the Economy and Improving Governance

27. The commitment to economic diversification is an opportunity to enhance competitiveness and the role of the private sector in the economy. Oil accounts for one quarter of GDP, half of fiscal revenues, and two thirds of export proceeds. The authorities seek to reduce this dependence by accelerating industrialization and infrastructure development in other sectors. Their medium-term plans envisage an increased share of manufacturing in GDP, improved productivity in agriculture, development of advanced technologies, health and education reforms, and selected privatization. Based on the results of a growth accounting model, staff stressed that increases in productivity to complement gains in capital accumulation and employment are needed (Box 3). Discussions focused on four broad areas:

- **Using oil savings to finance productive non-oil investment**. The authorities argued that the current yields on financial investments of the NFRK are lower than the potential wider benefits from infrastructure and development-oriented job-creating programs that could be financed with oil savings. Staff supported partial use of the oil savings for non-oil investments, but noted that such an approach can be successful only if projects are well chosen, fiscally sustainable, and consistent with sound governance and implementation capacity.

- **Reducing the role of the public sector**. The public sector is taking an increasingly large role in the economy. The government has announced that public sector entities will undertake a number of construction and development projects, and that the NFRK resources will be used to finance the acquisition of a larger stake in the Kashagan oil field by the state oil and gas company (KMG). Staff emphasized that a more important role for the private sector is key to the dynamic development of the economy. Plans for privatization via the "People's IPOs" program to allow citizens to acquire stakes in large corporations (expected to start in the fall of 2012), PPP-type schemes, and other modalities, would allow private investors' participation on a competitive basis.

- **Improving competitiveness and the business environment**. Following recent gains in some of the international rankings, the authorities aim to further enhance governance and transparency, to promote investment (Appendix 3). They are also interested in continuing to attract investments to tax free special economic zones for the production of domestically consumed and exported goods. Staff cautioned against the maintenance of subsidies and tax exemptions that would generate price distortions and affect tax collection, and emphasized that clear rules and sound institutions are crucial for a more friendly business climate and increased interest from investors.

- **Removing barriers to trade and further integrating into the global economy**. The authorities are pursuing closer integration with neighbors and improved trade relations with countries in all regions. They noted that the Customs Union and the creation of a single economic space with Russia and Belarus have the potential to boost trade, investment and growth. Staff stressed that regional integration works best if conceived as a stepping stone toward multilateral trade liberalization. It will also be important to avoid protectionist measures against nonmembers of the Customs Union. In that regard, it is encouraging that Russia will formally join the WTO in mid–2012, and Kazakhstan is expected to achieve WTO accession by late 2012.

28. Looking ahead, there is a clear need to ensure that growth benefits the population as a whole. In addition to being broad based, growth in Kazakhstan needs to be inclusive. Recent demonstrations of social discontent signal the need to continue to pursue policies targeted at the reduction of poverty and inequality, especially in rural areas. In that regard, the authorities' plans to improve coverage and administration of the existing social safety net are a welcome step. Further improvements in the provision of health and quality of education are important for increasing the productivity of human capital.

Box 3. Sources of Growth

Favorable hydrocarbon prices led to strong growth and expansion of resource sectors, following gradual market reforms in the 1990s and substantial foreign investments. The share of mining in GDP grew from 8 percent in 1998 to 20 percent in 2010, while the contribution of manufacturing and agriculture declined from 18 and 9 percent in 1998 to 12 and 6 percent in 2010, respectively.

A growth accounting model[1/] suggests that:

- **Physical capital accumulation has increasingly become the most important source of growth**, **particularly since 2005**. The high volatility of the capital stock in the early 2000s reflects its modernization in the first years of transition, when old machinery and equipment were being replaced. This shift resulted in massive investments and bulky depreciations, and led to steady capital accumulation in the late 2000s. In 2005–10 the capital stock in mining increased nearly two and a half times in real terms. In manufacturing, after an initial decline, the capital stock expanded at a significantly lower rate than in mining, and in agriculture it decreased nearly by half in the early 2000s, returning to its 1998 level only in 2007.
- **Overall employment and average schooling have also expanded**. Kazakhstan has traditionally enjoyed higher labor force participation than resource-rich peers, and official unemployment rates have been low and steadily declining. However, labor mobility across sectors has been relatively limited. Nearly a third of employment remains concentrated in agriculture despite the continuous decline in the sector's share in total value added. Unsurprisingly, mining is not a major employer, accounting for only 2½ percent of employment in 2010, a share that has remained stable since the mid 1990s. The share of manufacturing in employment has declined steadily in line with its share in GDP, even though labor productivity in manufacturing has been higher than the average in the economy.
- **Total factor productivity (TFP) has been declining since 2007**. TFP has shifted from being a major source of growth in 1999–2003 to become less important in 2003–06 and negative in the most recent period. This pattern is shared by most sectors including agriculture, manufacturing, and to a lesser extent mining. Most countries that underwent a transition from centrally planned to market economies experienced fast gains in TFP in the period of rapid reforms followed by a slower expansion as reforms were being completed. The decline of TFP may be temporary, reflecting lower utilization of capital at the time of its rapid accumulation, including through FDI. Nonetheless, since productivity is an important source of growth in the long run, a continued decline in TFP would be a cause for concern.

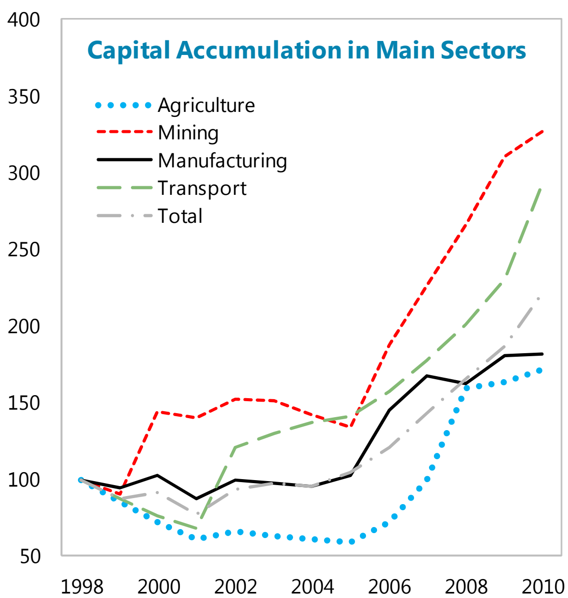
Enhancing productivity growth is therefore crucial. If the current trend were to continue in the long term, sustaining high growth rates would require increasingly higher rates of physical capital accumulation. Enhancements in TFP growth could be achieved by: 1) ensuring that production factors are channeled to their most efficient uses—increased labor mobility across sectors and firms can boost productivity by channeling labor from less productive to more productive ones; and 2) bringing the non-oil tradable sectors closer to the technological frontier—it is key that government's industrial development and diversification policies aim at encouraging technological innovation in addition to investment in physical capital. Importantly, an increased role of the private sector in the economy would be crucial in enhancing efficient resource allocation and innovation.

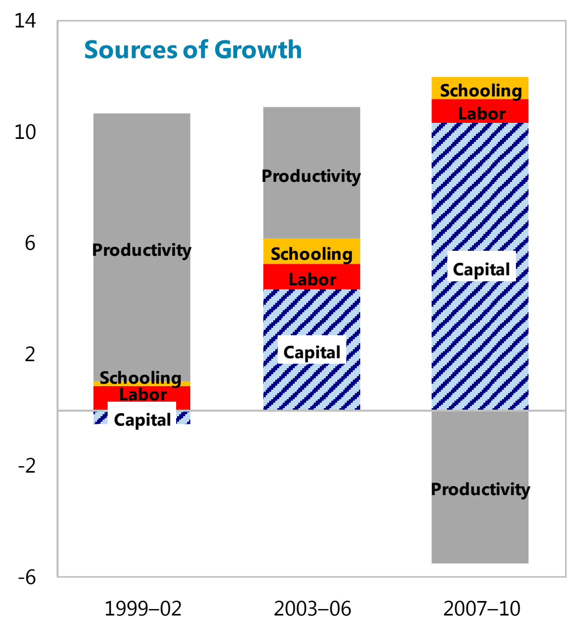
1/ The model assumes a production function $Y_i = A_i K_i^{\alpha_i} H_i^{1-\alpha_i}$ in each sector, where $H_i = L_i e^{r s_i}$ and total factor productivity is calculated as a residual.

Kazakhstan: Sources of Growth

Structure of GDP and Employment

	1999–02	2003–06	2007–10	1999–02	2003–06	2007–10
		(Percent of GDP)			(Percent of employment)	
Agriculture	9.2	7.0	5.5	31.1	33.1	29.5
Construction	5.7	7.7	8.5	3.8	5.5	6.9
Manufacturing	16.3	13.4	11.6	8.7	7.2	6.9
Mining	12.4	15.0	18.2	2.3	2.6	2.5
Real estate	12.5	15.6	13.9	3.3	3.6	3.7
Trade	13.3	12.4	12.7	17.1	14.5	14.6
Transport and Communication	10.7	10.4	8.7	8.3	7.3	7.5





Sources: Agency of Statistics of the Republic of Kazakhstan, and Fund staff estimates.

STAFF APPRAISAL

29. Macroeconomic policies have responded to the oil price-driven recovery, but the legacy of the boom and bust cycle on bank soundness remains unresolved. The authorities have reacted to the upswing in the cycle by appropriately unwinding the stimulus provided at the time of the crisis. Fiscal policy has been gradually tightened, although the non-oil deficit remains above the long-term sustainable level. High excess bank liquidity has been sterilized by the NBK and the tenge has shown some more flexibility than in the past, though the NBK has been active in offsetting frequent fluctuations in portfolio flows reflecting changes in risk perceptions. Against this background, addressing the continuous deterioration of the quality of banks' loan portfolio has proven challenging, and hopes that the rebound in economic activity and ad hoc stimulus support would restore bank balance sheets have not materialized. As a result, banks, especially some large ones, remain vulnerable and unsupportive of the government's diversification strategy. The banking sector's capital needs present a contingent liability for the public sector.

30. The growth outlook is positive but subject to external and domestic risks. A further downturn in eurozone economies, in particular if it affects China and Russia, would hurt Kazakhstan's trade, investment, and financial flows. If these developments are combined with a decline in commodity prices, the adverse impact on the economy and the banking sector would be even higher. Conversely, if world oil prices remain high, the economy would continue to benefit from positive spillovers. The authorities' preparation of contingency plans to deal with external shocks is welcome. The weak banking system and the changing socio-political environment are crucial domestic sources of vulnerability.

31. In the absence of a shock, however, it will be important to resist current plans to spend a higher share of the oil surplus. The authorities attribute a high likelihood to an adverse global scenario that would inhibit domestic growth. This perception, coupled with continued demand for public sector support from different sectors and a spread of social discontent, has led the government to temporarily increase the transfers from the oil fund to the budget and step up spending plans. In the absence of additional shocks, the envisaged expansionary fiscal policy would risk derailing the non-oil deficit from the downward trend observed in recent years and delaying its convergence to the medium-term target. While social spending must be privileged, treating other stimulus spending plans as contingent would be important, as premature and excessive reaction could unnecessarily invigorate demand and result in overheating.

32. Despite the recent sharp reduction in inflation, the NBK may need to tighten monetary policy if price pressures arise. The current record-low inflation has been supported by decreasing world food prices, an extraordinary harvest, and the use of administrative measures to limit price increases in key food items. Dismantling these measures soon is a necessary step to avoid market distortions, but together with the potential fiscal expansion, this could reignite inflationary pressures. NBK policy rates lack traction in a shallow market with limited interbank transactions and little exchange rate flexibility. Nonetheless, given the uncertainty, the NBK may need to avoid signaling further monetary easing and stand ready to tighten policies by stepping up open market operations or increasing reserve requirements if domestic demand picks up.

33. Restoring the health of the financial system remains an urgent and immediate priority. The NBK needs to be proactive in strengthening banking supervision. Envisaged and desirable regulatory improvements, including a commitment to adopt Basel III type measures, need to be complemented by strict enforcement of regulations, as prolonged forbearance does not provide incentives to the large banks to clean up their balance sheets. A comprehensive resolution of the bad debt problem is essential for the resumption of normal banking activities. The new mechanism to manage troubled assets represents only a partial solution to the problem. A successful strategy will require enforcing banks to accept realistic asset valuation and recognize losses. Forceful action will be needed to ensure adequate provisioning, replenish bank capital where needed, and close unviable banks. At the same time, subsidized lending to selected troubled borrowers that creates distortions and may lead to new NPLs should be discontinued.

34. To minimize costs and risks, a fast solution to the BTA external liability problems is needed. Losses are mounting as the bank remains operational while protracted and complex negotiations with creditors on the extent of the difficulties and the viability of a business plan take place. While the restoration of BTA's viability is not an automatic and easy task, a credible plan, based on a comprehensive and forward looking balance sheet assessment, is yet to be developed. Once legal constraints are addressed, all options, including the bank's closure, should remain open until there is agreement on a viable business plan.

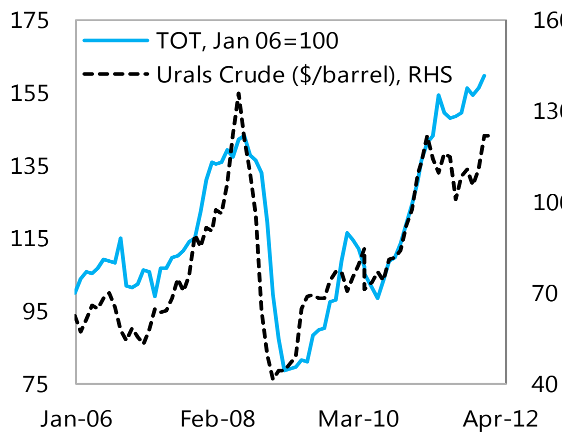
35. Looking ahead, macroeconomic policymaking would benefit from improved medium-term frameworks and better policy coordination. In the fiscal area, this strategy would require broadening the tax base to make achievement of the fiscal target credible, and fully integrating the NFRK and state entities' accounts into the medium-term fiscal framework. On the monetary front, strengthening the transmission mechanism would require a well-functioning benchmark yield curve with full market determination of prices and deeper financial markets in domestic and foreign currency. Greater exchange rate flexibility should support monetary management and the economy's response to external shocks, while mitigating speculative demand for financial assets. Ultimately, to fully garner the benefits of these reforms a well-capitalized and well-regulated financial system will be required.

36. Success in promoting sustainable development will entail reduced oil dependence and increased reliance on private consumption and investment as sources of growth. The government's plans to use some of the oil savings to finance job-creating and productive investments are consistent with economic diversification, but need to be complemented by enhanced participation of the private sector in the economy. Private sector investment will respond to further enhancements in competitiveness and the business environment by addressing governance issues and building institutions. These reforms, along with further integration of Kazakhstan into the global economy, should help ensure that the oil wealth benefits the population as a whole.

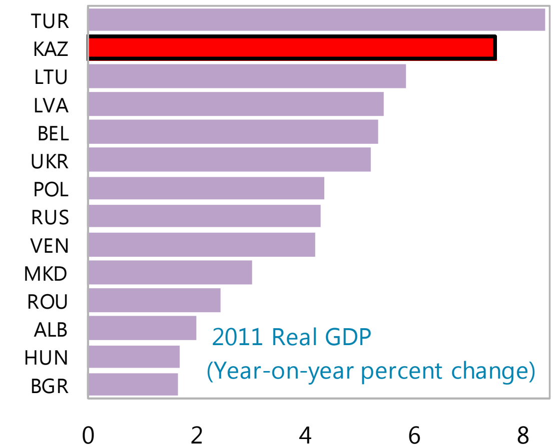
37. It is proposed that the next Article IV consultation take place on the standard 12–month cycle.

Figure 1. Kazakhstan: Macroeconomic Developments

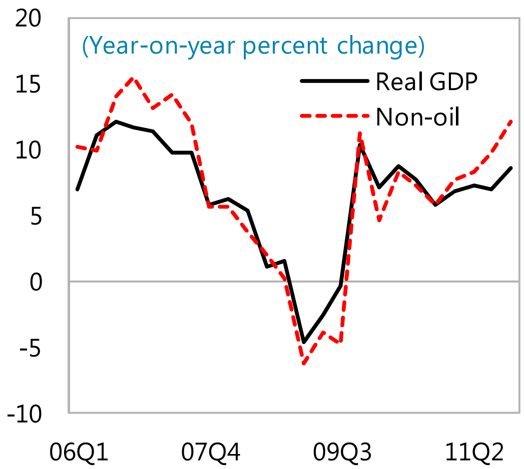
Higher oil prices led to favorable terms of trade...



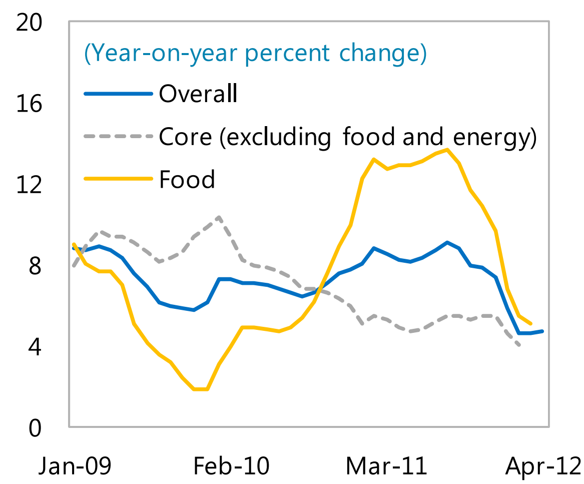
...contributing to robust growth...



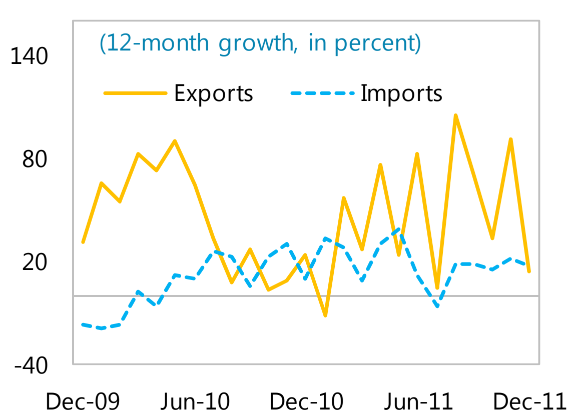
...that is now driven more by domestic demand.



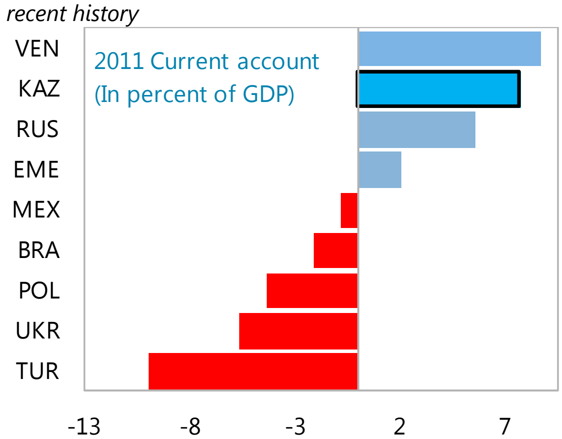
External factors and administrative measures helped to reduce inflation



Exports continued to recover while import growth remained contained...



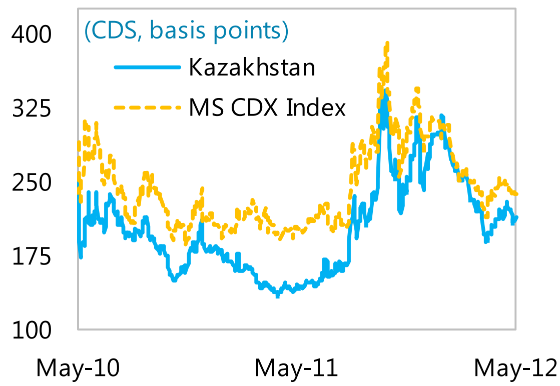
...and current account surplus reached its highest level in recent history



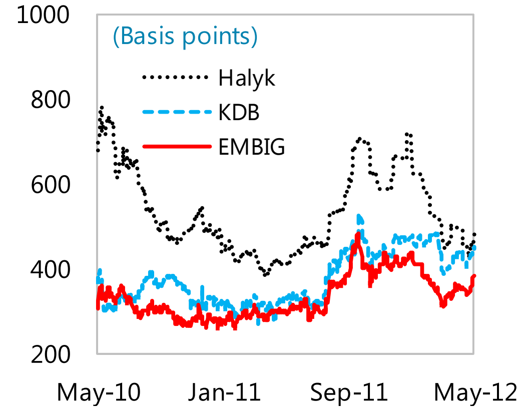
Sources: Kazakhstani authorities, and IMF staff estimates. Terms of trade are staff estimates based on monthly data, and may differ from the authorities' estimates.

Figure 2. Kazakhstan: Financial Market Developments

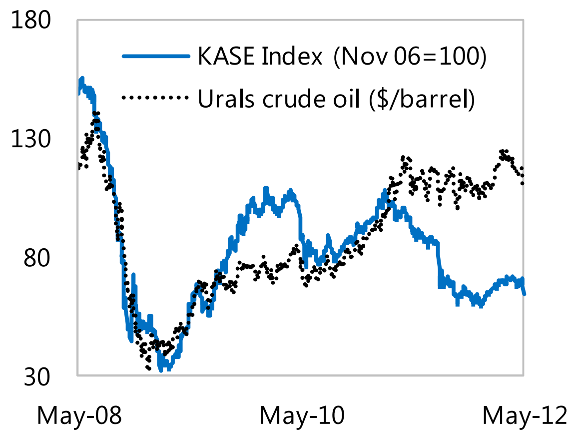
Sovereign CDS spreads have been largely influenced by developments in Russian and global markets…



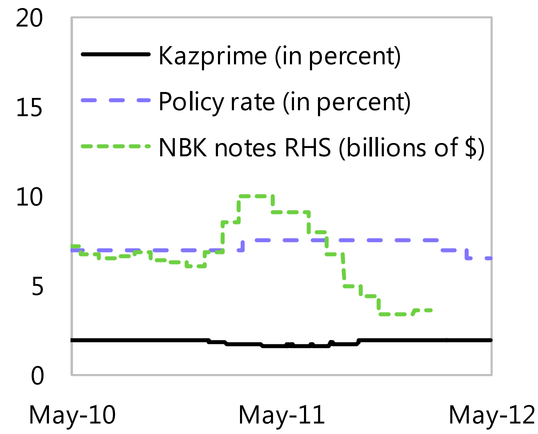
…which also affected the quasi-sovereign and corporate bond spreads…



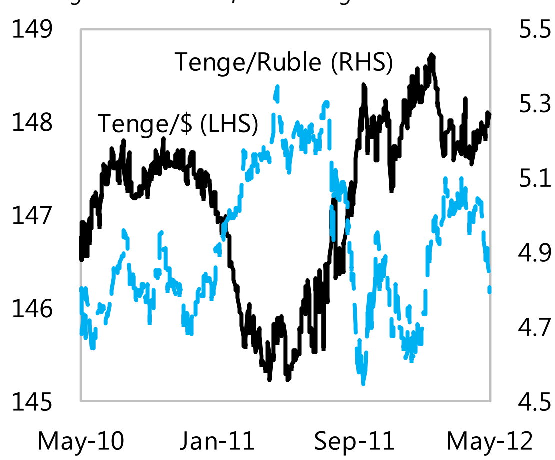
…as well as the stock market.



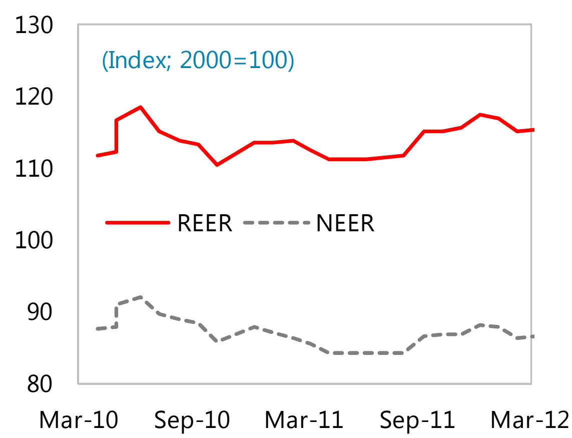
The NBK signaled monetary loosening…



…and allowed some more flexibility in the exchange rate following the abolition of the trading band.



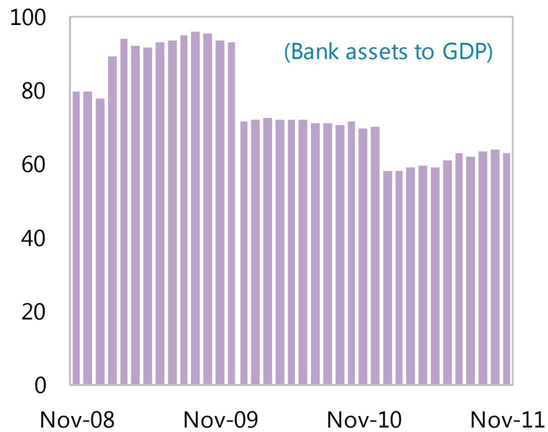
The real effective exchange rate appreciated slightly since 2011.



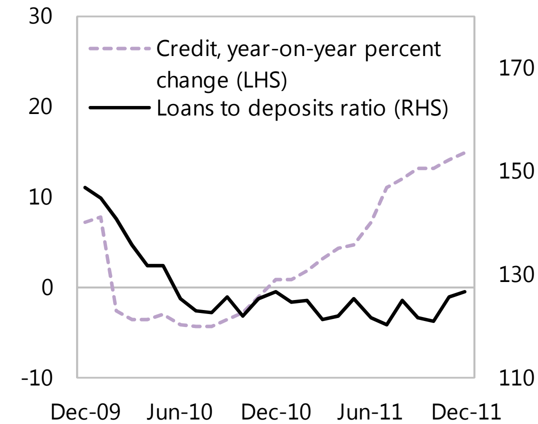
Sources: Kazakhstani authorities, Bloomberg, and IMF staff estimates.
1/The band widened from T/$150 (+/- 3 percent) to T/$150 (+10/-15 percent) in February 2010, and was abandoned at end February 2011

Figure 3. Kazakhstan: Banking Sector Developments

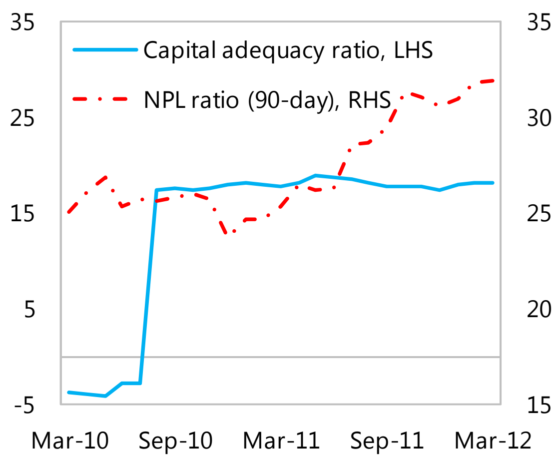
The size of the banking system reached a more sustainable level after forced deleveraging…



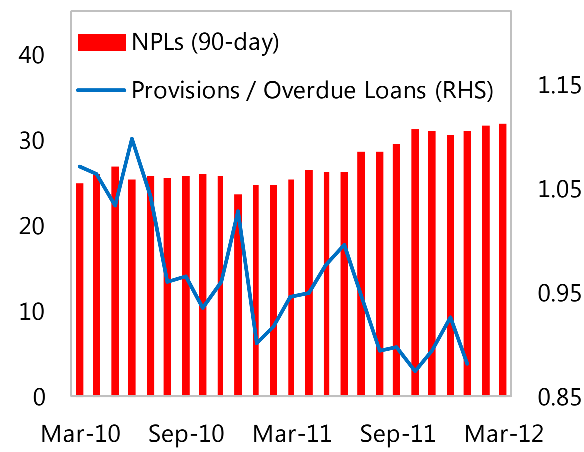
…while credit growth picked up after three years of stagnation.



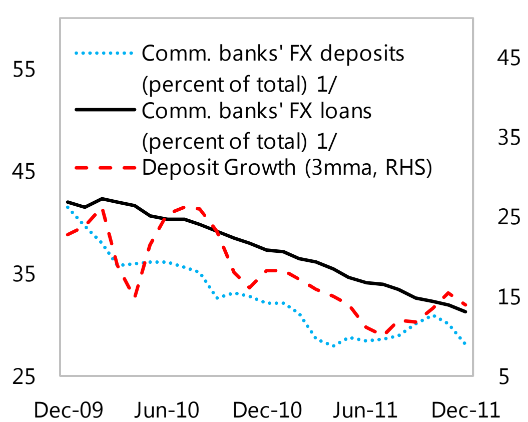
The capital adequacy ratio has stabilized at near pre-crisis level, while NPL ratio continues to deteriorate…



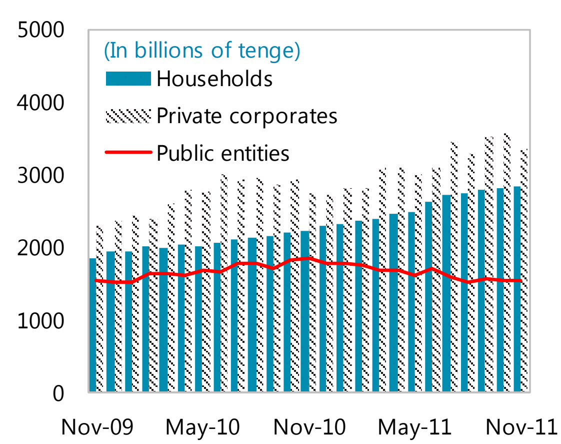
…and provisioning coverage decreases.



Confidence in the tenge has supported a decline in deposit dollarization…

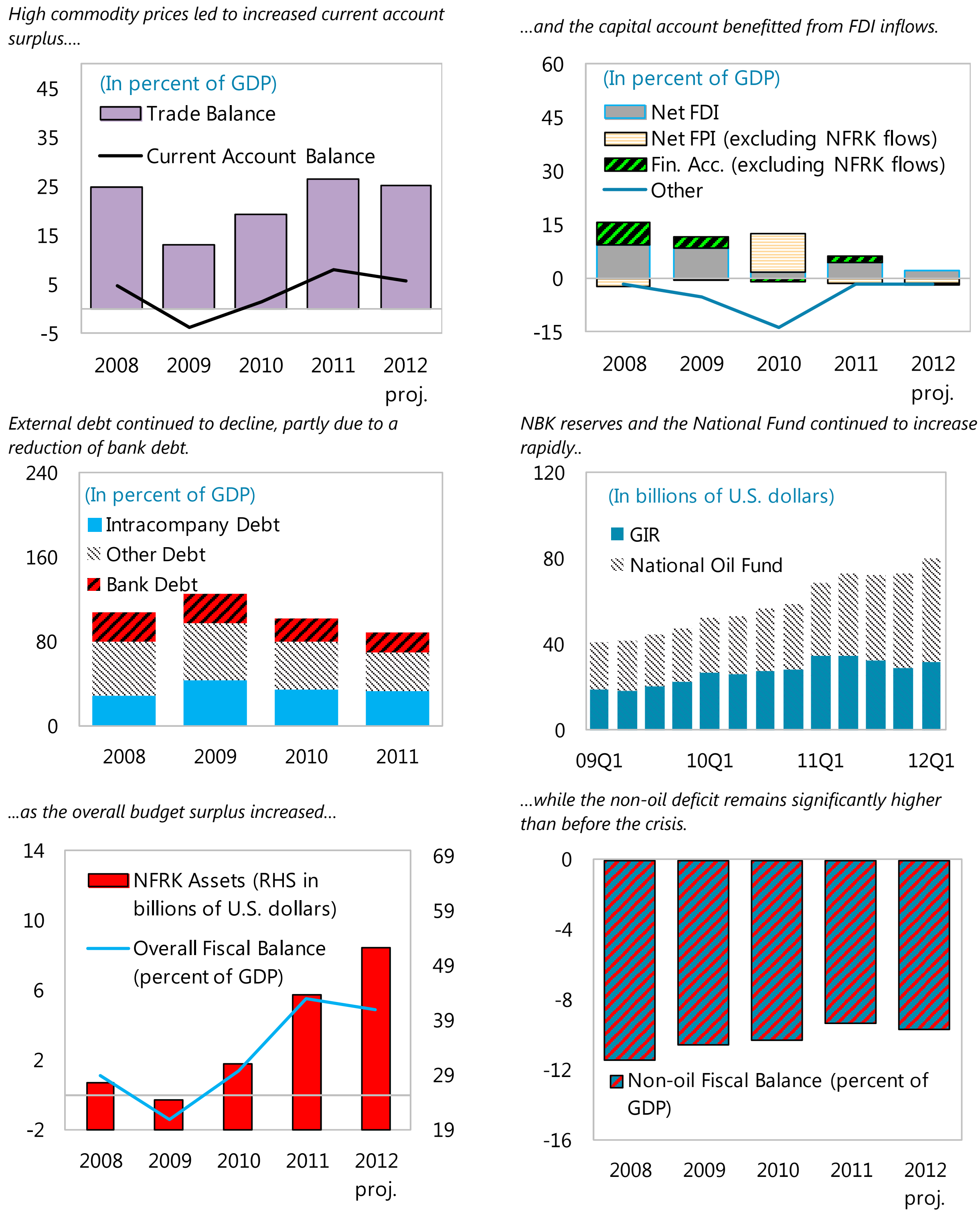


…but large public sector deposits remain important for bank balance sheets.



Sources: Kazakhstani authorities, GFSR, and IMF staff estimates.
1/ Accounting for exchange rate valuation effects.

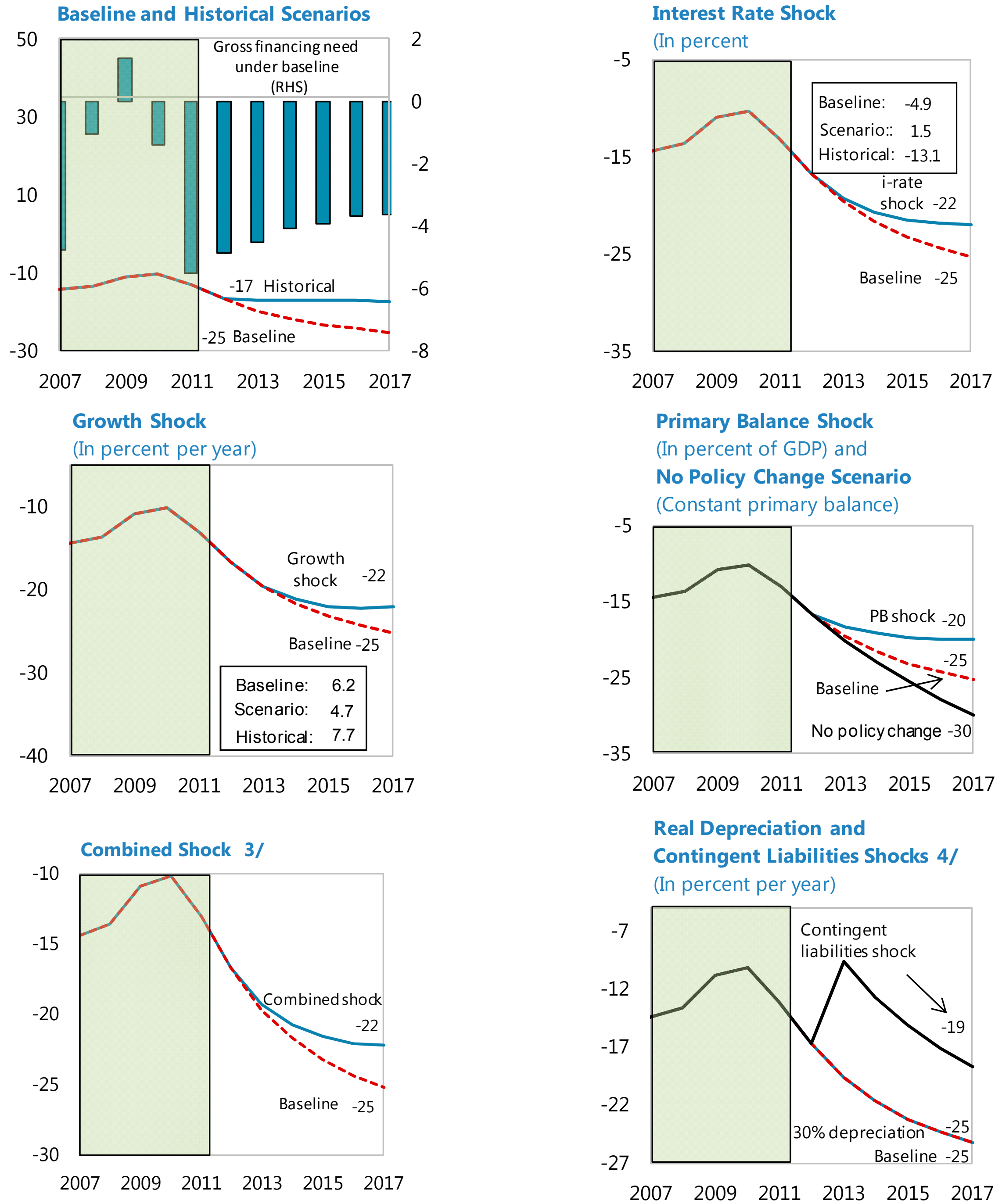
Figure 4. Kazakhstan: External and Fiscal Sector Developments and Outlook



Sources: Kazakhstani authorities and IMF staff estimates.

Figure 5. Kazakhstan: Public Debt Sustainability: Bound Tests 1/ 2/

(Public debt in percent of GDP)



Sources: International Monetary Fund, country desk data, and staff estimates.

1/ Shaded areas represent actual data. 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.

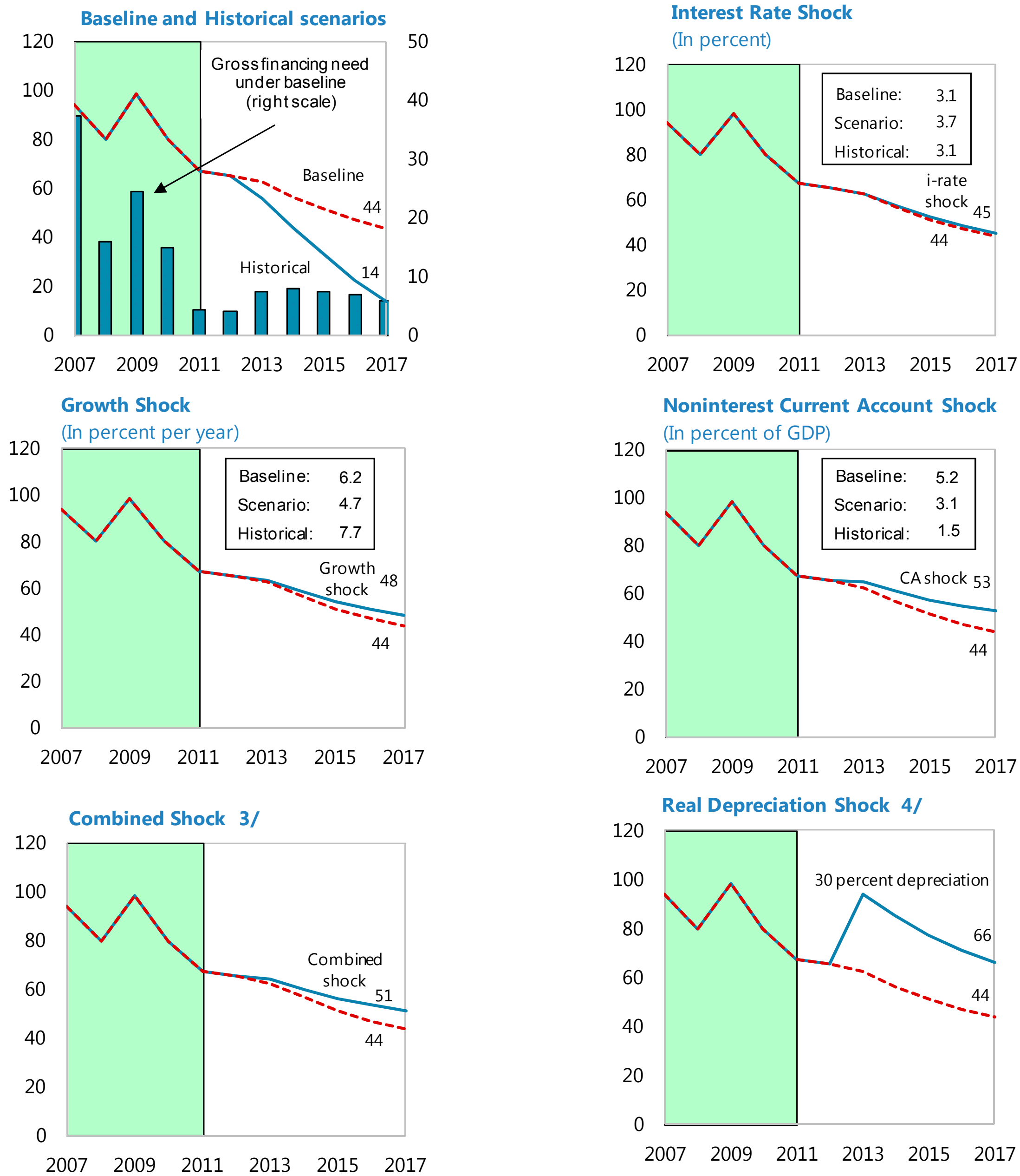
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.

4/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2012, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Figure 6. Kazakhstan: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. 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/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2012.

Table 1. Kazakhstan: Selected Economic Indicators, 2009–17

	2009	2010	2011	2012	2013	2014	2015	2016	2017
				Projections					
	(Annual percent change, unless otherwise indicated)								
National accounts and prices									
Real GDP	1.2	7.3	7.5	5.9	6.0	6.2	6.3	6.3	6.4
Real oil	7.1	7.3	1.0	1.6	1.3	1.9	5.6	5.9	5.6
Real non-oil	0.5	7.2	8.3	6.4	6.5	6.7	6.4	6.3	6.5
Crude oil and gas condensate production (million tons)	75	80	81	82	83	85	90	95	100
Consumer price index (eop)	6.2	7.8	7.4	6.6	6.8	6.4	6.3	6.0	6.0
Consumer price index (p.a)	7.3	7.1	8.3	5.6	7.2	6.6	6.3	6.0	6.0
GDP Deflator	3.3	19.6	16.4	6.3	3.8	3.0	3.6	3.9	4.4
Gross domestic investment (percent of GDP)	30.3	26.5	21.7	20.9	21.6	22.2	22.8	23.2	23.8
Gross national saving (percent of GDP) 1/	26.7	28.1	29.3	28.0	27.0	26.2	26.1	26.1	26.8
Exchange rate (tenge per U.S. dollars; eop)	22.9	-0.7	0.4	…	…	…	…	…	…
Exchange rate (tenge per Russian rubles; eop)	19.4	-1.4	-4.7	…	…	…	…	…	…
	(In percent of GDP, unless otherwise indicated)								
General government fiscal accounts									
Revenues and grants	22.1	23.9	27.5	27.1	26.7	25.9	25.3	24.7	24.3
Of which: oil revenues	9.2	11.7	14.8	14.6	14.0	12.8	11.9	11.0	10.1
Expenditures and net lending	23.5	22.5	22.0	22.2	22.2	21.8	21.4	21.0	20.7
Overall fiscal balance	-1.4	1.4	5.5	4.9	4.5	4.1	3.9	3.7	3.6
Financing	1.6	-2.0	-5.4	-4.9	-4.5	-4.1	-3.9	-3.7	-3.6
Domestic financing	2.9	1.8	1.5	0.6	-0.3	-0.7	-0.6	-0.9	-0.8
Foreign financing	0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NFRK	-1.7	-4.5	-6.9	-5.4	-4.2	-3.3	-3.4	-2.8	-2.8
Non-oil fiscal balance (percent of GDP)	-10.6	-10.3	-9.3	-9.7	-9.4	-8.7	-8.0	-7.3	-6.5
Non-oil fiscal balance (percent of non-oil GDP)	-13.7	-13.6	-12.4	-13.0	-12.2	-10.9	-9.7	-8.7	-7.6
	(Annual percent change, unless otherwise indicated)								
Monetary accounts									
Reserve money	60.7	5.0	10.2	16.7	14.5	14.8	12.8	12.3	12.5
Broad money	17.9	15.7	14.1	15.4	15.5	13.8	12.4	12.3	12.5
Broad money velocity (annual average)	2.3	2.6	2.8	2.7	2.6	2.5	2.5	2.4	2.4
Credit to the economy 2/	7.2	0.9	14.9	15.5	15.2	13.0	12.9	11.3	11.9
Credit to the economy (percent of GDP)	50.2	39.5	36.3	37.2	39.0	40.3	41.3	41.6	41.9
NBK refinance rate (eop; percent)	7.0	7.0	7.5	…	…	…	…	…	…
	(In billions of U.S. dollars, unless otherwise indicated)								
External accounts									
Current account balance (percent of GDP)	-3.6	1.6	7.6	7.1	5.3	4.0	3.3	2.9	3.0
Exports of goods and services	48.2	65.8	93.0	102.1	103.7	104.6	109.2	115.7	123.6
Oil and gas condensate	26.2	37.0	55.2	62.1	60.4	57.2	56.9	58.2	60.1
Imports of goods and services	-39.0	-44.2	-52.1	-57.8	-61.6	-65.9	-70.8	-76.7	-84.1
Foreign direct investments (net, percent of GDP)	8.7	2.0	4.5	4.7	3.1	3.6	3.3	3.0	2.7
NBK gross reserves (eop) 3/	23.1	28.3	29.3	35.3	38.4	42.8	44.8	48.5	54.2
In months of next year's imports of goods and services	6.3	6.5	6.1	6.9	7.0	7.3	7.0	6.9	8.3
NFRK assets (eop)	24.4	31.0	43.7	54.9	64.6	73.0	82.5	91.4	101.2
Public external debt, incl. guaranteed (percent of GDP)	3.2	3.5	3.0	2.8	3.0	3.0	2.9	2.8	2.8
Total external debt	112.9	118.2	123.8	134.6	141.7	142.5	144.2	148.3	154.9
In percent of GDP	97.9	79.9	66.6	65.2	62.3	56.4	51.1	46.9	43.6
Excluding intracompany debt (percent of GDP)	54.8	44.5	34.4	31.8	28.4	22.5	17.6	14.2	12.0
Memorandum items:									
Nominal GDP (in billions of tenge)	17,008	21,815	27,301	30,718	33,801	36,970	40,733	45,003	49,991
Nominal GDP (in billions of U.S. dollars)	115.3	148.0	186.2	206.4	227.5	252.5	282.5	316.2	355.2
Crude oil, gas cnds. Production (millions of barrels per day) 4/	1.56	1.67	1.69	1.71	1.73	1.77	1.87	1.98	2.08
Oil price (in U.S. dollars per barrel)	61.8	79.0	104.0	114.7	110.0	102.8	97.2	93.3	91.0

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

1/ Calculated as gross domestic investment, plus the current account balance.
2/ In 2009, credit growth would be -2.5 percent, if adjusted for the devaluation.
3/ Does not include NFRK.
4/ Based on a conversion factor of 7.5 barrels of oil per ton.

Table 2. Kazakhstan: Balance of Payments, 2009–17

	2009	2010	2011	2012	2013	2014	2015	2016	2017
				Projections					
				(In billions of U.S. dollars)					
Current account	-4.1	2.4	14.1	14.7	12.2	10.1	9.2	9.1	10.6
Trade balance	15.0	28.7	47.3	53.9	52.9	50.9	52.0	53.8	56.0
Exports (f.o.b.)	43.9	61.6	88.5	97.4	98.8	99.5	104.0	110.4	118.1
Oil and gas condensate	26.2	37.0	55.2	62.1	60.4	57.2	56.9	58.2	60.1
Non-oil exports	17.7	24.6	33.3	35.2	38.4	42.3	47.0	52.2	58.0
Imports (f.o.b.)	-29.0	-32.9	-41.2	-43.4	-45.9	-48.6	-52.0	-56.5	-62.1
Oil and gas condensate	-1.4	-2.4	-2.5	-3.2	-3.2	-3.3	-3.4	-3.5	-3.4
Non-oil, gas imports	-27.5	-30.5	-38.7	-40.3	-42.6	-45.4	-48.6	-53.1	-58.7
Services and income balance	-18.4	-25.8	-32.9	-38.6	-40.1	-40.0	-41.9	-43.7	-44.2
Services, net	-5.8	-7.1	-6.4	-9.6	-10.8	-12.2	-13.5	-14.8	-16.5
Income, net	-12.6	-18.7	-26.5	-29.0	-29.2	-27.8	-28.3	-28.9	-27.7
Of which: Income to direct investors	-10.4	-16.5	-23.5	-25.6	-25.2	-23.1	-23.3	-23.7	-23.0
Current transfers	-0.7	-0.5	-0.3	-0.6	-0.7	-0.7	-0.9	-1.0	-1.1
Capital and financial account	7.4	-0.7	-8.0	-8.8	-9.1	-5.7	-7.2	-5.5	-4.9
Foreign direct investment	10.1	2.9	8.4	9.8	7.0	9.1	9.2	9.4	9.5
Amortization of intracompany liabilities	-6.0	-7.4	-6.7	-9.5	-9.1	-8.2	-8.4	-8.5	-8.2
Portfolio investment, net	3.0	8.5	-13.5	-13.6	-12.9	-11.7	-13.1	-11.7	-11.0
Of which: National Fund	3.2	-7.3	-12.8	-10.9	-9.2	-7.9	-8.5	-7.0	-6.3
Other investment	-5.8	-20.0	-3.0	-3.1	-3.1	-3.2	-3.3	-3.5	-3.7
Errors and omissions	-0.8	3.0	-5.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.5	4.7	0.3	5.9	3.1	4.4	2.0	3.7	5.7
Financing: Net international reserves of NBK	-2.5	-4.7	-0.3	-5.9	-3.1	-4.4	-2.0	-3.7	-5.7
Memorandum items: 1/				(In percent of GDP)					
Current account	-3.6	1.6	7.6	7.1	5.3	4.0	3.3	2.9	3.0
Exports of goods	38.1	41.6	47.5	47.2	43.4	39.4	36.8	34.9	33.2
Oil exports	22.7	25.0	29.6	30.1	26.5	22.6	20.2	18.4	16.9
Non-oil exports	15.4	16.6	17.8	17.1	16.9	16.8	16.6	16.5	16.3
Imports of goods	-25.1	-22.2	-22.1	-21.0	-20.2	-19.3	-18.4	-17.9	-17.5
				(Annual growth rate, in percent)					
Exports	-39.0	40.2	43.7	10.0	1.5	0.8	4.5	6.1	7.0
Non-oil exports	-37.7	38.6	35.6	5.8	9.0	10.3	11.1	11.0	11.1
Volume on non-oil exports	-24.0	11.9	19.9	14.1	6.1	5.4	5.8	5.7	5.8
Average price of non-oil exports	-18.0	27.9	15.4	-8.8	0.1	-1.8	-1.4	-0.4	0.1
Imports	-24.7	13.6	25.2	5.4	5.6	6.0	6.9	8.7	9.8
Oil and gas imports	-47.8	66.1	4.2	26.5	2.6	0.9	3.0	2.8	-2.5
Non-oil imports	-22.9	10.9	26.9	4.0	5.9	6.4	7.2	9.1	10.6
Volume on non-oil imports	-13.0	-6.7	15.0	8.6	4.0	5.2	6.7	8.0	9.5
Average price of non-oil imports	-12.1	18.3	11.4	-4.7	-0.4	-1.3	-0.5	-0.2	0.1
Exports of oil and gas condensate (in MT)	67.3	67.5	71.5	73.0	74.0	75.0	79.0	84.0	89.0
NBK gross international reserves (in billions of U.S. dollars)	23.1	28.3	29.3	35.3	38.4	42.8	44.8	48.5	54.2
In months of next year's imports of goods and services	6.3	6.5	6.1	6.9	7.0	7.3	7.0	6.9	8.3
Excluding bank deposits in FX at NBK	21.7	28.0	...	...	...	...	...	...	...
National Fund (including interest), e.o.p.	24.4	31.0	43.7	54.9	64.6	73.0	82.5	91.4	101.2
External debt in percent of GDP	97.9	79.9	66.6	65.2	62.3	56.4	51.1	46.9	43.6
Excluding intra-company loans	54.8	44.5	34.4	31.8	28.4	22.5	17.6	14.2	12.0
World oil price (U.S. dollars per barrel)	61.8	79.0	104.0	114.7	110.0	102.8	97.2	93.3	91.0

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

1/ Estimates and projections are based on GDP at market exchange rates.

Table 3A. Kazakhstan: General Government Fiscal Operations, 2009–17

	2009	2010	2011	2012	2013	2014	2015	2016	2017
				Projections					
				(In billions of tenge)					
Total revenue and grants	3,766	5,223	7,521	8,311	9,036	9,562	10,319	11,129	12,152
Total revenue	3,766	5,223	7,521	8,311	9,036	9,562	10,319	11,129	12,152
Of which: Tax revenue	3,598	5,185	7,337	8,219	8,904	9,402	10,073	10,742	11,506
Oil revenue	1,563	2,555	4,042	4,481	4,721	4,725	4,866	4,945	5,033
Non-oil tax revenue	2,035	2,630	3,295	3,737	4,183	4,678	5,207	5,798	6,474
Total expenditure and net lending and transfers	4,002	4,915	6,012	6,813	7,509	8,059	8,719	9,468	10,345
Total expenditure and net lending	4,002	4,915	6,012	6,813	7,509	8,059	8,719	9,468	10,345
Total expenditure	3,971	4,805	5,872	6,656	7,336	7,870	8,511	9,238	10,090
Current expenditure	2,975	3,625	4,554	5,098	5,554	5,862	6,232	6,645	7,123
Capital expenditure	997	1,180	1,318	1,557	1,782	2,008	2,279	2,593	2,967
Net lending	31	110	140	157	173	189	208	230	256
Overall budget balance	-236	308	1,509	1,499	1,528	1,503	1,599	1,662	1,806
Statistical discrepancy	35	-126	47	0	0	0	0	0	0
Financing	271	-435	-1,462	-1,499	-1,528	-1,503	-1,599	-1,662	-1,806
Domestic financing, net	469	380	411	171	-93	-270	-228	-397	-418
Foreign financing, net	76	148	-1	-3	-4	-4	-4	-4	-3
Privatization receipts	17	12	8	6	4	3	2	1	1
NFRK 1/	-290	-974	-1,880	-1,673	-1,435	-1,232	-1,370	-1,262	-1,386
				(In percent of GDP)					
Total revenue and grants	22.1	23.9	27.5	27.1	26.7	25.9	25.3	24.7	24.3
Total revenue	22.1	23.9	27.5	27.1	26.7	25.9	25.3	24.7	24.3
Of which: Tax revenue	21.2	23.8	26.9	26.8	26.3	25.4	24.7	23.9	23.0
Oil revenue	9.2	11.7	14.8	14.6	14.0	12.8	11.9	11.0	10.1
Non-oil tax revenue	12.0	12.1	12.1	12.2	12.4	12.7	12.8	12.9	12.9
Total expenditure and net lending and transfers	23.5	22.5	22.0	22.2	22.2	21.8	21.4	21.0	20.7
Total expenditure and net lending	23.5	22.5	22.0	22.2	22.2	21.8	21.4	21.0	20.7
Total expenditure	23.4	22.0	21.5	21.7	21.7	21.3	20.9	20.5	20.2
Current expenditure	17.5	16.6	16.7	16.6	16.4	15.9	15.3	14.8	14.2
Capital expenditure	5.9	5.4	4.8	5.1	5.3	5.4	5.6	5.8	5.9
Net lending	0.2	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Primary balance	-1.0	1.8	6.0	5.3	4.8	4.3	4.1	3.9	3.7
Overall balance	-1.4	1.4	5.5	4.9	4.5	4.1	3.9	3.7	3.6
Non-oil primary balance	-10.2	-9.9	-8.8	-9.3	-9.1	-8.5	-7.8	-7.1	-6.3
Non-oil overall balance	-10.6	-10.3	-9.3	-9.7	-9.4	-8.7	-8.0	-7.3	-6.5
Financing	1.6	-2.0	-5.4	-4.9	-4.5	-4.1	-3.9	-3.7	-3.6
Domestic financing, net	2.8	1.7	1.5	0.6	-0.3	-0.7	-0.6	-0.9	-0.8
Foreign financing, net	0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
NFRK 1/	-1.7	-4.5	-6.9	-5.4	-4.2	-3.3	-3.4	-2.8	-2.8
Memorandum items:									
Off-budget stimulus spending (percent of GDP) 2/	5.2	0.7	0.0	0.5	0.8	...	...	...	...
Non-oil balance (in percent of non-oil GDP)	-13.7	-13.6	-12.4	-13.0	-12.2	-10.9	-9.7	-8.7	-7.6
Cyclically adjusted non-oil balance (to non-oil GDP)	-13.0	-13.0	-12.1	-12.6	-11.8	-10.4	-9.4	-9.2	-8.2
Cyclically adjusted non-oil balance (to GDP)	-10.0	-9.9	-9.0	-9.4	-9.1	-8.4	-7.7	-6.9	-6.1
Wages (in percent of GDP)	3.5	3.1	3.0	3.1	3.2	3.3	3.3	3.4	3.4
Gross debt to GDP (percent)	10.2	10.7	10.5	9.9	8.7	7.2	6.0	4.5	3.2
Net liabilities (in percent of GDP)	-10.9	-10.2	-13.2	-16.7	-19.7	-21.7	-23.2	-24.4	-25.3
NFRK assets (in billions U.S. dollars) 1/	24.4	31.0	43.7	54.9	64.6	73.0	82.5	91.4	101.2
Use of oil revenues (in percent of GDP)	7.3	7.8	7.7	9.1	9.7	9.4	8.6	8.2	7.3
Nominal GDP (in billions KZT)	17,008	21,815	27,301	30,718	33,801	36,970	40,733	45,003	49,991

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

1/ National Fund of the Republic of Kazakhstan. (-) is accumulation in the Fund.

2/ Includes staff estimates of expenditures financed by Samruk-Kazyna under the anti-crisis plan.

Table 3B. Kazakhstan: Statement of Operations - General Government, 2009–17

				Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
				(In billions of tenge)					
Revenue	3,766	5,223	7,521	8,311	9,036	9,562	10,319	11,129	12,152
Taxes	3,365	4,931	7,040	7,933	8,579	9,034	9,657	10,274	10,979
Oil tax revenue	1,563	2,555	4,042	4,481	4,721	4,725	4,866	4,945	5,033
Nonoil revenue	2,203	2,668	3,479	3,830	4,316	4,837	5,452	6,185	7,119
Social contributions	233	254	297	286	325	369	416	468	527
Grants	0	0	0	0	0	0	0	0	0
Other revenue	168	38	184	92	132	159	246	387	646
Expenditure	3,986	4,903	6,003	6,807	7,505	8,056	8,717	9,466	10,344
Expense	3,005	3,735	4,693	5,255	5,727	6,051	6,441	6,875	7,379
Compensation of employees	591	681	824	945	1,070	1,207	1,358	1,525	1,715
Use of goods and services	1,032	1,249	1,564	1,751	1,907	2,013	2,140	2,282	2,446
Interest	69	95	122	117	106	91	75	72	57
Other expense	1,313	1,710	2,184	2,442	2,643	2,740	2,867	2,996	3,161
Net acquisition of nonfinancial assets	980	1,169	1,310	1,552	1,778	2,005	2,277	2,592	2,966
Net operating balance	761	1,489	2,827	3,056	3,310	3,511	3,878	4,254	4,773
Net lending/borrowing	-220	320	1,517	1,504	1,532	1,506	1,601	1,663	1,807
Net acquisition of financial assets 1/	290	974	1,880	1,673	1,435	1,232	1,370	1,262	1,386
Net incurrence of liabilities	545	528	410	169	-97	-274	-232	-401	-422
Domestic	469	380	411	171	-93	-270	-228	-397	-418
Foreign	76	148	-1	-3	-4	-4	-4	-4	-3
				(In percent of GDP)					
Revenue	22.1	23.9	27.5	27.1	26.7	25.9	25.3	24.7	24.3
Taxes	19.8	22.6	25.8	25.8	25.4	24.4	23.7	22.8	22.0
Oil tax revenue	9.2	11.7	14.8	14.6	14.0	12.8	11.9	11.0	10.1
Nonoil revenue	13.0	12.2	12.7	12.5	12.8	13.1	13.4	13.7	14.2
Social contributions	1.4	1.2	1.1	0.9	1.0	1.0	1.0	1.0	1.1
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other revenue	1.0	0.2	0.7	0.3	0.4	0.4	0.6	0.9	1.3
Expenditure	23.4	22.5	22.0	22.2	22.2	21.8	21.4	21.0	20.7
Expense	17.7	17.1	17.2	17.1	16.9	16.4	15.8	15.3	14.8
Compensation of employees	3.5	3.1	3.0	3.1	3.2	3.3	3.3	3.4	3.4
Use of goods and services	6.1	5.7	5.7	5.7	5.6	5.4	5.3	5.1	4.9
Interest	0.4	0.4	0.4	0.4	0.3	0.2	0.2	0.2	0.1
Other expense	7.7	7.8	8.0	7.9	7.8	7.4	7.0	6.7	6.3
Net acquisition of nonfinancial assets	5.8	5.4	4.8	5.1	5.3	5.4	5.6	5.8	5.9
Net operating balance	4.5	6.8	10.4	9.9	9.8	9.5	9.5	9.5	9.5
Net lending/borrowing	-1.3	1.5	5.6	4.9	4.5	4.1	3.9	3.7	3.6
Net acquisition of financial assets 1/	1.7	4.5	6.9	5.4	4.2	3.3	3.4	2.8	2.8
Net incurrence of liabilities	3.2	2.4	1.5	0.5	-0.3	-0.7	-0.6	-0.9	-0.8
Domestic	2.8	1.7	1.5	0.6	-0.3	-0.7	-0.6	-0.9	-0.8
Foreign	0.4	0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0

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

1/ Includes accumulation in the National Fund of the Republic of Kazakhstan.

Table 4. Kazakhstan: General Government Balance Sheet, 2009–17

				Projections					
	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(In billions of tenge)								
Net Financial Worth	1,502	2,668	4,318	5,477	6,512	7,842	8,899	10,065	11,443
Financial assets 1/	3,242	4,999	7,188	8,515	9,453	10,510	11,334	12,099	13,056
Domestic	366	432	720	705	430	456	483	512	543
Currency and deposits	366	432	720	705	430	456	483	512	543
Foreign	2,875	4,566	6,468	7,810	9,023	10,054	10,851	11,587	12,513
Currency and deposits	2,875	4,566	6,468	7,810	9,023	10,054	10,851	11,587	12,513
Liabilities 2/	1,739	2,330	2,870	3,038	2,941	2,667	2,436	2,035	1,613
Domestic	1,295	1,675	2,087	2,258	2,165	1,895	1,666	1,269	851
Securities other than shares	1,295	1,675	2,087	2,258	2,165	1,895	1,666	1,269	851
Foreign	444	655	783	780	776	773	769	766	762
Securities other than shares	0	0	5	...	...	...	...	...	...
Loans	329	553	660	...	...	...	...	...	...

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

1/ Data does not include government assets of Samruk-Kazyna and its companies.

2/ Data does not include liabilities of Samruk-Kazyna and its companies.

Table 5. Kazakhstan: Monetary Accounts, 2008–13

	2008	2009	2010	2011	Projections 2012	2013
	(End of period, in billions of tenge)					
Monetary Survey						
Net Foreign Assets	811	2,806	4,601	5,370	6,445	6,790
Net Domestic Assets	5,993	5,756	4,941	5,439	5,702	7,294
Domestic Credit	8,580	9,575	10,146	11,275	13,151	15,082
Net claims on central government	223	-72	16	-203	-286	-261
Net claims on other government	34	228	824	8	7	8
Credit to the private sector	7,970	8,544	8,619	9,901	11,434	13,174
Other claims on the economy	353	875	687	697	1,118	1,293
Other items, net	-2,586	-3,819	-5,204	-5,836	-7,449	-7,788
Broad money	6,267	7,386	8,546	9,751	11,252	13,000
Currency in circulation	858	914	1,148	1,366	835	965
Total deposits	5,409	6,473	7,398	8,385	10,417	12,036
Domestic currency deposits	3,493	3,644	4,808	5,756	6,729	7,681
Foreign currency deposits	1,917	2,828	2,590	2,630	3,688	4,355
Nonliquid liabilities	80	92	116	148	109	109
Statistical discrepancy	457	1,084	879	911	785	974
Accounts of National Bank of Kazakhstan						
Net foreign assets	2,402	3,475	4,153	4,376	5,204	5,589
Net international reserves 1/	2,403	3,448	4,211	4,357	5,285	5,681
Net domestic assets	-264	-824	-1,542	-1,531	-1,886	-1,750
Net domestic credit	-41	-71	-662	-568	-587	-613
Net claims on central government	14	-313	-383	-664	-772	-863
Net claims on other government	6	190	10	12	10	0
Net claims on the private sector	0	1	1	2	2	2
Net claims on banks	-62	52	-290	82	173	248
Other items, net	-223	-753	-879	-963	-1,299	-1,138
Reserve money	1,525	2,451	2,573	2,836	3,309	3,790
Currency in circulation	987	1,048	1,306	1,548	1,324	1,478
Liabilities to banks	328	949	722	728	1,281	1,477
Required reserves	295	460	292	631	926	1,072
Other liabilities	33	489	429	97	355	405
Demand deposits	210	454	545	560	705	835
Other deposits	0	0	0	0	0	0
Other liquid liabilities	612	201	38	9	9	49
Deposit money banks						
Net foreign assets	-1,591	-669	448	994	1,241	1,201
Net domestic assets	6,258	6,579	6,483	6,970	7,588	9,044
Domestic credit	8,621	9,646	10,808	11,843	13,738	15,694
Net claims on central government	209	241	399	461	486	601
Net claims on other government	28	38	814	868	875	876
Credit to the private sector	7,969	8,544	8,618	9,898	11,432	13,172
Banks' reserves	597	1,438	1,074	802	1,137	1,237
Net claims on other financial corporations	-182	-615	-97	-186	-191	-191
Other items, net	-2,363	-3,067	-4,325	-4,873	-6,150	-6,650
Banks' liabilities	4,667	5,910	6,931	7,964	8,829	10,245
Demand deposits	1,149	1,733	2,112	2,762	3,187	3,682
Other deposits	3,438	4,085	4,703	5,055	5,502	6,424
Other liabilities	80	92	116	148	140	140
Memorandum items:						
Reserve money (percent change, year-on-year)	4.2	60.7	5.0	10.2	16.7	14.5
Broad money (percent change, year-on-year)	35.4	17.9	15.7	14.1	15.4	15.5
Credit to the economy (percent change, year-on-year)	5.2	7.2	0.9	14.9	15.5	15.2
Velocity of broad money	2.6	2.3	2.6	2.8	2.7	2.6
Money multiplier	4.1	3.0	3.3	3.4	3.4	3.4
Foreign currency deposits (in percent of total deposits) 2/	41	47	37	33	30	31
Foreign currency loans (in percent of total loans) 2/	44	47	42	36	35	34

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

1/ Does not include oil fund resources.

2/ Commercial banks only.

Table 6. Kazakhstan: Selected Prudential Indicators of the Banking Sector, 2007–12

	2007	2008	2009	2010	2011	2012 Q1
Capital adequacy ratio (K2, percent of risk weighted assets)	14.2	14.9	-8.2	17.9	17.4	18.2
Tier I capital (K1, percent of risk weighted assets)	10.7	12.4	-11.6	11.6	12.9	13.6
Growth in banks' total assets	31.7	1.8	-2.8	4.1	6.5	3.8
Growth in banks' loans (credit to the private sector)	55.2	5.2	7.2	0.9	14.9	15.5
Growth of claims on private nonfinancial institutions	48.7	12.2	-1.8	5.8	17.3	1.1
Growth of claims on households	68.1	-8.0	-10.4	-3.4	10.0	1.4
Classified assets to total assets 1/	45.9	44.4	67.4	58.9	63.8	64.1
Classified loans to total loans 1/	60.3	57.0	74.6	73.6	74.3	73.9
Percentage of doubtful category 5 and loss loans in total loan portfolio 2/	3.2	8.1	36.5	32.6	35.1	33.1
Percentage of loans that are 90 days past due in loan portfolio	...	5.2	21.2	23.8	30.8	31.9
Loans classified as loss (percent of total loans)	1.5	4.4	30.6	20.0	22.0	22.4
Loan loss provisions (percent of total loans)	5.9	11.1	37.7	30.9	32.1	31.1
Bad assets that are 100 percent provisioned (percent of total assets)	1.2	3.4	29.2	17.6	19.8	16.7
Net foreign assets (percent of total assets)	23.1	24.5	16.1	16.5	13.9	13.5
Net open position in FX (percent of capital)	2.1	3.9	...	0.8	-1.2	0.7
Share of resident deposits denominated in FX 3/	30.3	40.0	43.9	35.6	31.7	34.5
Share of FX loans to residents 4/	42.0	43.5	48.1	42.4	35.7	34.0
Securities (percent of total assets)	6.5	6.9	14.1	12.4	14.5	13.9
Liquid assets to short term liabilities 5/	97.0	158.2	211.6	247.6	244.4	294.5
Loans-to-deposit ratio	89.6	201.5	160.5	132.8	134.3	126.9
Share of liabilities in foreign exchange to total liabilities	62.3	59.7	53.8	44.3	40.5	41.3
Loans-to-deposit ratio, excluding deposits of nonresident legal entities	237.1	206.5	165.3	134.7	136.8	129.1
FX denominated loans-to-FX denominated deposits ratio	336.0	254.2	192.7	179.2	181.5	152.7
Return on assets, before tax (percent of assets, e.o.p)	2.3	0.2	-24.1	12.0	-0.1	-1.3
Return on equity, before tax (percent of equity, e.o.p)	18.4	1.9	...	...	-0.9	-12.1

Sources: FSC, NBK, and IMF staff calculations.

1/ Loans or assets classified as doubtful and loss.

2/ The share of the fifth category of doubtful loans and the bad loans, percent.

3/ Deposits of residents in foreign currency to total deposits, percent.

4/ Loans to residents in foreign currency to total loans to residents, percent.

5/ Calculation of this coefficient was changed from July 1, 2008 (excluding demand liabilities).

Table 7. Kazakhstan: Public Sector Debt Sustainability Framework, 2007–17

	2007	2008	2009	2010	2011	Projections 2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
	(In percent of GDP, unless otherwise indicated)											
Baseline: Public sector debt 1/	-14.4	-13.7	-10.9	-10.2	-13.2	-16.7	-19.7	-21.7	-23.2	-24.4	-25.3	2.6
Of which: Foreign-currency denominated	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in public sector debt	-3.7	0.8	2.8	0.7	-2.9	-3.6	-3.0	-2.0	-1.5	-1.1	-0.9	
Identified debt-creating flows (4+7+12)	-2.7	2.2	2.0	1.0	-3.5	-3.4	-3.0	-2.4	-1.9	-1.5	-1.2	
Primary deficit	-5.0	-1.4	1.0	-1.8	-6.0	-5.3	-4.8	-4.3	-4.1	-3.9	-3.7	
Revenue and grants	29.3	27.9	22.1	23.9	27.5	27.1	26.7	25.9	25.3	24.7	24.3	
Primary (noninterest) expenditure	24.3	26.5	23.1	22.1	21.6	21.8	21.9	21.6	21.2	20.9	20.6	
Automatic debt dynamics 2/	2.3	3.6	1.0	2.8	2.5	1.8	1.8	1.9	2.2	2.4	2.5	
Contribution from interest rate/growth differential 3/	2.3	3.6	1.0	2.8	2.5	1.8	1.8	1.9	2.2	2.4	2.5	
Of which: Contribution from real interest rate	1.6	3.2	0.8	2.2	1.9	1.2	0.9	0.8	0.9	1.0	1.1	
Of which: Contribution from real GDP growth	0.8	0.4	0.2	0.6	0.6	0.7	0.9	1.1	1.2	1.3	1.4	
Contribution from exchange rate depreciation 4/	0.0	0.0	0.0	0.0	0.0	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 5/	-1.0	-1.4	0.8	-0.3	0.6	-0.1	0.0	0.4	0.4	0.3	0.3	
Public sector debt-to-revenue ratio 1/	-49.2	-48.9	-49.3	-42.8	-47.8	-61.8	-73.7	-83.9	-91.7	-98.6	-104.0	
Gross financing need 6/	-4.7	-1.1	1.4	-1.4	-5.5	-4.9	-4.5	-4.1	-3.9	-3.7	-3.6	
In billions of U.S. dollars	-4.9	-1.4	1.6	-2.1	-10.2	-10.1	-10.3	-10.3	-11.1	-11.7	-12.8	
Scenario with key variables at their historical averages 7/						-16.7	-17.1	-17.1	-17.1	-17.1	-17.2	3.2
Scenario with no policy change (constant primary balance) in 2012–17						-16.7	-20.1	-23.0	-25.6	-27.9	-30.0	3.1
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	8.9	3.2	1.2	7.3	7.5	5.9	6.0	6.2	6.3	6.3	6.4	
Average nominal interest rate on public debt (in percent) 8/	-3.1	-3.4	-3.1	-5.1	-5.4	-3.3	-2.1	-1.4	-0.9	-0.8	-0.5	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-16.7	-28.1	-6.4	-24.7	-21.9	-9.5	-5.9	-4.4	-4.6	-4.7	-4.9	
Nominal appreciation (increase in US dollar value of local currency, in percent)	5.6	-0.4	-18.7	0.7	-0.4	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	13.6	24.7	3.3	19.6	16.4	6.3	3.8	3.0	3.6	3.9	4.4	
Growth of real primary spending (deflated by GDP deflator, in percent)	32.6	12.4	-11.6	2.5	5.0	7.0	6.5	4.5	4.7	4.6	4.9	
Primary deficit	-5.0	-1.4	1.0	-1.8	-6.0	-5.3	-4.8	-4.3	-4.1	-3.9	-3.7	

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

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

2/ Derived as [(r - p(1+g) - g + ae(1+r)]/(1+g+p+gp)) times previous period debt ratio, with r = interest rate; p = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as r - π (1+g) and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as ae(1+r).

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium- and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Table 8. Kazakhstan: External Debt Sustainability Framework, 2007–17

	2007	2008	2009	2010	2011			Projections 2012	2013	2014	2015	2016	2017	Debt-stabilizing noninterest CAB 6/
						(In percent of GDP, unless otherwise indicated)								
Baseline: External debt	93.9	79.8	97.9	79.9	66.6			65.2	62.3	56.4	51.1	46.9	43.6	-7.8
Change in external debt	2.6	-14.1	18.1	-18.0	-13.3			-1.9	-2.9	-5.8	-5.4	-4.2	-3.3	
Identified external debt-creating flows (4+8+9)	-23.1	-36.6	5.8	-30.7	-30.3			-17.9	-14.3	-13.4	-12.0	-10.8	-10.2	
Current account deficit, excluding interest payments	4.3	-7.9	0.7	-3.4	-9.1			-8.6	-6.8	-5.5	-4.8	-4.4	-4.6	
Deficit in balance of goods and services	-6.7	-19.8	-7.9	-14.6	-21.9			-21.5	-18.5	-15.3	-13.6	-12.3	-11.1	
Exports	50.3	56.5	41.8	44.5	49.9			49.5	45.6	41.4	38.6	36.6	34.8	
Imports	43.6	36.7	33.8	29.9	28.0			28.0	27.1	26.1	25.0	24.2	23.7	
Net non-debt creating capital inflows (negative)	-11.6	-9.6	-11.5	-7.4	-7.0			-7.2	-5.4	-5.9	-5.5	-5.0	-4.5	
Automatic debt dynamics 1/	-15.8	-19.1	16.7	-20.0	-14.2			-2.1	-2.1	-2.0	-1.7	-1.3	-1.1	
Contribution from nominal interest rate	3.8	3.2	2.9	1.7	1.6			1.4	1.5	1.5	1.5	1.5	1.6	
Contribution from real GDP growth	-6.4	-2.3	-1.1	-5.5	-4.8			-3.5	-3.5	-3.5	-3.2	-2.9	-2.7	
Contribution from price and exchange rate change	-13.2	-20.0	14.9	-16.2	-11.0			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	25.7	22.5	12.2	12.7	17.0			16.0	11.3	7.6	6.6	6.6	6.9	
External debt-to-exports ratio (in percent)	186.6	141.3	234.3	179.6	133.4			131.8	136.7	136.3	132.1	128.1	125.3	
Gross external financing need (in billions of U.S. dollars	38.4	21.6	28.2	21.8	7.8			8.3	16.8	19.9	21.0	21.6	21.1	
In percent of GDP	37.3	16.0	24.4	14.7	4.2	10-Year	10-Year	4.0	7.4	7.9	7.4	6.8	5.9	
Scenario with key variables at their historical averages 5/								65.2	55.8	43.9	32.7	22.5	13.6	-11.3
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	8.9	3.2	1.2	7.3	7.5	7.7	3.1	5.9	6.0	6.2	6.3	6.3	6.4	
GDP deflator in US dollars (change in percent)	16.9	27.0	-15.7	19.7	16.0	15.6	13.6	5.6	4.0	4.5	5.3	5.3	5.6	
Nominal external interest rate (in percent)	5.3	4.5	3.1	2.3	2.4	3.1	1.3	2.4	2.5	2.7	3.0	3.4	3.8	
Growth of exports (US dollar terms, in percent)	24.9	47.2	-37.0	36.7	41.2	27.6	25.3	9.8	1.5	0.9	4.4	6.0	6.8	
Growth of imports (US dollar terms, in percent)	36.8	10.2	-21.3	13.4	17.8	18.7	18.4	10.9	6.6	7.0	7.3	8.4	9.6	
Current account balance, excluding interest payments	-4.3	7.9	-0.7	3.4	9.2	1.5	4.3	8.6	6.8	5.5	4.8	4.4	4.6	
Net non-debt creating capital inflows	11.6	9.6	11.5	7.4	7.0	8.9	2.6	7.2	5.4	5.9	5.5	5.0	4.5	

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

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 US 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/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

Appendix 1. Kazakhstan: External Stability Assessment

Current Account and Exchange Rate

With oil prices gradually falling and an increase in non-oil imports to finance development projects, the current account surplus is projected to decline gradually from the current record high to 3 percent of GDP by 2017.

The current account and the real effective exchange rate are broadly in line with medium-term fundamentals. Staff assessed the exchange rate using the augmented methodology for oil exporters developed by MCD, as well as employing the standard CGER methodologies. In all three methodologies of the CGER, the tenge was found close to equilibrium or slightly undervalued. The macroeconomic balance approach showed a slight undervaluation. Based on the external sustainability approach, the extent of undervaluation is larger, but when the present value of the NFRK is included in the net external asset position, the undervaluation is lower. The equilibrium real exchange rate approach shows virtually no deviation from the estimated equilibrium.

Kazakhstan: Methodologies to Assess Real Exchange Rate Misalignment 1/

	Underlying Current Account	Current Account Norm	Estimated over(+)/ under(-)
Macroeconomic Balance 1/ 2/	9.6	8.0	-1.7
Equilibrium Real Exchange Rate 1/ 3/	n.a.	n.a.	-0.7
External Sustainability			
Standard CGER specifications 4/	9.6	-2.8	-12.8
NPV of NFRK assets included 4/	9.6	5.7	-4.1

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

1/ Based on estimates for net oil exporters of "Are Middle Easternt Current Account Imbalance Excessive," WP/11/195.

2/ Based on 2017 projections. The current account excludes oil-related net income flows.

3/ Based on medium-term fundamentals (2017 projections).

4/ Norm and underlying current account positions exclude oil-related net income flows. The norm is the adjusted current account balance needed to stabilize the 2017 net foreign asset position, given the trade shares as of 2010.

Capital and Financial Accounts

Total external debt continued to decline from 80 percent of GDP in 2010 to 67 percent in 2011. Excluding inter-company obligations, external debt is now 34½ percent of GDP. Banks' net external position has been negative since the restructuring, and the remaining external debt is less than 10 percent of GDP at end-2011.

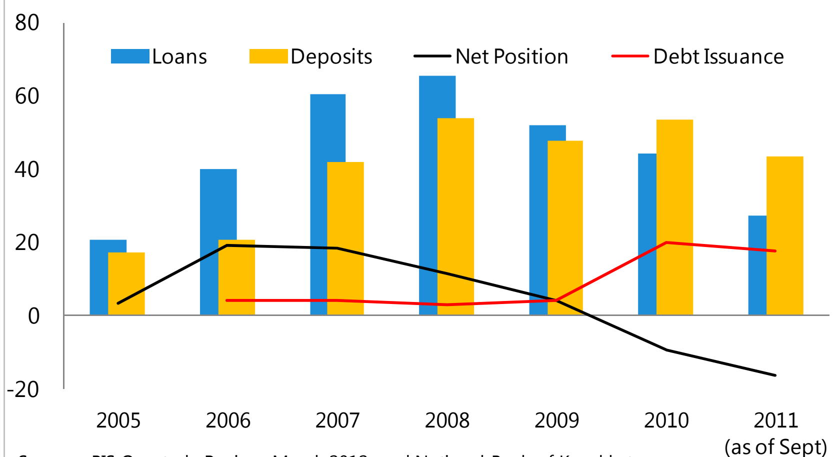
International Reserves

NBK's international reserve adequacy is comparable to that of large and sustainable EMEs. If assets of the NFRK are included, the level compares well to other oil and fuel exporters. The new reserve adequacy metric (see SM/11/31) suggests that reserves in the range of 16.4–24.6 percent of GDP in 2011 may be considered appropriate in the case of Kazakhstan. The actual data as of end-March 2012 shows 16.5 percent for NBK's reserves and 41 percent if the NFRK is included.

In 2011, the change in reserves has been guided in part by the central bank's efforts to limit excessive volatility in the nominal exchange rate. As such, during periods of strong inflows (up to July 2011), the NBK intervened to buy dollars, with reserves rising from $28 billion to $37 billion. However, as flows (mainly portfolio) reversed, reserves declined to around $29 billion by year-end. In the first two months of 2012, fresh inflows led the central bank to accumulate reserves, which now stand at $34½ billion. In contrast, foreign assets in the national oil fund have steadily risen throughout the year as oil-related revenues were saved.

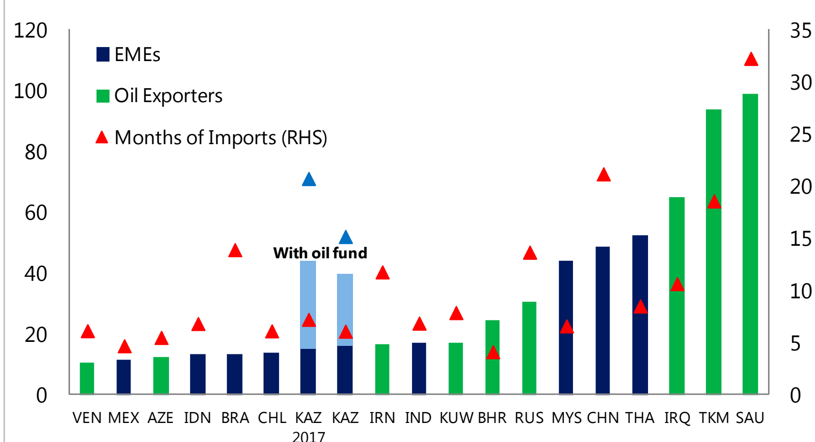
Kazakhstan: External Stability

The net external position of banks has been negative since the restructuring in 2010, while there has been an increase in nonbank external debt.



Sources: BIS Quarterly Review: March 2012, and National Bank of Kazakhstan.

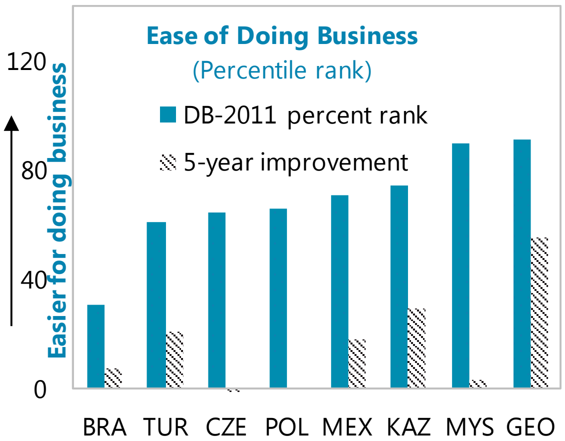
NBK's international reserves are comparable to key EMEs, and with the oil savings fund, they are comparable to other oil and fuel exporters.

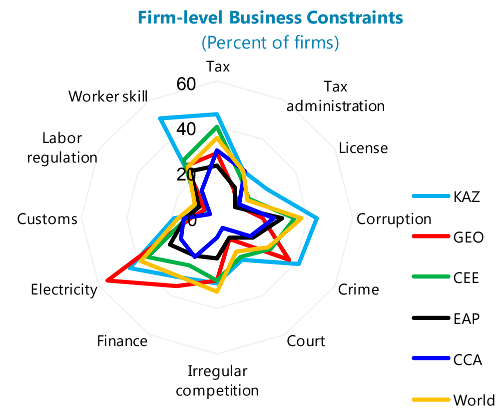


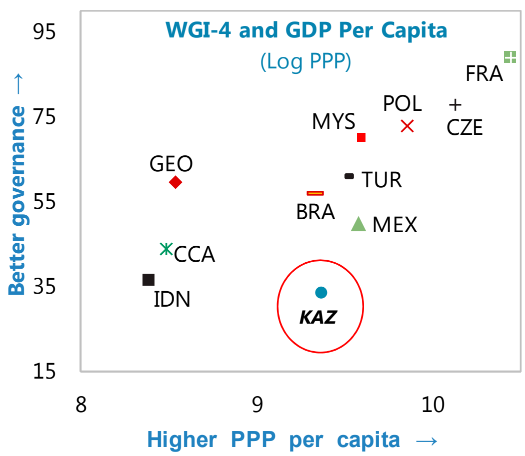
Sources: WEO, Kazakhstanti authorities, and IMF staff calculations.

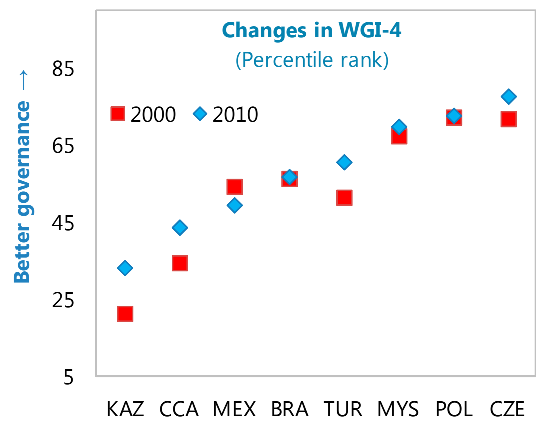
Appendix 2. Kazakhstan: Risk Assessment Matrix		
Nature/source of main threats	**Likelihood of realization in the next three years**	**Expected impact on the economy if risk is realized**
Global slowdown affecting China and Russia EU, Russia, and China are the main trading partners. Risk indicators tend to move in line with those of Russia. China is a major source of investment.	**Staff assessment: Medium** Staff currently projects growth in China and Russia to remain sufficiently strong.	**Staff assessment: Medium** Kazakhstan would be affected through trade, finance, and investment channels. A deterioration of market conditions in Russia could have an impact on FDI and portfolio inflows.
Large and prolonged decline in oil prices The economy remains highly dependent on oil for export proceeds and budget revenues.	**Staff assessment: Low** A global recession with a protracted slow growth could depress demand for energy and cause a sharp fall in oil prices.	**Staff assessment: High** While reserves are sufficient to avoid an immediate fiscal shock, the recovery in transport, communications and other non-oil sectors would be endangered.
Failure to improve the health of the banking system The banking system is fragile, and BTA debt negotiations are likely to be difficult, especially if the market sentiment toward emerging markets deteriorates.	**Staff assessment: Medium to high** Attempts to resolve banking sector issues have not been successful so far. New proposed schemes present only a partial solution, and have been delayed.	**Staff assessment: High** Less than two years after the previous bank debt restructuring, the impact on confidence will be high, and could lead to deposit runs and credit crunch. The capital shortfall of the system is large, and represents a contingent liability for the government.
Political uncertainty Political incentives may be misaligned with economic priorities.	**Staff assessment: Medium to high** The risk has increased following episodes of social unrest in parts of the country.	**Staff assessment: Medium to high** Political factors may hinder effective policymaking and affect growth and stability.

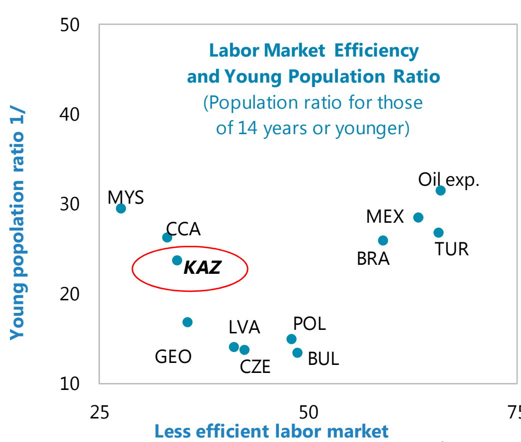
Appendix 3. Kazakhstan: Business Environment and Governance

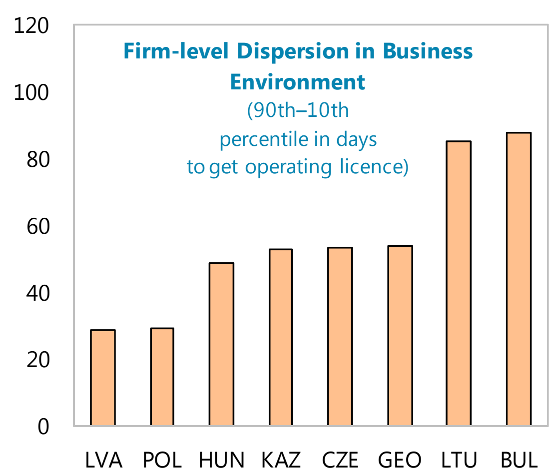




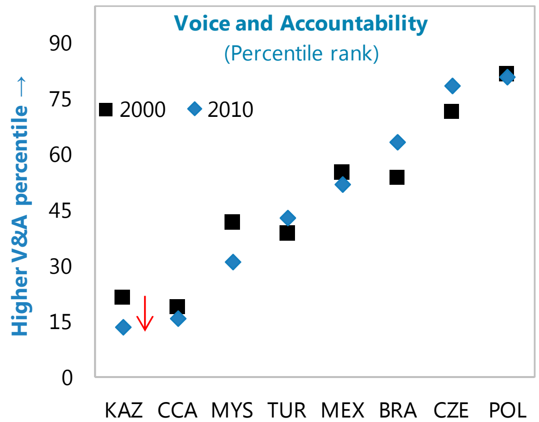


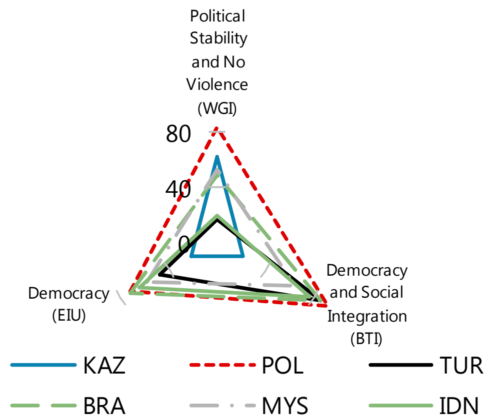






Appendix 3. Continued. Kazakhstan: Business Environment and Governance





Sources: Doing Business (2006 and 2011), World Bank Enterprise Surveys, Worldwide Governance Indicators 2010, Global Competitiveness Report (2010; pillar 7 without female participation and brain drain), World Development Indicators, World Bank Enterprise Surveys, BTI, ICRG, and IMF staff calculations and estimates.

Kazakhstan: Selected Transparency and Effectiveness Indicators

SDDS/GDDS subscriber	SDDS since March 2003
Regularly publish IMF Staff Reports	Yes
Most recent FSAP/Update and other financial ROSCs	March 2008
Fiscal ROSC/Update	April 2003
Data ROSC/Update	February 2008
AML/CFT ROSC	August 2004
Sovereign credit rating	S&P: BBB+, Stable; Fitch: BBB, Positive; Moody's: Baa2 Stable; Dagong: BBB-, Stable
Doing Business ranking	2011: 47 (out of 183)
WB World Governance Indicator Composite 1/	2010: 33 (0-100, higher is better); 2000: 22 (0-100)
WEF Global Competetiveness Indicator Ranking	2011: 72 (out of 142); 2009: 67 (out of 133)
WEF Labor Market Composite 2/	2011: 47 (out of 142)
Corruption Perception Index	2010: 2.9 (0-10, higher is better; rank 105 out of 178)
Fiscal sector	
Comrehensive coverage of public finance statistics	Insufficient transparency of quasifiscal and SOE operations
Government reports on performance versus objectives	MTEF has limited impact on fiscal decision making
Sovereign Wealth Fund	Disclusure of assets but not of inveastments
Extractive Industries	
Extractive Industries Transparency Initiative (EITI)	Candidate status renewed until 2013, by which time Kazakhstan has to demonstrate compliance with EITI rules
Financial sector	
Availibility of detailed bank data	Yes
Transparency on financial transactions of Central Bank	No reporting of interventions

Sources: IMF, Wikipedia, World Bank and World Economic Forum
http://www.doingbusiness.org/reports/global-reports/doing-business-2012
http://reports.weforum.org/global-competitiveness-2011-2012/
1/ Combines rankings from government effectiveness, regulatory quality, rule of law, and control of corruption.
2/ Combines rankings from cooperation in labor-employment relations, flexibility in wage determination, rigidity of employment, hiring and firing practices, redundancy costs, pay and productivity, and reliance on professional management.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

May 31, 2012

Prepared By

The Middle East and Central Asia Department
(In Consultation with Other Departments)

CONTENTS

ANNEX I. RELATIONS WITH THE FUND

(As of May 1, 2012)

Membership Status

Joined: 07/15/92; Accepted 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 de jure exchange rate arrangement is a managed float, while the de facto arrangement is classified as crawl-like.

General Resources Account

	SDR Million	Percent Quota
Quota	365.70	100.00
Fund holdings of currency	365.70	100.00
Reserve position in the Fund	0.01	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	343.65	100.00
Holdings	344.56	100.26

Outstanding Purchases and Loans

None

Latest Financial Arrangements

In millions of SDR

Type	Arrangement	Date	Amount Approved	Amount Drawn
ECF	12/13/99	3/19/02	329.10	0.00
ECF	7/17/96	7/16/99	309.40	154.70
Stand-By	6/05/95	6/04/96	185.60	85.60

Projected Payments to Fund

None

Safeguards Assessments

Not applicable to the National Bank of Kazakhstan (NBK) at this time.

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. From late 1999 to October 2007, the exchange rate regime was a managed float with no preannounced path. From October 2007 the tenge was maintained within a narrow range against the U.S. dollar. In February 2009 the tenge was devalued by 18 percent against the US dollar, and a trading band of T150/US$ +/- 3 percent was established. In February 2010, the trading band was widened and set at an asymmetric T150/US$ +10/-15 percent. In February 2011, the trading band was officially abolished, and the de jure exchange rate arrangement was changed from a pegged exchange rate within horizontal bands to a managed float. The de facto exchange rate arrangement is classified as crawl-like, because the tenge has been consistently tracking a trend against the U.S. dollar within a 2 percent margin. 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.

Article IV Consultation

Kazakhstan is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747-(10/96) (9/28/2010). The last consultation was concluded on June 16, 2011 (see IMF Country Reports No. 11/150 and 11/151).

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 and a second FSAP Update mission took place in March 2008. 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. An update of the data ROSC was undertaken in 2006 and the report was published in February 2008 (Annex V).

AML/CFT Assessment

Kazakhstan's anti-money laundering and combating the financing of terrorism (AML/CFT) framework was recently assessed against the AML/CFT standard, the Financial Action Task Force (FATF) 40+9 Recommendations. The evaluation was conducted by the Eurasian Group on money laundering and financing of terrorism (EAG), the FATF-style regional body of which Kazakhstan is a member, and the final mutual evaluation report was adopted in June 2011. The report indicates that the main sources of criminal proceeds in Kazakhstan are crimes related to fraud and abuse of public office. The evaluators found that Kazakhstan had a relatively comprehensive AML/CFT framework in place, but that significant deficiencies nevertheless remained, notably with respect to customer due diligence measures and the reporting of suspicious transactions.

Technical Assistance

Kazakhstan has received technical assistance and training by the Fund in virtually every area of economic policy, including through about 90 technical assistance missions provided during 1993–2012 by FAD, LEG, MCM, 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, to the Ministry of Finance, and a peripatetic expert to the Financial Supervision Agency. 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 2003.

Monetary and Capital Markets Department

Technical assistance has enabled steady progress in a number of areas 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. September 2004: Bringing banking prudential regulation up to EU standards.
2. September 2004: Implementing inflation targeting: next steps.
3. November 2007: Strengthening banking supervision and risk assessment.
4. 2009–12: Developing banking sector stress testing. The initial mission in January 2009 was followed up by a number of visits by a peripatetic expert to the FSA over the course of 2009–12.
5. November 2010: Reducing nonperforming loans in the banking system (joint with LEG).

Fiscal Affairs Department

The Fiscal Affairs Department has given 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. September 2004: Treasury reform process
3. September 2011: Public financial management
4. October 2011: Accounting reform and IT system functionality

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. January 2006: Real sector and balance of payments statistics.
2. August 2006: Real sector statistics.
3. December 2006: ROSC Update mission (and DQAF).
4. April 2008: GFSM 2001 implementation.
5. January 2009: Monetary statistics
6. April 2011: BOP statistics.

Legal Department

1. April 2008: Reforms to tax law
2. April 2010: Anti-money laundering and combating the financing of terrorism (jointly with the World Bank and United Nations Office on Drugs and Crime).
3. November 2010: Reducing nonperforming loans in the banking system (joint with MCM).
4. July 2011: Bankruptcy legislation

IMF Institute

Kazakhstani 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 others. In addition, the IMF Institute has conducted courses in the region. Seminars and training sessions have also been conducted by MCM and STA technical assistance missions.

Resident Representative

The position was terminated in August 2003, but the Fund maintains a local office in Almaty.

ANNEX II. RELATIONS WITH THE WORLD BANK

(As of May 1, 2012)

Kazakhstan became a member of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) in July 1992 and a member of the International Finance Corporation (IFC) in September 1993. In 2010 Kazakhstan became an IDA donor under the IDA 16 replenishment. Kazakhstan is the largest client of the IFC in Central Asia.

IBRD in Kazakhstan

The Bank's lending operations in Kazakhstan are wide-ranging and all fall within the key pillars of the Country Partnership Strategy (CPS) adopted in 2004. The new CPS for 2012–17 was presented to the Board of Directors on May 1, 2012. As of April 2012, the IBRD loan program comprises twelve projects with a total commitment of $2.55 billion, of which $887 million has been disbursed. Among the twelve projects, implementation of two projects (agricultural competitiveness and Moinak electricity transmission) will be completed by the end of this calendar year. The other ten active projects are: forest protection and reforestation, Ust-Kamenogorsk environmental remediation, technology commercialization, customs development, tax administration reform, health sector technology transfer and institutional reform, technical and vocational education modernization, strengthening the national statistical system, South West roads, and Alma electricity transmission. A new road project to complete construction of the last section of the Western Europe-Western China corridor linking Almaty to the border with China was presented to the Board of Directors on May 1, 2012.

The Joint Economic Research Program (JERP) provides extensive analytical support to the Government's development needs. Analytical and advisory services (AAA) under the JERP remain in high demand and currently comprise 21 activities amounting to $4.4 million. As in previous years, the current JERP is focused on the government's strategic priorities in: (i) enhancing competitiveness; (ii) mitigating macroeconomic risks; (iii) strengthening public finance management and administration; and (iv) improving human development.

IFC in Kazakhstan

Kazakhstan is the IFC's largest client in Central Asia. As of the end of March 2012, IFC's total committed portfolio in Kazakhstan amounted to $345 million, of which $336 million has been disbursed. IFC's efforts in Kazakhstan are directed to foster private sector led growth, particularly in the non-extractive sectors and frontier regions. The investment portfolio is mostly concentrated in the financial sector and general manufacturing, although recently IFC has begun making investments in the agribusiness sector. In the financial sector, IFC is focusing on: (i) further stabilization, diversification, and extension of the maturity of the banks' funding base; and (ii) establishment of the best international corporate governance and regulatory environment. As a result of the financial sector crisis, the IFC has aimed to identify partner financial institutions to contribute to the stabilization of the financial sector and increase access to finance in priority sectors. In this regard, over the past three and a half years, the IFC has provided close to $600 million in equity, quasi-equity, senior debt, and trade finance to several banks.

IFC's investment program has been expanding in recent years. Investments grew tenfold between FY05 and FY08 (to $110 million) and nearly doubled again in FY09. In FY10, IFC invested a record $336 million in five projects in the financial and agribusiness sectors, with vast majority provided to commercial banks. Post-crisis investment levels have been more modest, with $103 million invested in five projects in FY11 and $66 million invested in FY12 to date.

In addition, the IFC is providing advisory services in several key areas. These include Corporate Governance and Private Public Partnerships (PPPs), where IFC's Transaction Advisory team is in discussions to help the government structure PPPs in the roads and health sectors. A new advisory investment climate initiative has been launched to assist Central Asian countries, including Kazakhstan, in strengthening transparency of tax systems.

ANNEX III. RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

(As of May 1, 2012)

The European Bank for Reconstruction and Development (EBRD) is the largest investor outside the oil and gas sector in Kazakhstan. As of May 1, 2012, the EBRD's total business volume in Kazakhstan, including co-financing, stood at €11 billion, with investments totaling €4.4 billion (both these figures include approximately €2.4 billion in cumulative Trade Facilitation Program turnover). As of May 1, 2012, the EBRD's portfolio in Kazakhstan amounted to €1.8 billion. During 2011, the EBRD signed 14 projects, including regional ones, for a total amount of EBRD finance about €300 million. During the first four months of 2012, the EBRD signed six operations with a total annual business volume (ABV) of €93 million.

In its country strategy, approved in 2010, the EBRD aims to assist Kazakhstan in promoting economic diversification and moving towards a more sustainable model of financial development. The EBRD's main operational objectives for 2012 are:

- **In the corporate sector**, support investment in the manufacturing and the agribusiness sectors to address immediate financing needs, while promoting the modernization and diversification of the economy, best business and environmental practices, and energy efficiency.

- **In the financial sector**, work with the Kazakhstani authorities and other IFIs to strengthen the country's financial sector; re-engage with partner banks; expand the partner banks group; and assist the authorities with resolving the banks' NPL problem and identifying and implementing policy reforms to promote de-dollarization, develop local capital markets, and increase the availability of sustainable local currency financing.

- **In the infrastructure sector**, restructure the national railway company and support its energy-efficiency improvement program; improve the infrastructure in Kazakh municipalities; expand activities into the solid waste and district heating sectors and support municipal sector reform, including innovative methods for developing and financing projects in the water segment.

- **In the power and energy sector**, support clean energy through the provision of financing to modern generating facilities, stemming losses in the distribution segment through rehabilitation of power lines and developing pilot renewable energy projects with private operators (subject to bankability and integrity).

Sector Business Group		Commitments	Portfolio
Energy	Private	245.5	185
	State	314.5	226
Financial Institutions	Private	2,045	347
	State	0	0
Industry, Commerce, and Agribusiness	Private	890	458
	State	45	0
Infrastructure	Private	102	102
	State	725	486
TOTAL		€ 4.4 billion	€1.8 billion

Note: * Including € 2.4 billion in cumulative Trade Facilitation Program lines

ANNEX IV. RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of April 19, 2012)

Kazakhstan became a member of the Asian Development Bank (ADB) in 1994. In the early years of transition from a centrally planned to a more market-driven economy, ADB focused on efforts to sustain a higher growth rate, promote environmental friendly development, support the private sector, and encourage regional integration.

As of April 19, 2012, cumulative public sector loan commitments to Kazakhstan amounted to $2.34 billion, of which about $1.39 billion has been disbursed. Commitments cover 20 public sector loans in agriculture and natural resources, education, finance, transport and communications, water supply and sanitation, and irrigation. The loan operations were complemented with 65 technical assistance (TA) projects totaling over $28 million. Kazakhstan is no longer eligible for concessional resources from the ADB's Asian Development Fund.

In recent years, ADB operations focused on water distribution and irrigation, road transportation, budget support, private sector, and small and medium enterprises (SMEs). In supporting the State Drinking Water Sector Program, 2002–15, ADB provided a $35 million loan in 2004 for basic water supply services and a capacity-building program to improve living/health conditions in Akmola and North and South Kazakhstan. After a slight pause from 2004, ADB's public sector operations in Kazakhstan resumed in 2008 with the signing of the $225 million loan agreement for the Central Asia Regional Economic Cooperation Program (CAREC) Transport Corridor 1 project under a $700 million Multi-tranche Financing Facility (MFF). The Transport Corridor project aims to improve a major transport corridor across Kazakhstan, linking it with its eastern and western neighbors, as well as opening up north-south routes.

In 2009, ADB supported Kazakhstan in mitigating the impact of the global financial/economic crisis with a $500 million loan. The loan supported the government's crisis-mitigation action plan and the employment-generation program and helped Kazakhstan finance its budget deficit. ADB also approved another loan totaling $187 million under the MFF for reconstruction of CAREC Transport Corridor 1 (Zhambyl Oblast sections) that year.

In 2010, ADB approved three loans totaling $608 million. An SME Investment Program Tranche 1 project to enhance efficiency and competitiveness of the financial sector and SMEs was approved as part of a $500 million MFF. The other two were the CAREC Transport Corridor 1 Tranche 3 and the CAREC Transport Corridor 2 Tranche 1. In 2011, ADB approved the CAREC Transport Corridor 1 Tranche 4 and the CAREC Transport Corridor 1 (Taraz Bypass) loans totaling $339 million.

Recent technical assistance projects include: preparation of the CAREC road projects in 2009 ($825,000); (ii) capacity development to support SME development approved in 2010 (for $650,000) and (iii) preparation of the Astana Lightrail Transport project ($565,000) approved in 2011.

In 2011, an energy efficiency diagnostic study to identify investment priorities totaling $200,000 was also approved. Kazakhstan also participates in a number of ongoing regional TA projects.

Private sector operations of ADB in Kazakhstan began in 2006, and have been focused on the banking sector, with five private sector financings amounted to $375 million. Near-term ADB private sector financing prospects are in the areas of private infrastructure and natural resource projects.

Kazakhstan was one of the 4 founding partners of the CAREC Program in 1997 (together with China, Kyrgyz Republic, and Uzbekistan). Since then, six other countries have joined the partnership, and CAREC-related investments in the partner countries have totaled $17 billion, over the period 2001–11. Four of the six CAREC road and rail corridors traverse Kazakhstan, developing these Central Asian corridors is a priority for achieving the vision of land bridges connecting Europe and Asia.

A new country partnership strategy (CPS) to guide ADB operations during 2012–16 is being prepared. The CPS proposes to support economic diversification and the increased competitiveness. It envisages support for regional cooperation, private sector development, inclusive growth, and knowledge exchange. Under the CPS, ADB's support will focus on transport, finance, urban, and energy sectors. Important corporate level cross-cutting themes include regional cooperation, gender, environment and climate change, good governance, and private sector development and operations.

ANNEX V. STATISTICAL ISSUES

(as of May 1, 2012)

I. Assessment of Data Adequacy for Surveillance	
General: Data provision has some shortcomings, but is broadly adequate for surveillance. The most affected areas are monetary and balance of payments statistics, with remaining deficiencies in national accounts.	
National accounts: The quality of GDP statistics is affected by the limited coverage of small businesses in selected activities such as retail and construction. While some progress has been made in compiling and reporting GDP by final expenditure consistent with output-based measures, dissemination of quarterly GDP series data is conducted on a discrete basis only.	
Government finance statistics: Progress has been made in the classification of the fiscal accounts consistent with the Fund's Government Finance Statistics Manual 2001 (GFSM 2001). 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. In addition, statistics on the enlarged government (including public enterprises) is not available.	
Monetary statistics: The monetary statistics based on the Standardized Report Forms (SRFs) complied by the central bank have a few inconsistencies, and a technical assistance mission in January 2009 provided several recommendations.	
Balance of payments: In general, the balance of payments is compiled in concordance with the fifth edition of the Balance of Payments Statistics Manual (BPM5). However, 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 nonresident entities. This leads to discrepancies with national accounts statistics where this activity is treated as domestic production. In addition, the errors and omissions have been large and increasing. The technical assistance mission in April 2010 addressed these issues.	
II. Data Standards and Quality	
Participant in the Special Data Dissemination System (SDDS) since March 2003. Metadata need to be updated.	Data ROSC published in 2002.

Kazakhstan: Table of Common Indicators Required for Surveillance
(As of May 20, 2012)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items: Data Quality-Methodological Soundness[8]	Memo Items: Data Quality-Accuracy and Reliability[9]
Exchange Rates	05/20/12	05/20/12	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/30/12	05/07/12	M	M	M		
Reserve/Base Money	03/31/12	04/27/12	M	M	M	O, O, LO, LO	O, O, O, O, O
Broad Money	03/31/12	04/27/12	M	M	M		
Central Bank Balance Sheet	04/30/12	05/07/12	M	M	M		
Consolidated Balance Sheet of the Banking System	03/31/12	04/25/12	M	I	I		
Interest Rates[2]	04/30/12	04/30/12	I	I	I		
Consumer Price Index	04/30/12	05/03/12	M	M	M	O, O, O, O	O, O, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3]—General Government[4]	03/31/12	04/27/12	M	M	M	O, LO, LO, LO	O, O, O, O, LNO
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	03/31/12	04/27/12	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q1/2012	04/20/12	Q	Q	Q		
External Current Account Balance	Q1/2012	04/30/12	Q	Q	Q	LO, O, O, O	O, O, O, O ,O
Exports and Imports of Goods and Services	Q1/2012	04/30/12	Q	Q	Q		
GDP/GNP	Q1/2012	04/30/12	Q	Q	Q	O, O, O, LO	LO, O, LO, O, O
Gross External Debt	Q1/2012	04/30/12	Q	Q	Q		
International Investment Position[6]	Q1/2012	04/30/12	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discounts 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] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the update of the data ROSC published in February 2008, based on the findings of the mission that took place during November 29–December 13, 2006 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); not observed (NO); and not available (NA).
[9] Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

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

IMF Executive Board Concludes 2012 Article IV Consultation with the Republic of Kazakhstan

On June 18, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation1 with the Republic of Kazakhstan.

Background

Real GDP growth reached 7½ percent in 2011. While growth of oil production slowed, high commodity prices helped spur domestic demand and activity in transport and communications. Agriculture recovered from a severe drought, but activity in construction and real estate remained flat. Official unemployment rate, at 5¼ percent, continued to be unaffected by real growth, as was the case at the time of the slowdown.

Driven by rising global food prices and large increases in public sector wages, inflation peaked at 9 percent in mid-2011, exceeding the official objective range of 6–8 percent. More recently, however, slowing international commodity prices, an exceptionally high harvest, and the use of administrative measures to limit food and fuel price increases helped to bring inflation below 5 percent. Core inflation, which excludes energy and food, remains subdued.

The current account surplus rose to 7½ percent of GDP, the highest level in recent years, as robust exports outpaced the demand–driven rebound in imports. Assets in the National Fund (NFRK) rose rapidly, and together with National Bank of Kazakhstan's (NBK)

[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. An explanation of any qualifiers used in summing up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm

international reserves, reached a comfortable level equivalent to 17 months of imports and 110 percent of broad money.

Fiscal and monetary policies have adapted to the economic recovery. An expansion of nonoil revenues from improved tax collection combined with a small decrease in the expenditure-to-GDP ratio resulted in a decline in the nonoil fiscal deficit. Key monetary indicators continued to grow at a slower rate than nominal GDP, and as inflation pressures subsided, the NBK signaled a more accommodative monetary policy stance, cutting its policy rate by 100 bps in early 2012. The tenge has started to show more flexibility, with the NBK intervening on both sides of the market to avoid undue exchange rate volatility in either direction.

The banking sector has still not fully recovered from the severe shock in 2007. Foreign liabilities have fallen drastically, aggregate liquidity is ample, and provisioning of overdue loans is still relatively high. Nevertheless, domestic banks' burden of nonperforming loans has further increased, and BTA bank has embarked on a second debt restructuring with external creditors. So far, economic growth and government ad-hoc support to distressed borrowers in the construction, real estate and SME sectors have not improved the quality of the loan portfolio, as activity in construction and real estate, the sectors subject to highest bank exposure, remains flat.

Executive Board Assessment

Directors commended the authorities' policies which, together with high commodity prices, yielded a strong economic recovery and helped rebuild external buffers. The authorities have appropriately responded to the upswing in the cycle by gradually tightening fiscal policy, sterilizing excess bank liquidity, and allowing greater exchange rate flexibility. Directors noted that the growth outlook is positive, but subject to downside risks. They called on the authorities to address vulnerabilities in the banking sector posed by the deterioration of asset quality, and further strengthen the macroeconomic framework.

Directors appreciated the preparation of plans to deal with a possible protracted global slowdown and a decline in oil prices. They stressed that achieving the non-oil medium-term deficit target remains a priority and spending plans should not unduly stimulate demand in the absence of a shock. They encouraged the central bank to closely monitor inflation, and to stand ready to tighten monetary policy if domestic demand picks up.

Directors underscored the need to address the continued rise in bank troubled assets, which presents a public sector contingent liability. They stressed that restoring banks' health would support growth and economic diversification. Envisaged regulatory improvements should be complemented with strict enforcement to provide an incentive for banks to clean up their balance sheets. Directors noted that the new mechanism to manage troubled assets represents only a partial solution. A successful strategy would require action by the central bank to enforce realistic asset valuation and loss recognition, ensure adequate provisioning, replenish bank capital where needed, and close unviable banks. To mitigate further risks, a quick and definitive solution to the difficulties of BTA bank is a crucial priority. Directors welcomed the plan to adopt Basel III standards by year-end.

Directors considered that macroeconomic policymaking would benefit from improved medium-term frameworks and policy coordination. In the fiscal area, this would require broadening the tax base and fully integrating the oil fund and state entities' accounts into the fiscal framework. In the monetary sector, strengthening the transmission mechanism by deepening financial markets would allow the gradual unwinding of administrative price controls. Greater exchange rate flexibility would facilitate monetary management and the economy's response to external shocks. A well-capitalized and well-regulated financial system would be important to support these reforms.

Directors welcomed the authorities' ambitious plans to promote growth in the non-oil sector. The envisaged job-creating government investments, partly financed by oil savings, will however need to be complemented by enhanced private sector participation. Directors therefore called for sustained efforts to improve the business environment through strengthened governance and institutions and integrate Kazakhstan into the global economy. Along with improvements in the coverage of the social safety net, these reforms would promote greater social inclusiveness and help ensure that the oil wealth benefits the population as a whole.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Kazakhstan: Selected Economic Indicators, 2009–13

	2009	2010	2011	Proj. 1/ 2012	Proj. 1/ 2013
		(Changes in percent)			
Real economy					
Real GDP	1.2	7.3	7.5	5.9	6.0
CPI (end-of-period)	6.2	7.8	7.4	6.6	6.8
		(In percent of GDP)			
Public finance					
Government revenue and grants	22.1	23.9	27.5	27.1	26.7
Government expenditures	23.4	22.0	21.5	21.7	21.7
General government balance 2/	-1.4	1.4	5.5	4.9	4.5
General government non-oil balance	-10.6	-10.3	-9.3	-9.7	-9.4
General government debt (end-of-period) 3/	10.2	10.7	10.5	9.9	8.7
		(Changes in percent)			
Money and credit 4/					
Base money	60.7	5.0	10.2	16.7	14.5
Broad money	17.9	15.7	14.1	15.4	15.5
Credit to the economy 5/	7.2	0.9	14.9	15.5	15.2
NBK refinance rate (eop; percent)	7.0	7.0	7.5	...	...
		(In percent of GDP)			
Balance of payments 6/					
Trade balance	13.0	19.4	25.4	26.1	23.3
Current account balance	-3.6	1.6	7.6	7.1	5.3
External debt	97.9	79.9	66.6	65.2	62.3
Excluding intra-company loans	54.8	44.5	34.4	31.8	28.4
Gross international reserves					
In billions of U.S. dollars, end of period	23.1	28.3	29.3	35.3	38.4
In months of next year’s imports of goods and nonfactor services	6.3	6.5	6.1	6.9	7.0
		(Changes in percent)			
Exchange rate 7/					
Tenge vs. U.S. dollar (end of period)	-22.9	0.7	-0.4	...	...
Tenge vs. Russian ruble (end of period)	-19.4	1.4	4.7	...	...
Tenge vs. Euro (end of period)	-24.5	8.3	2.0	...	...
Real effective exchange rate (p.a) 8/	-6.7	3.3	-0.6	...	...

Source: Kazakhstan authorities and IMF staff estimates and projections.
1/ Staff projections.
2/ Privatization revenues are treated as a financing item.
3/ Gross domestic and external government debt, including government guaranteed debt.
4/ Reflects data available at the time of the mission.
5/ Source: Monetary survey of the banking system.
6/ The GDP in US. Dollar is calculated using the period average exchange rate average.
7/ A positive sign indicates appreciation.
8/ National Bank of Kazakhstan estimates.

Statement by Mr. Rene Weber, Executive Director for the Republic of Kazakhstan and Mr. Kuanyshbek Sazanov, Advisor to Executive Director
June 18, 2012

1. On behalf of our Kazakh authorities, we thank the staff for this report, which provides helpful policy recommendations. They welcome the regular dialogue with the Fund in the context of the Article IV consultations and look forward to continued cooperation, including in the area of technical assistance. The authorities stress that the economy's strong and sustained growth performance, substantial current account surplus, and ample financial buffers should mitigate concerns about financial stability in the country. They nevertheless appreciate the risk assessment by staff as well as the particular focus on spillovers that could impact the Kazakh economy. The authorities would like to comment as follows on policy developments and their policy stance.

Monetary Policy

2. The authorities emphasize that the National Bank of Kazakhstan (NBK) will continue to conduct monetary policy aimed at price stability. The main goal of monetary policy is to keep inflation both in 2012 and over the medium term within the 6 to 8 percent range (year-on-year). The authorities agree with the staff that the main drivers of inflation are high international food and energy prices and that these factors were behind the peak in inflation in mid-2011, which has now slowed to within the target range and, in May 2012, fell even below that range to its lowest level since 1999.

3. The flexibility of the exchange rate has increased but the NBK will continue to intervene to prevent sharp fluctuations in the rate. The stability of the national currency, the tenge, is considered important also from the perspective of the status of the currency in the region and to allow domestic producers to compete on predictable terms. There is currently also a premium on a stable exchange rate as developments in the global economy are highly uncertain. The NBK intends to further increase the flexibility of the exchange rate, as warranted, in support of an accelerated development of the Kazakh economy. Kazakhstan has ample capacity to credibly maintain its managed floating exchange rate regime. At the end of May 2012 the country's international reserves exceeded US$85 billion, which includes more than US$51 billion of National Fund assets.

4. The authorities acknowledge the challenges in establishing a sound macroeconomic framework and a resilient financial sector as the impact of the global crisis lingers. The effectiveness of further measures will also depend on the strategy by the NBK regarding monetary policy development and implementation. Currently, the NBK is considering the possibility to improve the efficiency of the monetary policy transmission mechanism, mostly through an active use of open market operations. This will improve liquidity management and help build a yield curve in the money market.

Fiscal Policy

5. The authorities confirm that their fiscal strategy over the medium term focuses on (i) a reduction in the non-oil budget deficit, which by 2020 should not exceed 3 percent of GDP, and (ii) a decrease in the use of National Fund resources to finance current expenditures, which reflects a transition to funding solely through the regular budget. On the revenue side, the main objective is to provide for a stable environment for economic activity, thereby supporting industrial innovation, promoting non-oil sector development, and attracting investments. Envisaged changes in the tax code aim at improving tax administration, which will improve the transparency and predictability of fiscal policy.

6. Fiscal policy is designed to be countercyclical. During periods of strong economic activity, government spending will be restrained at a level lower than the nominal rate of GDP growth, while during economic downturns such spending aims to support domestic demand, including through public investment. This approach should allow for an appropriate policy response both to a worsening of global economic conditions and to a potential overheating of the economy.

7. In order to ensure a sufficient fiscal policy buffer, the accumulation of financial resources in the National Fund will continue by limiting the guaranteed transfer from the National Fund to the budget to the amount of 1,380 billion tenge (about US$9.2 billion) per year 2012-14. This buffer enhances the authorities' room for maneuver to support the economy should external conditions deteriorate. It will also increase the savings for future generations and reduce the budget's dependence on oil revenue. Any government borrowing need will primarily be met on the domestic market. The authorities are ready to adjust their fiscal stance, and if needed their budgetary framework, should domestic or international developments call for it.

Financial Sector Policies

8. The authorities are aware of the financial sector development and stability issues highlighted by staff, namely related to the level of bank lending and the share of non-performing loans in the system. The NBK acknowledges that the new mechanism for solving problem loans—through the use of a new, centralized Problem Loans Fund (PLF) and specialized SPVs created by banks—is not sufficient to resolve the non-performing loan problem to its full extent. However, the authorities stress that the SPVs do not get preferential terms when it comes to forming provisions, and shifting loans into an SPV requires a bank to establish an action plan whose implementation is monitored by the NBK. Legislative amendments made in 2011 provide for an exemption from taxation of SPV income (until January 1, 2018), along with the establishment of operating procedures for SPVs. The authorities consider that the mechanism foreseen to achieve improvements in the quality of the loan books, both in the PLF and the SPVs, once operational, will be effective.

9. The authorities share the staff's concern regarding the risks which are related to a deterioration of the quality of banks' assets, to be acquired by the PLF, and which may result in considerable losses for the PLF. In order to mitigate these risks, best international practices

will be applied in implementing adequate asset evaluation procedures and managerial practices that should help minimize losses. It is the authorities' intention that the PLF establishes a benchmark for financial market participants on how problem assets should be fairly valued and better managed. In addition, in line with the staff's advice, banks themselves must actively seek solutions to resolve problem loans by writing them off or selling them at market prices. The sole transfer or sale of non-performing loans to the SPVs, without taking comprehensive measures to improve the quality of the loans, will not contribute to a resolution of the issue.

10. The NBK currently considers adopting the Basel III standards, and the necessary preparatory work is under way. This work involves consultations with the banks with a view to determining the extent to which these standards (related to capital, liquidity, and provisioning) will be implemented in accordance with the decisions of the Council on Financial Stability and Financial Market Development of Kazakhstan. The authorities expect that the necessary preparations could be in place by October 2012. The legal steps to incorporate Basel III into national legislation could subsequently be concluded at the beginning of November 2012.

11. The authorities stress that the NBK in its activities, including in regulating and supervising financial institutions, is guided by international practices and experience. Judged by this yardstick, the current level of bank capitalization in Kazakhstan is higher and the requirements for provisioning are stricter than in countries with comparable economic structures and challenges. The NBK also is in regular dialogue with financial institutions with the aim to strengthen the regulatory and supervisory framework. It has done so in order to enhance assets classification and provisioning, to ensure the use of up-to-date risk management systems in the banks, and to address the issues related to the introduction of Basel III. Discussions on macro-prudential policy tools to support financial stability have also been part of this dialogue.