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Republic of Kazakhstan: 2008 Article IV Consultation—Staff Report; Staff Statement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with the Republic of Kazakhstan, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 30, 2008, 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 June 16, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff statement of July 7, 2008 updating information on recent developments.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 9, 2008 discussion of the staff report that concluded the Article IV consultation.

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

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

Staff Report for the 2008 Article IV Consultation

Prepared by Staff Representatives for the
2008 Consultation with the Republic of Kazakhstan

Approved by David Owen and Martin Fetherston

June 16, 2008

Executive Summary

Kazakhstan has been significantly affected by the global financial market turmoil that began last summer. Banks have lost access to new external financing, credit extension has stalled, growth has slowed, and risks to the outlook are on the downside. Nevertheless, Kazakhstan has considerable public financial resources to help it weather the current situation and the country is benefiting from high oil and commodity prices. Medium-term growth prospects remain favorable.

Policies should focus on managing risks to the outlook and setting the stage for a resumption of strong and sustained growth. Monetary, fiscal, and financial sector policies should all move toward achieving these objectives.

Strengthening the banking system is essential. A realistic assessment of the health of the banks needs to be made and steps taken to mitigate risks, including by bolstering capital bases, strengthening bank supervision, and further developing the financial safety net framework. The authorities are moving in this direction. They are considering a number of changes to the banking law, and the FSA has stepped up its supervision of banks.

Exchange rate stability is a key policy objective at present. This is important to maintain depositor confidence, limit the risks from the large foreign currency exposure of the corporate sector, and help reduce inflation. When conditions in financial markets improve, a return to a more flexible exchange rate policy would be desirable. Given its limited movement against the U.S. dollar since October, the tenge exchange rate has been reclassified as a *de facto* conventional peg. There is no clear evidence of over or undervaluation of the real exchange rate.

Macroeconomic policies should remain supportive of growth. Inflation pressures are beginning to ease, and the current monetary policy stance is appropriate for now. Staff recommends that the automatic fiscal stabilizers be allowed to operate, and see room for a discretionary fiscal stimulus package if growth slows more sharply than expected.

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I. Recent Developments, Outlook, and Risks

1. **At the time of the 2007 Article IV consultation, Kazakhstan's economy was enjoying an extended period of very rapid growth**. Between 2001 and 2007, real GDP growth averaged 10 percent annually, underpinned by the development of the oil sector, generally prudent macroeconomic policies, structural reforms, and increased access to global financial markets. As a result of this strong growth, real per capita incomes have doubled since 2000 and social indicators have improved.

2. **The banking sector played a central role in this rapid growth**. Banks dominate the financial system in Kazakhstan, accounting for 80 percent of total assets. They are mostly locally and privately owned, although foreign participation has increased recently. The system is highly concentrated, with the largest five banks accounting for 78 percent of market share. Banks are very reliant on external financing, with external liabilities making up about 45 percent of the aggregate balance sheet. Easy access to external funding fueled very rapid domestic credit growth, which expanded at an annual average rate of 70 percent from end-2004 to August 2007, bringing bank credit to around 75 percent of GDP by end-2007. Lending was mainly to the household, trade, and construction sectors (the oil sector is not reliant on domestic banks for its financing).

Balance Sheet of the Banking Sector, March 2008 *($ bns.)*

Assets	103.2	Liabilities	103.2
Currency and Deposits	14.7	Deposits	38.7
o/w: in Foreign Currency	11.1	o/w: in Foreign Currency	15.3
Securities	6.4	Securities	6.4
o/w: NBK notes	1.2		
o/w: Government securities	1.8	Borrowing	39.4
o/w: Nonresident securities	2.0	o/w: Nonresidents	37.8
		o/w: Direct loans	14.8
Loans	76.5	o/w: SPV deposits	20.3
o/w: in Foreign Currency	38.9		
o/w: Construction	10.6		
o/w: Trade	12.8	Other	1.2
o/w: Households	21.0		
Other	5.5	Capital	17.5

Source: Kazakhstani authorities; Fund staff calculations.

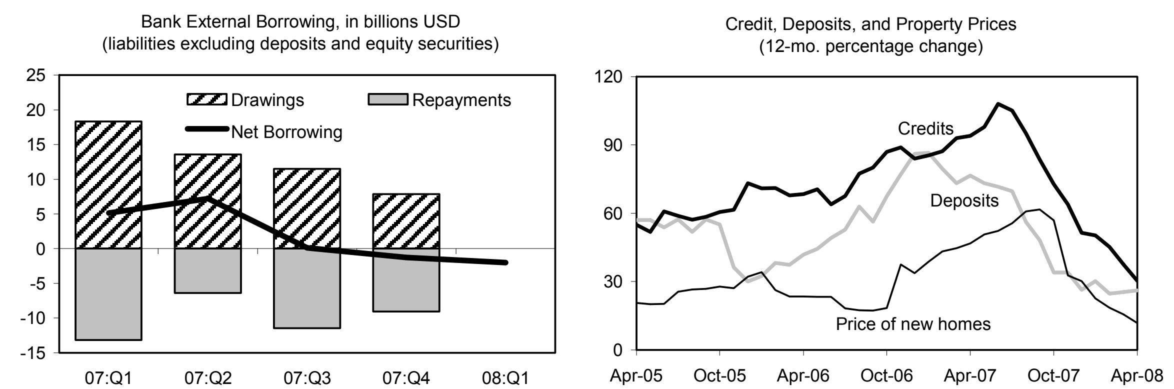
3. **The economic situation in Kazakhstan has changed significantly since the onset of the global financial turmoil last summer** (Tables 1–4). Market perceptions of risk on Kazakhstan's assets rose sharply in September and, despite a substantial decline over the past month, remain elevated (Figure 1). Commercial bank access to external funding has been sharply reduced. Banks have been repaying syndicated loans and Eurobond issues as they have come due, while raising new financing through nonresident deposits, private loan replacements, government agency-guaranteed loans, and to some extent liquidating their own

foreign assets. Some of this borrowing is reported to be at higher cost and shorter maturity than the maturing liabilities. Rating agencies downgraded the banks and the sovereign in early October 2007 (to BBB- by S&P for the sovereign long-term foreign currency rating). Several banks were downgraded again in December, while the sovereign rating outlook was revised to negative by S&P in late April. As confidence in the banks declined, household deposits contracted during August–October and nonresidents sold about $4 billion worth of tenge assets—mostly held in central bank notes—putting significant downward pressure on the exchange rate (Figure 2).

Commercial Banks' Foreign Assets and Liabilities
(quarterly change, in millions USD)

	2007:Q3	2007:Q4	2008:Q1
Net Foreign Assets	-1,197	2,099	1,003
Claims on Nonresidents	-800	2,300	-607
Securities	-681	-622	-699
Financial Derivatives	104	49	150
Cash and deposits with nonresidents	-188	2,489	-232
Loans to Nonresidents	6	248	113
Short-term loans and repos	-2	-4	0
Other Loans	8	252	113
Liabilities to Nonresidents	397	201	-1,610
Securities	372	-6	-135
Financial Derivatives	-82	-28	-63
Deposits of nonresidents	-439	1,000	401
Loans from nonresidents	545	-763	-1,821
Short-term loans and repos	-1,231	-515	-619
Other Loans	1,776	-249	-1,203
Memorandum Items:			
Total Assets (e.o.p.)	98,484	101,470	102,897

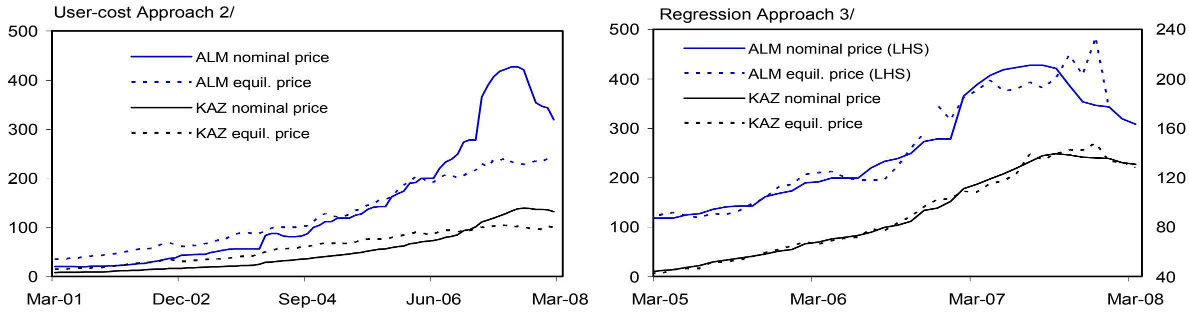
Source: National Bank of Kazakhstan; and Fund staff calculations.



Source: Kazakhstani authorities.

4. **In response to the tightening of liquidity conditions, banks have sharply curtailed their lending, and growth and property prices are weakening**. There has been no growth in bank lending since August, and this “credit crunch” is affecting the nonoil economy. Real GDP growth slowed to 6 percent (y/y) in the first quarter of 2008, from 8.9 percent (y/y) in the third quarter of 2007, and recent indicators of manufacturing and construction activity suggest that the nonoil economy remained weak into the second quarter (Figure 3). After several years of rapid gains, property prices are declining, most notably in Almaty where the prices of existing homes are down by 40 percent from their peak. This decline has partly corrected previous overvaluation, although the price adjustment may have further to go, particularly if credit availability and household incomes continue to weaken. Developments in Kazakhstan have also had repercussions in the region (Box 1).

Actual and Equilibrium Nominal House Prices 1/ (Thousands of tenge/sq.m.)



1/ Data shown for Kazakhstan (KAZ) and Almaty (ALM).
2/ Based on equilibrium in the housing market that the expected annual cost of home ownership equals the annual cost of renting.
3/ House price growth as a function of fundamentals (affordability ratio, income per capita growth, interest rate, and credit growth).
Source: Kazakhstani authorities; Fund staff calculations.

Box 1. Regional Linkages and Spillovers

Kazakhstan is becoming a more important player in central Asia. The primary channels linking the region's economies are trade, workers' remittances, and cross-border banking. The temporary ban on wheat exports in 2008 and the difficulties experienced by banks highlight the impact of policies and developments in Kazakhstan on the region.

Kazakhstani banks expanded rapidly in neighboring markets in recent years. The presence of Kazakhstani banks has become particularly notable in the Kyrgyz Republic, where they accounted for 48 percent of total lending in September 2007. The credit crunch led Kazakhstani banks to squeeze branches and subsidiaries abroad to shore up liquidity, causing a slowdown in credit extension in the Kyrgyz Republic. Credit growth has recovered in 2008 and the share of Kazakhstani banks' credit has stabilized at 45 percent of total. In Tajikistan, one Kazakhstani bank in particular has lent a significant sum to the cotton sector, which is secured by Tajik central bank reserves. This makes Tajikistan vulnerable to any problems at this bank (although the exposure is low from the bank's perspective). Finally, Kazakhstani banks' activities in Russia have been growing; while this helps them to diversify their balance sheets, it exposes them to new risks.

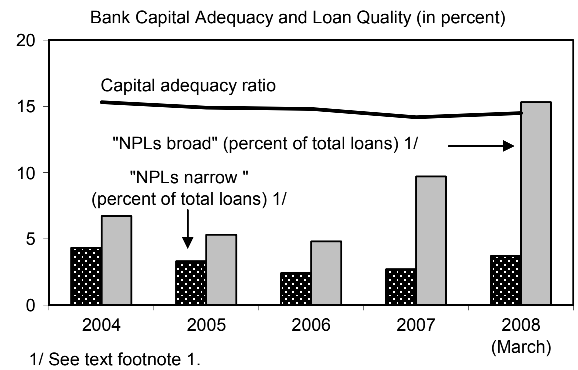
The slowdown in Kazakhstan is having a noticeable impact on some neighbors. The country is an important net importer from the CIS and a source of remittances, particularly for the Kyrgyz Republic (although little is captured in official data). All-in-all, growth in the Kyrgyz Republic (excluding gold) and Tajikistan is projected to slow to 5 percent this year, from 8.7 percent and 7.8 respectively in 2007.

	Remittances from KAZ /1 (% of GDP)	CIS trade with KAZ (% of total)			Credit from KAZ banks (% total credit)
		Imports	Wheat imports	Exports	
Kyrgyz Republic	4.7	8.8	96.5	15.2	45.0
Russia	0.0	1.9	…	3.5	0.0
Tajikistan	6.5	8.2	100.0	5.0	18.9
Uzbekistan	0.8	6.2	14.0	5.0	…

Source: Kazakhstani and CIS country authorities. Data for 2007.

1/ Country estimates. Most remittance flows travel "by road" and are not captured in official data.

5. **Financial soundness indicators are showing signs of deterioration** (Table 5). While capital adequacy is well above the regulatory minimum, falling liquidity ratios and deteriorating asset quality do raise concern, with the number of loans overdue by more than seven days rising sharply in recent months.[1] Banks are heavily exposed to the deteriorating property market, face indirect exchange rate risk from lending in foreign currency, and have further large external debt repayments coming due. The authorities estimate that the maturing external liabilities of banks in 2008 total $14 billion ($17 billion with interest), including repos and short-term deposits of nonresidents, and repayments are estimated to have been the highest in the first quarter.



1/ See text footnote 1.
Source: Kazakhstani authorities.

Maturing External Liabilities of Banks, 2008 1/
(in millions USD)

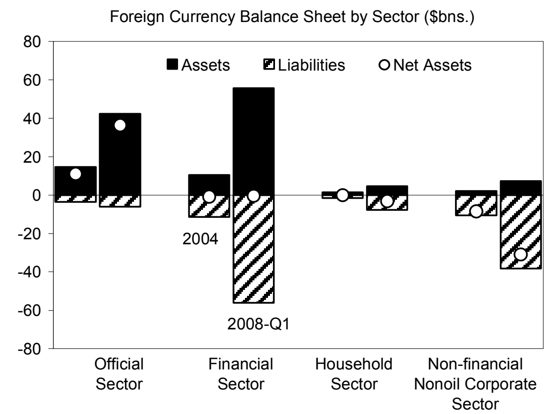
	2008				
	Q1	Q2	Q3	Q4	year
Total	5,145	3,741	2,529	2,687	14,102
Deposits 2/	494	296	296	296	1,383
Bonds and notes	205	402	0	364	971
Short-term loans 3/	1,546	1,378	275	548	3,747
Long-term loans	2,900	1,664	1,958	1,479	8,001

Source: National Bank of Kazakhstan; and Fund estimates.
1/ Excludes interest payments. Includes Kazakhstan Development Bank, accounting for less than $200 million of maturing liabilities.
2/ Short-term deposits of nonresidents redeemable in 2008 are distributed equally across quarters.
3/ Includes repo operations with nonresidents of $1 billion.

6. **The authorities reacted decisively to the sudden stop in capital inflows last year**. The central bank (NBK) provided large-scale liquidity support to banks during August–October through repurchase agreements, foreign exchange swaps, early redemption of NBK notes, and the easing of reserve requirements. It also intervened heavily in the foreign exchange market, using $6 billion (25 percent) of its reserves (15 percent of total official foreign currency assets) during August–October, and has since effectively pegged the tenge to the U.S. dollar. NBK reserves have recovered this year, rising by $4 billion through early June. The government directed $1 billion to support ongoing construction and investment projects in November 2007 (another $3 billion is slated for this year, although only $130 million is additional spending). After initially spiking, interbank interest rates have eased (Figure 2).

[1]Loan classification in Kazakhstan is based on a complex scoring system that classifies loans as "Standard," "Doubtful," and "Loss." "Doubtful" in turn is divided into five categories. The text chart and Table 5 show two measures of problem loans. "NPLs narrow" comprise the "Doubtful 5" plus "Loss" categories and include *loans overdue by 60 days or more, and loans that are still performing, but where the obligor is deemed "weak" or "failing"* (see also FitchRatings, April 2008). "NPLs broad" comprise categories "Doubtful 2, 4, 5, and Loss," and capture loans overdue by seven days or more, as well as those described above.

7. **Kazakhstan has large financial resources to help weather the current situation**. Official foreign currency assets totaled $46 billion in early June, comprising NBK reserves of $21 billion and oil fund (NFRK) assets of $25 billion. Commercial banks also have foreign assets of which about $3.5 billion are thought to be liquid. Total foreign assets broadly match foreign liabilities when the intracompany debt of the oil sector is excluded, while liquid foreign currency assets comfortably cover potential short-term foreign currency drains.



Source: Kazakhstani authorities; Fund staff calculations.

8. **Looking forward, growth is expected to remain relatively subdued**.[2] Assuming limited bank access to external financing and only modest deposit growth, credit to the economy is likely to decline in real terms. Nonoil GDP growth is forecast to slow to 4.7 percent this year, from 9.2 percent in 2007, with spillovers from the oil sector partly mitigating the impact of the credit crunch. Oil output should support somewhat stronger overall growth of close to 5 percent in 2008. A strengthening in growth to 6¼ percent is projected next year assuming global financial conditions improve and pressures on bank balance sheets are reduced. The current account is projected to move into surplus in 2008, following the large deficit last year, due to higher oil and commodity prices and much slower import growth (Table 2 and Figure 5). With banks repaying debt, the external debt/GDP ratio is projected to fall sharply this year, and appears to be on a sustainable path under a range of scenarios (Table 6 and Figure 6). After surging late last year, CPI inflation has eased on a month-to-month basis this year, and in the absence of further oil or food price shocks, is expected to fall below 10 percent (y/y) by year-end, from 19.5 percent at present. Despite a weakening in nonoil tax revenues, the

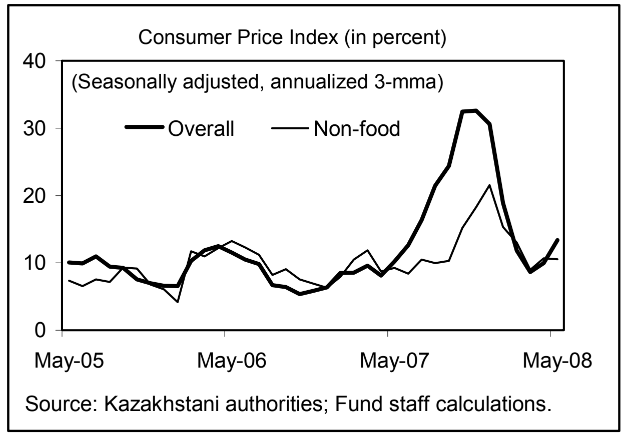
Sources of Foreign Currency Liquidity and Potential Drains
2008:H2-2009:H1 *($ bns.)*

Sources of foreign currency liquidity	59.7
o/w: Current account balance, proj.	10.2
Commercial banks, est. 1/	3.5
NBK 2/	21.0
National Oil Fund (NFRK)	25.0
Potential drains on foreign currency liquidity	43.2
o/w: Maturing external debt obligations	11.6
Commercial banks (excl. deposits)	7.5
Government	0.1
Other sectors (incl. intra-company debt)	4.0
Commercial bank deposits 3/	31.5
Nonresident holdings of NBK notes	0.1
Memorandum item:	
Total external debt	96.4
excluding intra-company debt	66.5

Source: Kazakhstani authorities, Fund staff estimates and projections.
1/ Foreign currency, securities, liquid foreign currency deposits at nonresident institutions.
2/ Includes commercial bank deposits in foreign currency at NBK.
3/ All deposits, excluding public sector deposits.

[2] The experience in Kazakhstan is expected to be broadly in line with other emerging market economies which have experienced the end of a credit boom (Figure 4).

overall budget surplus is projected to increase to 6¾ percent of GDP in 2008 due to strong oil revenue growth.



9. **Risks are on the downside, and a significantly weaker growth outturn than in the baseline forecast cannot be ruled out**. A prolonged period of tight conditions in global financial markets, a substantial drop in oil prices, and/or a domestic event that triggered a loss of confidence in the banks would adversely affect the economy.[3] In such cases, real credit would decline sharply, growth would weaken further, NPLs would jump, and bank capital ratios would decline. NPLs would increase more if the exchange rate depreciated given the unhedged foreign currency exposure in the nonoil corporate sector.

II. Policy Issues and Views of the Authorities

10. **The discussions focused on policies needed to manage the current risks to the outlook and set the stage for a resumption of strong growth and low inflation**. The authorities' views on the economic outlook are broadly similar to those of Fund staff, with the government and NBK both expecting real GDP growth of around 5 percent this year. The authorities recognize that the pace of expansion in recent years was unsustainable, and policies are now focused on managing a smooth transition to a sustainable growth path with priorities being to return inflation to single digit rates, strengthen the banking sector, and maintain fiscal discipline.

A. Banking Sector Policies

11. **The authorities are confident that the banks will be able to weather the current pressures they face**. The FSA pointed out that banks are well-capitalized, and that while rising, NPLs still remain low. Nevertheless, the supervisors are working to reduce the vulnerabilities facing the banks, and they welcomed the input from the Financial Sector Assessment Program (FSAP) Update in this regard (see text table on the following page for a list of the key FSAP recommendations). The FSA noted that the increase in recorded off-balance sheet items since the beginning of last year is largely due to a higher volume of

[3] A sharp decline in oil prices would have a substantial impact on the current account and budget balances. With oil prices at $50 a barrel, staff calculations suggest the current account would be in a deficit of 7¼ percent of GDP and the budget in a deficit of 1 percent of GDP in 2008.

Summary of Key FSAP Update Recommendations

<table>
<tr><th>Priority/ Timeframe</th><th>Higher priority</th><th>Lower priority</th></tr>
<tr><td>Immediate</td><td>

Strengthen bank supervision, both onsite and offsite by:

Strengthening evaluation of the quality of the loan portfolio, including loan concentration and consumer lending;
Assessing adequacy of bank liquidity management;
Collecting information about the nature of bank assets and liabilities abroad, assessing maturity, underlying pledges and covenants;

Ensure that banks have their own crisis preparation plans in place.
</td><td>

Test macro level EWS to ensure quality of signaling is improved;
Develop micro level EWS to ensure systemic and individual distresses are identified as early as possible.
</td></tr>
<tr><td>Near-term</td><td>

Capacity building at FSA to enable better monitoring of banks' risk management and asset valuation practices;
Finalize and test operational framework of MoU;
Bring bank restructuring/resolution framework into line with best practices.
</td><td>

Establish a framework for a high level Steering Committee to be in charge of policy issues during a systemic crisis;
Increase resources of the deposit insurance fund to adequate levels.
</td></tr>
<tr><td>Longer-term</td><td>

Improve capital market infrastructure to allow collateral-based money market transactions in an internationally compatible manner.
Improve consolidated supervison, including cross-border supervision.
</td><td>

Assess the state of laws, regulations, and market infrastructure for a government bond market;
Facilitate OTC markets to help develop and introduce products and techniques;
Extend role of Kazakhstan Mortgage Company (KMC) to provide liquidity to banks by purchasing mortgage assets.
</td></tr>
</table>

payment guarantees (linked to the rapid lending growth in the first half of 2007). Banks are required to provision against the contingent liabilities they face, and their exposure to financial derivative transactions is minimal (less than 1 percent of assets).

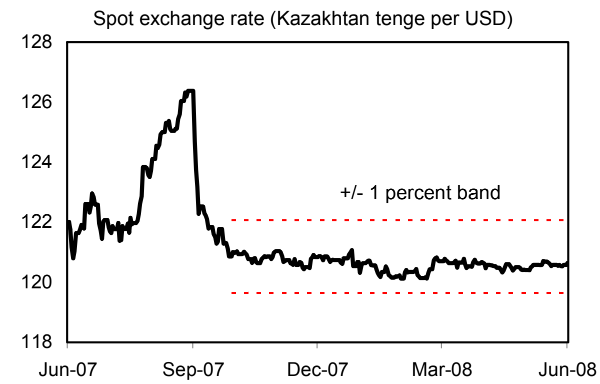
12. **The FSA has intensified its supervision of the banks in recent months and changes are also in train to strengthen the regulatory framework**. Onsite inspections of the largest banks have been stepped up, and FSA representatives have been installed at each of the large banks to increase contacts with bank management and more closely monitor bank operations. The FSA is also strengthening its stress testing and early warning system methodologies, in close cooperation with the NBK. To support these endeavors, the government has committed to significantly increase the resources of the agency, and the FSA hopes it will now be able to recruit and retain more experienced staff. Regulatory changes are being made to tighten limits on foreign borrowing (as a function of capital) and more closely monitor bank liquidity.

13. **The authorities are continuing to develop their financial safety net framework across a number of dimensions**. A Memorandum of Understanding (MoU) on Financial Stability, which has been signed by the government, the National Bank of Kazakhstan (NBK) and the Financial Supervision Agency (FSA), sets out the framework for cooperation in periods of financial stress. The NBK has established a framework for liquidity support for "financial stability purposes" under the MoU. In addition to the NBK's refinance window, the banks that have signed a "Memorandum of Cooperation and Interaction on Financial Stability" have access to exceptional liquidity support from the NBK (but must agree to certain conditions on their activities, including limits on foreign claims and liabilities). The NBK has also expanded the list of collateral it accepts at its refinance window, and has increased the capital of the deposit insurance fund, although it acknowledges that the fund would only be sufficient to cover deposits in the event of small banks failing.[4] To help manage financial difficulties at a bank, changes in the banking law are also being considered. These changes would increase the authorities' ability to react quickly to adverse developments in a bank's financial position, including through public capital injections (under the current legislation, the government can only inject capital into a bank when its capital ratio is below zero).

[4] The limit on individual deposit insurance is currently T 700,000 ($5,800 or about 85 percent of per capita income), a level that covers about 90 percent of household depositors.

B. Exchange Rate and Monetary Policy

14. **Exchange rate stability is a central policy objective of the NBK**. At present, exchange rate stability is viewed as essential for maintaining depositor confidence, limiting the risks from the large foreign currency exposure of the corporate sector, and helping reduce inflation. The central bank noted that downward pressures on the exchange rate had abated since the turn of the year, and its foreign currency reserves have been rising, in part due to the decision to delay the automatic conversion of oil fund revenues into foreign currency assets.[5] The country's official foreign assets (NBK reserves and NFRK assets) are now well above the level reached prior to the onset of market volatility in August 2007 (Box 2). Intervention in the foreign exchange market has been substantially scaled back (as a share of total transactions) in recent months, although the NBK stands ready to intervene in the market if downward pressures on the exchange rate re-emerge. The authorities continue to view the exchange rate regime as a "managed float with no predetermined path for the exchange rate."



Source: Bloomberg.

15. **The authorities place a high priority on reducing inflation**. The central bank raised its policy rate from 9 to 11 percent last December to help contain inflationary pressures, but has recently cut the reserve requirement on foreign liabilities (to 6 percent from 8 percent) to help bank liquidity. The current policy stance is seen as appropriate to balance a number of policy goals—preserving financial stability, cushioning downside risks to growth, and ensuring that inflation is on a firm downward path. The authorities have also implemented a ban on wheat and vegetable oil exports until September and October, respectively, in an effort to contain food prices and ensure sufficient reserves for domestic consumption (wheat exports to the Kyrgyz Republic are exempt). The NBK agreed with staff that weaker growth will likely help reduce inflation pressures in the coming months, but emphasized that it would be closely monitoring developments and would adjust its policy stance as needed. The NBK sees changes in its policy interest rate as an increasingly effective monetary policy instrument, although the exchange rate remains a very important tool for affecting economic outcomes (Box 3).

[5] The majority of tax revenues from the oil sector are paid to the government in tenge. These tenge revenues are then deposited with the NFRK and invested in foreign currency instruments. At present, the central bank, which manages the NFRK assets, has a six-month window in which to make the conversion from tenge to foreign currency.

Box 2. Optimal Reserve Measures for Kazakhstan

Based on traditional "rule of thumb" measures, Kazakhstan's reserves are comfortable (Figure 1). Recent research, however, has focused on the insurance motive for maintaining reserves. Jeanne (2007) develops a model in which the optimal level of reserves is determined by weighing the benefits of reserves—the reduced likelihood of a sudden stop and smoothed consumption during a crisis—against the opportunity cost of higher returns on less liquid assets. The probability of a sudden stop for emerging markets is estimated at about 10 percent from cross-country models, but for Kazakhstan this probability went up significantly with the onset of the global financial turmoil. In Figure 2, Jeanne's model has been calibrated for Kazakhstan for two different probabilities of a sudden stop, 10 and 100 percent.

NBK reserves were above their optimal level in early 2007, giving the central bank considerable scope to intervene in the foreign exchange market to cushion the impact of the sudden stop. The decline in reserves since last summer, however, means than NBK reserves are now below their optimal level, although total official foreign currency assets (including NFRK) are still very comfortable.

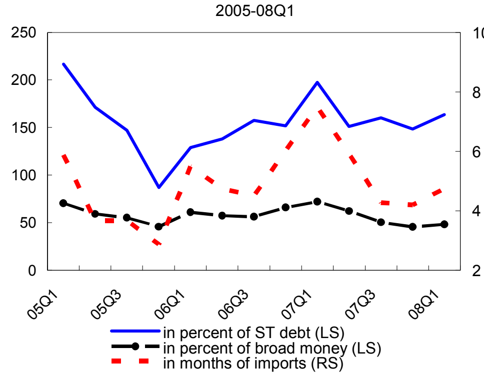


Figure 1. International Reserves, Coventional Measures 2005-08Q1

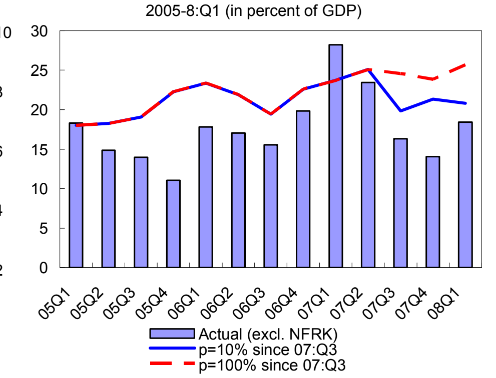


Figure 2. Optimal and Actual Reserves, Insurance Model 2005-8:Q1 (in percent of GDP)

C. Fiscal Policy and Other Issues

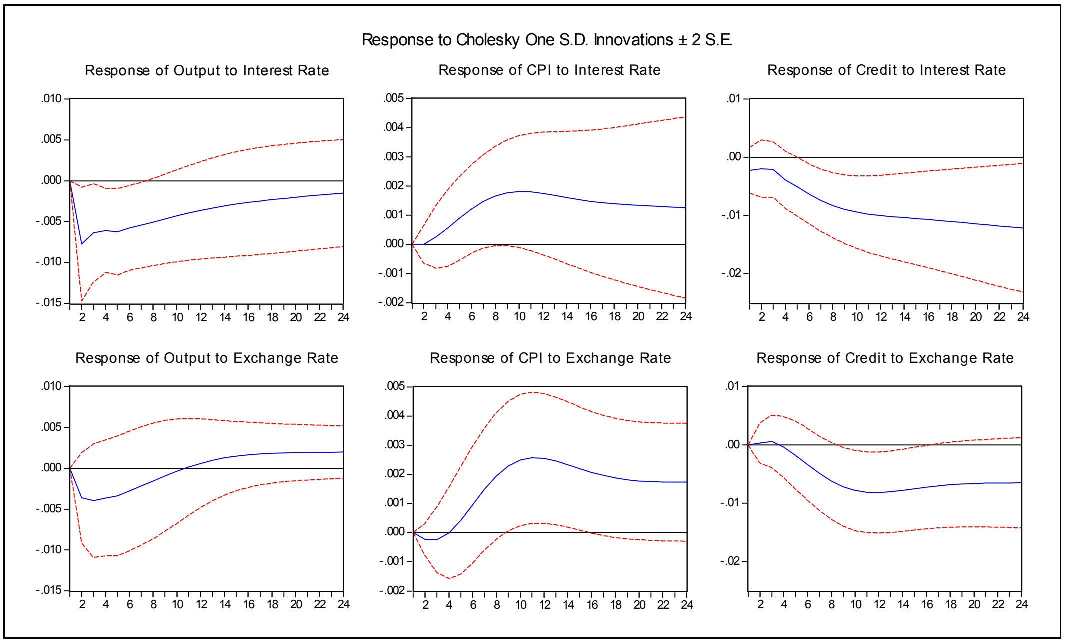
16. **During the discussions, the government stated its intention to meet its 2008 budget targets despite the slowing econom**y. Based on first quarter data, the authorities were anticipating a shortfall in revenues in 2008 of about T 200 billion (1.2 percent of GDP) relative to budget (the budget is based on a lower oil price assumption than assumed by the staff). They therefore intended to take offsetting measures, including freezing "nonpriority" spending (about T 84 billion) and introducing new revenue measures (see below). Subsequent to the mission, however, the government announced a supplementary budget that raised spending on wages and pensions and will result in a somewhat reduced fiscal surplus this year (relative to budget) of around ¾ percent of GDP.

17. **The government is preparing new tax and budget codes to bring public finances more into line with development priorities**. The objectives of the tax reform are to shift the

Box 3. The Monetary Transmission Mechanism in Kazakhstan

To look at channels of monetary transmission in Kazakhstan, a VAR model was run on seasonally adjusted monthly data (2000:1-2008:1). The variables included (in the order listed) are manufacturing production (a proxy for nonoil output), the consumer price index, the interest rate on NBK notes, private credit, and the dollar/tenge exchange rate. The exogenous variables are oil prices and the Federal Funds rate.[1]

The results suggest that both the interest rate and exchange rate channels are important. An exchange rate depreciation has a positive impact on the CPI and a negative effect on credit and output (although the latter is not statistically significant). An increase in interest rates has a negative impact on output and credit; the impact on inflation is incorrectly signed, but not statistically significant. To give an idea of the orders of magnitude, a 1 percentage point increase in the interest rate and a 5 percent depreciation of the exchange rate both reduce manufacturing output by about 2–2¼ percent in the short term.



[1] The variables exhibit unit root behavior, and there is evidence of cointegration. Given the short time span, unrestricted VARs in levels are estimated. The optimal lags selected are two, and the LM test indicates no autocorrelation in residuals.

burden of taxation more onto the subsoil and raw materials sectors to promote diversification of the economy and to simplify the tax system. As part of this initiative, the government recently imposed duties on crude oil exports that could raise T 120 billion in 2008. They are also considering imposing duties on other raw material exports in the near future. Other changes include a cut in the corporate tax rate and a further reduction in the VAT rate to 12 percent in 2009. It is hoped that the new tax code will be finalized by year-end. The authorities have also been working with the World Bank to develop a new budget code to improve the budget process and increase expenditure efficiency.

18. **The NFRK continues to be managed prudently, and the government does not expect to draw on the Fund beyond the amount of the guaranteed annual transfer to the budget**.[6] The assets of NFRK consist of a stabilization portfolio of about $5 billion (invested in short-term debt securities) and an investment portfolio (invested in longer-term debt and equity securities). While the NFRK fulfils both a stabilization and savings role, at present the government has no intention to use the Fund's assets to help cushion the downturn. Indeed, the government spent only 86 percent of the guaranteed transfer from the NFRK last year, and expects the mandated transfer to be adequate to meet spending needs this year.

19. **The authorities provided information about progress in the following areas**:

- **Trade policy**: The government has been engaged in intensive negotiations for WTO accession, and bilateral discussions have been concluded with 20 countries. While discussions for access to Kazakhstan for industrial goods from the United States have been completed, and are close to completion for the EU, further progress in other areas has been slowed by what the government sees as unreasonable demands from some bilateral partners.

- **The EITI initiative**. Kazakhstan is a member of the international EITI Board and has acquired the status of a candidate country for EITI implementation. The first national report on budget revenues and payments was published in February. The authorities are working to obtain the participation of all subsoil companies operating in the country; at present, companies accounting for 90 percent of the total volume of oil and gas extraction are participating.

- **AML/CFT legislation**. The draft bill on AML/CFT that was headed to parliament in 2007 is now undergoing amendments to bring it into closer compliance with international AML/CFT standards. The government hopes to complete the revisions and secure the passage of the law by year-end.

III. Staff Appraisal

20. **The current economic climate is challenging, but Kazakhstan has considerable financial resources to help it weather the situation, and medium-term growth prospects remain favorable**. The policy response of the authorities to the drying-up of external financing has so far been broadly appropriate, and policies should continue to focus on managing risks to the outlook and setting the stage for a resumption of strong and sustained growth.

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[6] Guaranteed transfers from the NFRK only finance spending on the Development Budget. The size of the transfer is established by a legislative act, and is determined by a formula based on a constant amount plus a portion of the previous stock of NFRK assets. The guaranteed transfer in 2008 is T 461.4 billion (2.6 percent of GDP).

21. **The health of the banking sector is central to the outlook**. NPLs are expected to continue rising, while banks face large external debt repayments during the remainder of the year which will continue to put pressure on their liquidity. In the face of these challenges, a clear picture of the vulnerabilities facing the banks needs to be developed, and steps taken to mitigate risks. Delaying adjustment, for example by replacing maturing external borrowing with new higher-cost, short-maturity funding, is likely to increase vulnerabilities in the future. Banks should have in place plans to maintain liquidity, preserve asset quality, and continue to meet solvency standards, including, if necessary, by raising additional capital. For their part, the supervisors need to ensure that banks are realistically assessing their business models, adequately provisioning to cover rising NPLs, taking a conservative approach to collateral valuations in an environment of limited liquidity and falling prices in the property market, and carefully monitoring risks from off-balance sheet transactions.

22. **Bank supervision and regulation need to be strengthened**. The recent efforts by the FSA to step up their supervision of banks and conduct more rigorous stress tests of the system are welcome. The government's commitment to increase the resources available to the FSA will help these endeavors. Efforts are particularly needed to develop offsite supervisory capacities, with a reduced emphasis on form filling, a greater role for analysis, and prompt follow-up, including through additional inspections when issues of concern arise. Regulatory measures to encourage banks to focus on raising domestic resources are welcome, although in some other areas it is important that overregulation does not distort the market forces of intermediation or stymie the risk-taking nature of the banking business.

23. **The authorities have made considerable progress in developing their financial safety net framework**. The principles of the Memorandum of Understanding (MoU) on Financial Stability, are sound and help establish a foundation for managing any difficulties that may emerge in the banking system. The liquidity support framework has proved effective at providing support to banks during the recent turbulence, although it is important that the central bank's balance sheet is not compromised by these operations. Reforms to give the authorities more flexibility to react to adverse changes in a bank's financial position would also be helpful.

24. **Staff support the NBK's policy of maintaining a stable exchange rate during this current period of uncertainty**. While staff have previously advocated greater exchange rate flexibility to help contain overheating pressures, the current position is justified by the different circumstances now facing the country. If downward pressures on the exchange rate were to resume, a number of steps could be taken to support the tenge, including: continuing to delay conversion of the oil fund receipts into dollars; encouraging commercial banks to use their own foreign currency assets to meet external debt repayment obligations; and intervening in the foreign exchange market, although under a clear operational rule that limits the amount of reserves committed to defend the exchange rate. When conditions in financial markets improve, a return to a more flexible exchange rate policy would be desirable.

25. **The exchange rate regime in Kazakhstan has been reclassified from a managed float to a conventional peg under the IMF's *de facto* classification system**. This is due to the very limited movement of the tenge against the U.S. dollar since last October. At present, the staff's assessment is that there is no clear evidence of either over or undervaluation of Kazakhstan's real exchange rate when compared to its estimated equilibrium level (Box 4).

26. **The NBK's current monetary policy stance is appropriate for now given that growth is expected to remain quite subdued, inflation pressures are beginning to ease, and there are few signs that recent high inflation is feeding into wages**. If, however, inflation does not ease as expected, wage pressures accelerate, or the exchange rate comes under significant downward pressure, a monetary tightening would need to be considered.

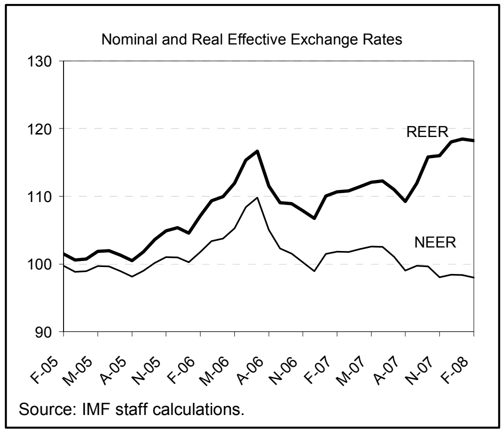
27. **The fiscal position in Kazakhstan is very strong, with a large budget surplus and low public debt**. The nonoil fiscal deficit this year is expected to remain below the level staff estimate to be consistent with maintaining per capita oil wealth constant in real terms (Figure 5). The government therefore has room to allow the automatic fiscal stabilizers to operate, rather than seeking to offset any shortfalls in tax revenue that may occur as a result of the slowing economy. Indeed, measures to increase tax rates or lower expenditures to meet previously set fiscal targets could aggravate the slowdown or lead to an inefficient allocation of resources where export taxes keep domestic prices artificially low. The staff welcomes the recently announced budget measures, and sees scope for a fiscal stimulus package in the event of a sharper-than-expected slowing in growth, although it is important that it be well-targeted and consistent with development and fiscal reform objectives.

28. **The recent sharp rise in food prices is a concern**. A well-crafted response is needed to mitigate the negative effect on poorer sections of the population, while encouraging increased production of food products in the future. Given the strong fiscal position, there is scope to introduce well-targeted government subsidies to low income households to help offset the higher cost of food. This would be a better response than measures that seek to influence prices, including trade restrictions, as these reduce incentives for higher production. Efforts to boost agricultural production and improve distribution systems will also help alleviate price pressures going forward.

29. **The publication of Kazakhstan's first report under the Extractive Industries Transparency Initiative (EITI) initiative is welcome**. This represents an important step in further increasing the transparency of revenues received by the government from companies in the oil sector. The staff encourages the prompt passage of the draft bill to help bring Kazakhstan's AML/CFT legislation in line with international best practice.

30. **It is proposed that the next Article IV consultation take place on the standard 12-month cycle**.

Box 4. Assessing the Real Exchange Rate (RER) in Kazakhstan



With the tenge effectively tied to the depreciating U.S. dollar since last August, the nominal effective exchange rate has weakened over the past year. The real effective exchange rate, however, has appreciated by 11 percent as the inflation differential between Kazakhstan and its main trading partners has widened.

Against this background, three approaches were applied to assess the RER against its estimated "equilibrium" medium-term level. The *equilibrium real exchange rate* (ERER) approach estimates an "equilibrium" level based on fundamental economic determinants. The *macroeconomic balance* (MB) approach estimates the "equilibrium" current account ("norm") and assesses the gap between this "norm" and the projected medium-term ("underlying") current account balance. Finally, the *purchasing power parity* (PPP) approach estimates the deviation of the RER from its "long-run level" based on an international comparison of price and productivity levels (deviations are on trade-weighted basis).

The ERER and PPP approaches suggest undervaluation, while the MB approach suggests overvaluation. The MB approach, however, has weaknesses for an oil exporter such as Kazakhstan. In the MB methodology, oil prices have a strong positive impact on the estimated current account "norm," but oil-related capital equipment imports and income flows to foreign owners—which are significant in Kazakhstan—are not captured in the model, hence overestimating the norm and the degree of overvaluation. The ERER approach also warrants some caution as the assumption of no misalignment over the sample period (1995–2007) is not likely to have held for Kazakhstan given the significant structural changes that were occurring in the economy during this time. A fourth methodology, the *external sustainability* approach, was not applied because of the difficulties of accounting for oil wealth in the ground in the case of an oil exporting country such as Kazakhstan.

On the basis of the analysis, staff assess that there is no clear evidence of either over or undervaluation of the real exchange rate compared to its estimated equilibrium level. There is, however, considerable uncertainty surrounding the assessment given methodological shortcomings and the variation in results.

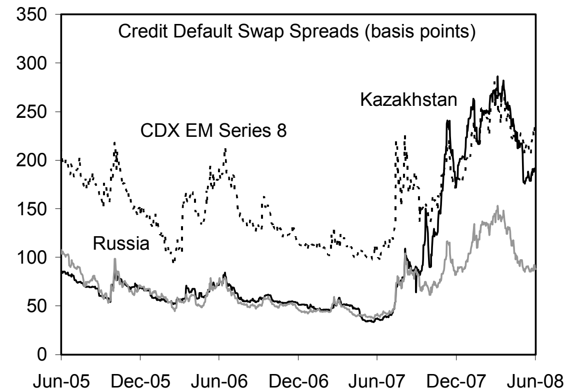
Kazakhstan: Methodologies to Assess Real Exchange Rate Misalignment 1/

	Underlying Current Account Balance	Current Account Norm	Estimated over(+)/ under(-) valuation
Equilibrium Real Exchange Rate 2/	na	na	-23
Macroeconomic Balance 3/	3.6	6.2	16
Purchasing Power Parity 4/	na	na	-19

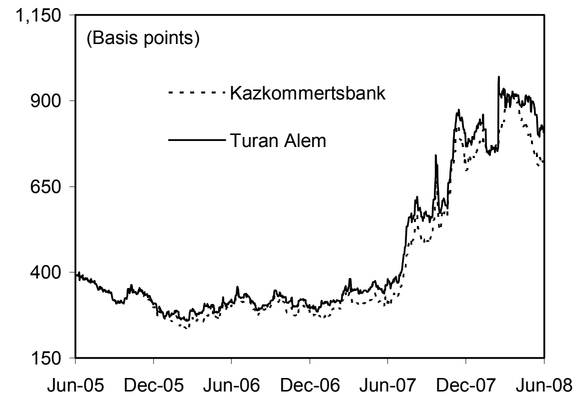
1/ Based on "Methodology for CGER Exchange Rate Assessments," SM/06/283.
2/ Based on current fundamentals (2007).
3/ Based on 2013 projections.
4/ Based on 2007 estimates.

Figure 1. Recent Financial Developments

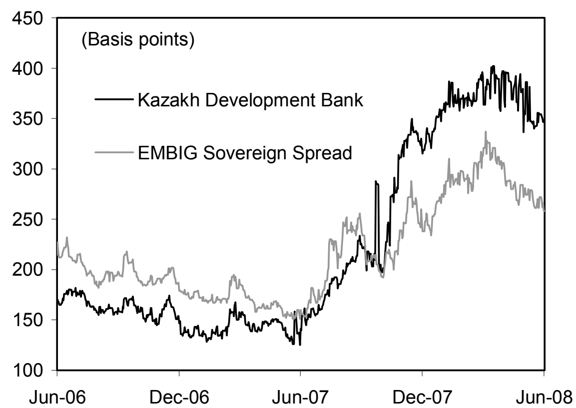
The onset of the global financial market turmoil led to a repricing of risk for Kazakhstan…



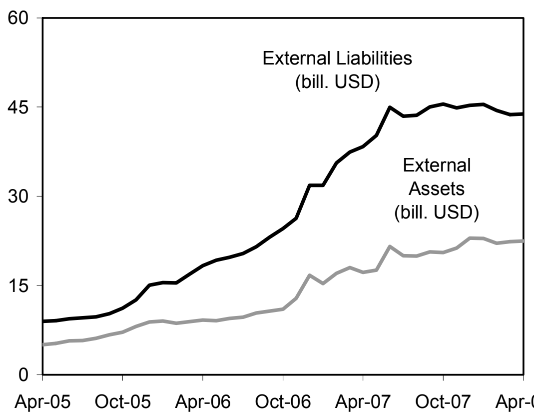
…bond spreads widened for banks…



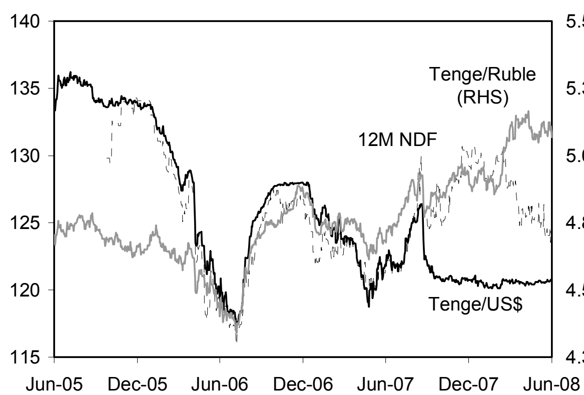
…and the sovereign, more so than for other emerging markets.



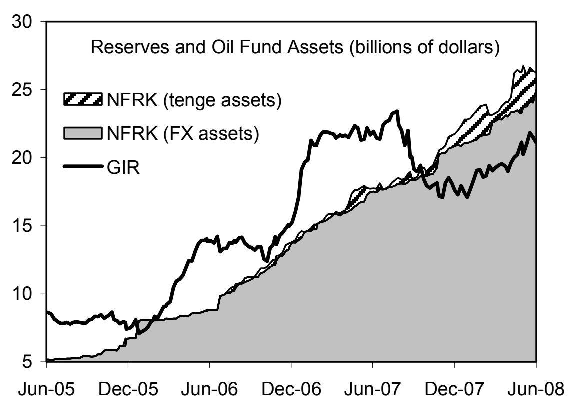
External borrowing by banks, which had been heavy in recent years, has become harder to obtain.



The exchange rate initially came under pressure, though it has been stable since October…



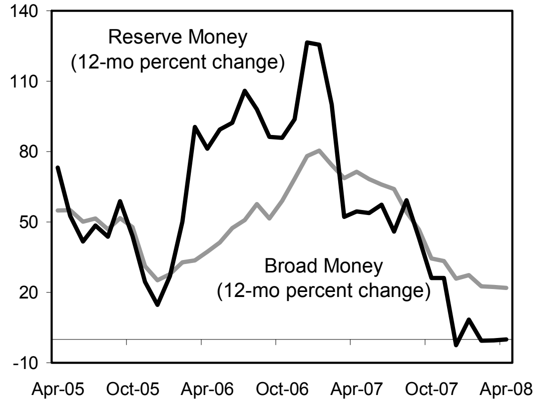
…and following a drop, reserves are recovering.



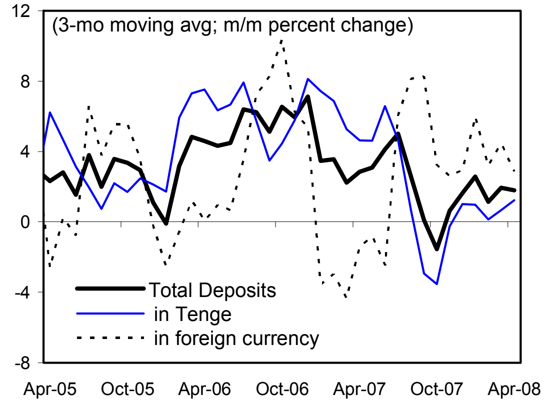
Source: Bloomberg and Kazakhstani authorities.

Figure 2. Recent Financial Developments (cont'd)

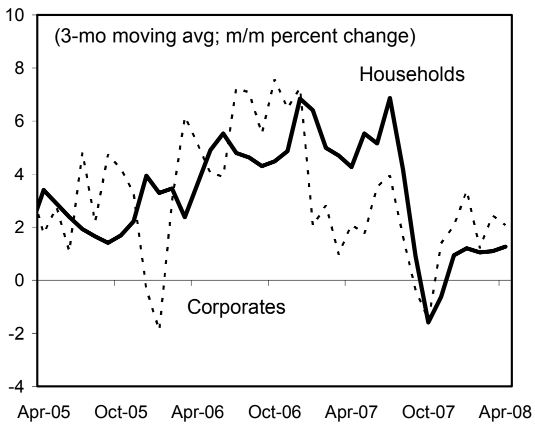
Growth in monetary aggregates has slowed sharply…



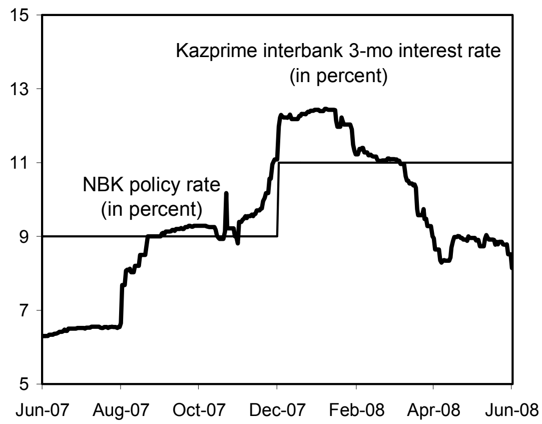
…with tenge deposits declining late last year.



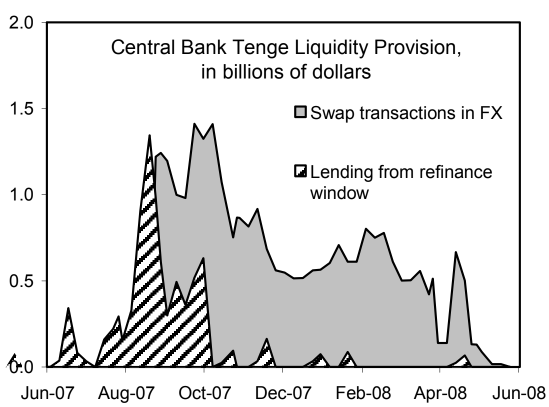
Household deposits have been particularly weak.



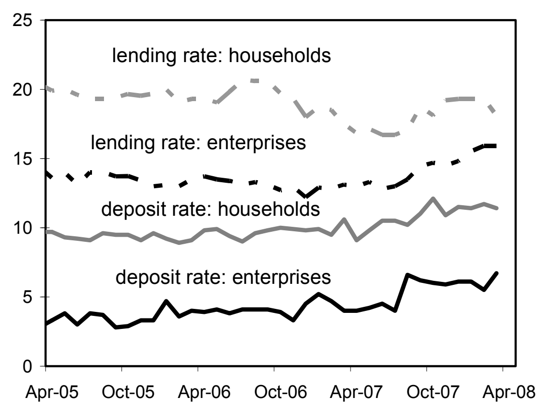
Interbank liquidity initially tightened…



…and the NBK provided large-scale liquidity support to banks.



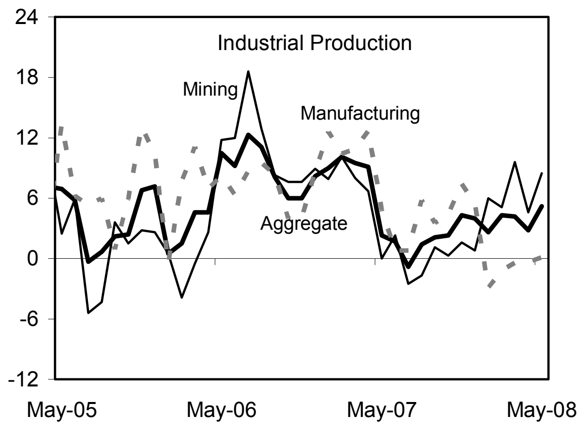
Interest rates have increased for both deposits and loans.



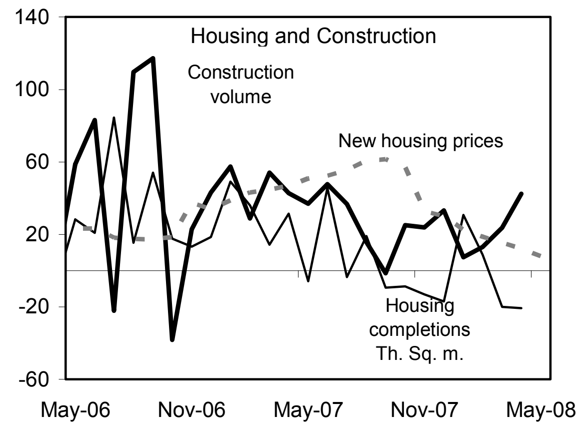
Source: Kazakhstani authorities.

Figure 3. Real Sector Developments
(12-month percent change)

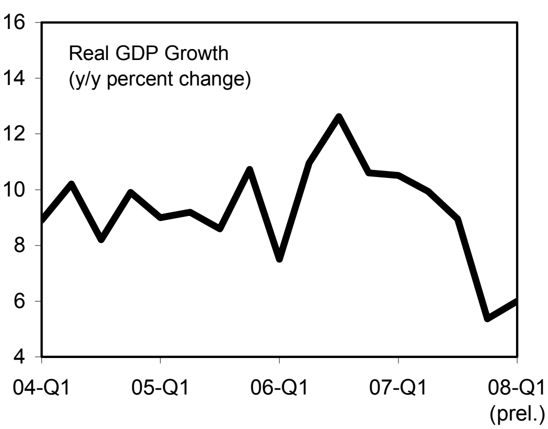
Industrial production growth has slowed…



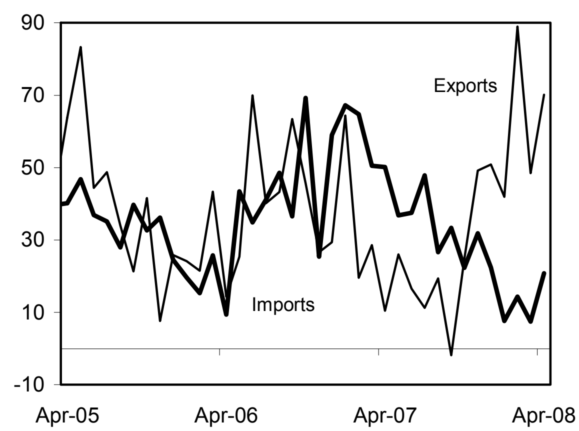
…as has activity in construction, along with housing prices.



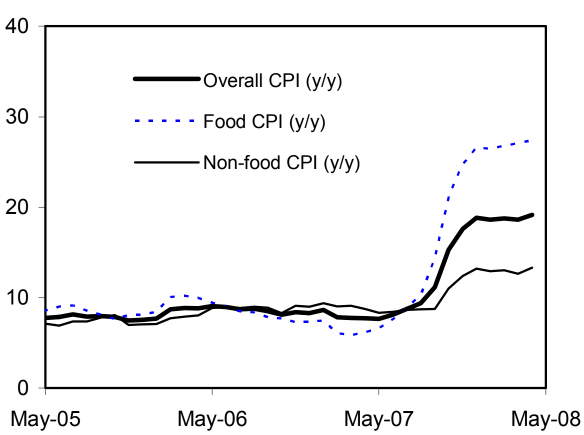
Real GDP growth slowed sharply in the fourth quarter of 2007 and first quarter of 2008…



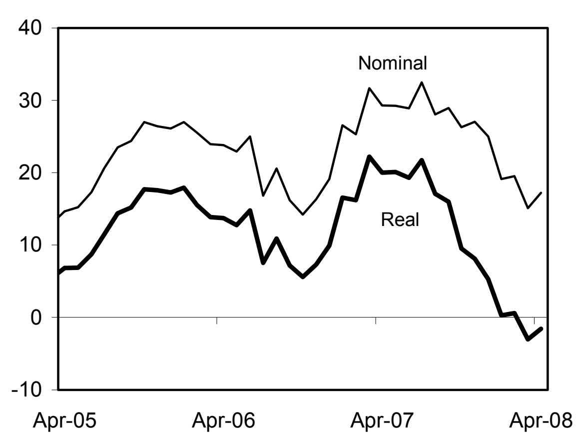
…and demand for imports has weakened considerably.



Consumer prices surged last year…

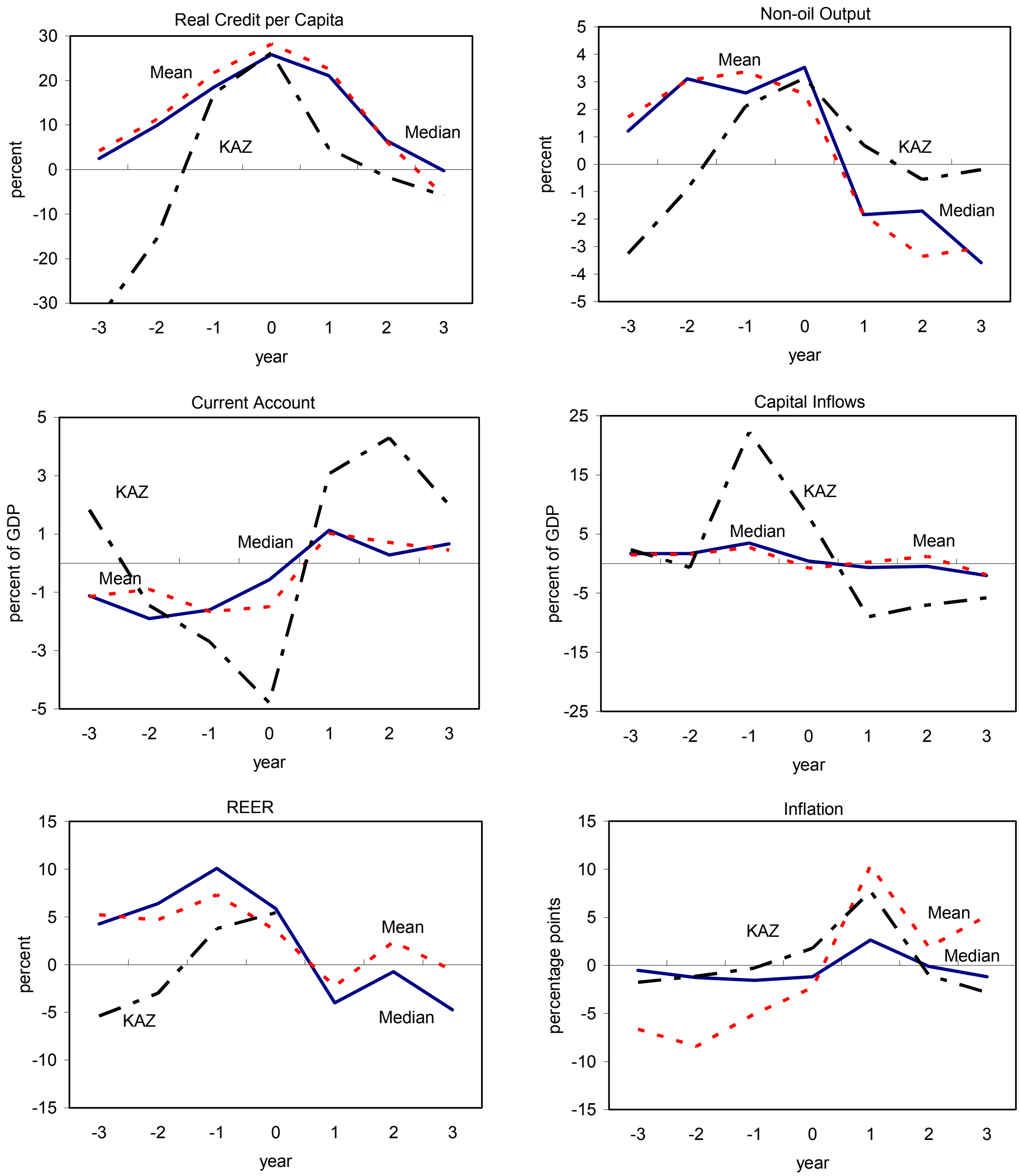


…though there is yet no pressure on wages.



Source: Kazakhstani authorities; and Bloomberg.

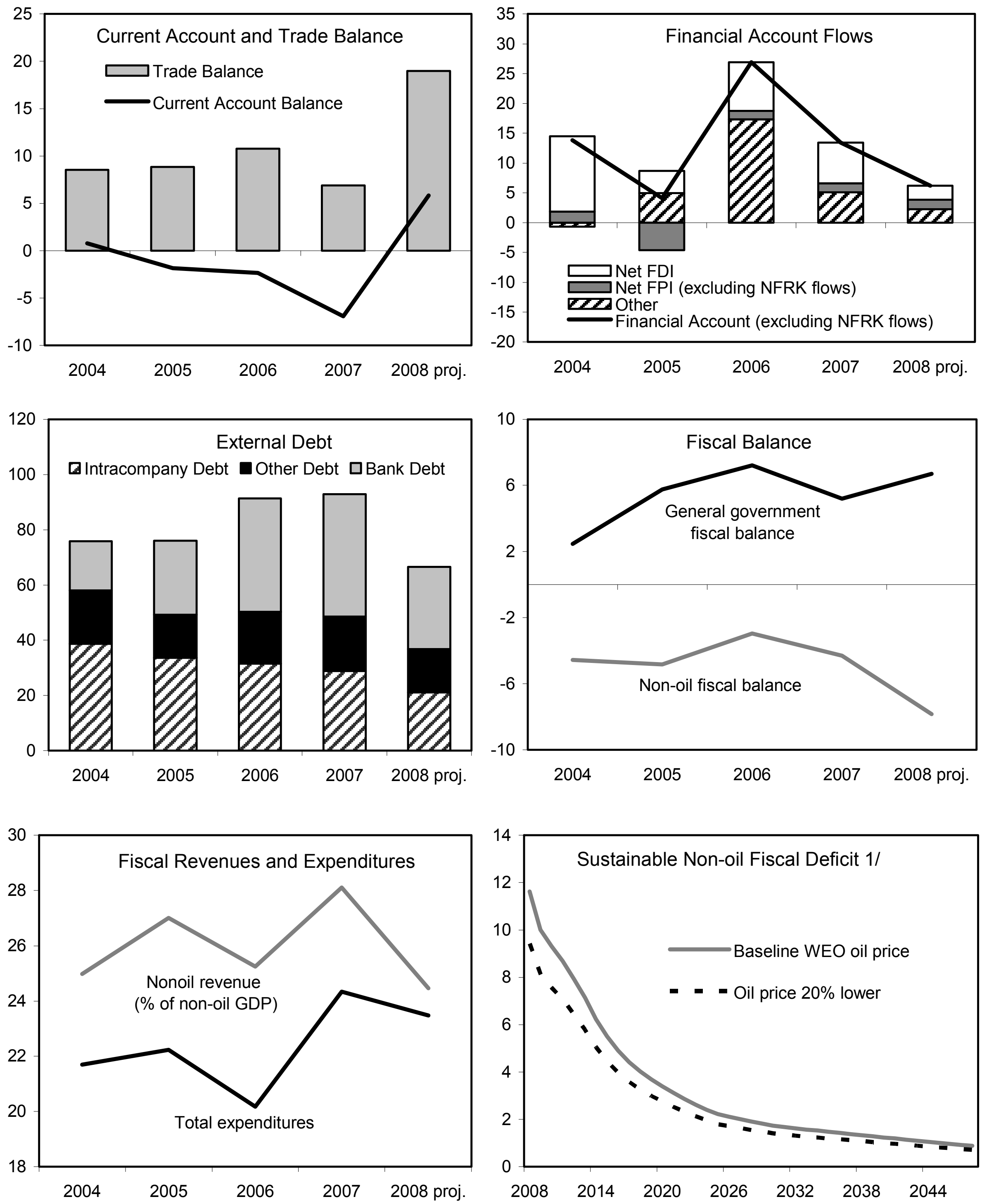
Figure 4. Kazakhstan: A Comparison with Previous Credit Booms in Emerging Markets 1/



Source: Mendoza, E. and M. Terrones. An Anatomy of Credit Booms: Evidence from Macroeconomic Aggregates and Firm Level Data, Working paper, 2007, and staff estimates.

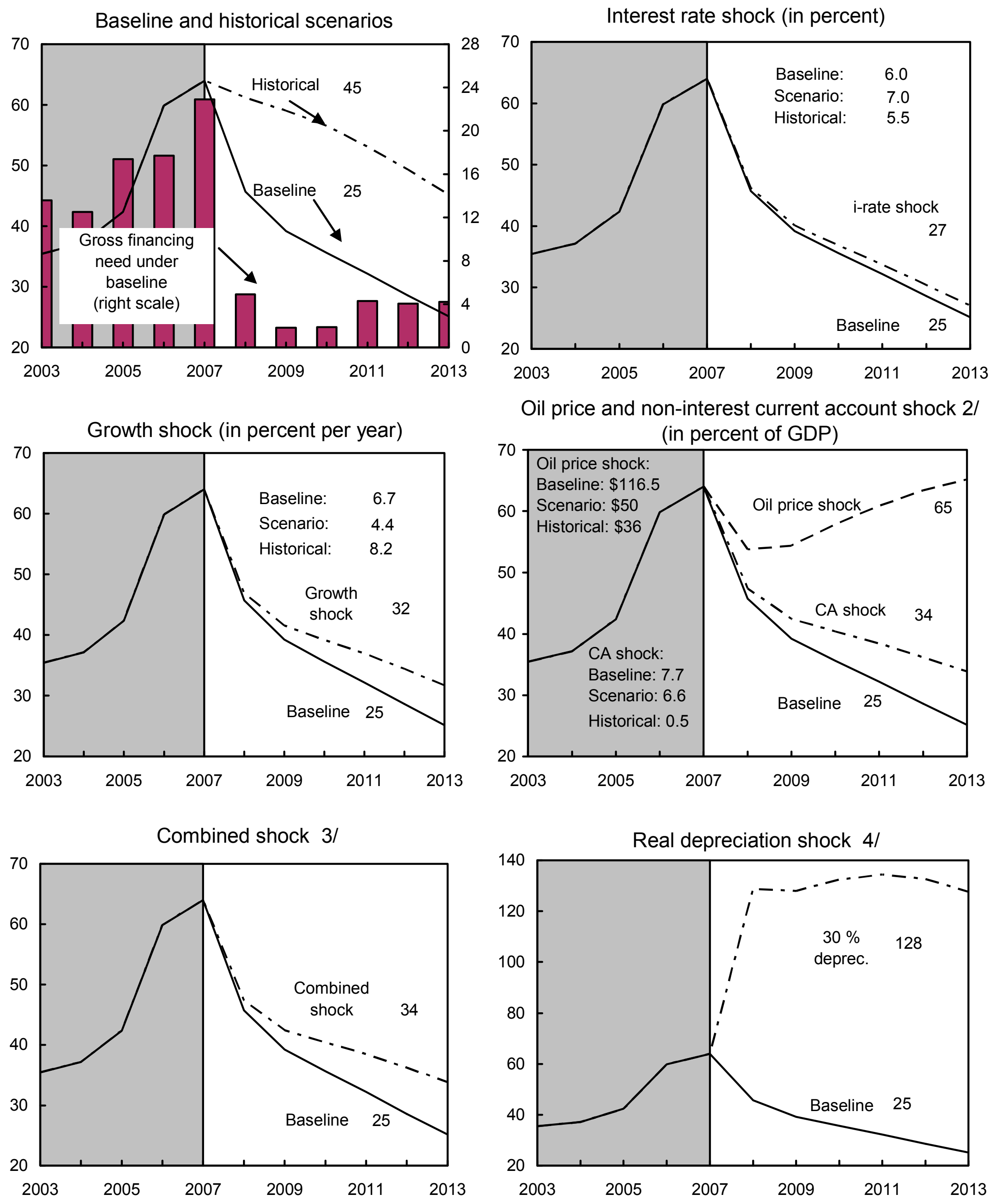
1/ All figures are shown as deviations from HP filtered trend. Means/medians are based on a sample of emerging market economies. A seven year event window is used with a peak shown at year 0. For Kazakhstan, year 0=2007, and years 1,2, and 3 are staff projections where shown.

Figure 5. External and Fiscal Sector Developments
(in percent of GDP)



Source: Kazakhstani authorities; and staff estimates.
1/ Non-oil fiscal deficit that would maintain per capita oil wealth constant in real terms.

Figure 6. Kazakhstan: External Debt Sustainability: Bound Tests 1/
(External debt, excluding intra-company debt, in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data including 2007. 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/ Oil price shock is a permanent drop in oil price to $50/barrel in 2008. Nominal GDP in this scenario is kept at the baseline for comparison purposes.
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 2008, which corresponds to a 61 percent nominal depreciation.

Table 1. Kazakhstan: Selected Economic Indicators, 2005–13

				Projections					
	2005	2006	2007	2008	2009	2010	2011	2012	2013
(Annual percent change; unless otherwise indicated)									
National accounts and prices									
Real GDP	9.7	10.7	8.9	5.0	6.3	6.7	6.9	7.5	7.7
Real oil	1.7	5.0	7.3	6.8	10.2	6.0	3.8	7.2	8.4
Real non-oil	11.5	11.9	9.2	4.7	5.5	6.8	7.5	7.5	7.5
Consumer price index (eop)	7.5	8.4	18.8	9.7	7.0	7.0	6.5	6.0	6.0
Consumer price index (p.a)	7.6	8.6	10.8	16.9	8.2	6.5	6.5	6.0	6.0
Exchange rate (tenge/U.S. dollars, eop; 2008 is May)	2.9	-5.1	-5.3	0.2	...	...	...	...	...
Exchange rate (tenge/Russian ruble, eop; 2008 is May)	-0.4	3.7	1.2	3.9	...	...	...	...	...
Real effective exchange rate (p.a) (+ appreciation)	3.1	7.7	8.7	...	...	...	...	...	...
(In percent of GDP; unless otherwise indicated)									
General government fiscal accounts									
Revenues and grants	28.1	27.5	29.6	30.2	29.9	29.9	29.2	29.1	29.3
of which: oil revenues	10.6	10.2	9.5	14.5	13.8	12.8	11.3	10.7	10.4
Expenditures and net lending	22.3	20.2	24.4	23.5	23.7	23.7	23.7	23.7	23.7
Overall fiscal balance	5.8	7.2	5.2	6.7	6.2	6.2	5.5	5.4	5.5
Non-oil fiscal balance	-4.8	-3.0	-4.3	-7.8	-7.7	-6.6	-5.8	-5.3	-4.9
Non-oil fiscal balance (percent of non-oil GDP)	-7.4	-4.3	-6.0	-12.1	-11.9	-9.9	-8.2	-7.4	-6.7
Expenditures (percent change)	30.7	22.0	50.2	29.9	16.6	9.2	9.7	11.6	12.6
(Annual percent change, eop; unless otherwise indicated)									
Monetary accounts									
Reserve money	14.7	126.4	-2.5	...	...	...	...	...	...
Broad money	25.2	78.1	25.9	14.3	13.3	...	...	...	...
Broad money velocity (annual average)	4.1	3.6	3.1	...	...	...	...	...	...
Credit to the economy	73.2	84.0	51.4	5.4	13.5	...	...	...	...
Credit to the economy (percent of GDP, eop)	37.4	51.1	62.1	47.8	46.5	...	...	...	...
NBK refinance rate (in percent eop; 2008 is May)	8.0	9.0	9.0	11.0	...	...	...	...	...
Kazprime (in percent eop; 2008 is May)	...	5.5	12.4	8.5	...	...	...	...	...
(In billions of U.S. dollars; unless otherwise indicated)									
External accounts									
Current account balance (percent of GDP)	-1.8	-2.4	-6.9	5.8	8.3	7.3	6.0	4.9	3.6
Exports of goods and services	30.5	41.6	51.9	75.4	85.0	88.8	94.0	100.7	107.3
Oil and gas condensate	17.4	23.6	28.1	49.4	58.5	62.4	66.8	72.1	77.1
Imports of goods and services	25.5	32.8	44.7	48.3	50.3	54.8	60.9	68.2	76.7
Foreign direct investments (net, percent of GDP)	3.7	8.2	6.8	2.4	1.9	1.6	1.2	1.2	1.2
NBK gross reserves (eop) 1/	7.1	19.1	17.6	22.4	26.5	28.5	30.5	31.0	31.5
Excl. bank deposits in FX at NBK	6.9	17.9	13.9	...	...	...	...	...	...
In months of imports of goods and services	3.3	7.0	4.7	5.3	5.8	5.6	5.4	4.8	4.4
NFRK (eop) 2/	8.0	14.1	21.0	32.2	43.7	57.3	70.9	85.9	103.6
Public external debt, incl. guaranteed (percent of GDP)	4.1	2.7	1.7	1.3	1.1	1.0	0.9	0.8	0.7
Total external debt	43.4	74.0	96.4	95.4	95.5	96.2	96.6	97.2	97.8
in percent of GDP	76.0	91.3	92.8	67.9	59.6	54.4	49.4	44.2	39.2
excluding intracompany debt (percent of GDP)	42.4	59.9	64.0	46.5	40.5	36.8	33.3	29.6	26.0
(In percent of GDP)									
Final consumption	60.2	56.4	57.1	51.1	49.1	51.3	53.2	55.1	57.3
Net exports of goods and non-factor services	8.8	10.8	6.9	19.0	21.0	18.6	16.4	14.3	11.8
Gross capital formation = gross savings	31.0	32.8	36.0	30.0	30.0	30.2	30.5	30.7	30.9
Domestic savings	29.1	30.4	29.0	35.8	38.3	37.4	36.5	35.6	34.5
Government	10.7	12.2	11.4	12.6	12.0	12.0	11.3	11.2	11.4
Private sector	18.4	18.3	17.7	23.1	26.3	25.4	25.2	24.4	23.1
External savings	1.8	2.4	6.9	-5.8	-8.3	-7.3	-6.0	-4.9	-3.6
Memorandum items:									
Nominal GDP (in billions of tenge)	7,591	10,214	12,726	17,439	20,342	22,223	24,391	27,197	30,641
Nominal GDP (in billions of U.S. dollars)	57.1	81.0	103.8	142.9	165.6	182.9	202.4	227.6	258.6
Exchange rate (tenge/U.S. dollar; eop; 2008 is May)	133.8	127.0	120.3	120.6	...	...	...	...	...
Crude oil and gas condensate (million bbl/day) 3/	1.26	1.34	1.39	1.48	1.66	1.73	1.75	1.87	2.08
Oil price (in U.S. dollars per barrel)	53.4	64.3	71.1	116.5	125.0	123.5	123.5	123.5	123.8

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

1/ Excludes deposits of the National Fund.
2/ Excludes transitory domestic currency deposits.
3/ Based on a conversion factor of 7.5 barrels of oil per ton.

Table 2. Kazakhstan: Balance of Payments, 2005–13

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

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Projections					
Current account	-1.1	-1.9	-7.2	8.3	13.8	13.3	12.2	11.2	9.4
Trade balance	10.3	14.6	15.1	35.6	44.1	44.5	44.7	45.2	44.6
Exports (f.o.b.)	28.3	38.8	48.3	71.5	80.7	84.1	88.8	95.1	101.1
Oil and gas condensate	17.4	23.6	28.1	49.4	58.5	62.4	66.8	72.1	77.1
Non-oil and gas exports	10.9	15.2	20.2	22.0	22.2	21.6	22.0	23.0	24.0
Imports (f.o.b.)	-18.0	-24.1	-33.2	-35.8	-36.6	-39.6	-44.1	-49.9	-56.5
Services and income balance	-11.0	-15.3	-20.1	-25.3	-28.0	-28.6	-29.5	-30.7	-31.5
Services, net	-5.3	-5.9	-8.0	-8.5	-9.5	-10.5	-11.7	-13.0	-13.8
Income, net	-5.7	-9.4	-12.1	-16.8	-18.6	-18.0	-17.8	-17.7	-17.7
of which: Income to direct investors	-4.6	-7.6	-10.3	-15.3	-16.0	-16.2	-16.4	-16.6	-16.7
Current transfers	-0.4	-1.2	-2.2	-2.0	-2.3	-2.6	-2.9	-3.3	-3.7
Capital and financial account	0.9	16.1	7.4	-0.7	-7.0	-8.5	-7.5	-8.0	-6.1
Foreign direct investment, net	2.1	6.6	7.1	3.4	3.2	3.0	2.5	2.8	3.0
Amortization of intracompany liabilities	-4.4	-4.2	-5.6	-6.6	-8.7	-9.3	-9.9	-10.0	-10.1
Portfolio investment, net	-4.0	-4.5	-4.6	-7.3	-10.4	-11.2	-10.0	-10.8	-12.3
of which: National Fund	-1.3	-5.7	-6.2	-9.5	-11.0	-11.8	-10.6	-11.4	-13.2
Other investment	2.8	14.0	5.3	3.3	0.3	-0.3	0.1	0.1	3.2
Long-term loans and credits, net	2.2	14.5	11.3	3.3	1.5	1.0	1.0	1.0	2.5
Short-term loans and credit, net	0.6	-0.5	-6.0	-0.1	-1.2	-1.3	-0.9	-0.9	0.7
Errors and omissions	-1.8	-3.1	-3.3	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7
Overall balance	-1.9	11.1	-3.1	4.9	4.1	2.0	2.0	0.5	0.5
Financing	1.9	-11.1	3.1	-4.9	-4.1	-2.0	-2.0	-0.5	-0.5
Net international reserves of the NBK (increase -)	1.9	-11.1	3.1	-4.9	-4.1	-2.0	-2.0	-0.5	-0.5
Memorandum items: 1/									
Current account (in percent of annual GDP)	-1.8	-2.4	-6.9	5.8	8.3	7.3	6.0	4.9	3.6
Exports in percent of GDP	49.5	47.9	46.6	50.0	48.7	46.0	43.9	41.8	39.1
Oil exports	30.5	29.1	27.6	34.6	35.4	34.1	33.0	31.7	29.8
Non-oil exports	19.1	18.7	18.9	15.4	13.4	11.8	10.9	10.1	9.3
Imports in percent of GDP	31.5	29.8	32.0	25.1	22.1	21.6	21.8	21.9	21.9
Annual growth rate (in percent)									
Exports	37.4	37.0	24.7	47.8	12.9	4.1	5.7	7.0	6.4
Non-oil exports	18.7	38.9	33.5	8.8	0.7	-2.4	1.7	4.3	4.5
Volume on non-oil exports	5.1	5.3	15.7	4.0	8.2	6.0	5.5	5.5	5.5
Imports	30.1	34.2	37.7	7.8	2.1	8.3	11.5	13.0	13.3
Oil and gas imports	0.0	10.0	37.4	77.7	7.5	-1.2	0.0	0.0	0.2
Non-oil imports	22.6	36.6	37.7	2.1	1.3	9.7	13.0	14.5	14.7
Volume on non-oil imports	14.0	17.2	23.3	-2.3	4.3	13.5	14.0	14.0	14.0
Exports of crude oil and gas condensate (MT)	52.5	54.6	60.8	65.0	70.0	76.0	81.0	87.0	92.0
NBK gross international reserves (in bill. USD)	7.1	19.1	17.6	22.4	26.5	28.5	30.5	31.0	31.5
excluding bank deposits in FX at NBK	6.9	17.9	13.9	…	…	…	…	…	…
in months of next year imports of g.n.f.s.	3.3	7.0	4.7	5.3	5.8	5.6	5.4	4.8	4.4
National Fund, e.o.p, bill. USD	8.0	14.1	21.0	32.2	43.7	57.3	70.9	85.9	103.6
External debt (in percent of GDP)	76.0	91.3	92.8	66.5	56.9	51.2	45.7	40.3	35.3
excluding intra-company loans	42.4	59.9	64.0	45.7	39.2	35.6	32.2	28.6	25.2
Public ext. debt service (in pcnt of exports of gnfs	4.1	1.1	1.4	0.3	0.2	0.2	0.2	0.2	0.0
World oil price (U.S. dollars per barrel)	53.4	64.3	71.1	116.5	125.0	123.5	123.5	123.5	123.8

Sources: Kazakhstani authorities and Fund staff estimates.

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

Table 3. Kazakhstan: General Government Fiscal Operations, 2005–13

	2005	2006	2007	Projections 2008	2009	2010	2011	2012	2013
				(in billions of Tenge)					
Total revenue and grants	2,132	2,804	3,767	5,260	6,078	6,644	7,116	7,914	8,968
Total revenue	2,132	2,804	3,767	5,260	6,078	6,644	7,116	7,914	8,968
Oil revenue	803	1,039	1,208	2,536	2,809	2,849	2,756	2,916	3,196
Non-oil revenue	1,329	1,765	2,559	2,724	3,268	3,795	4,360	4,999	5,772
Tax revenue	1,998	2,709	3,393	5,055	5,785	6,195	6,567	7,269	8,208
Non-oil tax revenue	1,195	1,753	2,185	2,518	2,976	3,346	3,811	4,353	5,012
Nontax revenue	101	64	338	157	236	387	481	569	674
Income from capital transactions	32	42	36	49	57	62	68	76	86
Total expenditure and net lending and	1,695	2,068	3,106	4,091	4,825	5,271	5,786	6,451	7,268
Total expenditure and net lending	1,695	2,067	3,106	4,091	4,825	5,271	5,786	6,451	7,268
Total expenditure	1,687	2,060	3,098	4,095	4,830	5,277	5,791	6,458	7,275
Current expenditure	1,319	1,562	2,318	3,054	3,638	3,974	4,362	4,863	5,479
Capital expenditure	368	498	779	1,040	1,192	1,303	1,430	1,594	1,796
Net lending	7	8	8	-4	-5	-5	-6	-6	-7
Overall budget balance	437	736	661	1,169	1,253	1,373	1,330	1,463	1,699
Statistical discrepancy	-63	-1	9	0	0	0	0	0	0
Financing	-499	-738	-652	-1,169	-1,253	-1,373	-1,330	-1,463	-1,699
Domestic financing, net	18	-85	274	133	166	187	216	242	284
Foreign financing, net	-127	2	-44	4	2	8	22	13	12
Privatization receipts	15	48	60	42	29	21	14	10	7
National Fund of the Republic of Kazakhstan	-405	-703	-941	-1,348	-1,450	-1,588	-1,582	-1,728	-2,002
				(in percent of GDP)					
Total revenue and grants	28.1	27.5	29.6	30.2	29.9	29.9	29.2	29.1	29.3
Total revenue	28.1	27.5	29.6	30.2	29.9	29.9	29.2	29.1	29.3
Oil revenue	10.6	10.2	9.5	14.5	13.8	12.8	11.3	10.7	10.4
Non-oil revenue	17.5	17.3	20.1	15.6	16.1	17.1	17.9	18.4	18.8
Tax revenue	26.3	26.5	26.7	29.0	28.4	27.9	26.9	26.7	26.8
Non-oil tax revenue	15.7	17.2	17.2	14.4	14.6	15.1	15.6	16.0	16.4
Nontax revenue	1.3	0.6	2.7	0.9	1.2	1.7	2.0	2.1	2.2
Income from capital transactions	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Total expenditure and net lending and	22.3	20.2	24.4	23.5	23.7	23.7	23.7	23.7	23.7
Total expenditure and net lending	22.3	20.2	24.4	23.5	23.7	23.7	23.7	23.7	23.7
Total expenditure	22.2	20.2	24.3	23.5	23.7	23.7	23.7	23.7	23.7
Current expenditure	17.4	15.3	18.2	17.5	17.9	17.9	17.9	17.9	17.9
Capital expenditure	4.8	4.9	6.1	6.0	5.9	5.9	5.9	5.9	5.9
Net lending	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall budget balance	5.8	7.2	5.2	6.7	6.2	6.2	5.5	5.4	5.5
Statistical discrepancy	-0.8	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Financing	-6.6	-7.2	-5.1	-6.7	-6.2	-6.2	-5.5	-5.4	-5.5
Domestic financing, net	0.2	-0.8	2.2	0.8	0.8	0.8	0.9	0.9	0.9
Foreign financing, net	-1.7	0.0	-0.3	0.0	0.0	0.0	0.1	0.0	0.0
Privatization receipts	0.2	0.5	0.5	0.2	0.1	0.1	0.1	0.0	0.0
National Fund of the Republic of Kazakhstan	-5.3	-6.9	-7.4	-7.7	-7.1	-7.1	-6.5	-6.4	-6.5
Memorandum items:									
Non-oil balance (in billions of tenge)	-366.4	-302.6	-547.2	-1,367.0	-1,556.8	-1,476.4	-1,426.0	-1,452.7	-1,496.2
(in percent of GDP)	-4.8	-3.0	-4.3	-7.8	-7.7	-6.6	-5.8	-5.3	-4.9
Non-oil balance to non-oil GDP (percent)	-7.4	-4.3	-6.0	-12.3	-12.2	-10.2	-8.6	-7.7	-7.0
Non-oil revenues to non-oil GDP (percent)	27.0	25.2	28.1	24.5	25.7	26.2	26.3	26.5	26.8

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

Table 4. Kazakhstan: Monetary Survey, 2004—2008

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

	2004	2005	2006	2007	2008 April
National Bank of Kazakhstan					
Net foreign assets	1,206	945	2,429	2,120	2,495
Net domestic assets	-515	-272	-921	-628	-961
Domestic credit	-445	-188	-729	-187	-336
Net credit to government	-72	-43	-197	-54	-145
Credit to banks	-188	-83	-332	-37	-216
Credit to the rest of the economy	-185	-63	-199	-96	25
Other items (net)	-70	-84	-193	-442	-604
Reserve money 1/	578	663	1,501	1,464	1,534
Currency outside NBK	411	459	687	860	828
Deposits with NBK	167	204	814	604	706
Banking system					
Net foreign assets	735	116	506	-567	-69
Net domestic assets	1,109	2,027	3,374	5,317	5,037
Domestic credit	1,695	2,928	5,164	8,000	8,021
Net credit to government	53	86	-60	94	73
Credit to the economy	1,639	2,838	5,222	7,905	7,947
Capital accounts and other items net	-587	-900	-1,790	-2,682	-2,984
Broad money	1,649	2,065	3,678	4,630	4,853
Currency in circulation	379	412	601	740	719
Deposits	1,270	1,653	3,077	3,890	4,133
Tenge deposits	721	960	1,994	2,646	2,675
Foreign currency deposits	549	693	1,083	1,244	1,458
NBK notes outside the banking system	194	79	203	120	115
Memorandum items:					
Net international reserves (US$ millions)	9,277	7,070	19,127	17,600	20,683
excluding bank deposits in FX at NBK	9,258	6,938	17,859	13,879	16,627
NFRK (US$ million) 2/	5,131	8,015	14,092	21,006	23,300
Annual growth rates (in percent)					
Broad money	69.8	25.2	78.1	25.9	22.0
Currency in circulation	58.9	8.6	45.8	23.1	2.8
Reserve money	82.3	14.7	126.4	-2.5	0.0
Credit to the economy	52.4	73.2	84.0	51.4	30.4

Source: National Bank of Kazakhstan.

1/ Excludes other nonfinancial institutions.

2/ Transitory deposits in tenge not included.

Table 5. Kazakhstan: Selected Prudential Indicators of the Banking Sector, 2004–2008 Q1

	2004	2005	2006	2007	2008 March
	(e.o.p. and in percent, unless otherwise indicated)				
Capital adequacy ratio (K2)	15.3	14.9	14.8	14.2	14.5
Tier I capital (K1, percent of assets)	8.0	8.0	9.0	10.7	12.4
Growth in banks' total assets	60.4	68.5	96.5	31.7	23.4
Off-balance sheet (OBS) items (percent of total assets) 1/	68.9	63.8	76.4	94.4	88.7
Growth in banks' loans	51.7	74.7	84.8	51.0	37.2
Growth of claims on private non-financial institutions	37.8	61.5	65.0	49.1	34.9
Growth of claims on households	148.1	120.0	129.4	68.1	41.9
Classified assets to total assets 2/ 3/	27.7	26.8	27.8	40.8	38.8
Classified loans to total loans 2/ 3/	43.8	41.8	47.3	57.4	57.1
NPLs Narrow definition (percent of total loans) 4/	4.3	3.3	2.4	2.7	3.7
NPLs Broad definition (percent of total loans) 5/	6.3	5.3	4.9	9.8	15.3
Loans classified as loss (percent of total loans)	2.9	2.2	1.6	1.4	2.1
Loan loss provisions (percent of total loans)	4.1	5.6	5.0	5.9	6.9
Net foreign assets (percent of total assets)	-17.1	-17.1	-19.2	-21.1	-20.3
Net open position in FX (percent of Tier I capital)	-29.8	-12.5	-3.6	8.2	…
Share of resident deposits denominated in FX	43.0	41.9	35.2	32.0	34.5
Share of FX loans to residents	43.4	45.6	38.2	35.5	…
Securities (percent of total assets)	16.9	14.1	13.7	6.6	6.2
Liquid assets to short term liabilities	103	95	118	97	105
Loans in percent of deposits	107	165	174	210	198
FX loans in percent of FX deposits	105	199	235	289	254
Return on assets, before tax (percent of assets, e.o.p)	1.2	1.6	1.4	1.8	…
Return on equity, before tax (percent of equity)	11.5	16.6	14.6	15.0	…

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

1/ Includes contingent claims, contingent liabilities, transactions in foreign exchange and precious metals, and derivatives.

2/ Loans or assets classified as doubtful and loss.

3/ New classification scheme introduced in early 2003.

4/ NPL–Narrow definition, consisting of loans overdue past 60 days and other qualified loans (FSA Category 5 and Loss). NPL definition closest to conventional 90-day norm.

5/ NPL–Broad definition, consisting of loans overdue past 7 days and other qualified loans (FSA Categories 2, 4, 5, and Loss). NPL definition presented by FSA and consistent with definition used in 2007 Article IV Report.

Table 6. Kazakhstan: External Debt Sustainability Framework, 2004-2013

(In percent of GDP, unless otherwise indicated)

	Actual 2004	2005	2006	2007	10-Year Historical Average	10-Year Standard Deviation	2008	2009	2010	2011	2012	2013	Debt-stabilizing non-interest current account 6/
							I. Baseline Projections						
1 **Baseline: External debt**	**37.2**	**42.4**	**59.9**	**64.0**			**45.7**	**39.2**	**35.6**	**32.2**	**28.6**	**25.2**	**-3.3**
2 Change in external debt	1.7	5.2	17.5	4.2			-18.3	-6.5	-3.6	-3.4	-3.6	-3.5	
3 Identified external debt-creating flows (4+8+9)	-15.9	-8.2	-15.6	-10.3			-11.2	-13.5	-12.1	-10.4	-9.0	-7.2	
4 Current account deficit, excluding interest payments	-2.1	-0.2	-0.7	4.2			-8.1	-10.8	-9.5	-8.0	-6.7	-5.1	
5 Deficit in balance of goods and services	-8.5	-8.8	-10.8	-6.9			-19.0	-21.0	-18.6	-16.4	-14.3	-11.8	
6 Exports	52.4	53.4	51.3	50.0			52.7	51.3	48.5	46.4	44.2	41.5	
7 Imports	43.9	44.6	40.5	43.1			33.8	30.4	30.0	30.1	30.0	29.7	
8 Net non-debt creating capital inflows (negative)	-5.0	-0.9	-5.5	-4.1			-3.0	-2.7	-2.4	-2.2	-1.9	-1.6	
9 Automatic debt dynamics 1/	-8.7	-7.1	-9.4	-10.5			0.0	0.0	-0.1	-0.2	-0.4	-0.5	
10 Contribution from nominal interest rate	1.4	2.0	3.1	2.7			2.3	2.5	2.2	2.0	1.7	1.5	
11 Contribution from real GDP growth	-2.4	-2.7	-3.2	-4.0			-2.3	-2.5	-2.4	-2.2	-2.1	-1.9	
12 Contribution from price and exchange rate changes 2/	-7.7	-6.4	-9.3	-9.2			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	17.6	13.4	33.1	14.5			-7.1	7.0	8.4	7.0	5.4	3.7	
External debt-to-exports ratio (in percent)	70.9	79.3	116.6	128.1			86.7	76.4	73.4	69.3	64.7	60.6	
Gross external financing need (in billions of US dollars) 4/	5.4	9.9	14.4	23.8			7.0	3.0	3.4	8.7	9.2	10.9	
in percent of GDP	12.5	17.4	17.7	22.9			4.9	1.8	1.9	4.3	4.1	4.2	
Key Macroeconomic Assumptions Underlying Baseline													
Real GDP growth (in percent)	9.6	9.7	10.7	8.5	8.2	4.4	5.0	6.3	6.7	6.9	7.5	7.7	
GDP deflator in US dollars (change in percent)	27.6	20.7	28.1	18.1	9.1	16.0	31.1	9.0	3.5	3.5	4.6	5.5	
Nominal external interest rate (in percent)	5.4	7.2	10.3	5.8	5.5	2.1	4.9	6.3	6.3	6.2	6.1	5.8	
Growth of exports (US dollar terms, in percent)	51.3	35.0	36.2	24.9	22.7	21.6	45.2	12.8	4.4	5.9	7.1	6.5	
Growth of imports (US dollar terms, in percent)	42.2	34.6	28.9	36.2	19.8	18.7	7.9	4.1	9.0	11.1	12.2	12.4	
Current account balance, excluding interest payments	2.1	0.2	0.7	-4.2	-0.1	3.3	8.1	10.8	9.5	8.0	6.7	5.1	
Net non-debt creating capital inflows	5.0	0.9	5.5	4.1	3.6	1.5	3.0	2.7	2.4	2.2	1.9	1.6	
							II. Stress Tests for External Debt Ratio						**Debt-stabilizing non-interest current account 6/**
A. Alternative Scenarios													
A1. Key variables are at their historical averages in 2008-13 4/							**61.2**	**59.0**	**56.6**	**53.1**	**49.3**	**45.2**	**-8.4**
B. Bound Tests													
B1. Nominal interest rate is at baseline plus one-half standard deviation							**46.2**	**40.1**	**36.8**	**33.7**	**30.4**	**27.1**	**-3.2**
B2. Real GDP growth is at baseline minus one-half standard deviations							**46.9**	**41.6**	**39.2**	**37.0**	**34.4**	**31.7**	**-3.4**
B3. Non-interest current account is at baseline minus one-half standard deviations							**47.4**	**42.4**	**40.4**	**38.4**	**36.2**	**33.9**	**-3.9**
B4. Combination of B1-B3 using 1/4 standard deviation shocks							**47.4**	**42.4**	**40.4**	**38.5**	**36.2**	**33.8**	**-3.5**
B5. One time 30 percent real depreciation in 2008							**128.8**	**128.0**	**132.4**	**134.4**	**132.7**	**127.6**	**-12.8**

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 non-interest 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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

2008 Article IV Consultation—Informational Annex

June 16, 2008

Contents Page

Annex I. Kazakhstan: Relations with the Fund
(As of June 12, 2008)

- ***Mission:*** Article IV consultation discussions were held April 21–30, 2008 in Astana and Almaty. The concluding statement of the mission is available at http://www.imf.org/external/np/ms/2008/043008.htm.
- ***Staff Team:*** Messrs./Mmes. Callen (head), Laframboise, Oner, and Hasanov (all MCD), and Lohmus (MCM). Messrs. Kiekens and Orynbaev (both OED) joined the policy discussions.
- ***Country Interlocutors***: Prime Minister Massimov, National Bank of Kazakhstan Governor Saidenov, Minister of Economy and Budget Planning Sultanov, Vice Minister of Finance Yergozhin, Financial Supervision Agency Chairwoman Bakhmutova, and other officials, parliamentarians, private sector participants, and the press.
- ***Fund Relations***: Kazakhstan accepted the obligations of Article VIII, Sections 2, 3, and 4 in 1996 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The exchange rate regime has been classified as a conventional peg (previously a managed float).
- ***Statistical Issues:*** The authorities subscribe to the SDDS and the provision of data is adequate for surveillance purposes.
- ***Outreach:*** The mission met with the local press.

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

II. General Resources Account	**SDR Million**	**% Quota**
Quota	365.70	100.0
Fund holdings of currency	365.70	100.0
Reserve position in the Fund	0.01	0.0

III. SDR Department	**SDR Million**	**% Allocation**
Holdings	0.88	n.a.

IV. Outstanding Purchases and Loans **None**

V. Financial Arrangements

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

VI. Projected Obligations to the Fund

None.

VII. Safeguards Assessments

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

VIII. Exchange Rate Arrangements

The currency of Kazakhstan is the tenge, which was introduced in November 1993. The official exchange rate is determined on the basis of foreign exchange auctions that are held daily. Auctions are held for U.S. dollars, euros, and Russian rubles, and official rates are quoted for over 30 other currencies on the basis of cross-rates. Since late 1999, the exchange rate regime has been a managed float with no preannounced path, although since October 2007 the exchange rate has effectively been pegged to the U.S. dollar. As a result, the classification of the tenge exchange rate has been changed to a conventional peg. On June 12, 2008, the tenge/U.S. dollar rate was 120.8. The exchange rates at numerous exchange bureaus are very close to the auction rate, and the spread between buying and selling rates is very small. The exchange system is free from restrictions on payments and transfers for current international transactions.

IX. Article IV Consultation

Kazakhstan is on the standard 12-month consultation cycle. The last consultation was concluded on July 10, 2007 (see IMF Country Report No. 07/235).

X. FSAP Participation and ROSCS

Kazakhstan participated in the Financial Sector Assessment Program (FSAP) in 2000. The staff report on the Financial Sector Stability Assessment (FSSA) was issued on November 27, 2000 (FO/DIS/00/142). The FSSA included the following ROSC modules: Basel Core Principles for Effective Banking Supervision, Core Principles for Systemically Important Payment Systems, Code of Good Practices on Transparency in Monetary and Financial Policies, IOSCO Objectives and Principles of Securities Regulation, and IAIS Insurance Core Principles. An FSAP Update mission took place in February 2004 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 (see Annex V).

XI. Technical Assistance

Kazakhstan has received technical assistance and training by the Fund in virtually every area of economic policy, including through about 75 technical assistance missions provided during 1993–2007 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, and to the Ministry of Finance. Other international agencies and governments, including the World Bank, EU TACIS, EBRD, UNDP, and OECD, also are providing a wide variety of technical assistance.

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

Monetary and Capital Markets

Technical assistance has enabled steady progress to be made 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. December 2002: Sequencing of Capital Account Liberalization and Financial Sector Supervision.
2. January 2003: Assessment of the CPSS Core Principles for Systematically Important. Payment Systems and Transparency of Payment System Oversight.
3. September 2004: Bringing Banking Prudential Regulation up to EU Standards.
4. September 2004: Implementing Inflation Targeting: Next Steps.
5. November 2007: Strengthening Banking Supervision and Risk Assessment.

Fiscal Affairs

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

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

Statistics

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

1. November 2002: International Reserves Template.
2. January 2006: Real sector and balance of payments statistics.
3. August 2006: Real sector statistics.
4. December 2006: ROSC Update mission (and DQAF).
5. April 2008: GFSM 2001 Implementation.

Legal Department

December 2003: Draft Law on Mandatory Reporting on Certain Financial Transactions
April 2008: Reforms to Tax Law.

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 other areas. In addition, the Fund's Institute has conducted courses in the region. Seminars and training sessions have also been conducted by MCM and STA technical assistance missions.

XII. Resident Representatives

Position terminated in August 2003.

Annex II. Kazakhstan: Relations with the World Bank Group
(As of January 31, 2008)

Kazakhstan became a member of the International Bank for Reconstruction and Development (IBRD) and International Development Association (IDA) in July 1992 and of the International Finance Corporation (IFC) in September 1993. The Bank's lending program has been curtailed in recent years as a result of the country's reduced borrowing needs, but this year was revived with four new approved projects which will start implementation in FY09. In addition to new lending activities, there is an expanded program of economic research which allows the Bank to respond to the government's critical development needs. In FY08 the total financing of the Joint Economic Research Program (JERP) amounts to just under $3 million, of which about 66 percent is directly financed by the government. The research under this extended umbrella is build around four main activities aligned with the government's development priorities: (i) public finance management review; (ii) administrative reform; (iii) modernization of communal services; and (iv) private sector development initiatives.

At present, the Bank's program comprises thirteen projects (twelve IBRD loans and one Global Environmental Facility (GEF) grant) with a total commitment of $713 million, of which $313 million has been disbursed. In the Bank's portfolio, there are eight active loans (Road Transport Restructuring, Electricity Transmission Rehabilitation, Syr Darya Control and Northern Aral Sea - Phase I, Nura River Clean-Up, Agricultural Post-Privatization Assistance - Phase II, Agricultural Competitiveness, North–South Electricity Transmission, and Forest Protection and Reforestation) with a commitment of $534 million, one old GEF grant (Drylands Management) of $5 million, and four recently approved new loans (Ust–Kamenogorsk Environment Remediation, Customs Development, Health Sector Technology Transfer and Institutional Reform, and Technology Commercialization) with a commitment of $174 million. The Bank is also preparing five new projects (Irrigation and Drainage Improvement - Phase II, South–West Transport Corridor Road Rehabilitation, Vocational Education and Training, Territorial Development, and Syr Darya Control and Northern Aral Sea - Phase II) with an expected financing envelope of about $654 million.

Kazakhstan is the IFC's largest client in Central Asia. As of end-February 2008, IFC's total portfolio in Kazakhstan was $124 million, which is mostly in general manufacturing and financial sector investments. IFC will continue to expand its work by fostering dynamic private sector led growth in Kazakhstan, particularly in the nonextractive sectors and in the frontier regions of the country. This includes ongoing support to the financial sector, and when possible, investments to promote SME development, as well as investments in manufacturing, construction and construction materials, infrastructure, and the service sector. IFC will focus on: (a) further stabilization, diversification, and extension of the maturity of the funding base in the banking sector; and (b) establishment of the best international banking and corporate governance and regulatory environment.

Annex III. Kazakhstan: Relations with the EBRD
(As of December 31, 2007)

The EBRD is the largest investor outside the oil and gas sector in Kazakhstan. As of December 2007, the bank's total business volume in Kazakhstan stood at €3.4 billion with EBRD investments totalling €1.7 billion. The bank's gross cumulative disbursements reached €1.4 billion. During 2007, the bank signed 20 projects for total EBRD finance of €532 million. The sector allocation of business volume has shifted towards the corporate sector and more than 80 percent of all EBRD investments are now in the private sector. The portfolio private/public ratio is not expected to change much during the coming year. The bank aims to increase the share of equity in its annual business volume in Kazakhstan (which reached 21 percent of projects signed in 2007). EBRD involvement in the country remains guided by the Bank's most recent country strategy for Kazakhstan, approved in November 2006.

The Bank's main operational objectives for 2007–2008 are the following:

***Enterprise sector*:** Support economic diversification and enhance competition by working directly with corporates across various sectors such as general industry, power, agribusiness, telecoms and property. Promote projects leading to higher energy efficiency and increase the capitalization of enterprises through equity investments. Increase competition in the natural resources sector by working with smaller operators and on higher risk projects. Dedicate resources in order to directly finance smaller projects and continue to provide micro and small financing and tailored capacity building using the Kazakhstan Small Business Programme (KSBP) and leasing facility. Promote high standards of corporate governance, integrity and transparency of ownership, including through FDI. Selectively support regional cross-border expansion of reputable Kazakh companies to neighbouring markets.

Infrastructure sector: Increase EBRD's support in transport, energy, and telecommunication infrastructure development to satisfy the growing needs of the economy and promote reforms. The bank will focus on non-sovereign projects. On a selective basis, it will take leadership in developing and actively engaging in appropriately structured public-private partnerships (PPPs) that involve competitive tender processes. Work with state holding company Samruk on finding synergies between different parts of infrastructure and improving corporate governance in respective of state owned enterprises. Support further regulatory and tariff development that promotes investments and fair access to infrastructure.

Financial sector: To promote strategic FDI into the financial sector, but also to open up the capital base of local banks to reputable financial investors through initial public offerings (IPOs) or private placements. To continue to work actively with existing shareholders of Kazakh banks to achieve better transparency of ownership and corporate governance. Facilitate competition in the financial sector by providing debt and equity, particularly to medium-sized banks and nonbank microfinance institutions (NBMFIs), thus supporting micro, small-, and medium-sized enterprises (MSMEs). A special emphasis will be on the provision of financial resources outside the main cities and in rural areas. The Bank will support the development of leasing, insurance and pensions, the further deepening of mortgage markets (especially outside of the two main cities) and facilitate the securitization of assets by Kazakh financial institutions.

Policy dialogue: Support the Government in its efforts to improve the investment climate and to diversify the economic structure, leading to improved global competitiveness. Cooperate with the state-holding companies Samruk and Kazyna to achieve corporate governance and operational improvements of state-owned enterprises. Promote transparent practices and fight corruption to improve the business environment. Promote adoption of the anti-money laundering (AML) legislation, especially in light of the government initiative to create the Regional Financial Centre in Almaty (RFCA).

Main trends in the portfolio over the past year

The most notable progress was made in the General Industry sector. Two new industry projects started—an investment in Kazakhstan Kagazy project (EBRD finance €20 million), and a loan to Karcement Kazakhstan (EBRD finance €15.5 million). A loan was also signed in brewery production to EFES Kazakhstan (EBRD finance €30 million). One of the milestone projects signed in 2007 in Kazakhstan is the Mittal Steel Temirtau Health & Safety Loan (EBRD finance of €70.5 million) designed to support improvements to the health and safety practices at coal mines. The project is the first in a wider EBRD initiative to support improvements to environmental, health and safety practices in mines in the Bank’s countries of operations. Another important project is the equity subscription for €40 million EBRD share in Kazakhstan–Meinl Caucasus and Central Asia, a retail real estate investment fund/joint-venture.

The Bank strengthened its efforts to improve transparency of ownership and integrity in Kazakhstan's banking sector. The Bank made a €15 million equity investment for a 20 percent stake in Kazinvestbank. Equity market development was also supported through investments in two funds, Centras Private Equity (€8 million) and Barings Vostok Fund (€6 million). The Bank promoted further development of the market for residential mortgages by providing a mortgage finance facility to Bank Centre Credit for €3 million. EBRD also signed a €219 million syndicated A/B loan to Kazkommertsbank, one-third of which for its own account. The Trade Facilitation Program (TFP) remained an important instrument in supporting a wide range of trade transactions of Kazakh enterprises, including long-term intraregional imports. In 2007, the EBRD committed loans and guarantees under the Regional Trade facilitation program in excess of €93 million.

Priorities for the coming year

Power shortages are becoming an important constraint on private sector development, especially in Southern Kazakhstan. To support the Government with regulatory improvements and tariff reform should be the key focus of the Bank’s operations in this area, leading to investments in power generation, transmission and distribution.

The **transport and communication infrastructure** will be key to the country’s long term competitiveness and regional cooperation and integration. Rehabilitation of the road network, including the South–West transport corridor, will play an important role, as will the necessary improvements of airport infrastructure.

The Bank will aim to capitalize from its improved presence in the **corporate sector**, making long-term funding and equity finance available to corporates, especially now that commercial bank funding has slowed down significantly. The focus here should be on value-added processing, for instance in agribusiness, and manufacturing industries. This should include projects with energy efficiency and safety components.

In the **financial sector**, the Bank's assistance is needed in light of the global credit crunch, the resulting large repayment obligations of Kazakh banks, and the related slowdown of bank lending in Kazakhstan. The Bank will continue to provide long-term debt, to support the equity of banks, to facilitate the entry of strategic investors, and will aim to reconnect Kazakh banks to the international financial markets through arranging syndicated loans (A/B structure). For 2008, the focus will be on SME and micro lending, as well as the introduction of energy efficiency credit lines. In addition, the Bank will have an important role to play in working with private equity funds and nonbank financial institutions to promote the development of the local capital market as a complement to bank lending. Transparency of shareholding structures and the willingness to improve corporate governance will be a precondition to any future Bank financing in Kazakhstan.

EBRD Portfolio December 31, 2007 Euros million			
Sector Business Group (SIC)		Commitments	Portfolio
Energy	Private	113	101
	State	90	80
FI	Private	888	496
	State	3	3
Corporate	Private	401	282
	State	41	0
Infrastructure	Private	0	0
	State	198	108
TOTAL		**1,734**	**1,070**

Annex IV. Kazakhstan: Relations with the Asian Development Bank

(As of March 5, 2008)

Kazakhstan became a member of the Asian Development Bank (ADB) in 1994. As of March 2008, total public sector loan commitments amounted to $483 million, covering 14 loans in agriculture and natural resources, education, finance, transport and communications, and water supply, sanitation and waste management. Kazakhstan is no longer eligible for concessional resources from the Asian Development Fund. As of January 2008, total loan disbursements amounted to $435 million. ADB's focal areas continue to be private sector development, environmentally sustainable development, and regional cooperation.

Private sector operations are at the forefront of current and future ADB operations in the country. A Private Sector Operations Agreement between the Republic of Kazakhstan and the ADB was signed in November 2004. It provided a basis for ADB's business opportunities in the Kazakhstani private sector. During 2006–2007, seven private sector financings in the amount of $550 million were approved by the ADB for Kazakhstan to boost financial sector and SME development in the country.

ADB's debut local currency bonds (in Tenge) in Kazakhstan were issued in August 2007. The issue had a principal amount of 6 billion Tenge (equivalent to $49 million). Proceeds of the Tenge bond issue were used to finance ADB's private sector banking activities in the country (ADB's first local currency loan to JSC Bank Center Credit to support small- and medium-sized business was approved on August 7).

ADB operations for the private sector focus primarily on two sectors: (i) finance and capital markets, and (ii) infrastructure. In the financial and capital markets sector, ADB assists private sector intermediaries in banking, leasing, micro credit, small- and medium-enterprises (SME), private equity funds, insurance, and securitization. In the infrastructure sector, ADB's focus is on telecommunications, power and energy, water supply and sanitation, ports, airports, toll roads, and support for subsovereign credit.

This new thrust towards private sector operations will be supported by public sector technical assistance, investments to create an enabling environment for the private sector, and selected public lending programs. The latter will be in rural water supply and water resources management to improve livelihood in rural areas and reducing urban-rural gap. After the successful completion of water resources management and land improvement project in South Kazakhstan Oblast in December 2006, the Government requested the ADB to assist with a second phase project to complete irrigation on the remaining 87,000 ha in the project area. ADB approved a Project Preparatory TA in December 2007.

Annex V. Kazakhstan: Statistical Issues

The quality of the economic statistics is generally adequate for surveillance. Kazakhstan has made considerable progress since the 2002 data ROSC, as reflected in the update published on February 2008. On March 2003, Kazakhstan became a subscriber to the Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system.

Sector specific issues

Building on the progress achieved since 2002, IMF missions in February and August, 2006 assisted in developing a more analytically useful disaggregation of the national accounts and balance of payments into oil and nonoil sector components. This should permit a better assessment of macroeconomic developments and policy formulation. STA also provided recommendations for improving the quarterly national accounts (QNA) data.

However, several weaknesses remain in both the quality of GDP estimates by sector produced by the National Statistical Agency (NSA), and the quality and timeliness of GDP estimates by expenditure. First, the quality of **GDP estimates by industry** is affected by the limited coverage of small businesses in selected activities such as retail and construction. Second, while some progress has been made in making **GDP estimates by final expenditure** consistent with output-based measures, compilation and dissemination of quarterly GDP series data should be conducted on a discrete basis only. The 2006 Multitopic Statistics Mission on Oil Activities made recommendations in a number of other areas, including: deflators, data sources for intermediate consumption and inventories, adjustments for holding gains for intermediate consumption, methods for deriving constant price estimates of changes in inventories, taxes and subsidies, and retail trade, and methods for recording work in progress.

Overall, the NSA utilizes sound statistical techniques to ensure the accuracy and reliability of the consumer price index (CPI). However, use of the geometric mean as elementary aggregate is recommended instead of the relative of average prices, as is the case for the producer price index. Also, there is scope for improving the imputation method used for some seasonal items in long time series for the CPI.

Progress has also 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**. Since 1997, the authorities have reported detailed data for publication in the *GFS Yearbook.* The latest data reported for publication cover consolidated general government and are presented using a format consistent with the *GFSM 2001*. There is no program for transition to the accrual methodology of GFSM 2001. The Ministry of Finance also provides monthly indicators covering the general government for publication in *International Financial Statistics (IFS).*

The existing framework for compiling monetary statistics generally conforms to the methodology in the IMF's *Monetary and Financial Statistics Manual (MFSM)***, and data are compiled on a timely basis**. Steps are being taken by the National Bank of Kazakhstan (NBK) to further improve the quality of data. In particular, **the chart of accounts for commercial banks** has been revised to enable the NBK to distinguish sectors and financial instruments in accordance with the *MFSM*. The NBK compiles monetary statistics based on the Standardized Report Forms (SRFs*),* which are published in the *IFS Supplement*. The NBK has extended **institutional coverage** to compile a financial sector survey that includes the Development Bank. The authorities have started implementing the recommendations of the previous STA missions regarding the use of residency criteria as defined in the *Balance of Payments Manual*, fifth edition (*BPM5*), including classifying foreign branches and foreign companies' representatives as "resident." The NBK is now addressing the issues raised by MCD and STA regarding the inconsistencies in the positions between the NBK (reported in SRF 1SR) and the other depository corporations (reported in SRF 2SR).

There are also shortcomings in external debt statistics. Public and publicly-guaranteed debt excludes external debt of public enterprises and development institutions, which is instead included in private debt.

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

Kazakhstan: Table of Common Indicators Required for Surveillance
(As of June 12, 2008)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items	
						Data Quality-Methodological soundness[7]	Data Quality-Accuracy and reliability[8]
Exchange Rates	06/12/08	06/12/08	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	06/06/08	06/06/08	W	W	M		
Reserve/Base Money	06/06/08	06/06/08	W	W	M	O, O, LO, LO	O, O, O, O, O
Broad Money	04/30/08	05/30/08	M	M	M		
Central Bank Balance Sheet	04/30/08	05/30/08	M	M	M		
Consolidated Balance Sheet of the Banking System	04/30/08	05/30/08	M	M	M		
Interest Rates[2]	06/06/08	06/06/08	W	W	M		
Consumer Price Index	04/2008	05/13/08	M	M	M	O, O, O, O	O, O, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3]—General Government[4]	04/2008	05/29/08	M	M	M	O, LO, LO, LO	O, O, O, O, LNO
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	04/2008	05/29/08	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	03/31/08	04/25/08	Q	Q	Q		
External Current Account Balance	Q4/2007	03/31/08	Q	Q	Q	LO, O, O, O	O, O, O, O ,O
Exports and Imports of Goods and Services	Q4/2007	03/31/08	Q	Q	Q		
GDP/GNP	Q4/2007	03/14/08	Q	Q	Q	O, O, O, LO	LO, O, LO, O, O
Gross External Debt	Q4/2007	03/31/08	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); NA: Not Available.
[7] Reflects the assessment provided in the 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), or not observed (NO).
8 Same as footnote 7, except referring to international standards concerning source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the IMF Staff Representative
July 9, 2008

1. The following information has become available since the staff report was issued. These developments do not change the thrust of the staff appraisal.

2. Recent data releases show that:

- The CPI increased by 1.2 percent (m/m) in June, and by 5.7 percent in the first half of 2008. The year-on-year inflation rate rose to 20 percent in June, from 19.5 percent in May. Food price inflation was a little over 29 percent (y/y) in June, while non-food prices rose by 13.6 percent (y/y).

- The current account swung from a deficit of $2 billion in the fourth quarter of 2007 to a surplus of $3.9 billion in the first quarter of 2008 due to a sharp slowdown in imports and higher oil prices. The financial account remained weak in the first quarter as bank access to external financing declined.

- Official foreign currency assets have continued to rise. At end-June, foreign exchange reserves stood at $21.2 billion and NFRK foreign currency assets at $25.7 billion.

3. The National Bank of Kazakhstan (NBK) lowered its refinancing rate from 11 percent to 10.5 percent on July 1. It also announced that minimum reserve requirements would be cut from 6 percent to 5 percent on domestic liabilities and from 8 percent to 7 percent on other liabilities as of July 29. The cut in reserve requirements is expected to free up about T 90 billion ($750 million) in liquidity for the banking system. The NBK cited its desire to support credit expansion and growth and its expectation that inflation will ease in the second half of the year as the reasons for its actions.

4. In the financial sector, non-performing loans on bank balance sheets have continued to rise, reaching 16.4 percent of total loans ("broad" definition) at end-May, up from 15.3 percent at end-March (on the "narrow" definition also shown in the staff report, NPLs increased to 4.4 percent at end-May, from 3.7 percent at end-March). An investment fund based in the United Arab Emirates has recently announced its intention to increase its stake in Kazkommertsbank, Kazakhstan's second largest bank, from 8 percent to 25 percent (the transaction still requires regulatory approval). Lastly, the Kazakhstan Deposit Insurance Fund (KDIF) has received a capital injection from the NBK of T 14 billion, almost doubling its capital to T 30 billion ($250 million).

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL
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Public Information Notice (PIN) No. 08/108
FOR IMMEDIATE RELEASE
August 18, 2008

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

IMF Executive Board Concludes 2008 Article IV Consultation with the Republic of Kazakhstan

On July 9, 2008, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Kazakhstan.[1]

Background

From 2000–2007, the Kazakhstan economy enjoyed an extended period of very rapid growth, with real GDP growth averaging 10 percent annually. The expansion was underpinned by the development of the oil sector, prudent macroeconomic policies, structural reforms, and increased access to global financial markets. As a result, real per capita incomes have doubled since 2000 and social indicators have improved.

More recently, the global financial turmoil that began last summer had a significant impact on the Kazakhstan economy. Market perceptions of risk on Kazakhstan's assets rose sharply last September and remain relatively elevated. As commercial bank access to external funding was reduced, domestic liquidity conditions tightened considerably, and banks sharply curtailed lending. Real GDP growth has slowed and, after several years of rapid gains, property prices are declining.

[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.

Bank profitability has nonetheless remained robust and aggregate capital adequacy is above the regulatory minimum. However, financial soundness indicators are showing some signs of deterioration and the banking system is exposed to risks related to the property market and lending in foreign currency to the corporate sector. The authorities are working to reduce the vulnerabilities facing the banks by intensifying supervision, strengthening the regulatory framework, and establishing a comprehensive financial safety net framework.

The authorities reacted appropriately to the sudden stop in capital inflows. The central bank (NBK) provided extra liquidity support to banks and intervened in the foreign exchange market to ensure exchange rate stability. Foreign reserves have since recovered, oil fund (NFRK) assets have continued to grow, and the government has allocated additional fiscal spending to support ongoing construction and investment projects. Fiscal policy has nevertheless remained prudent: the overall fiscal surplus was 5.2 percent of GDP in 2007 and is expected to rise further in 2008 on the back of strong oil revenues.

Economic growth is expected to remain relatively subdued. Real GDP is forecast to grow by 5 percent and 6¼ percent in 2008 and 2009 respectively. The current account is projected to move into surplus in 2008 following the large deficit last year, due to higher oil and commodity prices and much slower import growth. Consumer price inflation (CPI) has begun to ease and is expected to decline to single digit rates by year-end. While risks to the outlook are on the downside, the country has large financial resources to help weather the current situation.

Executive Board Assessment

Executive Directors observed that the economic situation has been affected significantly by the recent global financial turmoil, with growth slowing down and liquidity conditions tightening. The authorities' prompt policy responses have been instrumental in helping the country weather the current difficulties. Directors noted that, while risks to the outlook remain on the downside, growth prospects in the medium term are still favorable, and the Republic of Kazakhstan has considerable financial resources at it disposal, including comfortable levels of the oil fund and international reserves. Directors stressed that policies should continue to focus on managing risks and promoting a return to strong, sustainable growth, supported by a sound banking system and ongoing reforms aimed at diversifying the economy and boosting competition.

Directors welcomed the considerable progress made in developing a financial safety net framework, which has proven effective in supporting the banking sector in response to the dry-up of external financing over the past year. They looked forward to the operationalization of a Memorandum of Understanding on Financial Stability, which sets out the framework for cooperation among relevant bodies during periods of financial distress. In this context, they underscored the importance of enhancing the authorities' flexibility to react to adverse developments in banks without compromising the central bank's financial position or creating moral hazard.

Directors noted with concern the deteriorating loan quality at the banks, linked to their high exposures to the weakening property market and rapid credit growth in recent years. Further efforts will be needed to strengthen banking supervision and regulations, and to fully implement the Financial Sector Assessment Program (FSAP) Update recommendations. Immediate priorities are to improve both onsite and offsite supervision, and to strengthen capacity for stress testing and risk analysis. Steps should also be taken to ensure that banks have sufficient capital and provisioning, and to strengthen the operational autonomy of the Financial Supervision Agency.

Directors agreed that, in current circumstances, preserving a stable exchange rate is key to boosting depositor confidence, limiting the risks from the large foreign currency exposure of the corporate sector, and helping reduce inflation. Any intervention in the foreign exchange market to ease downward pressures on the exchange rate should be carried out under clear operational rules that limit reserve losses. Directors encouraged the authorities to return to a more flexible exchange rate policy when financial market conditions improve. They noted the staff's assessment that there is currently no clear evidence of undervaluation or overvaluation of the real exchange rate relative to its equilibrium.

Directors emphasized the importance of pursuing monetary policy that strikes an appropriate balance between preserving financial stability, cushioning downside risks to growth, and ensuring a downward path of inflation. They encouraged the authorities to monitor headline inflation closely, given the possibility of further food and oil price increases, and to stand ready to tighten monetary policy as needed to bring down inflation to the targeted level.

Directors commended the authorities for their prudent fiscal management, which has resulted in large budget surpluses and low public debt, and created ample room for automatic stabilizers to operate. With the economy weakening, Directors supported the recently announced measures to increase spending in priority areas. They saw room for a further well-targeted fiscal stimulus should growth slow more sharply than expected, while being mindful of its inflationary impact. At the same time, efforts should continue to improve public financial management, with the assistance of the World Bank. Directors looked forward to the finalization of a new tax code, which should help ease the tax burden on the nonoil sector.

Directors emphasized the need for a well-crafted response to the sharp rise in food prices, including well-targeted transfer programs for low-income households. Efforts should be strengthened to improve agricultural production and distribution systems, while avoiding trade restrictions that affect prices in international markets.

Directors welcomed the publication of the Republic of Kazakhstan's first report under the Extractive Industries Transparency Initiative. They encouraged the prompt passage of the draft bill to help bring the Republic of Kazakhstan's AML/CFT legislation in line with international best practice.

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. The staff report (use the free Adobe Acrobat Reader to view this pdf file) for the 2008 Article IV Consultation with Kazakhstan is also available.

Kazakhstan Selected Economic Indicators

	2003	2004	2005	2006	2007	Proj. 1/ 2008
			(Changes in percent)			
Real economy						
Real GDP	9.3	9.6	9.7	10.7	8.9	5.0
CPI (end-of-period)	6.8	6.7	7.5	8.4	18.8	9.7
			(In percent of GDP)			
Public finance						
Government revenue and grants	25.4	24.6	28.1	27.5	29.6	30.2
Government expenditures	22.6	22.1	22.3	20.2	24.4	23.5
General government balance 2/	2.7	2.5	5.8	7.2	5.2	6.7
General government non-oil balance	-3.2	-4.6	-4.8	-3.0	-4.3	-7.8
General government debt (end-of-period) 3/	15.0	11.4	8.1	6.7	5.9	5.1
			(Changes in percent)			
Money and credit						
Base money	52.2	82.3	14.7	126.4	-2.5	...
Broad money	27.0	69.8	25.2	78.1	25.9	…
Banking sector credit to the economy	45.6	52.4	73.2	84.0	51.4	...
Interest rate on NBK notes (end of period)	5.2	4.0	2.2	4.8	6.0	...
			(In percent of GDP)			
Balance of payments						
Trade balance	11.9	15.7	18.1	18.1	14.6	24.9
Current account balance	-0.9	0.8	-1.8	-2.4	-6.9	5.8
External debt	74.3	75.8	76.0	91.3	92.8	66.5
Gross international reserves						
In billions of U.S. dollars, end of period	5.0	9.3	7.1	19.1	17.6	22.4
In months of imports of goods	3.1	5.9	3.3	7.0	4.7	5.3
			(Changes in percent)			
Exchange rate						
Tenge per U.S. dollar (end of period)	-8.0	-9.3	2.9	-5.1	-5.3	...
Tenge per Russian ruble (end of period)	-0.8	-4.0	-0.4	3.7	1.2	...
Real effective exchange rate (p.a) 4/	-3.6	5.8	3.1	7.7	8.7	...

Sources: Kazakhstani authorities; and IMF staff estimates and projections.
1/ Staff projections.
2/ Under this definition of the general government balance, privatization revenue is treated as a financing item and measured from below the line, which includes a statistical discrepancy.
3/ Gross domestic and external debt, including government guaranteed debt.
4/ A positive sign indicates appreciation.