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REPUBLIC OF KAZAKHSTAN

2014 ARTICLE IV CONSULTATION—STAFF REPORT; PRESS RELEASE

August 2014

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 2014 Article IV consultation with Kazakhstan, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 21, 2014, following discussions that ended on April 30, 2014, with the officials of Kazakhstan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 20, 2014.
- An **Informational Annex** prepared by the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its July 21, 2014 consideration of the staff report that concluded the Article IV consultation with Kazakhstan.

The following document has been or will be separately released.

Selected Issues Paper

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

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REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION

June 20, 2014

KEY ISSUES

Context: Solid growth in recent years, supported by high oil prices and output, has boosted living standards. This year, the economy is slowing down, in large part because of weaker domestic and external demand, and regional tensions. Inflation is expected to accelerate temporarily due to the devaluation of the tenge (February 2014). Enhancing the policy architecture and promoting a business environment unencumbered by the state remain key challenges for Kazakhstan to become a dynamic emerging market economy and ensure durable and balanced long-term growth. The recent reappointment of Prime Minister Massimov was accompanied by the authorities' commitment to speeding up structural reforms. In this context, the government is strengthening its links with the multilateral development banks (MDBs). The May 29 signing of the Eurasian Economic Union (EEU), with Russia and Belarus, is not expected to have near-term economic effects; medium-term effects will depend on how the Union's rules and regulations will be implemented.

Focus of consultation and key recommendations: Amid uncertain external and domestic environments, the consultation focused on policy measures to mitigate shocks and achieve the authorities' short- and medium-term objectives, in particular: (i) restoring confidence and stability in the post-devaluation environment; (ii) resolving the nonperforming loans (NPL) problem, in line with the recent FSAP recommendations; (iii) bolstering the monetary and fiscal policy frameworks, as recommended last year; and (iv) accelerating structural reforms, including the implementation of industrialization and diversification policies carefully and transparently.

Previous consultation: During the 2013 Article IV Consultation, Directors encouraged the authorities to take advantage of the positive outlook to strengthen the macroeconomic policy architecture, including by (i) showing greater determination to addressing the high level of NPLs; (ii) following through on the planned introduction of a new policy interest rate to enhance the transmission mechanism of monetary policy; and (iii) revamping the medium-term fiscal framework through improved coverage and transparency. Since then, the authorities have been more resolute in dealing with the NPL problem. However, progress in strengthening the monetary and fiscal policy frameworks has been slow.

Approved By
Juha Kähkönen (MCD) and Mark Flanagan (SPR)

The staff team comprised Hossein Samiei (head), Natan Epstein, Amr Hosny, Gohar Minasyan, and SeokHyun Yoon (all MCD). Discussions were held in Almaty on April 21–25 and in Astana on April 28–30. The mission met with Prime Minister Massimov, Central Bank Governor Kelimbetov, Minister of Finance Sultanov, and Minister of Economy and Budget Planning Dossayev among other officials, as well as representatives from the private sector, civil society, and the MDBs. Mr. Saudabayev (OED) attended most of the meetings. The mission's concluding statement was published by the authorities.

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CONTEXT

1. **Solid growth over the past decade, supported by rising oil prices and output, helped Kazakhstan achieve a middle-income country status, but vulnerabilities remain.** High oil prices helped the economy recover rapidly from the 2008–09 crisis. Output growth has been somewhat lower in the past three years than the pre-crisis levels but remains strong, while inflation and employment growth have been relatively stable (Figure 1). At the same time, the banking sector has been burdened by a legacy of high NPLs from the crisis. While government debt is low and fiscal buffers are high, state-owned enterprises' debt, given the large size of their activities, poses contingent liability risks for the state. Downside domestic and external demand risks weigh on the outlook for growth.

2. **In the face of slowing economic growth and concerns about external competitiveness, the National Bank of Kazakhstan (NBK) devalued the local currency by 18 percent in February.** The authorities justified the devaluation by the deterioration in the current account balance, concern about competitiveness due to depreciation in the Russian ruble, and a fall in central bank international reserves. The devaluation was accompanied by the introduction of a narrow exchange rate band. In staff's assessment, based on CGER-type methodology, the tenge was only moderately overvalued at end-2013 (Box 1).

3. **Amid uncertain external environment, the reappointment of Prime Minister Massimov in April was aimed at bolstering confidence and reforms.** The direction of macroeconomic policy is unlikely to be altered significantly, but some new spending plans have been introduced, and Mr. Massimov, who previously held the Prime Minister position during 2007–12, has signaled his intention to speed up structural reforms, with the help of the MDBs.

RECENT DEVELOPMENTS

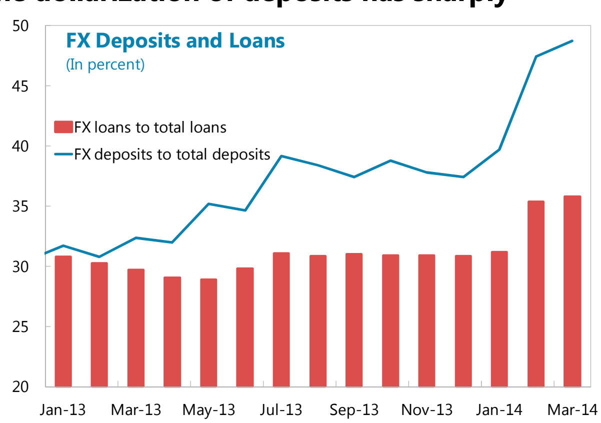
4. **Growth amounted to 6 percent in 2013, but has slowed since then, while inflation has risen.** Growth in 2013 was driven primarily by domestic demand, with household consumption growing at 9 percent year-on-year, helped by rapid expansion in consumer credit. As a result, the positive output gap widened, to just below 1 percent of potential GDP.[1] However, preliminary data in the first quarter of 2014 suggest that real GDP growth has decelerated on the back of: (i) weak external demand, especially from China; (ii) negative wealth effects for consumers and weaker investor confidence following the February devaluation and possibly developments in Russia and Ukraine; and (iii) slower production in the mining sector. At the same time, the devaluation has been fueling inflation despite some price controls. In May, headline CPI inflation reached 6.9 percent year-on-year (up from 4.8 percent at end-2013).

[1] Staff uses various methods to calculate the output gap, but estimates remain rough given rapid structural transformation.

5. The external position weakened in 2013, although it improved in 2014: Q1 and vulnerabilities are limited by large buffers.[2] The current account turned into a small deficit in 2013, from a surplus averaging over 2 percent of GDP in the preceding three years. The decline was mainly driven by a sharp fall in non-oil exports (mostly metals and grains). Foreign direct investment inflows slowed sharply in 2013 as large investment projects, mostly related to the Kashagan oil field, came to an end. This contributed to a fall in official reserves, by US$3.6 billion to US$24.7 billion (about 4½ months of imports). Preliminary 2014: Q1 data showed a sharp improvement in the current account, as imports compressed by US$4 billion (due to slowing demand and some temporary factors) and exports grew by less than US$1 billion (mostly due to oil exports from last year's output). As of end-April, official reserves recovered last year's losses, reaching just over US$28 billion, and are considered adequate based on the IMF's reserve adequacy metric. Moreover, the country's overall international investment position, including the assets in the national oil fund (NFRK), has been on an increasing path.[3]

6. The banking sector recovery continued, while vulnerabilities remain due to elevated NPLs (Figures 2 and 3). Banks' profits have continued to improve over the past year, albeit gradually, helped by rapid growth in consumer lending, with the return on assets ratio for the sector (excluding troubled BTA and Alliance banks) rising to 1.8 percent in 2013 (from 1.3 percent in 2012). The financial system remains saddled with a large stock of NPLs, at about 32 percent, most of which is concentrated in three of the seven largest banks. The system's aggregate capital adequacy ratio (CAR) has stabilized at around 17 percent, with the Tier I capital ratio at around 13 percent, following the external debt restructuring and state-funded recapitalization of BTA. The presence of foreign-owned banks in Kazakhstan continued to decline, with the sale of HSBC subsidiary to Halyk bank expected to be completed by end-year.

7. Increasing retail funding and reduced market borrowings in recent years have improved the profile of banks' funding, although the dollarization of deposits has sharply increased recently. Wholesale funding (bond and cross-border interbank borrowings) has declined from its pre-crisis peak of 50 percent to 20 percent of the banking system' total liabilities at end-2013. Owing to the continued deposit growth of both household and corporate clients and modest overall lending growth, the loan-to-deposit ratios for both domestic and foreign currency have improved in recent years. However, the high dependence of big banks on large corporate deposits poses concentration risks. Also, while dependence on foreign



Sources: Kazakhstani authorities and IMF staff estimates.

[2] See the Selected Issues Paper entitled "External Sector Assessment" for further analysis of the external sector position.

[3] A debt sustainability analysis suggests that external debt remains within a safe threshold.

currency denominated wholesale funding has declined markedly, exchange rate-induced credit risk remains high, and the recent sharp increase in the dollarization of bank deposits (from about 30 percent to around 50 percent of total deposits, in part due to the devaluation) has complicated the management of tenge liquidity.

8. Amid tightening tenge liquidity and volatile money market interest rates, the official refinancing rate remained unchanged, while the NBK deposit rate was raised. The liquidity tightening was exacerbated by the gradual withdrawal of pension funds from the money market (due to the unification of pension funds) and speculative pressures on the tenge/USD exchange rate. In the absence of effective central bank instruments for managing liquidity, including limited use of refinancing loans or credit auctions, volatility in money market interest rates remained high, particularly around quarterly tax reporting periods. Despite an unchanged refinancing rate (policy rate), money market interest rates have trended higher, at times exceeding the refinancing rate by a large margin (Figures 4 and 5). The authorities increased the NBK deposit rate by 225 basis points to 2.75 percent, hence narrowing the interest rate corridor. Although overnight and seven-day money market rates have declined significantly recently, banks' longer-term tenge funding is scarce, in part due to the rapid increase in the dollarization of time deposits in recent months. To help alleviate this problem, the NBK has announced the offering of up to US$10 billion in one-year foreign-currency swap operations with banks, with an implied interest rate of 3 percent (beginning July 1).

9. Fiscal balances improved significantly in 2013. The overall fiscal surplus widened to 5.2 percent of GDP in 2013, from 4.5 percent of GDP in 2012, as total spending declined by 1.5 percent of GDP compared to 2012 (Figure 6). The reduction of expenditures was due to both lower current (especially wages and goods and services) and capital spending relative to GDP. Meanwhile, non-oil tax revenues increased by 0.5 percent of GDP, reversing the declining trend of the past few years, largely on account of strong VAT receipts. As a result, the non-oil deficit declined to 7 percent of GDP (from 8.9 percent), compared to an estimated sustainable level of 6 percent of GDP.[4]

10. In response to the devaluation and slowing growth, the 2014 budget was amended in February and additional off-budget spending was announced. Public wages and social benefits were increased on average by 10 percent (effective April) to mitigate the negative effects of the devaluation on real incomes. In addition, a one trillion tenge (US$5.4 billion, or 2½ percent of GDP) package from NFRK was deployed to serve multiple objectives over a period of two years. Specifically, out of the 500 billion tenge assigned for the current year half was allocated to capitalizing the Problem Loan Fund (PLF) and the other half to onlending (via commercial banks) to SMEs and other priority sectors. On the revenue side, the oil export customs duty was hiked by 30 percent.

[4] The sustainable level of non-oil deficit was estimated by staff using a Permanent Income Hypothesis annuity framework to be 7.5 percent of non-oil GDP, which is equivalent to 6 percent of total GDP.

11. In recent months, the government has elevated the priority of the structural reform agenda. In particular, it has actively engaged with international development partners to accelerate structural reforms, with a focus on improving the investment climate and fostering balanced regional development. In this context, the government has recently signed partnership agreements with the ADB and EBRD to support the development of SMEs and the non-oil private sector. In conjunction with financing of projects and with the aim of supporting lending to SMEs, the NBK has signed repurchasing (repo) and foreign-currency swap arrangements with the EBRD.[5] The government also recently signed a loan agreement with the World Bank to modernize the agricultural sector. While Kazakhstan's economic growth continued to be comparatively inclusive, recent efforts to further reduce income inequality have been relatively weak.

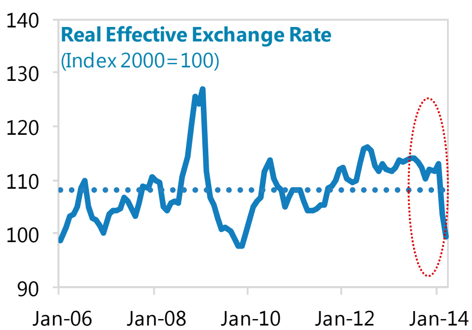
12. Kazakhstan is engaged in regional and global economic integration. The newly launched EEU will formally come into effect in January 2015, with Belarus, Kazakhstan, and Russia as members. Compared to the existing Eurasian Customs Union, established in 2010 with a common external import tariff, the EEU envisages the free transit of goods, services, capital, and labor. At the same time, while the EEU suggests closer economic integration with a number of CIS economies, the government is also extending collaboration with China and the OECD and aims to finalize WTO accession this year.

[5] The swap arrangement is on similar terms offered to commercial banks.

Box 1. Kazakhstan: Assessment of Exchange Rate and External Competitiveness

While the exchange rate and official reserves were under pressure prior to the devaluation, the tenge did not appear overly uncompetitive. The CPI-based real effective exchange rate (REER) was slightly above its long-run average before falling about 10 percent below the average following the devaluation.

Based on a CGER-type methodology, the exchange rate appears to have been moderately overvalued at end-2013. The macroeconomic balance approach suggests that the real exchange rate was overvalued by about 3 percent (i.e., the exchange rate adjustment required to bring the underlying current account to a level consistent with its norm). The equilibrium REER approach, which pins the deviation of the REER from its estimated equilibrium level, suggests that the REER was overvalued by around 6 percent. Under the external sustainability approach, the current account norm was estimated at 2.1 percent of GDP, which implied an overvaluation of the tenge by about 4 percent.



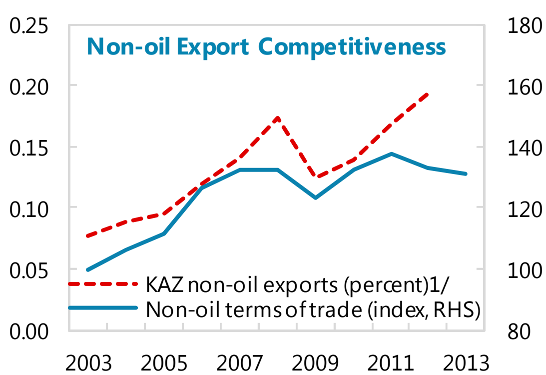
Note: Dotted line represents average for 2006–13.
Source: National Bank of Kazakhstan.

Methodologies to Assess Real Exchange Rate Misalignment

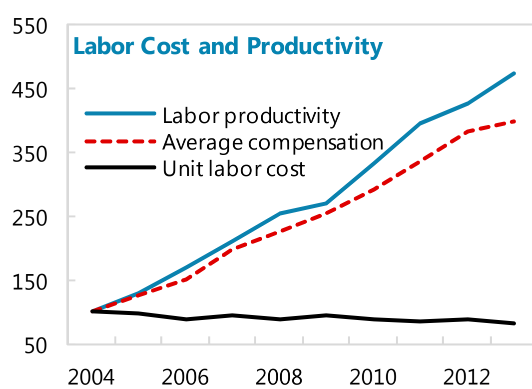
	Underlying CA[1/] (Percent of GDP)	CA Norm (Percent of GDP)	Estimated over(+)/ under(-) valuation
Macroeconomic Balance[2/]	1.3	1.9	2.8
Equilibrium Real Exchange Rate[2/]	n.a.	n.a.	5.7
External Sustainability[3/]	1.3	2.1	3.9

Sources: Kazakhstani authorities and IMF staff estimates and projections.
1/ Based on projections for 2019.
2/ Based on estimates for net oil exporters of "*Are Middle Eastern Current Account Imbalances Excessive*" WP/11/195.
3/ NFRK assets included. The norm is the adjusted current account balance needed to stabilize the 2019 NFA position.

Other indicators, furthermore, suggest that Kazakhstan has been gaining competitiveness in recent years. The global market penetration of Kazakh exports, measured by Kazakh non-oil exports' share of total world non-oil exports, has been improving, while the terms-of-trade has been broadly stable. At the same time, labor productivity has been growing faster than compensation, which has led to gradually declining unit labor costs.



1/ Share of world non-oil exports.
Source: IMF staff calculations.



Source: IMF staff calculations.

OUTLOOK AND RISKS

13. The growth outlook has become less favorable and inflation is projected to increase. Real GDP growth in 2014 is projected at 4¾ percent, one percentage point below earlier projections, despite the expected positive contributions from the fiscal stimulus. External demand has weakened recently, and household consumption growth is projected to decelerate due to lower credit growth and the negative wealth effect from the devaluation. Moreover, regional tensions and price controls announced after the devaluation are expected to adversely affect investment plans. Nonetheless, temporary inflationary pressures are likely to emerge from the devaluation with possible second-round effects from an increase in wages and social benefits. Staff's projections suggest inflation could rise to 9 percent. The authorities, however, are determined to keep inflation within the central bank's objective range of 6–8 percent, including through price controls and have for now maintained their real GDP growth projection of 6 percent for 2014.The current account is projected to improve to a surplus of 0.6 percent of GDP in 2014. As a result, official international reserves are expected to rebound to just over US$28 billion at end-2014 (equivalent to 5.2 months of imports).

14. Medium-term growth prospects are mainly driven by a projected (albeit delayed) increase in oil output in the Kashagan oil field. Growth is expected to average around 5½ percent over the medium term. Production in Kashagan started in September 2013, but it was halted in early October after the discovery of gas leaks in the pipeline network, delaying the expansion in production by two years.

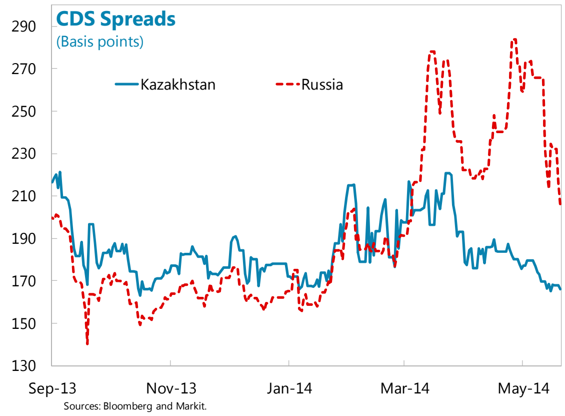
15. Risks to the outlook are predominantly on the downside (Appendix I). Weaker confidence following the devaluation poses downside domestic risks to growth in 2014. Furthermore, Kazakhstan is vulnerable to a prolonged slowdown in emerging markets and additional unfavorable developments in Russia and Ukraine, given the strong linkages with Russia (especially in the context the Custom's Union) and potential spillovers to Europe through gas exports from Russia (Box 2). The authorities agreed with staff's assessment of risks, and noted that oil-fund resources, as in the past, could be used to support the economy in the event of an additional large negative shock to growth.

Text Table 1. Kazakhstan: Medium-Term Macroeconomic Projections

	2013 Actual	2014 Proj.	2015–19 (avg.) Proj.
Real GDP Growth	6.0	4.7	5.3
Oil Output Growth	2.9	0.3	3.3
Non-oil Growth	7.2	6.3	5.9
Output Gap (percent of potential GDP)	1.0	0.5	0.0
Inflation (e.o.p.)	5.8	8.9	6.2
Current Account Balance (percent of GDP)	-0.1	0.6	-0.5
Gross International Reserves (percent of GDP)	11.0	12.9	11.2
NFRK Assets (percent of GDP) [1/]	31.4	38.7	45.3

Sources: Kazakhstani authorities and IMF staff estimates.
1/ NFRK.

Box 2. Kazakhstan: Economic Implications of the Russia-Ukraine Tensions



The impact of Russia-Ukraine tensions has so far been limited. While the tensions may have contributed to weaker investor sentiments and pressures on the tenge, financial and risk indicators' traditionally close links with those in Russia (largely reflecting common external factors) have weakened. Moreover, Fitch reaffirmed Kazakhstan's rating at BBB+ with a stable outlook on May 9, while S&P had downgraded Russia two weeks earlier.

Nevertheless, further unfavorable developments will have more serious negative consequences. Russia accounts for about 8 percent of Kazakh exports and for about a third of imports, of which capital and intermediate goods are a significant share. Trade with Ukraine, albeit smaller, is not insignificant. Thus growth may be negatively affected though weaker exports, as well as higher cost of imports of capital and intermediate goods—especially given the customs union with Russia and its trade preferential treatments. Growth could also be impacted through investment by a number of Russian companies, mostly in the oil and minerals sector. According to staff estimates, the direct impact (through trade and FDI) on Kazakhstan's growth of a 1 percentage point lower growth in Russia is in the range of 0.1–0.2 percentage points. However, the tensions could have much more serious implications in case of spillovers to activity in Europe through disruptions in gas exports via Ukraine. Other potential indirect effects include, on the negative side, lower global growth and increased risk premium, and, on the positive side, higher oil and grain prices. Finally, in the financial sector, the three Russian-owned banks—Sberbank, Alfa, and VTB—account for about 9 percent of Kazakhstan's banking system assets and further sanctions could impact their activities in Kazakhstan.

POLICY DISCUSSIONS

16. **Policy discussions centered on the short-term policy stance—including restoring confidence and stability—and on progress in improving policy frameworks.** In the short run, staff's assessment is that slower growth in 2014 warrants the authorities' somewhat looser-than-originally-planned fiscal stance. Monetary policy, on the other hand, may need to be tightened should inflationary expectations become unanchored. At the same time, to further enhance the policy architecture, staff has underscored the need for (i) a decisive follow-through on dealing with the NPL problem; (ii) strengthened monetary policy framework and gradual transition to greater exchange rate flexibility; (iii) improved medium-term planning of fiscal and quasi-fiscal activities; and (iv) a transparent and market-based reform and diversification strategy to help promote more inclusive growth. The authorities agreed with staff on the proposed short-term policy mix and broadly shared staff's view on the need to bolster the macroeconomic policy frameworks.

A. Financial Sector Issues

17. The authorities are taking more aggressive steps to reduce the large stock of NPLs. Staff saw the commitment to ensure that banks adhere to the NPL ceilings (15 percent by end–2014 and 10 percent by end–2015) as appropriately ambitious. It highlighted the importance of enforcing the NPL ceilings through credible supervisory actions, while ensuring adequate provisions. To facilitate the achievement of these targets, the authorities are buttressing existing policy vehicles and introducing an appropriate mix of incentives and penalties. The plan to substantially increase the financing of PLF—tenfold to 250 billion tenge (about US$1.4 billion)—is expected to be accompanied by expanding the eligibility of loans (especially real estate and construction) that can be purchased by the PLF and by granting special powers to the PLF. Moreover, the authorities recognize the need for expediting the parliamentary approval of their proposed legislative amendments concerning tax incentives for debt write-offs and the removal of legal obstacles to the transfer of NPLs into Special Purpose Vehicles (SPVs) or the PLF. Finally, the authorities are expected to revise the insolvency law to strengthen protection for legal rights of secured creditors.

18. The authorities expressed commitment to fully implement the recommendations of the Financial Sector Assessment Program (FSAP). Key priority areas, in addition to the single pension fund, insurance and securities market oversight, and financial infrastructure, include (Appendix II):

- *The divestiture of nationalized banks.* Given the systemic implications of the sale of BTA to Kazkommertsbank—with the combined entity accounting for about 25 percent of banking system assets and over 65 percent of all NPLs—the authorities shared staff's assessment on the need to carry out an asset quality review (AQR), preferably by an independent international entity and prior to the completion of the transaction. Staff also recommended that a time-bound plan for working out those NPLs is prepared as part of the deal and that the implementation of this plan is carefully monitored.
- *Bolstering the financial safety net and moving to risk-based oversight.* In staff's view, available resolution tools, as foreseen in current legislation, are impractical and should be amended. In particular, supervisors should have full authority to independently mandate the resolution methods (currently depositors and other creditors have a say in the resolution method) and have a clearly sequenced procedure for graduated intervention. A faster transition from granular compliance supervision towards more risk-based oversight is also needed.
- *The sharp further increase in financial dollarization following the devaluation.* The authorities shared staff's view that the prevalence of dollarization renders the financial system increasingly prone to foreign currency risks. Dollarization is also likely to put upward pressure on NPLs in the coming months, requiring vigilance to the emergence of related credit risk.

19. Staff welcomed the recent deployment of macroprudential measures aimed at halting the rapid growth in consumer lending. With a view to minimizing risks associated with rapid growth in consumer lending (46 percent in 2013), the NBK recently adopted the following measures:

(i) a 50 percent cap applied to the debt-to-income ratio; (ii) an increase in capital adequacy requirements on unsecured consumer loans to 100 percent (from 75 percent); and (iii) a 30 percent ceiling on the growth in consumer loans for each bank. In line with the FSAP recommendations, the authorities plan to monitor closely the impact of the regulations and stand ready to make necessary adjustments.

20. The governance structure of the unified pension fund (UAPF) may be prone to conflict of interest, requiring effective checks and controls. Under the recently unified structure, the NBK chairs both the board of the UAPF and the Council for the Management of Assets (CMA) that governs the investment policy. Moreover, the NBK is the statutory asset manager, the custodian, and the supervisor of banks. The authorities are mindful of staff's concerns regarding potential conflict of interest and the importance of separating ownership from control functions, and are committed to full transparency and accountability, including by the CMA, to ensure that the investment policy is free from undue interference.

B. Monetary Policy

21. Staff considered that, given the expected rise in inflation, the authorities should stand ready to tighten monetary policy, if necessary. In view of the importance of anchoring inflation expectations, and with the aim of more effectively signaling a possible tighter stance of monetary policy, staff advised the authorities to speed up the planned introduction of a new policy interest rate instrument. Staff cautioned that NBK's announced foreign-currency swap operations with banks aimed at alleviating the scarcity of long-term tenge liquidity should be seen as a temporary alternative to standard open market operations. Staff also noted that price controls should not be deployed as a policy tool given the damage they could do to the investment climate (and at a time when Kazakhstan is trying to diversify it economy). While agreeing on the need to stand ready to tighten monetary policy (which effectively involves tightening liquidity directly), the authorities did not expect to launch the new policy interest rate instrument this year.

22. The authorities and staff agreed that faster progress in developing a more effective monetary policy framework is paramount. Rising dollarization signals underlying lack of credibility in the current regime. Against this background, and in view of the authorities' stated goal of adopting inflation targeting over the medium term, staff advised the authorities to begin taking steps to enhance the monetary policy framework. In the near term, the key steps include:

- Introducing a new policy interest rate supported by open market operations. The continued volatility in the money market underscores the urgent need to make more rapid progress in this area. In staff's assessment, the NBK's tight exchange rate management, and its recent refocusing on the exchange rate both as primary objective and as dominant instrument of monetary policy, complicates the management of system liquidity (Box 3 and forthcoming IMF Working Paper 14/108 "Monetary Policy in Hybrid Regimes: The Case of Kazakhstan").
- Gradually widening the exchange rate band. This would give more room for interest rate policy, and would also help correct any small exchange rate undervaluation with less pressure on inflation and reserves.

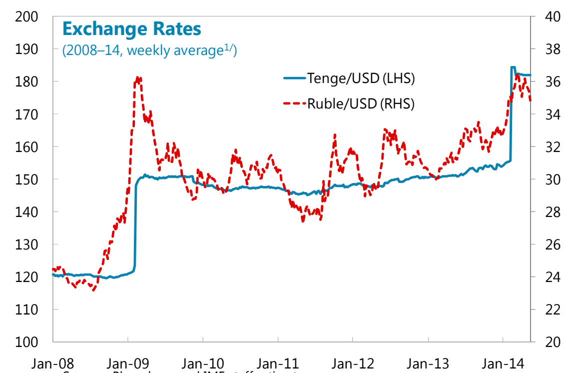
- Improving communication, including by publishing the monetary policy guidelines for 2014.

Later on, additional considerations could be given to strengthening inflation forecasting models and governance issues, for example, creating a standard monetary policy committee (see the accompanied Selected Issues Paper entitled "Toward Inflation Targeting in Kazakhstan"). In support of strengthening the monetary policy framework, the authorities have requested IMF technical assistance, which would identify the appropriate timeline for implementation of these steps.

Box 3. Kazakhstan: Liquidity Management and the Role of Monetary and Exchange Rate Policy

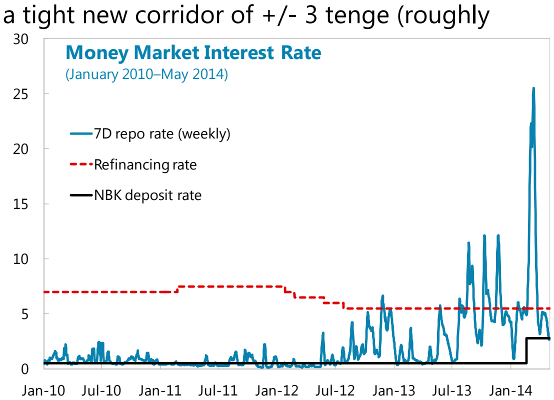
The de jure primary goal of NBK's monetary policy is price stability; however, de facto, a tightly managed exchange rate guides the management of system liquidity. The NBK's monetary policy guidelines are explicit about the primacy of the price-stability objective, with the view of promoting financial sector stability. In practice, however, the driving force behind the management of tenge liquidity, and in turn the conduct of monetary policy, is the tightly managed tenge/USD exchange rate and the frequency in which the NBK intervenes in the foreign exchange market.

As an open economy, Kazakhstan is exposed to external shocks, and periodically has resorted to one-step exchange rate devaluations. In early 2009, as a result of the sharp drop in global oil prices during the second half of 2008 (and following significant depreciation in the Russian Ruble and in currencies of other resource-exporting economies), the NBK devalued the tenge by 20 percent against the USD to a level of 150 tenge/USD. During 2009–13, the tenge/USD exchange rate was kept stable, despite volatility in other emerging market currencies. In September 2013, the NBK switched to the use of a multi-currency basket (with weights of 70, 20, and 10 percent for the USD, euro, and ruble, respectively) in smoothing "excessive" exchange rate fluctuations. However, in February 2014, the NBK unexpectedly devalued the tenge (by 18 percent), to a level of 185, and reestablished a tight new corridor of +/- 3 tenge (roughly 1.5 percent) around the new devalued rate.



Sources: Bloomberg and IMF staff estimates.
1/ May 2014: latest available data.

The NBK's benchmark interest rate, which historically has been stipulated as the official refinancing rate, plays little role in liquidity management and does not signal the stance of policy. The official refinancing rate and the NBK's deposit rate have constituted a sort of an interest rate corridor: the deposit rate serves as a hard floor, because it is tied to a standing facility, but the refinancing rate plays only an indicative role, and has served instead as a soft ceiling. During 2010–12, key money market interest rates hovered around the deposit rate (close to zero), indicating excess system liquidity. However, since 2012, interbank rates have drifted higher amid tightening of tenge liquidity conditions. In particular, over the past six months, in part due to sustained speculations of tenge devaluation, key interbank rates rose significantly, temporarily exceeding the refinancing rate by a large margin.



Sources: Bloomberg and IMF staff estimates.

C. Fiscal Policy

23. In view of slower growth and the availability of large buffers, staff supported a small fall in the overall surplus and a temporary deviation of the non-oil deficit from a declining trend. The overall balance is expected to narrow to 4.3 percent of GDP in 2014, from 5.2 percent of GDP in 2013. However, in cyclically adjusted terms, and excluding one-off spending on capitalization of the PLF,[6] it will be roughly unchanged from last year at 4.9 percent of GDP. The non-oil deficit is expected to increase sharply to about 9 percent of GDP in 2014, virtually undoing the impressive adjustment last year. With some of the spending to be conducted through quasi-fiscal institutions, staff urged the authorities to ensure the high quality and transparency of spending. Furthermore, the authorities indicated that they remain committed to their goal of reducing the non-oil deficit of the unconsolidated budget (not accounting for NFRK) to 2.8 percent of GDP by 2020.[7] While the authorities have yet to finalize the details of their medium-term fiscal plans, according to staff calculations and assuming unchanged policies, staff's estimated sustainable level of the non-oil deficit of 6 percent would be achieved before 2018. Gross public debt is expected to stay at low levels (Appendix III), although contingent liabilities will need to be monitored carefully.

24. Staff underscored that strengthening the fiscal policy framework remains a priority. Despite important steps outlined in the authorities' fiscal strategy adopted last year, there is ample scope for further progress, especially in extending the coverage of the fiscal framework (Box 4) and in improving its integration within the broader macroeconomic policy framework. In particular, staff's advice focused on: (i) consolidating NFRK within the authorities' fiscal accounts and using the non-oil deficit of the consolidated budget as an anchor for fiscal policy; (ii) reducing the scope of extra budgetary activity and properly accounting for contingent liabilities; (iii) improving revenue policies, including by minimizing ad hoc changes in export duties and relying more on income, progressive, and resource-rent taxation; and (iv) replacing administrative price controls with targeted measures to protect socially vulnerable groups (see the accompanying Selected Issues Paper entitled "Assessment of Inclusive Growth"). The authorities broadly shared staff's views but pointed to recent improvements, including the expected introduction of public audit system in the current year and Kazakhstan's recent progress in the Open Budget Index.[8] In this context staff welcomed the authorities' cooperation with the World Bank in the area of introducing results-based budgeting. In addition, an IMF technical assistance mission in June 2014 is expected to advise the authorities on further improving public sector accounting and design of a risk management approach for budget planning.

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[6] The capitalization of the PLF, which is about 0.6 percent of GDP and is planned towards the end of 2014, is expected to have only an indirect impact on growth through enabling the PLF to buy more NPLs and therefore contribute to credit growth.

[7] Based on staff calculations and assuming unchanged policies, this target is equivalent to the non-oil deficit of the consolidated budget of about 4.5 percent of GDP.

[8] http://internationalbudget.org/wp-content/uploads/OBI2012-KazakhstanCS-English.pdf

25. Staff stressed that continued prudent and transparent management of oil wealth is essential. Kazakhstan compares well with many other oil exporters in the transparency of operations of the national oil fund, which has dual objectives of stabilization and intergenerational equity. Staff urged the authorities to maintain the transparency, especially in the context of renewed initiatives to use NFRK for the government's diversification and industrialization plans. In particular, the announced US$5.4 billion package from NFRK needs to be appropriately aligned with the principles of efficient and sustainable management of its assets. To the extent possible, all spending out of NFRK should be channeled through the budget. Lending programs through quasi-fiscal institutions and commercial banks warrant careful planning and implementation. In particular, staff (based on the results of its earlier analytical work)[9] argued that public spending, while taking into account the positive impact on growth, should remain prudent to avoid Dutch disease problems. Furthermore, it will be important to ensure that development and diversification programs are transparent, cost-efficient, and in line with capacity. In this context, staff welcomed the authorities' plans to cooperate with MDBs in choosing projects to be financed from oil savings.

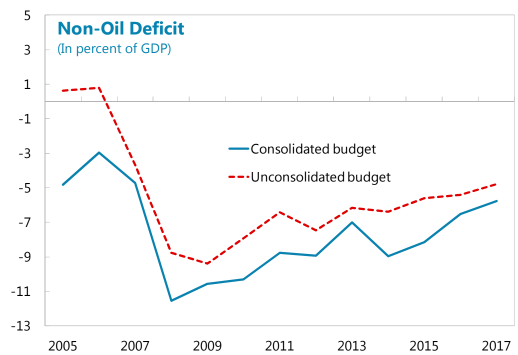
[9] See "Republic of Kazakhstan: Selected Issues" September 2013 (Country Report No. 13/291).

Box 4. Kazakhstan: Improving Fiscal Coverage

Accurate fiscal coverage is critical for the soundness of fiscal analysis and fiscal policy formulation. According to the GFS 2001 manual the general government sector encompasses all government units and all nonmarket nonprofit institutions that are controlled and mainly financed by the government units. In practice, since ensuring comprehensive fiscal coverage is costly, countries should prioritize expanding the coverage in areas that have the most policy significance.

In Kazakhstan, as in many other countries, official statistics excludes important parts of the public sector. Government fiscal accounts in Kazakhstan include central and local government operations but leave out extra-budgetary funds (including NFRK) and the operations of the SOE sector. At the same time, the authorities are mindful of the need to monitor closely some operations of the quasifiscal sector. In this regard, two important recent policy developments were the introduction of monitoring mechanisms and ceilings for external debt of the broader public sector, and the creation of Baiterek (government's development holding with total assets of about 6 percent of GDP), with the purpose of separating the quasifiscal and commercial operations of the SOE sector. Despite these improvements, expanding the fiscal coverage is essential for a fully informed conduct of fiscal policy.

Priorities for improving fiscal coverage in Kazakhstan are consolidating NFRK within the budget, and fully reflecting state programs in the budget. While, following the recommendations of the STA technical assistance mission in July 2013, the authorities have started consolidating NFRK into their government finance reporting and expect to consolidate the State Social Insurance Fund this year, they continue to rely on unconsolidated fiscal accounts for fiscal policy formulation. As a result, the authorities' definition of the non-oil deficit is different from that of staff. Moreover, the broader public sector is actively involved in implementation of government programs, including most importantly the Accelerated Industrial and Innovative Development program, of which the "Industrialization Map" is a key component. The financing mechanisms of these programs are diverse (direct transfers, subsidized loans, and PPPs) and Baiterek is a key player in these schemes. Accurate reflections of all the costs as well as accounting for contingent liabilities associated with these programs is crucial for ensuring that public funds are not wasted.



Sources: Kazakhstani authorities and IMF staff calculations.

Selcted Statistics on "Kazakhstan Industrialization Map" Program (KIM)

Number of projects under KIM	927
Investments , KT trillions	12.1
Jobs, thousands	430
Output of projects over 2010-13, KT trillions	2.7
Of which: in 2013	1.2
Share of KIM projects in manufacturing output in 2013	10.2
Contribution to economic growth in 2013, percent 1/	0.8
Contribution to economic growth in 2012, percent 1/	1.3
Contribution to economic growth in 2011, percent 1/	1.7

Source: Kazakhstan Ministry of Industry and New Technologies.

1/ Estimates of the Economic Research Institute of the Ministry of Economy and Budget Planning.

The authorities' accounting of the recent stimulus package in fiscal accounts highlights the deficiencies of limited fiscal coverage. Unlike staff calculations, the authorities' fiscal accounts do not fully reflect the package which renders them uninformative of the true fiscal policy stance. This omission includes the implicit subsidies involved in lending: for the current year, Baiterek has already issued a 100 billion tenge bond to NFRK with 0.1 percent annual rate and 20 year maturity and will in turn lend to banks at annual rate of 2 percent, while the interest rate for final borrowers (SMEs) will be set at 6 percent. The costs associated with this lending are not reflected in the government's fiscal accounts.

D. Structural Policies

26. Kazakhstan's economic growth has been broadly inclusive, but further efforts, especially in employment creation, are needed to reduce growing income gaps. Both income inequality and unemployment in Kazakhstan compare favorably to peers. That said, the recent efforts to further reduce income inequality by promoting faster employment growth have been relatively weak. Furthermore, despite some progress, poverty rates in rural areas are higher than some poorer regional peers. The unemployment rate has declined rapidly since 2000, but around 30 percent of the work force remains vulnerable (being, for example, self-employed or unpaid family worker). Productivity growth in the oil extracting regions was fueled by large capital investments, while employment creation was limited. Also the relationship between job creation and growth has been weak, particularly since the onset of the global crisis. Staff noted that deepening structural policies aimed at improving the functioning of the labor market would be crucial to fostering the development of labor-intensive sectors that do not depend on extractive industries (see the accompanying Selected Issues Paper entitled "Assessment of Inclusive Growth").

27. Staff welcomed efforts to speed up reforms, a prerequisite for Kazakhstan to become a dynamic emerging market economy (see also IMF's Middle East and Central Asia Departmental Paper 14/2 "The Caucasus and Central Asia: Transitioning to Emerging Markets").[10] In particular, staff stressed the need to bolster human capital and institutions and lower the role of the state in the economy. Successful diversification, which is the authorities' main long-term goal, requires addressing key structural weaknesses, namely human capital and institutions—areas where Kazakhstan lags behind successful emerging market economies (Figure 7). To promote private-sector led non-oil growth and job creation, the government's long-term development programs (as envisaged in the government's Kazakhstan 2050 Vision document) will need to focus on broad-based reforms, while avoiding top-down policies of picking winners. Staff welcomed the authorities' recent efforts to accelerate structural reforms in close cooperation with the World Bank, EBRD, ADB and other development institutions, including by promoting private sector activity and the development of the non-oil sector. Notably, faster progress is needed in addressing skill mismatches, starting business, enforcing contracts, and protecting investors. The authorities broadly shared this assessment. Moreover, in the context of gradually reducing the role of the state in the economy, the authorities plan to accelerate the public IPO program of large SOEs.

STAFF APPRAISAL

28. Amid uncertain external and domestic environments, policy measures should aim at mitigating shocks and achieving medium-term goals. Growth has been solid in recent years. However, the economy is slowing down this year and the outlook for growth is subject to downside risks, principally a prolonged slowdown in emerging markets and further unfavorable developments in Russia and Ukraine. To buttress the economy's capacity to withstand shocks and achieve

[10] http://www.imf.org/external/pubs/cat/longres.aspx?sk=41448.0

sustainable growth, the authorities should further bolster the macroeconomic policy frameworks and speed up the implementation of structural reforms.

29. Steadfast implementation of the FSAP recommendations requires further concerted efforts. The recent more aggressive action taken by the NBK to reduce the large stock of NPLs is welcome. Similar efforts should be extended to other FSAP recommendations. In particular, the NBK should ensure that strengthening existing resolution measures together with appropriate corrective supervisory actions enforce the NPL ceilings effectively. Moreover, given systemic implications, the authorities should facilitate an asset quality review by an independent international entity of Kazkommertsbank and BTA prior to the completion of their merger. Additional priorities include bolstering risk-based supervisory functions and closely monitoring the emergence of foreign currency risks due to higher dollarization.

30. The authorities should stand ready to tighten monetary policy, if necessary, while bolstering the interest rate policy lever and operations. With the view to ensuring that inflationary expectations are well anchored, and with the aim of more effectively signaling a possible tighter stance of monetary policy, the authorities should speed up the planned introduction of a new policy interest rate instrument, supported by active open market operations. As a complement to more effective interest rate policy, and as an intermediary step toward a more flexible exchange rate regime, the authorities should aim to widen the exchange rate band over time. Moreover, to anchor expectations about policy intentions and operations, it will be important to communicate more openly and clearly the transition plans, including publishing the monetary policy guidelines for 2014 as soon as possible.

31. In light of slowing growth, the near-term fiscal policy stance is appropriate, but strengthening the fiscal policy framework remains a priority. Care needs to be taken to ensure that overall spending increases, including recapitalizing the PLF and on-lending via Baiterek and commercial banks to support SMEs and priority sectors, are transparent and of high quality. At the same time, it is critical that the authorities remain committed to the non-oil deficit target of 6 percent of GDP by 2018. In addition, despite important steps outlined in the authorities' fiscal strategy adopted last year, there is ample scope for further progress, especially in extending the coverage of the fiscal framework and improving its integration within the broader macroeconomic policy framework. To better assess the fiscal policy stance, the authorities should consolidate NFRK into fiscal accounts, and reduce off-budget expenditure. Further, it is important that both annual and medium-term fiscal plans are well-integrated into broader macro policy objectives.

32. An ambitious structural reform agenda is paramount to Kazakhstan becoming a dynamic emerging market economy and ensuring sustainable and inclusive growth. Key priority areas include strengthening human capital and institutions and lowering the role of the state in a more diversified economy. Moreover, to promote private-sector led non-oil growth and job creation, the authorities' recent efforts to accelerate reforms in close cooperation with the international financial institutions are crucial to building up confidence and attracting foreign investment into the non-extractive sectors. Specific areas where more rapid progress is needed are addressing labor market skill mismatches, starting a new business, enforcing contracts, and protecting investors.

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

Table 1. Kazakhstan: Selected Economic Indicators, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
				(Annual percent change, unless otherwise indicated)					
National accounts and prices									
Real GDP 1/	7.5	5.0	6.0	4.7	4.8	4.8	5.8	5.2	5.7
Real oil	1.4	-2.2	2.9	0.3	0.0	1.5	6.0	3.3	5.5
Real non-oil	10.2	8.0	7.2	6.3	6.4	5.9	5.8	5.8	5.8
Real consumption	10.4	10.2	7.5	5.6	6.6	5.9	5.9	5.6	5.6
Real investment	5.4	11.0	9.7	2.0	4.5	4.0	4.1	4.2	4.3
Real exports	1.0	3.1	-1.1	5.2	2.6	3.9	6.4	5.0	6.4
Real imports	2.3	19.6	4.3	4.3	5.9	5.3	4.9	4.8	4.9
Output gap (in percent of potental GDP)	0.5	0.1	1.0	0.5	0.0	-0.4	0.1	-0.1	0.2
Crude oil and gas condensate production (million tons)	81	79	82	82	82	83	88	91	96
Consumer price index (p.a.)	8.3	5.1	5.8	8.9	6.6	6.2	6.1	6.0	6.0
Core consumer price index (p.a.)	8.0	5.6	4.3	9.7	6.7	6.5	6.3	6.4	6.4
GDP deflator	17.6	4.8	6.1	11.6	6.3	5.7	5.7	5.7	5.8
Exchange rate (tenge per U.S. dollar; eop)	0.4	1.5	2.2	20.4	2.0	0.0	0.0	0.0	0.0
				(In percent of GDP, unless otherwise indicated)					
General government fiscal accounts									
Revenues and grants	27.7	26.9	26.1	26.4	24.6	23.6	22.4	21.5	20.8
Of which: Oil revenues	14.7	13.4	12.2	13.3	12.3	11.0	10.2	9.3	8.7
Expenditures and net lending	21.8	22.4	20.9	22.1	20.4	19.0	17.9	17.9	18.0
Overall fiscal balance	5.9	4.5	5.2	4.3	4.1	4.5	4.5	3.5	2.9
Financing	-4.8	-4.0	-3.4	-4.3	-4.1	-4.5	-4.5	-3.5	-2.9
Domestic financing	1.5	2.7	2.2	2.1	1.8	1.2	1.1	1.7	2.3
Foreign financing	0.4	0.2	0.2	0.2	0.3	0.4	0.2	0.2	0.2
NFRK	-6.7	-6.9	-5.7	-6.6	-6.2	-6.1	-5.8	-5.5	-5.4
Non-oil fiscal balance (percent of GDP)	-8.8	-8.9	-7.0	-9.0	-8.1	-6.5	-5.8	-5.8	-5.8
Non-oil fiscal balance (percent of non-oil GDP)	-13.0	-13.0	-9.8	-12.7	-11.1	-8.5	-7.3	-7.2	-7.1
				(Annual percent change, eop, unless otherwise indicated)					
Monetary accounts									
Reserve money	10.3	1.9	-2.2	12.9	8.8	8.4	9.4	9.4	9.4
Broad money	15.0	7.9	10.3	16.8	11.3	10.8	11.9	11.9	11.9
Broad money velocity (annual average)	2.8	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Credit to the private sector 2/	14.3	11.6	12.7	16.9	11.3	10.8	11.9	11.2	11.9
Credit to the private sector (percent of GDP) 2/	40.9	41.5	41.6	41.6	41.6	41.6	41.6	41.6	41.6
NBK refinance rate (eop; percent)	7.5	5.5	5.5	…	…	…	…	…	…
				(In billions of U.S. dollars, unless otherwise indicated)					
External accounts									
Current account balance (percent of GDP)	5.4	0.5	-0.1	0.6	-0.6	-0.9	-0.3	-0.1	0.3
Exports of goods and services	89.5	91.8	88.7	90.9	90.0	91.6	96.5	100.6	106.5
Oil and gas condensate	55.2	56.4	55.2	56.6	54.1	52.6	53.9	54.3	56.3
Imports of goods and services	51.3	61.6	61.9	63.3	66.1	69.1	72.5	76.2	80.2
Foreign direct investments (net, percent of GDP)	-4.6	-5.8	-3.5	-3.6	-3.3	-3.0	-2.7	-2.5	-2.2
NBK gross reserves (eop) 3/	29.3	28.3	24.7	28.4	29.4	30.4	31.4	32.4	33.4
In months of next year's imports of goods and services	5.7	5.5	4.7	5.2	5.1	5.0	4.9	4.8	5.0
NFRK assets (eop)	43.6	57.8	70.5	85.1	99.8	115.6	132.6	150.6	170.2
Total external debt 4/	125.3	136.9	148.8	160.7	174.9	190.0	205.9	221.5	236.6
In percent of GDP	66.6	67.3	66.3	73.0	74.3	72.8	70.5	68.2	65.1
Excluding intracompany debt (percent of GDP)	33.4	34.1	33.9	35.7	36.8	36.8	36.2	35.5	34.1
Memorandum items:									
Nominal GDP (in billions of tenge)	27,572	30,347	34,140	39,898	44,423	49,239	55,101	61,299	68,588
Nominal GDP (in billions of U.S. dollars)	188.0	203.5	224.4	220.1	235.4	260.9	292.0	324.8	363.5
Crude oil, gas cnds. production (millions of barrels/day) 5/	1.69	1.65	1.70	1.70	1.70	1.73	1.83	1.89	2.00
Oil price (in U.S. dollars per barrel)	104.0	105.0	104.1	104.1	99.6	95.1	92.3	90.6	89.4

Sources: Kazakhstani authorities and Fund staff estimates and projections.
1/ The base year for real GDP calculations has been changed from 1994 in previous Fund documents to 2007.
2/ Private sector includes nonbank financial institutions, public and private nonfinancial institutions, nonprofit institutions, and households.
3/ Does not include NFRK.
4/ Gross debt, including arrears and other short-term debt.
5/ Based on a conversion factor of 7.6 barrels of oil per ton.

Table 2. Kazakhstan: Balance of Payments, 2011–19

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

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
Current account	10.2	1.1	-0.1	1.2	-1.3	-2.3	-1.0	-0.5	1.1
Trade balance	44.8	38.1	33.7	34.5	31.1	29.8	31.5	32.1	34.2
Exports (f.o.b.)	85.2	86.9	83.4	85.5	84.4	85.4	89.8	93.3	98.6
Oil and gas condensate	55.2	56.4	55.2	56.6	54.1	52.6	53.9	54.3	56.3
Non-oil exports	30.0	30.5	28.2	28.9	30.2	32.9	35.9	39.0	42.3
Imports (f.o.b.)	40.3	48.8	49.7	51.0	53.2	55.7	58.3	61.2	64.4
Oil and gas condensate	2.5	2.3	2.8	3.7	3.7	3.7	3.5	3.3	3.3
Non-oil, gas imports	37.8	46.5	46.9	47.3	49.5	52.0	54.8	57.9	61.1
Services and income balance	-34.4	-36.1	-32.2	-31.7	-30.8	-30.2	-30.4	-30.1	-30.5
Services, net	-6.6	-7.9	-6.9	-6.9	-7.2	-7.3	-7.5	-7.7	-7.9
Income, net	-27.7	-28.1	-25.3	-24.8	-23.6	-22.9	-22.9	-22.4	-22.6
Of which: Income to direct investors	25.2	24.7	22.7	22.7	21.7	21.1	21.1	20.7	20.9
Current transfers	-0.3	-1.0	-1.6	-1.6	-1.7	-1.9	-2.1	-2.4	-2.7
Capital and financial account	6.1	0.9	-3.5	4.9	-0.3	-1.3	0.0	0.5	2.1
Foreign direct investment	-8.6	-11.8	-7.8	-7.8	-7.9	-7.9	-7.9	-8.0	-8.0
Portfolio investment, net	12.7	17.5	6.1	8.8	9.0	9.5	10.1	10.4	11.0
Of which: National Fund	12.1	14.7	7.9	11.5	11.8	12.4	13.1	13.5	14.4
Other investment	1.9	-4.7	-1.8	3.9	-1.5	-3.0	-2.1	-1.8	-1.0
Errors and omissions	-3.8	-4.4	-5.8	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	-0.3	4.3	2.4	3.7	1.0	1.0	1.0	1.0	1.0
Financing: Net international reserves of NBK	0.3	-4.3	-2.4	-3.7	-1.0	-1.0	-1.0	-1.0	-1.0
Memorandum items: 1/				*(In percent of GDP)*					
Current account	5.4	0.5	-0.1	0.6	-0.6	-0.9	-0.3	-0.1	0.3
Exports of goods	45.3	42.7	37.2	38.8	35.8	32.7	30.8	28.7	27.1
Oil exports	29.3	27.7	24.6	25.7	23.0	20.1	18.5	16.7	15.5
Non-oil exports	16.0	15.0	12.6	13.1	12.8	12.6	12.3	12.0	11.6
Imports of goods	21.5	24.0	22.2	23.2	22.6	21.3	20.0	18.9	17.7
				(Annual growth rate, in percent)					
Exports	38.8	2.0	-4.1	2.5	-1.3	1.3	5.1	3.9	5.7
Non-oil exports	23.2	1.6	-7.6	2.5	4.6	8.8	9.2	8.5	8.5
Volume on non-oil exports	7.1	14.1	-4.8	8.3	7.4	8.1	8.1	8.1	8.1
Average price of non-oil exports	15.0	-11.0	-2.9	-5.4	-2.6	0.6	1.0	0.4	0.3
Imports	22.7	20.9	1.9	2.6	4.3	4.6	4.8	5.0	5.1
Oil and gas imports	4.2	-9.7	25.7	29.5	0.2	0.1	-5.3	-4.3	-2.8
Non-oil imports	24.1	22.9	0.8	1.0	4.6	4.9	5.5	5.6	5.6
Volume on non-oil imports	13.5	32.4	2.8	2.8	5.9	5.3	5.3	5.2	5.2
Average price of non-oil imports	10.6	-7.4	-2.0	-2.0	-1.2	-0.4	0.2	0.4	0.3
Exports of oil and gas condensate (in MT)	69.6	68.1	68.2	69.8	69.8	71.0	75.0	77.0	81.0
NBK gross international reserves (in billions of U.S. dollars)	29.3	28.3	24.7	28.4	29.4	30.4	31.4	32.4	33.4
In months of next year's imports of g&n.f.s. 2/	5.7	5.5	4.7	5.2	5.1	5.0	4.9	4.8	5.0
National Fund (including interest), e.o.p.	43.6	57.8	70.5	85.1	99.8	115.6	132.6	150.6	170.2
External debt in percent of GDP	66.6	67.3	66.3	73.0	74.3	72.8	70.5	68.2	65.1
Public external debt (percent GDP)	2.7	2.7	2.5	2.5	2.5	2.4	2.3	2.2	2.0
Private external debt (percent GDP)	64.0	64.6	63.8	70.5	71.8	70.4	68.2	66.0	63.1
Excluding intra-company loans (percent GDP)	33.4	34.1	33.9	35.7	36.8	36.8	36.2	35.5	34.1
World oil price (U.S. dollars per barrel)	104.0	105.0	104.1	104.1	99.6	95.1	92.3	90.6	89.4

Sources: Kazakhstani authorities and Fund staff estimates and projections.
1/ Estimates and projections are based on GDP at market exchange rates.
2/ The number reflects months of same year's imports of g&n.f.s. in 2019.

Table 3. Kazakhstan: Financial Soundness Indicators of the Banking Sector, 2008–13 1/

	2008	2009	2010	2011	2012	2013
Capital adequacy			*(In billions of tenge)*			
Regulatory capital	1948	-914	1821	1956	2072	2347
Of which: Tier 1	1525	-1054	1419	1492	1561	1691
Common shares and retained earnings	974	-1506	3621	2348	2375	2847
Preferred shares	54	87	248	250	213	212
Hybrid instruments	103	67	44	43	38	39
Of which: Tier 2	495	312	451	515	510	663
Of which: Tier 3	1	1	2	2	1	2
Risk Weighted assets	13106	11327	10312	11331	11534	12698
Of which: Credit risk	12528	8824	9439	10470	10905	12019
Of which: Market risk	243	2028	296	282	235	296
Of which: Operational risk	336	475	578	579	394	384
			(In percent)			
Regulatory capital as percent of risk-weighted assets *	15	-8	18	17	18	18
Regulatory Tier I capital to risk-weighted assets *	12	-9	14	13	14	13
Capital as percent of assets *	12	-8	11	10	14	13
Asset quality						
Nonperforming loans (NPL) as percent of gross loans *	5	22	24	31	30	31
Provisions as percent of NPL	69	75	63	70	77	83
NPL net of provisions as percent of tier I capital *	10	-48	56	65	52	41
Large exposures as percent of tier I capital *	166	-279	216	252	264	256
(10-largest credit to net credits) 25-largest credit to total loans	27	31	34	36	35	32
			(In billions of tenge)			
Written off loans**	43	82	162	153	235	308
Earnings and profitability			*(In percent)*			
Gross profits as percent of average assets (ROAA) *	0	-24	12	0	2	2
Gross profits as percent of average equity capital (ROAE) *	1	-1198	843	-3	13	13
Net interest margin (net interest income as percent of interest bearing assets) *	6	4	3	4	4	6
Gross income as percent of average assets	7	4	16	5	13	8
Net interest income as percent of gross income	77	105	16	71	27	60
Non-interest income as percent of gross income	23	-5	84	29	73	40
Trading net income as a percent of gross income *	3	-43	0	-2	-3	4
Non-interest expenses as percent of gross income *	35	65	21	68	68	38
Personnel expenses as percent of non-interest expenses *	11	22	6	21	8	14
Liquidity						
Liquid assets as percent of total assets *	14	19	21	21	18	17
Liquid assets as percent of short-term liabilities *	49	53	64	58	47	53
Foreign currency loans as percent of total loans *	52	57	50	44	38	38
Foreign currency liabilities as percent of total liabilities *	60	54	44	40	35	43
Deposits as percent of assets (excluding interbank deposits)	39	53	57	61	61	64
Of which: Household deposis	13	17	19	22	25	26
Of which: Corporate deposits	26	35	38	39	37	38
Of which: Interbank deposits	3	2	2	1	1	2
Of which: Other	19	16	1	1	1	1
Other wholesale/market-based funding as percent of assets	28	42	34	31	26	25
Loans as percent of deposits *	198	156	131	132	135	134
Sensitivity to market risk						
Off-balance sheet operations as percent of assets	82	79	63	76	76	74
Gross asset position in derivatives as a percentage of tier I capital *	12	-8	3	2	5	6
Gross liability position in derivatives as a percentage of tier I capital *	9	-7	5	4	5	6
Net (long) open position in foreign exchange as a percentage of tier I capital *	3	57	-2	0	-5	-5

Source: NBK.

1/ Data include BTA unless otherwise indicated.

*Core and encouraged set of indicators. Indicates available aggregate data for all banks.

**Excluding BTA and credit cards.

Table 4. Kazakhstan: Structure of the Financial System, 2005–13

(In billions of tenge, unless otherwise noted)

	2005	2006	2007	2008	2009	2010	2011	2012	2013
Number									
Banks	...	...	...	37	38	39	39	38	38
Of which: Banks with foreign participation	...	...	...	...	...	...	...	19	17
Subsidiaries of foreign banks	...	...	...	...	...	...	...	16	14
Banking groups	...	...	...	15	15	14	13	14	14
Insurance companies	37	39	41	44	41	38	38	35	34
Life	3	4	7	8	7	7	7	7	7
Nonlife	34	35	34	36	34	31	31	28	27
Pension funds	14	14	14	14	14	13	12	11	10
Securities dealers	67	69	63	71	50	44	42	29	22
Real estate investment funds with fixed capital	36	37	61	66	49	39	33	33	26
Mortgage companies and regional social housing corporations	...	...	...	...	...	...	...	...	...
Financial system assets (in billions of U.S. dollars or in percent)									
Banks	n.a.	n.a.	11,684.6	11,889.6	11,557.3	12,031.5	12,817.9	13,880.0	15,109.3
Banking groups	n.a.	n.a.	n.a.	10,966.3	10,852.3	10,867.3	10,685.3	11,675.8	n.a.
Of which: Four largest banking groups	n.a.	n.a.	n.a.	7,533.7	7,059.7	7,927.9	5,334.3	7,536.9	n.a.
Insurance sector	73.4	135.5	223.6	268.8	297.3	343.2	387.7	442.7	523.4
Life	2.9	7.0	13.2	17.8	22.8	36.1	50.8	78.7	114.9
Nonlife	70.5	128.5	210.4	251.0	274.4	307.1	336.9	364.1	408.5
Pension funds	650.2	915.1	1,211.9	1,412.9	1,860.8	2,260.1	2,652.2	3,188.3	3,735.9
Mutual funds	29.8	116.0	312.9	320.0	360.9	292.6	485.1	623.2	455.5
Of which: Open-end	0.7	1.3	1.6	1.4	0.8	0.8	0.6	0.5	0.3
Of which: Closed-end	11.3	45.9	194.5	150.7	295.6	262.0	453.9	573.7	417.0
Stock market participants	30.4	193.7	356.0	446.0	174.7	160.7	137.2	104.2	88.1
Assets as percent of GDP									
Banks	...	...	91.4	74.1	68.0	55.2	46.5	45.7	44.9
Banking groups	...	...	...	68.3	63.8	49.8	38.8	38.5	n.a.
Insurance companies (life and nonlife)	1.0	1.3	1.7	1.7	1.7	1.6	1.4	1.5	1.5
Pension funds	8.6	9.0	9.4	8.8	10.9	10.4	9.6	10.5	10.8
Mutual funds	0.4	1.1	2.4	2.0	2.1	1.3	1.8	2.1	1.3
Nominal GDP (billions of tenge)	7,590.6	10,213.7	12,849.8	16,052.9	17,007.6	21,815.5	27,571.9	30,347.0	34,443.4
Exchange rate (USD/KZT)	133.77	127.00	120.30	120.79	148.46	147.50	148.40	150.74	154.06

Source: NBK.

Table 5. Kazakhstan: Monetary Accounts, 2009–13

	2009	2010	2011	2012	2013
	(End of period, in billions of tenge)				
Monetary Survey					
Net Foreign Assets	2,776	4,482	5,261	5,871	6,427
Net Domestic Assets	4,833	4,125	4,964	5,258	5,926
Domestic Credit	9,443	10,037	11,593	13,081	14,791
Net claims on central government	94	158	302	482	594
Net claims on other government	1	7	8	7	7
Credit to the private sector 1/	9,347	9,872	11,283	12,592	14,190
Claims on households	2,340	2,243	2,483	3,026	3,807
Other items, net	-4,610	-5,912	-6,629	-7,823	-8,865
Broad money	7,487	8,483	9,752	10,522	11,601
Currency in circulation	913	1,148	1,366	1,528	1,512
Total deposits	6,574	7,334	8,387	8,994	10,089
Nonliquid liabilities	92	116	148	169	208
Statistical discrepancy	122	123	473	607	1,163
Accounts of NBK					
Net foreign assets 2/	3,348	4,054	4,269	4,171	3,742
Net international reserves 2/	3,345	4,087	4,269	4,182	3,724
Net domestic assets 2/	-574	-1,320	-949	-572	-140
Net domestic credit	87	-527	-79	457	671
Net claims on central government	-147	-241	-161	-118	-62
Net claims on other government	0	0	0	0	0
Net claims on the private sector 1/	302	132	147	171	179
Net claims on banks	-68	-418	-64	403	553
Other items, net	-661	-793	-870	-1,029	-810
Reserve money	2,451	2,572	2,837	2,890	2,826
Currency in circulation	1,048	1,306	1,548	1,737	1,763
Liabilities to banks	949	722	728	724	844
Required reserves	460	292	631	665	804
Other liabilities	489	429	97	59	39
Demand deposits	454	544	561	429	219
Other deposits	0	0	0	0	0
Other liquid liabilities	201	38	9	102	28
Deposit money banks					
Net foreign assets	-572	428	992	1,700	2,684
Net domestic assets	7,885	7,400	7,861	8,395	9,016
Domestic credit	10,730	11,689	12,838	14,045	15,771
Net claims on central government	241	399	463	600	656
Net claims on other government	1	7	8	7	7
Credit to the private sector 1/	9,046	9,740	11,136	12,421	14,010
Net claims on other financial corporations	350	346	316	376	560
Banks' reserves	1,442	1,542	1,231	1,018	1,097
Other items, net	-2,845	-4,289	-4,977	-5,650	-6,755
Banks' liabilities	7,313	7,828	8,854	10,095	11,700
Demand deposits	1,813	2,068	2,762	2,600	2,636
Other deposits	4,107	4,684	5,055	5,864	7,203
Other liabilities	1,394	1,076	1,037	1,631	1,862
Memorandum items:					
Reserve money (percent change, y-o-y)	60.7	5.0	10.3	1.9	-2.2
Broad money (percent change, y-o-y)	19.5	13.3	15.0	7.9	10.3
Credit to private sector (percent change, y-o-y)	10.4	5.6	14.3	11.6	12.7
Velocity of broad money	2.3	2.6	2.8	2.9	2.9
Money multiplier	3.1	3.3	3.4	3.6	4.1
Foreign currency deposits (in percent of total deposits) 3/	47	37	33	30	37
Foreign currency loans (in percent of total loans) 3/	47	42	36	31	31

Sources: Kazakhstani authorities and Fund staff estimates.

1/ Private sector includes nonbank financial institutions, public and private nonfinancial institutions, non-profit institutions, and households.

2/ Does not include oil fund resources.

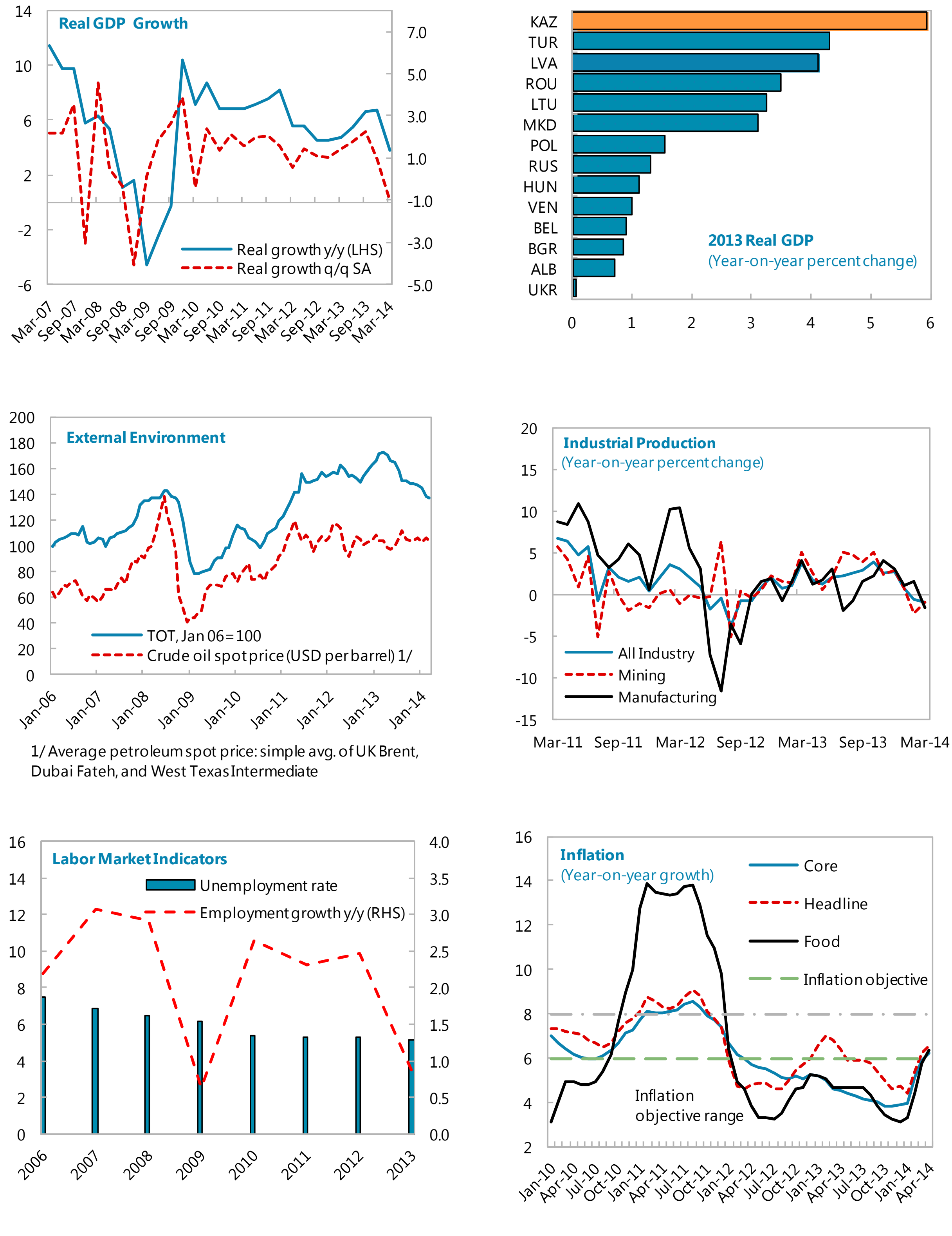
3/ Commercial banks only.

Table 6. Kazakhstan: General Government Fiscal Operations, 2011–19

	2011	2012	2013	2014	2015	2016	2017	2018	2019
				Projections					
				(In billions of tenge)					
Total revenue and grants	7,638	8,170	8,911	10,546	10,912	11,601	12,317	13,162	14,268
Tax revenue	7,337	7,507	8,176	9,747	10,126	10,718	11,329	12,061	13,048
Oil	4,042	4,076	4,150	5,294	5,453	5,440	5,628	5,724	5,965
Non-oil	3,295	3,431	4,025	4,453	4,673	5,278	5,701	6,337	7,083
Income from capital transactions	36	39	38	38	38	38	38	38	38
Nontax revenue	265	624	698	761	748	845	950	1,063	1,183
Grants	0	0	0	0	0	0	0	0	0
Total expenditure and net lending	6,012	6,810	7,151	8,827	9,074	9,367	9,858	10,986	12,312
Total expenditure	5,872	6,676	7,067	8,491	8,489	9,278	9,758	10,875	12,187
Current expenditure	4,554	5,291	5,668	6,895	6,758	7,309	7,555	8,363	9,308
Capital expenditure	1,318	1,385	1,399	1,595	1,732	1,969	2,203	2,512	2,879
Net lending 1/	140	134	83	336	585	89	100	111	124
Overall balance	1,627	1,360	1,761	1,719	1,838	2,234	2,459	2,175	1,957
Non-oil balance	-2,415	-2,716	-2,390	-3,575	-3,615	-3,206	-3,169	-3,549	-4,009
Statistical discrepancy	307	152	607	0	0	0	0	0	0
Financing	-1,320	-1,209	-1,154	-1,719	-1,838	-2,234	-2,459	-2,175	-1,957
Domestic financing, net	411	817	718	816	765	555	600	1,053	1,542
Foreign financing, net	108	68	54	87	139	173	138	152	168
Privatization receipts	14	14	20	20	20	20	20	20	20
NFRK 2/	-1,854	-2,108	-1,945	-2,642	-2,761	-2,981	-3,216	-3,400	-3,687
				(In percent of GDP)					
Total revenue and grants	27.7	26.9	26.1	26.4	24.6	23.6	22.4	21.5	20.8
Tax revenue	26.6	24.7	23.9	24.4	22.8	21.8	20.6	19.7	19.0
Oil	14.7	13.4	12.2	13.3	12.3	11.0	10.2	9.3	8.7
Non-oil	12.0	11.3	11.8	11.2	10.5	10.7	10.3	10.3	10.3
Income from capital transactions	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nontax revenue	1.0	2.1	2.0	1.9	1.7	1.7	1.7	1.7	1.7
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	21.8	22.4	20.9	22.1	20.4	19.0	17.9	17.9	18.0
Total expenditure	21.3	22.0	20.7	21.3	19.1	18.8	17.7	17.7	17.8
Current expenditure	16.5	17.4	16.6	17.3	15.2	14.8	13.7	13.6	13.6
Capital expenditure	4.8	4.6	4.1	4.0	3.9	4.0	4.0	4.1	4.2
Net lending 1/	0.5	0.4	0.2	0.8	1.3	0.2	0.2	0.2	0.2
Overall balance	5.9	4.5	5.2	4.3	4.1	4.5	4.5	3.5	2.9
Non-oil balance	-8.8	-8.9	-7.0	-9.0	-8.1	-6.5	-5.8	-5.8	-5.8
Financing	-4.8	-4.0	-3.4	-4.3	-4.1	-4.5	-4.5	-3.5	-2.9
Domestic financing, net	1.5	2.7	2.1	2.0	1.7	1.1	1.1	1.7	2.2
Foreign financing, net	0.4	0.2	0.2	0.2	0.3	0.4	0.2	0.2	0.2
Privatization receipts	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
NFRK 2/	-6.7	-6.9	-5.7	-6.6	-6.2	-6.1	-5.8	-5.5	-5.4
Memorandum items:									
Non-oil balance (in percent of non-oil GDP)	-13.0	-13.0	-9.8	-12.7	-11.1	-8.5	-7.3	-7.2	-7.1
Non-oil revenues (in percent of non-oil GDP)	19.4	19.6	19.6	18.7	16.7	16.3	15.4	15.1	14.8
Gross public debt (percent of GDP) 3/	10.4	12.4	13.3	13.6	14.3	14.4	14.2	14.7	15.6
NFRK assets (in billions U.S. dollars) 1/	43.6	57.8	70.5	85.1	99.8	115.6	132.6	150.6	170.2
Nominal GDP (in billions KZT)	27,572	30,347	34,140	39,898	44,423	49,239	55,101	61,299	68,588

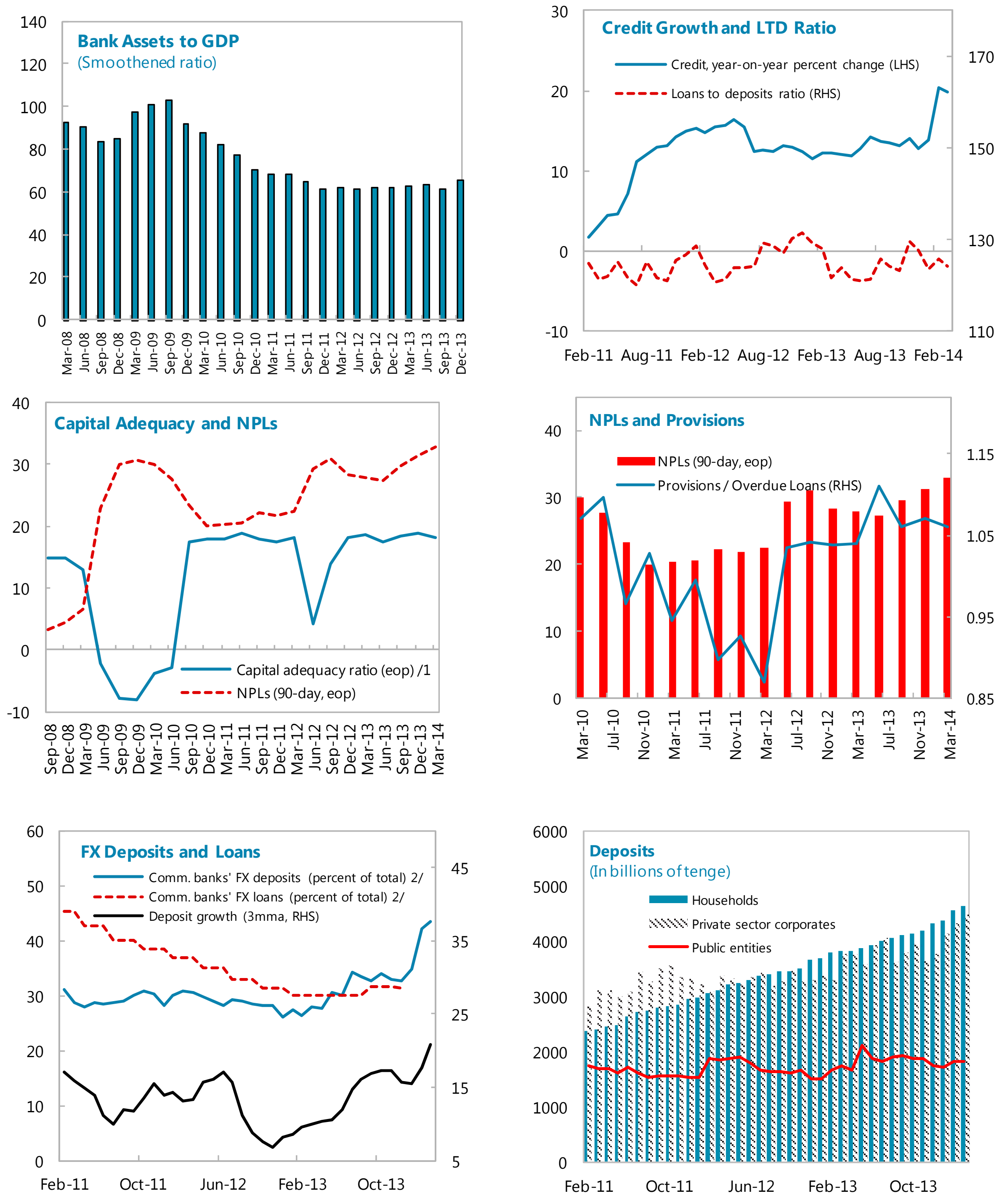
Sources: Kazakhstani authorities and Fund staff estimates and projections.
1/ Includes staff's estimates of the announced lending package from the NFKR for the period 2014–16.
2/ National Fund of the Republic of Kazakhstan. (-) is accumulation in the Fund.
3/ General government, including republican and local budgets.

Figure 1. Kazakhstan: Economic Developments



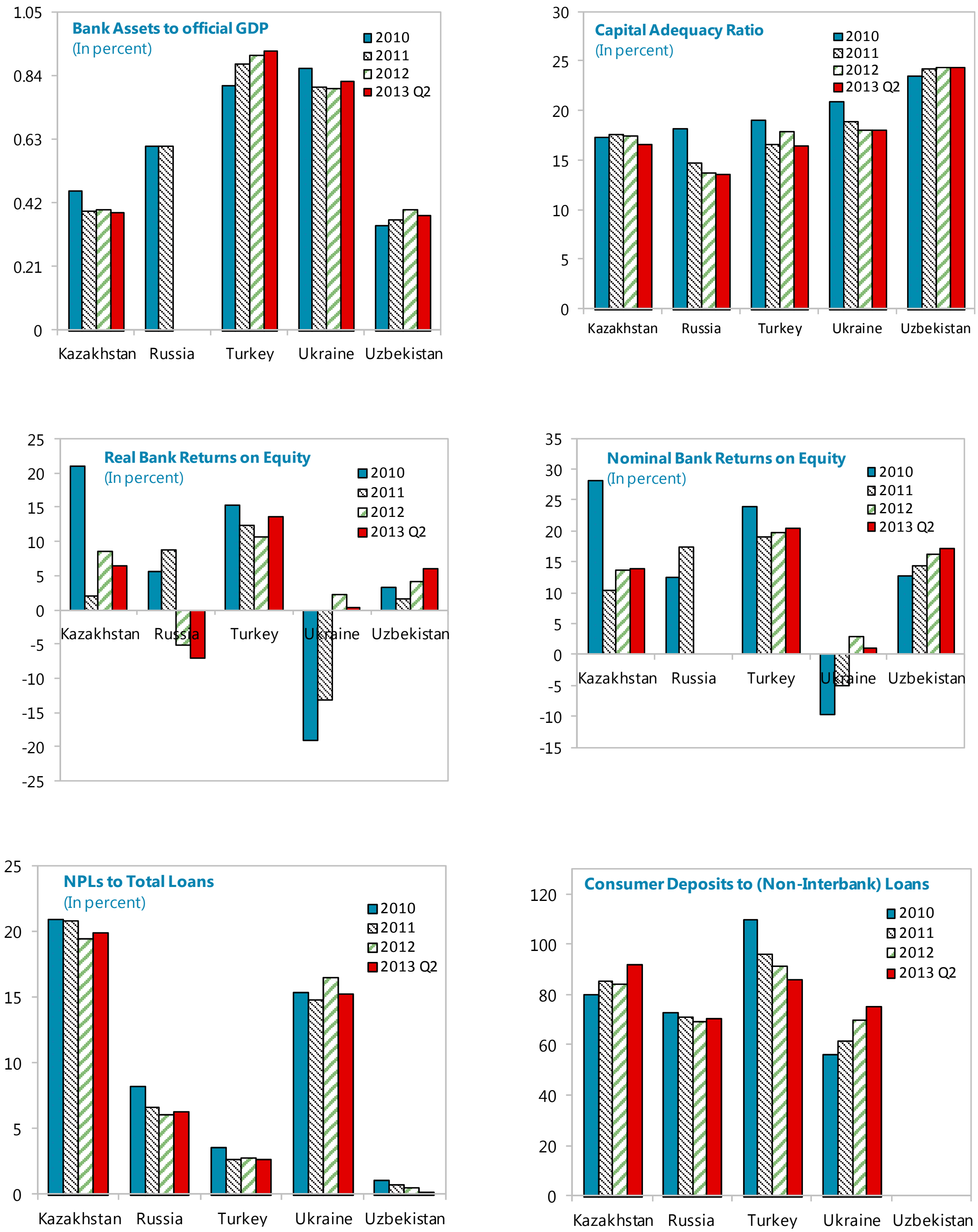
Sources: Kazakhstani authorities and IMF staff estimates.

Figure 2. Kazakhstan: Banking Sector Developments



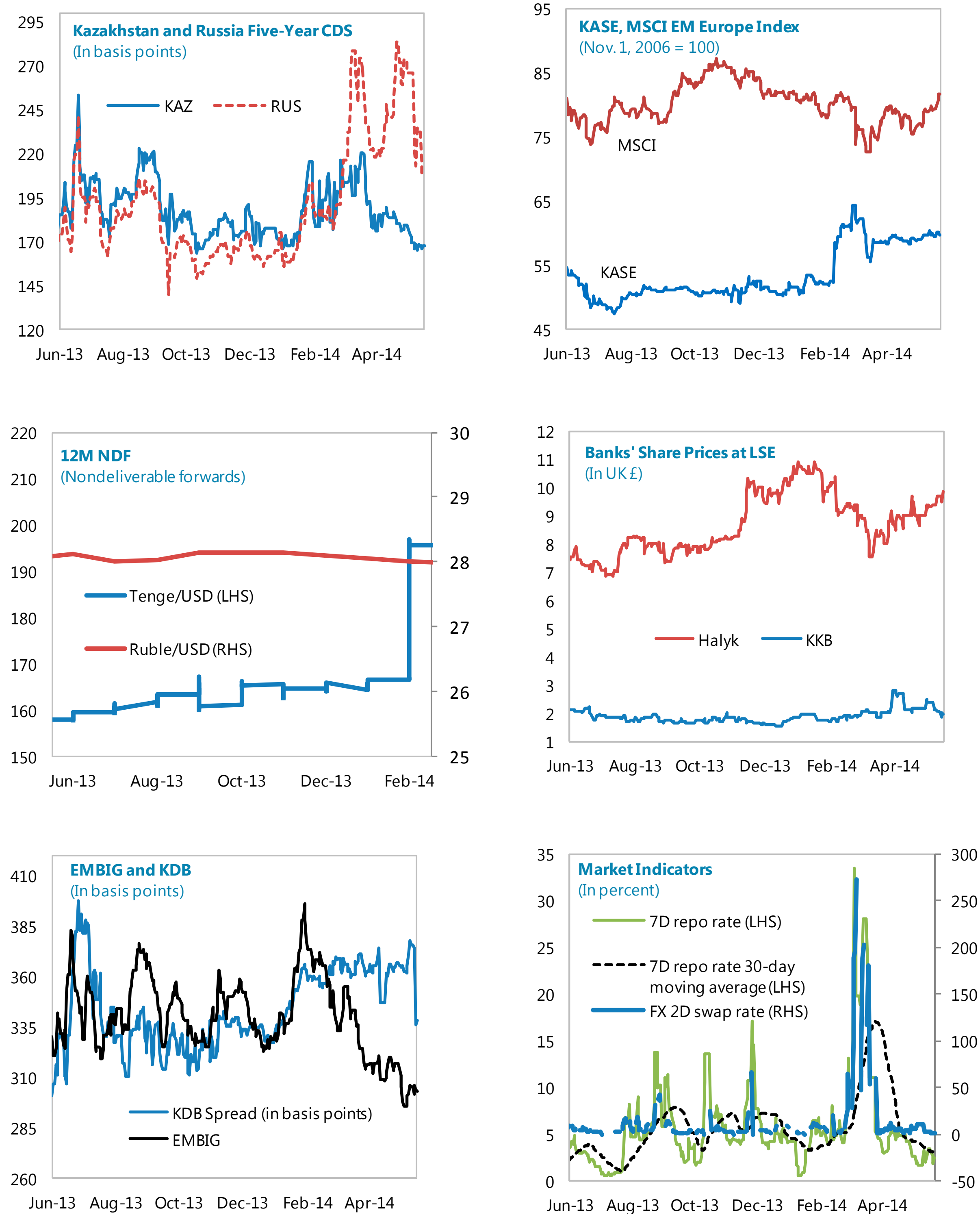
Sources: Kazakhstani authorities, GFSR, and IMF staff estimates.
1/ Authorities did not provide systemwide CAR data during BTA's second debt restructuring, hence the gap in the CAR graph.
2/ Accounting for exchange rate valuation effects.

Figure 3. Kazakhstan: Key Financial Soundness Indicators, Cross-Country Comparison



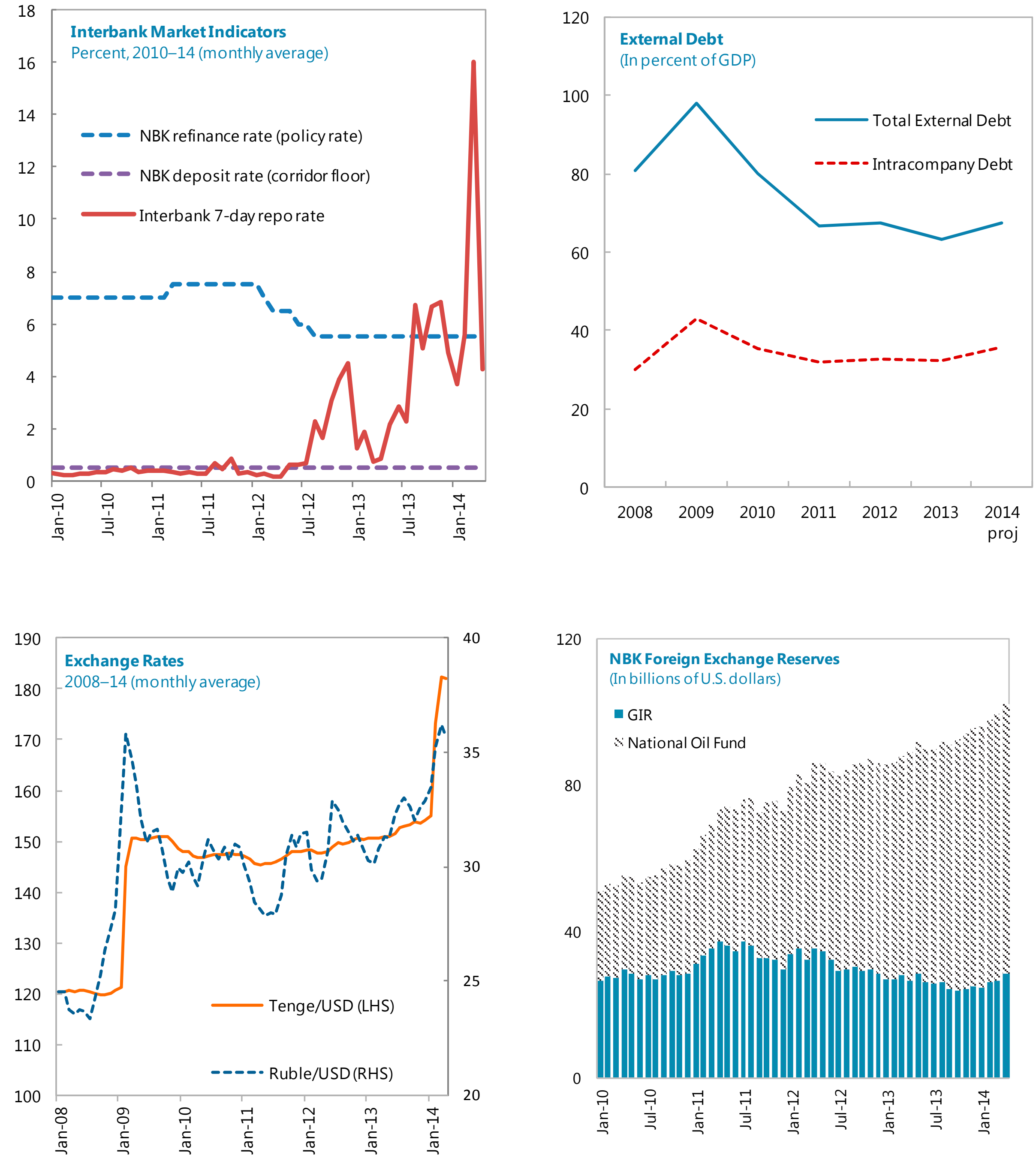
Sources: IMF FSI database and World Economic Outlook.

Figure 4. Kazakhstan: Capital Markets and Expected Default Frequencies



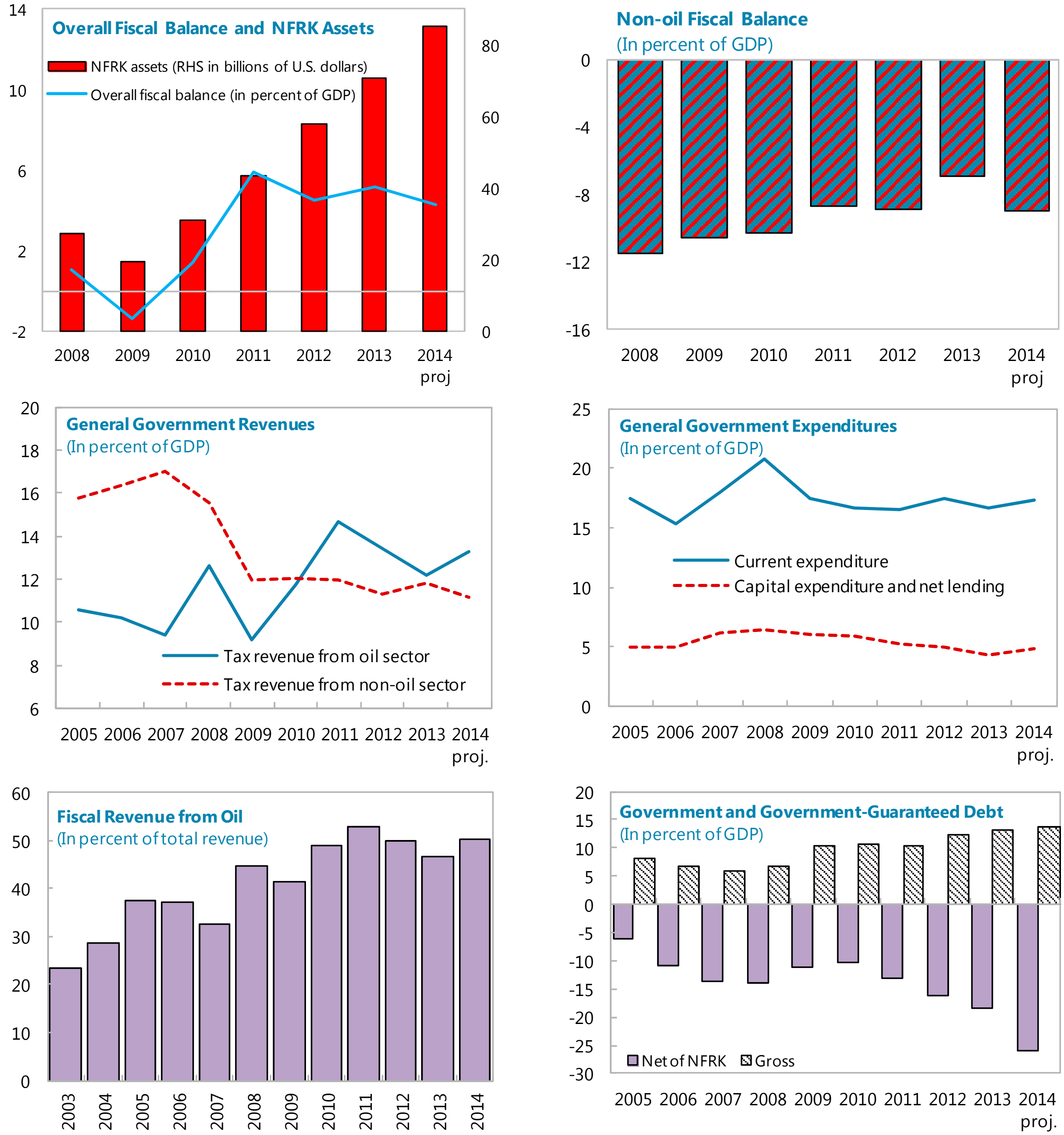
Source: Bloomberg.

Figure 5. Kazakhstan: Monetary and External Sector Developments



Sources: Kazakhstani authorities, Bloomberg, and IMF staff estimates.

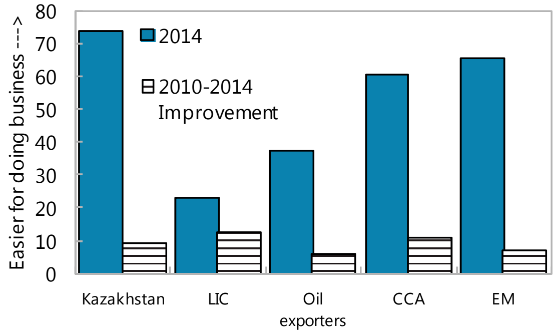
Figure 6. Kazakhstan: Fiscal Sector Developments and Outlook



Sources: Kazakhstani authorities and IMF staff estimates.

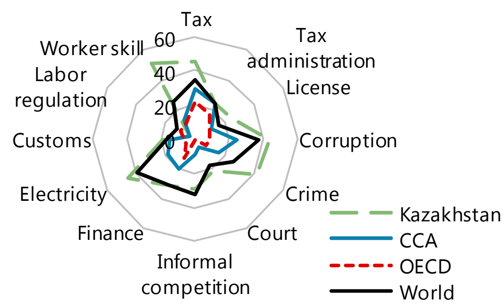
Figure 7. Kazakhstan: Business Environment and Governance Indicators

Ease of Doing Business
(Percentile rank)



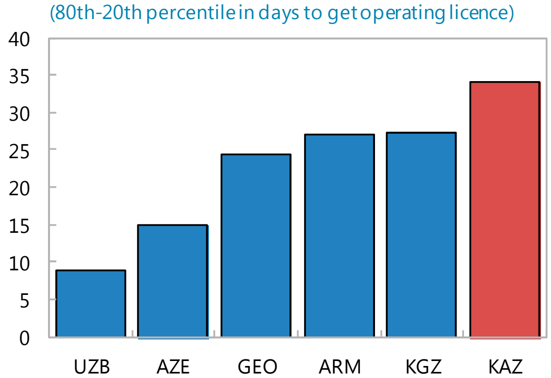
Sources: World Bank Doing Business (2014), and IMF staff calculations.

Firm-Level Business Constraints
(Percentage of firms identifying constraints)



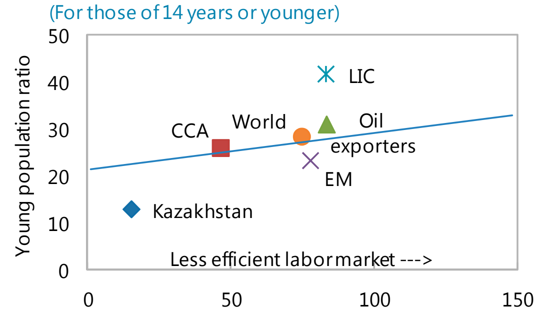
Sources: World Bank BEEP Survey (2008), and IMF staff calculations.

Firm-Level Dispersion in Business Environment
(80th-20th percentile in days to get operating licence)



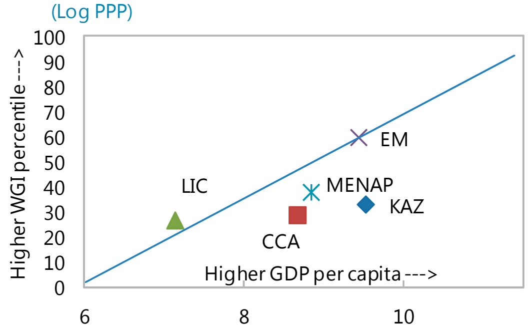
Sources: World Bank BEEPS, and IMF staff calculations.

Labor Market Efficiency and Young Population Ratio
(For those of 14 years or younger)



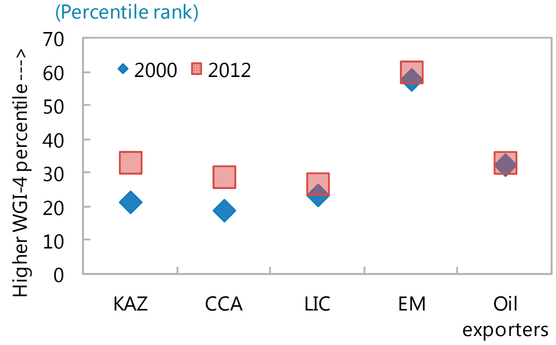
Sources: WEF Global Competitiveness Report (2013–14, pillar seven without female participation and brain drain), WDI (2012), and IMF staff calculations; trend line is based on across country regression.

WGI-4 and GDP per capita
(Log PPP)



Sources: Worldwide Governance Indicators (government effectiveness, regulatory quality, rule of law, and control of corruption); trend line is based on across country regression.

Changes in WGI-4, 2000-2012
(Percentile rank)



Sources: Worldwide Governance Indicators (government effectiveness, regulatory quality, rule of law, and control of corruption), and IMF staff calculations.

Appendix I. Kazakhstan: Risk Assessment Matrix[11]

Nature/source of main threats	Likelihood of realization in the next three years	Expected impact on the economy if risk is realized	Recommended policy response
Sustained decline in commodity prices. Kazakhstan's economy remains highly dependent on oil for export and budget revenues.	**Staff assessment: Medium** Decline in oil prices may be triggered by deceleration of global demand and coming-on stream of excess capacity in the medium term.	**Staff assessment: High** Growth would decelerate noticeably, mainly due to reduced oil exports and a fall in oil-related capital flows. The tenge could come under sustained downward pressure.	Transparent and high quality fiscal response (with spending priorities determined in a temporary and targeted way) to arrest significant deceleration of growth.
Protracted period of slower growth in emerging economies. Russia and China are key trading partners, accounting for about 30 percent of Kazakhstan's exports. Market risk indicators tend to move in line with those of Russia. China is a major source of investment.	**Staff assessment: Medium** Latest Fund staff's projections suggest that trend growth in emerging economies is lower as a result of weaker than expected productive capacity and human capital.	**Staff assessment: Medium** Kazakhstan's growth would be affected adversely through trade (lower external demand), finance, and investment channels.	Transparent and high quality fiscal response (with spending priorities determined in a temporary and targeted way) to arrest significant deceleration of growth.
Increasing geopolitical tensions surrounding Russia/Ukraine. Kazakhstan is vulnerable due to strong trade and financial linkages with Russia and to some degree with Ukraine.	**Staff assessment: Medium** Growth in Russia may fall on account of shaken investor confidence, tighter financing conditions and possible sanctions.	**Staff assessment: Medium** Kazakhstan would be affected through lower export demand and investment flows from Russia. Political uncertainty may increase, with downward pressure on the tenge.	Transparent and high quality fiscal response (with spending priorities determined in a temporary and targeted way) to arrest significant deceleration of growth.

[11] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Nature/source of main threats	Likelihood of realization in the next three years	Expected impact on the economy if risk is realized	Recommended policy response
Domestic confidence. Lack of progress in resolving the long-standing NPL problem and in improving the monetary and exchange rate policy framework would weaken confidence.	**Staff assessment: Medium** Triggers may include: (i) slower-than-expected implementation of the NPL resolution framework; and (ii) possible further tenge devaluation.	**Staff assessment: Medium** Renewed concerns about financial stability may lead to pressure on bank deposits. Financial sector stress could also lead to a credit crunch. Uncertainty about policy action and effectiveness would negatively affect investment.	Monetary tightening to contain rising inflation and strengthening of macro policy frameworks to restore confidence.
Delays or reversals in structural reforms. Increasing the role of the state in economic activity may negatively affect Kazakhstan's prospects of becoming a dynamic emerging market economy.	**Staff assessment: Medium** The government's industrialization and diversification policy agenda focuses heavily on top-down industrialization, while progress on broad-based institutional reforms remains slow.	**Staff assessment: Medium** Inefficient and nontransparent public spending may lead to waste of public wealth and eventually lead to lower long-term growth.	Focus on broad-based structural reforms to boost human capital and institutions. Ensure political commitment to the reform process and high standards of efficiency in all public spending.

Appendix II. Kazakhstan: FSAP Key Recommendations

Recommendations and Authority Responsible for Implementation	¶	Time[1]
Financial Stability		
Closely monitor quality of foreign currency-denominated loans [NBK].		I
Closely monitor banks' concentrated large exposures [NBK].		I
Banking Oversight		
Rebalance the emphasis of supervision towards a more risk-based approach [NBK].		MT
Support the supervisor's capacity to challenge banks' decisions on provisioning [NBK].		I
Intensify the supervision of the cross-border operations of Kazakh banks and signing MoU [NBK].		NT
Analyze regularly indirect credit risk and market risk, including foreign exchange rate risk [NBK].		I
Monitor the impact of the adopted MaPPs and conduct assessments of effectiveness [NBK].		MT
Financial Safety Net, Resolution of NPLs, and Systemic Liquidity Management		
Revise purchase and assumption and bridge bank resolution options to exclude a requirement for depositor and creditor approval [NBK].		MT
Limit emergency liquidity assistance to institutions that are solvent and financially capable of paying a penalty rate of interest [NBK].		NT
Develop a procedure for documenting financial stability analysis in cases of provision of state support to the financial sector [NBK].		NT
Implement a multi-track approach for resolving the overhang of NPLs [NBK].		NT
Reduce procedural costs of enforcement obstacles arising from non-registered or junior pledge holders in foreclosures [Government/Legislator].		NT
Revise the insolvency law to strengthen protection for legal rights of secured creditors by giving them a higher priority in creditors' ranking [Government/Legislator].		NT
Incentivize out-of-court restructuring by providing tax incentives at creditor's and debtor's level for debt write-offs, partial forgiveness, bad debt and collateral sales [Government/Legislator].		NT
Operationalize the PLF by providing for its broad mandate in NPLs resolution, including bundling of NPLs and adequate financial and staffing resources [NBK/Government/Legislator].		NT
Facilitate NPLs transfers into SPVs including by revising bank secrecy rules and property rights registration of the debt assignments and collateral transfers [Government/Legislator].		NT
Public Pensions, Insurance, and Securities Market Oversight		
Include in UAPF's Charter a clear mandate for UAPF to maximize the retirement income for its members [Government/Legislator].		I
Adjust the mandatory worker's compensation to avoid collapse of the insurance sector [Government/ Parliament].		I
Reduce uncertainty in continuity of market rules; confirm legal fact and time of settlement finality [Government, NBK].		I

[1] I-Immediate" is within one year; "NT-near-term" is one to three years; "MT-medium-term" is three to five years.

Appendix III. Kazakhstan: Debt Sustainability Assessment

Kazakhstan Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

(In percent of GDP unless otherwise indicated)

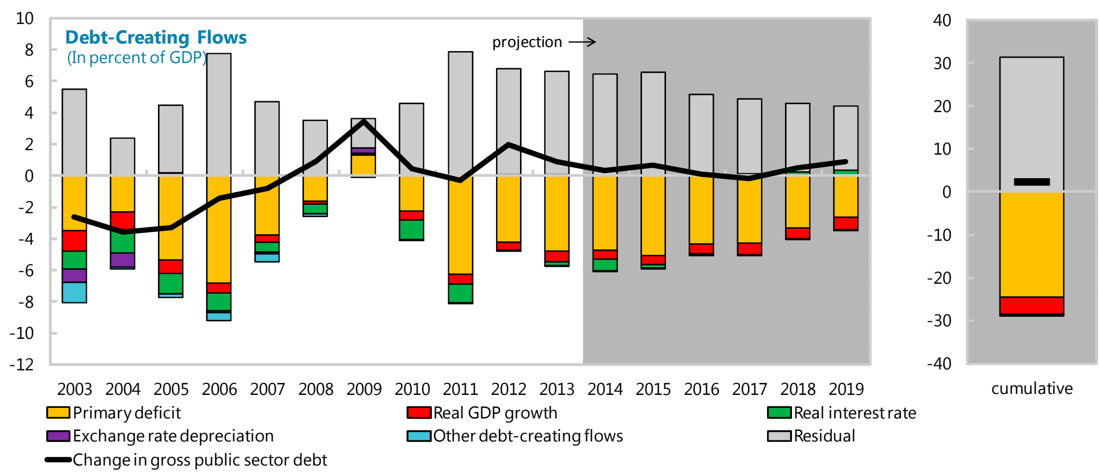
Debt, Economic and Market Indicators [1/]

	Actual			Projections					
	2003-2011 [2/]	2012	2013	2014	2015	2016	2017	2018	2019
Nominal gross public debt	9.5	12.4	13.3	13.6	14.3	14.4	14.2	14.7	15.6
Public gross financing needs	-4.2	-4.9	-5.4	-5.2	-5.4	-4.5	-4.3	-3.2	-2.4
Real GDP growth (in percent)	7.5	5.0	6.0	4.7	4.8	4.8	5.8	5.2	5.7
Inflation (GDP deflator, in percent)	16.2	4.8	6.1	11.6	6.0	5.7	5.7	5.7	5.8
Nominal GDP growth (in percent)	25.0	10.1	12.5	16.8	11.0	10.8	11.8	11.2	11.9
Effective interest rate (in percent) [4/]	5.5	4.5	4.7	5.4	4.8	5.7	6.9	7.9	8.6

As of May 20, 2014		
Sovereign Spreads		
Bond Spread (bp) 3/	271	
5Y CDS (bp)	166	
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB+	BBB+
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2003-2011	2012	2013	2014	2015	2016	2017	2018	2019	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.8	2.0	0.9	0.4	0.7	0.1	-0.2	0.5	0.9	2.4	
Identified debt-creating flows	-5.5	-4.8	-5.7	-6.1	-5.9	-5.1	-5.0	-3.8	-3.2	-29.0	
Primary deficit	-3.4	-4.3	-4.8	-4.8	-5.1	-4.4	-4.3	-3.4	-2.7	-24.6	-0.5
Primary (noninterest) revenue and gra	25.6	25.8	25.0	25.4	23.6	22.5	21.3	20.4	19.8	133.1	
Primary (noninterest) expenditure	22.2	21.6	20.2	20.7	18.5	18.2	17.0	17.1	17.1	108.5	
Automatic debt dynamics [5/]	-1.8	-0.5	-0.8	-1.3	-0.8	-0.6	-0.6	-0.4	-0.4	-4.2	
Interest rate/growth differential [6/]	-1.6	-0.5	-0.9	-1.3	-0.8	-0.6	-0.6	-0.4	-0.4	-4.2	
Of which: real interest rate	-1.0	0.0	-0.2	-0.8	-0.2	0.0	0.1	0.2	0.3	-0.3	
Of which: real GDP growth	-0.7	-0.5	-0.7	-0.5	-0.6	-0.6	-0.8	-0.7	-0.8	-3.9	
Exchange rate depreciation [7/]	-0.2	0.0	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.3	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Please specify (1) (e.g., privatization r	-0.3	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., other debt flo	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	4.7	6.8	6.6	6.5	6.6	5.1	4.8	4.3	4.1	31.4	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ EMBIG (bp).

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

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

6/ The real interest rate contribution is derived from the numerator in footnote 5 as r - π (1+g) and the real growth contribution as -g.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as ae(1+r).

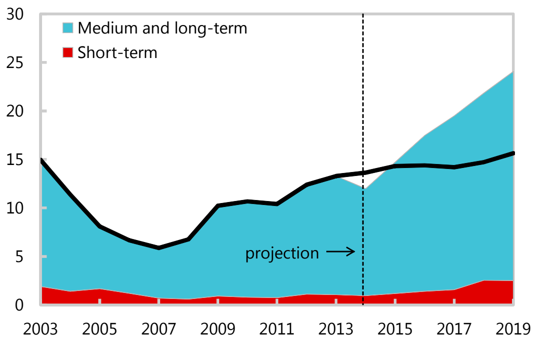
8/ Reflects asset accumulation in the oil fund.

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

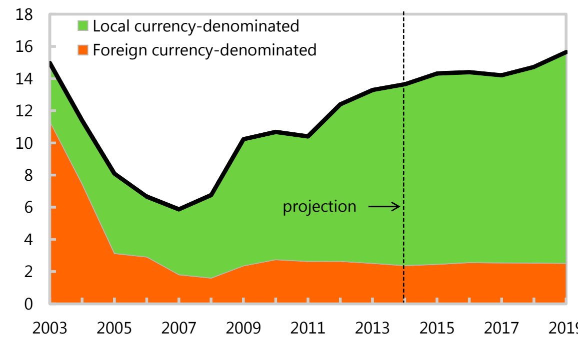
Kazakhstan Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

By Maturity
(In percent of GDP)



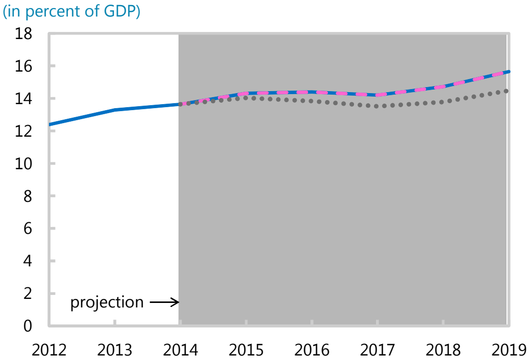
By Currency
(In percent of GDP)



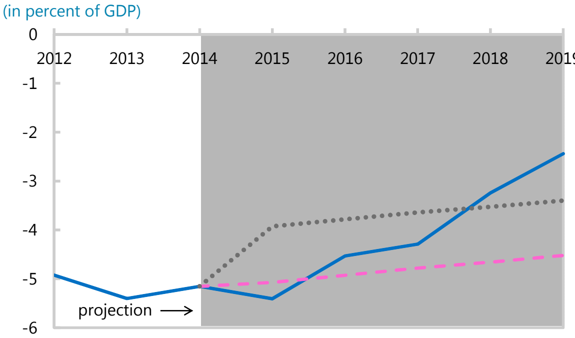
Alternative Scenarios

Baseline
Historical
Constant Primary Balance

Gross Nominal Public Debt 1/
(in percent of GDP)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(In percent)

Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.7	4.8	4.8	5.8	5.2	5.7
Inflation	11.6	6.0	5.7	5.7	5.7	5.8
Primary Balance	4.8	5.1	4.4	4.3	3.4	2.7
Effective interest rate	5.4	4.8	5.7	6.9	7.9	8.6
Constant Primary Balance Scenario						
Real GDP growth	4.7	4.8	4.8	5.8	5.2	5.7
Inflation	11.6	6.0	5.7	5.7	5.7	5.8
Primary Balance	4.8	4.8	4.8	4.8	4.8	4.8
Effective interest rate	5.4	4.8	5.7	6.9	7.9	8.6

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	4.7	6.9	6.9	6.9	6.9	6.9
Inflation	11.6	6.0	5.7	5.7	5.7	5.8
Primary Balance	4.8	3.6	3.6	3.6	3.6	3.6
Effective interest rate	5.4	4.8	5.7	6.9	7.9	8.6

Source: IMF staff.

Kazakhstan: External Debt Sustainability Framework, 2009–19

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013	10-Year Historical Average	10-Year Standard Deviation	2014	2015	2016	2017	2018	2019	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	97.9	79.9	66.6	67.3	66.3			**73.0**	**74.3**	**72.8**	**70.5**	**68.2**	**65.1**	**-8.0**
2 Change in external debt	17.0	-18.0	-13.2	0.6	-1.0			6.7	1.3	-1.4	-2.3	-2.3	-3.1	
3 Identified external debt-creating flows (4+8+9)	7.5	-25.1	-27.0	-11.2	-9.7			-7.4	-6.0	-5.3	-6.0	-5.5	-5.8	
4 Current account deficit, excluding interest payments	1.4	-3.6	-8.2	-3.3	-1.9			-2.5	-1.1	-0.6	-0.9	-1.0	-1.3	
5 Deficit in balance of goods and services	-7.8	-14.4	-20.3	-14.8	-11.9			-12.6	-10.0	-8.3	-7.9	-7.1	-6.9	
6 Exports	41.7	44.2	47.6	45.1	39.5			41.4	38.0	34.8	32.8	30.7	29.1	
7 Imports	33.8	29.9	27.3	30.2	27.6			28.8	28.1	26.5	24.9	23.6	22.2	
8 Net non-debt creating capital inflows (negative)	-8.8	-2.6	-4.6	-5.6	-3.5			-3.6	-3.4	-3.1	-2.8	-2.5	-2.2	
9 Automatic debt dynamics 1/	14.8	-19.0	-14.2	-2.3	-4.4			-1.3	-1.5	-1.6	-2.4	-2.0	-2.3	
10 Contribution from nominal interest rate	2.1	2.6	2.8	2.8	1.9			1.9	1.8	1.6	1.4	1.3	1.2	
11 Contribution from real GDP growth	-1.1	-5.6	-4.7	-3.1	-3.7			-3.2	-3.3	-3.2	-3.8	-3.3	-3.5	
12 Contribution from price and exchange rate changes 2/	13.8	-16.1	-12.3	-2.0	-2.6			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	9.5	7.1	13.8	11.8	8.7			14.0	7.3	3.8	3.7	3.1	2.7	
External debt-to-exports ratio (in percent)	235.0	180.5	140.0	149.2	167.7			176.4	195.4	209.0	215.1	222.0	223.9	
Gross external financing need (in billions of US dollars) 4/	18.8	12.2	4.6	13.6	16.3			16.3	21.4	24.2	24.9	26.3	26.7	
in percent of GDP	16.3	8.3	2.4	6.7	7.2			7.4	9.1	9.3	8.6	8.1	7.4	
Scenario with key variables at their historical averages 5/								**73.0**	**60.1**	**47.7**	**36.5**	**26.0**	**16.3**	**-9.5**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	1.2	7.3	7.5	5.0	6.0	6.9	3.1	4.7	4.8	4.8	5.8	5.2	5.7	
GDP deflator in US dollars (change in percent)	-14.6	19.7	18.2	3.1	4.0	14.9	13.4	-6.4	1.8	5.7	5.7	5.7	5.8	
Nominal external interest rate (in percent)	2.3	3.4	4.4	4.6	3.1	4.7	3.7	2.9	2.6	2.4	2.2	2.1	2.0	
Growth of exports (US dollar terms, in percent)	-37.0	36.4	36.7	2.5	-3.4	22.9	27.5	2.6	-1.9	1.5	5.3	4.2	5.8	
Growth of imports (US dollar terms, in percent)	-21.3	13.5	16.0	20.0	0.5	18.1	19.1	2.3	4.0	4.7	5.1	5.3	5.2	
Current account balance, excluding interest payments	-1.4	3.6	8.2	3.3	1.9	2.5	4.5	2.5	1.1	0.6	0.9	1.0	1.3	
Net non-debt creating capital inflows	8.8	2.6	4.6	5.6	3.5	7.1	3.5	3.6	3.4	3.1	2.8	2.5	2.2	

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).

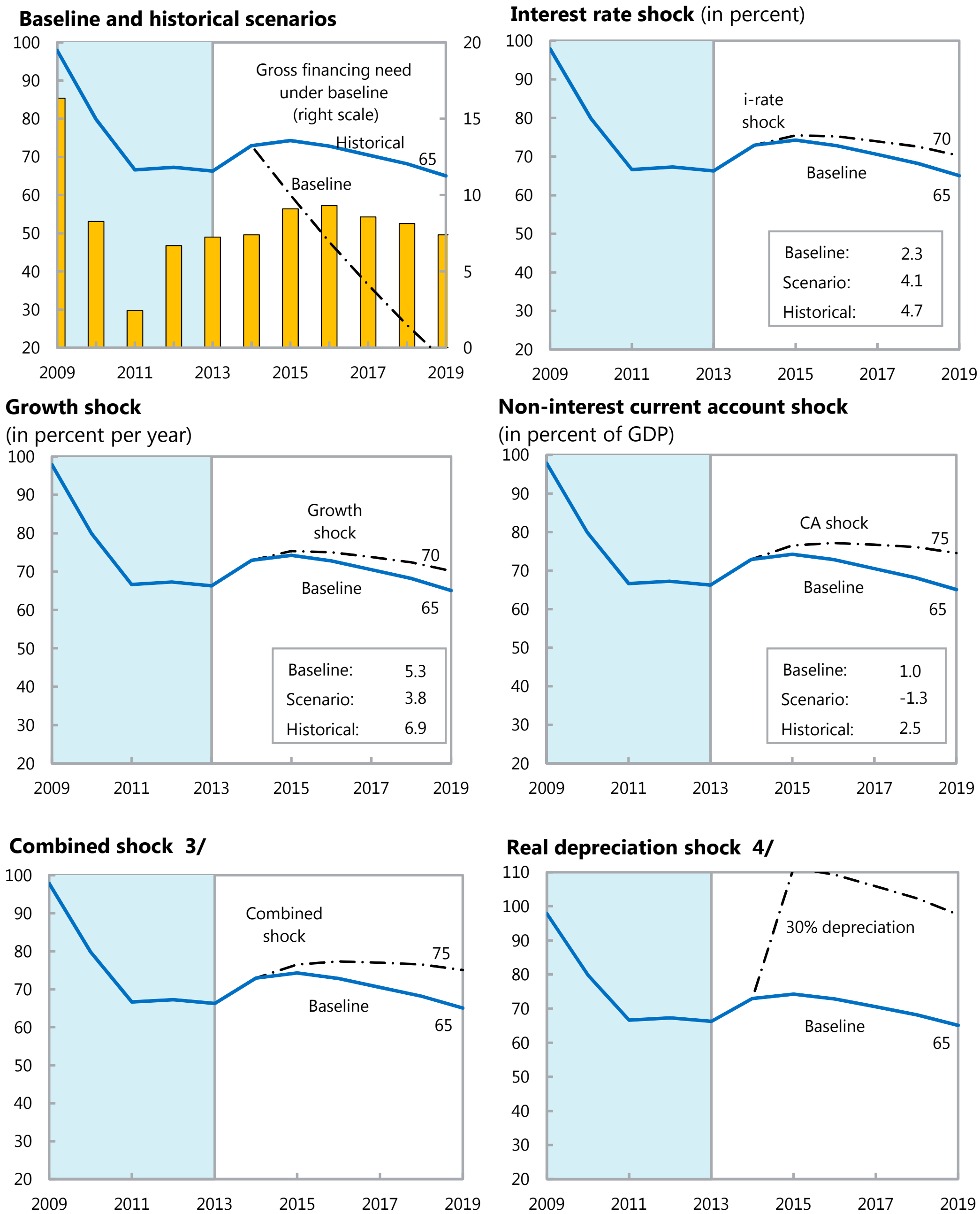
3/ For projection, line includes the impact of price and exchange rate changes.

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.

Kazakhstan: External Debt Sustainability: Bound Tests 1/ 2/
(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2015.

INTERNATIONAL MONETARY FUND

June 20, 2014

REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND

(As of June 11, 2014)

Membership status

Joined: 07/15/92; Accepted Article VIII, Sections 2, 3, and 4 in 1996 and maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions. The de jure exchange rate arrangement is a managed float, while the de facto arrangement is classified as stabilized.

General resources account

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

SDR department

	SDR million	Percent allocation
Net cumulative allocation	343.65	100.00
Holdings	348.31	101.36

Outstanding purchases and loans

None

Latest financial arrangements

In millions of SDR

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

Projected payments to Fund

None

Safeguards assessments

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

Exchange rate arrangements

The currency of Kazakhstan is the tenge, which was introduced in November 1993. The official exchange rate is determined on the basis of foreign exchange auctions that are held daily. Auctions are held for U.S. dollars, euros, and Russian rubles, and official rates are quoted for over 30 other currencies on the basis of cross-rates. From late 1999 to October 2007, the exchange rate regime was a managed float with no preannounced path. From October 2007 the tenge was maintained within a narrow range against the U.S. dollar. In February 2009, the tenge was devalued by 18 percent against the US dollar, and a trading band of T150/USD +/- 3 percent was established. In February 2010, the trading band was widened and set at an asymmetric T150/USD +10/-15 percent. In February 2011, the trading band was officially abolished, and the de jure exchange rate arrangement was changed from a pegged exchange rate within horizontal bands to a managed float. Between September 2013 and February 2014, the tenge was managed within an unofficial 2 percent band against a basket of currencies comprised of the U.S. dollar (70 percent), the euro (20 percent), and the Russian ruble (10 percent). Since February 2014 (following an 18 percent devaluation against the U.S. dollar), the tenge has stabilized within a trading band of T185/USD +/- 3 tenge/USD. The de facto exchange rate has been reclassified from a crawl-like to a stabilized arrangement, effective February 11, 2014. The NBK may conduct foreign exchange operations both on the regulated Kazakhstan Stock Exchange (KASE) and in the interbank foreign exchange markets. The NBK intervenes on its own behalf directly with market participants based on their quotes and does not publish information on its interventions. The exchange system is free from restrictions on payments and transfers for current international transactions.

Article IV Consultation

Kazakhstan is on the standard 12-month consultation cycle, in accordance with the Decision on Article IV Consultation Cycles (Decision No. 14747–(10/96) (9/28/2010). The last consultation was concluded on August 2, 2013 (see IMF Country Report No. 13/290).

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. FSAP Updates were conducted in February 2004, March 2008, and February 2014. 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 (IMF Country Report No. 08/56, Annex V).

AML/CFT assessment

Kazakhstan's anti-money laundering and combating the financing of terrorism (AML/CFT) framework was recently assessed against the AML/CFT standard, the Financial Action Task Force (FATF) 40+9 Recommendations. The evaluation was conducted by the Eurasian Group on money laundering and financing of terrorism (EAG), the FATF-style regional body of which Kazakhstan is a member, and the final mutual evaluation report was adopted in June 2011. The report indicates that the main sources of criminal proceeds in Kazakhstan are crimes related to fraud and abuse of public office. The evaluators found that Kazakhstan had a relatively comprehensive AML/CFT framework in place, but that significant deficiencies nevertheless remained, notably with respect to customer due diligence measures and the reporting of suspicious transactions. Kazakhstan is tentatively scheduled to undergo its next AML/CFT assessment by the EAG in April 2017.

Technical Assistance

Kazakhstan has received technical assistance and training by the Fund in virtually every area of economic policy, including through over 90 technical assistance missions provided during 1993–2014 by FAD, LEG, MCM, STA, and the IMF Institute. In addition to short-term missions, the Fund has provided resident advisors to the National Bank of Kazakhstan, to the Agency of Statistics of the Republic of Kazakhstan, to the ministry of finance, and a peripatetic expert to the Financial Supervision Agency. Other international agencies and governments, including the World Bank, EU TACIS, EBRD, UNDP, and OECD, also are providing a wide variety of technical assistance. The following list summarizes the technical assistance provided by the Fund to Kazakhstan since 2003.

Monetary and Capital Markets Department

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

1. September 2004: Bringing banking prudential regulation up to EU standards.
2. September 2004: Implementing inflation targeting: next steps.
3. November 2007: Strengthening banking supervision and risk assessment.
4. 2009–12: Developing banking sector stress testing. The initial mission in January 2009 was followed up by a number of visits by a peripatetic expert to the FSA over the course of 2009–12.
5. November 2010: Reducing nonperforming loans in the banking system (joint with LEG).
6. February 2013–14: Resolving banking system problem assets. Posting of a long-term expert (one year) to the Fund for Problem Loans, financed by the Japanese government (JSA).

Fiscal Affairs Department

The Fiscal Affairs Department has given advice to Kazakhstan in the areas of tax and expenditure administration, the establishment of a treasury system, public financial management, accounting reform, IT system functionality, and the introduction of a social safety net.

1. April 2003: Customs administration.
2. September 2004: Treasury reform process.
3. 2011–14: Technical assistance provided by IMF regional advisor on Public Financial Management.
4. May 2014: HQ-led PFM mission on fiscal risk management, IPSAS and accrual accounting.

Statistics

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

1. January 2006: Real sector and balance of payments statistics.
2. August 2006: Real sector statistics.
3. December 2006: ROSC Update mission (and DQAF).
4. April 2008: GFSM 2001 implementation.
5. January 2009: Monetary statistics.
6. April 2011: BOP statistics.
7. July 2013: Government Finance Statistics.

Legal Department

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

IMF Institute

Kazakhstani officials have participated in courses in Washington and at the Vienna Institute in the areas of macroeconomic management, expenditure control, financial programming, taxation, statistics, and others. In addition, the IMF Institute has conducted courses in the region. Seminars and training sessions have also been conducted by MCM and STA technical assistance missions.

Resident representative

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

RELATIONS WITH THE WORLD BANK

(As of May 15, 2014)

Kazakhstan became a member of the International Bank for Reconstruction and Development (IBRD) and the International Development Association (IDA) in July 1992 and a member of the International Finance Corporation (IFC) in September 1993. In 2010 Kazakhstan became an IDA donor under the IDA16 replenishment. Kazakhstan is the largest client of the IFC in Central Asia.

IBRD in Kazakhstan

The Bank's lending operations in Kazakhstan are aligned with the Country Partnership Strategy (CPS) for FY12–17, endorsed by the Board in May 2012. As of May 2014, the IBRD loan program comprised thirteen projects with a total commitment of US$3.7 billion, of which US$1.8 billion has been disbursed. While 90 percent of the commitments are concentrated in the on-going South-West roads project and the East-West roads project, the portfolio remains diverse with two-thirds of the projects focused on institutional building. The other eleven projects are: forest protection and reforestation, technology commercialization, customs development, tax administration reform, health sector technology transfer and institutional reform, technical and vocational education modernization, statistical capacity building, Ust-Kamenogorsk environmental remediation, Alma electricity transmission, second irrigation and drainage (signed in April 2014), and justice sector institutional strengthening (signed in April 2014) .

The Bank also provides extensive advisory and analytical services (AAA) to the Government through the Joint Economic Research Program (JERP). The JERP is instrumental in providing policy analysis, strategic planning expertise, and good practice options to assist the Government with the reform agenda in the field of economic and social development and the institutional capacity of the Government to conduct economic and sectoral work. The JERP for FY14 amounted to over US$4.5 million and comprised 26 largely interrelated and programmatic activities focusing on the Government's strategic priorities in competitiveness agenda (including counter-cyclical macroeconomic policy options, trade integration, investment climate improvement, management of innovations, and insolvency regime); public finance management and public services (including introduction of the result oriented budget, tax policy improvement, and reforming of housing and communal services); social modernization (including development of the framework for better human capital outcomes, improvement of social safety network, and bringing the quality education to international standards); and sustainable development (improving industrial competitiveness for greener production and disaster risk management).

IFC in Kazakhstan

In the context of the CPS for FY12–17, IFC's role is to contribute to the government's development plans by supporting the private sector to advance economic diversification and growth agenda, particularly in the non-extractive sectors and frontier regions. In the short term IFC is focusing on strengthening the financial sector, both in the context of the post-crisis recovery and as a prerequisite to pursue the diversification agenda, and infrastructure development, including through

Public Private Partnerships (PPPs). In the medium term more efforts will be dedicated to the establishment of best practices in international banking, improvement of the corporate governance and the regulatory environment, SMEs development, increasing investments in value-added manufacturing, agribusiness and services, and supporting the energy efficiency.

IFC’s investment program has been expanding in the context of the crisis response. It grew tenfold between FY05 and FY08 (to US$110 million) and nearly doubled again in FY09. In FY10, IFC invested a record US$336 million in five projects in the financial and agribusiness sectors, with vast majority provided to commercial banks. Post-crisis IFC’s investment level has moderated and averaged at about US$100 million per year in FY11–13. As of May 2014, Kazakhstan remains IFC's largest client in Central Asia with total committed portfolio of US$246 million, of which US$245 million is outstanding. The investment portfolio is mostly concentrated in the financial sector, infrastructure, general manufacturing and consumer services, although IFC has begun making investments in the agribusiness sector as well.

RELATIONS WITH THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

(As of July 5, 2013)

The European Bank for Reconstruction and Development (EBRD) is the largest investor outside the oil and gas sector in Kazakhstan and in 2013 will celebrate its twentieth anniversary in the country. As of 30 June 2013, the EBRD's total investments in Kazakhstan, including co-financing, stood at €12 billion, with the Bank's own share totaling €4.8 billion (both these figures include approximately €1.3 billion in cumulative Trade Facilitation Program turnover). As of 30 June 2013, the EBRD's portfolio in Kazakhstan amounted to €1.9 billion. During 2012, the EBRD signed 18 projects, including regional ones, for a total amount of EBRD finance €374 million. During the first half of 2013, the EBRD signed seven operations with a total annual bank investment of €155 million.

In its country strategy, approved in 2010, the EBRD aims to assist Kazakhstan in promoting economic diversification and moving towards a more sustainable model of financial development. The EBRD's main operational objectives for 2013 are:

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

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

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

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

Sector Business Group		**Commitments**	**Portfolio**
Energy	Private	257	182
	State	361	264
Financial Institutions	Private	2,098*	304
	State	0	0
Industry, Commerce, and Agribusiness	Private	895	439
	State	46	0
Infrastructure	Private	78	77
	State	853	604
TOTAL		**€4.8 billion**	**€1.9 billion**

Note: * Including €1.3 billion in cumulative Trade Facilitation Program lines.

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of 20 May 2014)

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

As of 15 May 2014, cumulative public sector loan commitments to Kazakhstan amounted to almost US$3 billion, of which about US$1.8 billion has been disbursed. Commitments cover 25 public sector loan operations in agriculture and natural resources, education, finance, transport and communications, water supply and sanitation, irrigation, and small and medium-sized enterprises (SMEs). These loans were complemented with 68 technical assistance (TA) projects amounting to about US$31.1 million. Kazakhstan is eligible for the ordinary capital resources (OCR) only. Kazakhstan became a donor to the Asian Development Fund, ADB's concessional financing resource, with a US$5.49 million contribution in 2012.

ADB's current country partnership strategy (CPS) to guide operations during 2012–16 aims to support economic diversification and increased competitiveness. The CPS envisages to support regional cooperation, private sector development and operations, inclusive growth, and knowledge solutions. ADB's focus is in the transport, finance, urban, and energy sectors. As knowledge solutions are central to the new CPS, the government and ADB established a joint Knowledge and Experience Exchange Program (KEEP) in 2013. The KEEP commits the parties to a 50 percent cost-sharing arrangement with a total financing of US$2.5 million from 2013–15.

In the transport sector, ADB has been supporting Kazakhstan in realizing its transit potential and integration into the global transport network via two multitranche financing facilities (MFFs) totaling US$1.5 billion to improve road networks in two regions of Kazakhstan (Zhambyl and Mangystau), along the CAREC Transport Corridors 1 and 2. Six projects are under implementation with some sections completed and in use. Once fully completed, the projects will contribute to increased external trade and economic development. In 2010, ADB approved a US$500 million MFF for the SME Investment Program to enhance efficiency and competitiveness of the financial sector and SMEs. Tranche 1 in the amount of US$150 million was provided to the DAMU Entrepreneurship Development Fund for onlending to three participating financial institutions (PFIs), and was fully disbursed in April 2013. A subsequent tranche 2 amounting to US$150 million was approved in December 2013. Currency and interest rate risks are mitigated through local currency-denominated, fixed-rate loans.

In the energy sector, ADB is focusing on energy efficiency, and providing technical assistance on modernization of district heating networks and on institutional capacity development.

Knowledge partnerships were established through two major studies (one on Kazakhstan's industrial policy, and the other on knowledge-based economy) to promote a constructive dialogue among high-level policy makers and share lessons and best practices of other developing member countries and advanced economies, with the aim of exploring appropriate future policy options and to improve planning strategies. At the sector level, advisory support is being provided for financing urban infrastructure in secondary cities.

Private sector operations of ADB in Kazakhstan began in 2006, with private sector financing to six entities in the financial and agribusiness sectors amounting to US$455.2 million approved to-date. Near-term ADB private sector financing prospects are in private infrastructure and energy sectors.

Kazakhstan was one of the four founding partners of the CAREC Program in 1997 (together with the People's Republic of China, the Kyrgyz Republic, and Uzbekistan). Since then, six other countries have joined the partnership, and CAREC-related investments in the partner countries have totaled US$22.4 billion, over the period 2001–13. Four of the six CAREC road and rail corridors traverse Kazakhstan, and developing these Central Asian corridors is a priority for achieving CAREC's goal of land bridges connecting Europe and Asia. In October 2013, Kazakhstan hosted the twelfth CAREC Ministerial Conference in Astana which brought together the ministers of the 10 member countries to discuss the progress of CAREC. In May 2014, Kazakhstan hosted the ADB Annual Meeting of the Board of Governors. About 3,000 participants attended the event and discussed connectivity, innovation, and the need to keep up with the demands of a changing Asia and Pacific.

STATISTICAL ISSUES

(As of May 27, 2014)

I. Assessment of Data Adequacy for Surveillance
General: Data provision has some shortcomings, but is broadly adequate for surveillance. The most affected areas are balance of payments statistics, monetary statistics, and coverage of fiscal statistics as well as national accounts.
Real Sector: The quality of GDP statistics is affected by the limited coverage of small businesses in selected activities such as retail and construction. Some progress has been made in compiling and reporting GDP by final expenditure consistent with output-based measures. The quality of consumer price statistics is affected by occasional use of administrative price controls. Typically, for each good or service administrative controls are imposed on the variety that is included in the CPI basket. Since producers/importers are not compensated by the government for any losses due to the price controls, they may switch to noncontrolled varieties and/or compensate by increasing the prices of non-controlled varieties.
Government finance statistics: Progress has been made in the classification of the fiscal accounts consistent with the Fund's Government Finance Statistics Manual 2001 (GFSM 2001). However, statistics on the enlarged government (including public enterprises) is not available.
Monetary statistics: The monetary statistics based on the Standardized Report Forms (SRFs) complied by the central bank have had a few inconsistencies.
Balance of payments: The authorities have transitioned to the compilation of balance of payments in concordance with the sixth edition of Balance of Payments Statistics Manual (BPM6) starting 2013. Deficiencies remain in foreign direct investment statistics as local branch offices of foreign companies operating in the construction sector are considered nonresident entities. This leads to discrepancies with national accounts statistics where this activity is treated as domestic production. In external debt statistics there are discrepancies between data compiled by different governmental agencies owing to methodological differences. Statistical treatment of trade within the customs union is not accurate, which has contributed to large and increasing errors and omissions. The authorities are cooperating with relevant agencies in the customs union partner countries to resolve these problems.

II. Data Standards and Quality	
Participant in the Special Data Dissemination System (SDDS) since March 2003.	Data ROSC published in 2008.

Kazakhstan: Table of Common Indicators Required for Surveillance

(As of May 27, 2014)

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of publication[7]	Memo Items	
						Data Quality-Methodological Soundness[8]	Data Quality-Accuracy and Reliability[9]
Exchange Rates	05/27/14	05/27/14	D	D	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	04/30/14	05/07/14	M	M	M		
Reserve/Base Money	04/30/14	05/07/14	M	M	M	O, O, LO, LO	O, O, O, O, O
Broad Money	04/30/14	05/07/14	M	M	M		
Central Bank Balance Sheet	04/30/14	05/07/14	M	M	M		
Consolidated Balance Sheet of the Banking System	04/30/14	05/07/14	M	I	I		
Interest Rates[2]	04/30/14	05/07/14	I	I	I		
Consumer Price Index	04/30/14	05/07/14	M	M	M	O, O, O, O	O, O, LO, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3]—General Government[4]	04/30/14	05/07/14	M	M	M	O, LO, LO, LO	O, O, O, O, LNO
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	04/30/14	05/07/14	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Q1/2014	04/30/14	Q	Q	Q		
External Current Account Balance	Q1/2014	04/30/14	Q	Q	Q	LO, O, O, O	O, O, O, O ,O
Exports and Imports of Goods and Services	Q1/2014	04/30/14	Q	Q	Q		
GDP/GNP	Q1/2014	04/30/14	Q	Q	Q	O, O, O, LO	LO, O, LO, O, O
Gross External Debt	Q1/2014	04/30/14	Q	Q	Q		
International Investment Position[6]	Q1/2014	04/30/14	Q	Q	Q		

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.
[2] Both market-based and officially-determined, including discounts rates, money market rates, rates on treasury bills, notes, and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[7] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[8] Reflects the assessment provided in the update of the data ROSC published in February 2008, based on the findings of the mission that took place during November 29–December 13, 2006 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O); largely observed (LO); largely not observed (LNO); not observed (NO); and not available (NA).
[9] Same as footnote 8, except referring to international standards concerning (respectively) source data, assessment of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

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IMF Executive Board Concludes 2014 Article IV Consultation with the Republic of Kazakhstan

On July 21, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Kazakhstan.

Growth slowed from 6 percent in 2013 to 3.8 percent year-on-year in the first quarter of 2014. The slowdown reflects weaker external demand, especially from China and Russia, the confidence effects of regional tensions and the February devaluation of the tenge on domestic demand, and slower production in the mining sector. Inflation, on the other hand, has risen, fueled by the devaluation and amid heightened external uncertainties, reaching 7 percent year-on-year in June compared with 4.8 percent at end-2013. Fiscal balances improved significantly last year and the national oil fund assets reached 31 percent of GDP. The banking sector recovery continues.

Real GDP growth in 2014 is projected at 4.8 percent, one percentage point below earlier projections, despite the expected positive contributions from the fiscal stimulus. At the same time, headline inflation is expected to further increase to around 9 percent in 2014, although the authorities are determined to maintain it within the 6–8 percent target range. Medium-term growth prospects hinge on the projected rise in oil output. Risks to the outlook are predominantly on the downside, reflecting possible additional unfavorable developments in Russia and Ukraine, and a prolonged slowdown in emerging markets.

The authorities have taken more aggressive steps to reduce the large stock of Non Performing Loans (NPLs), and have committed to enhancing the monetary and fiscal policy frameworks. They have also strengthened their commitment to speeding up structural reforms and in this context deepened their cooperation with the multilateral development institutions. The newly launched Eurasian Economic Union, with Belarus, Kazakhstan, and Russia as members, will

[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.

formally come into effect in January 2015, while accession to the World Trade Organization (WTO) is expected later this year.

Executive Board Assessment[2]

Directors commended Kazakhstan's solid economic performance in recent years. However, given the recent growth slowdown and rise in inflation amid heightened external uncertainties, Directors stressed the importance of strengthening the macroeconomic policy frameworks to improve the economy's resilience and long-term prospects.

Directors considered the near-term fiscal policy stance to be appropriately supportive of growth, but saw a need to better ensure the quality and transparency of planned increases in spending. They also welcomed the authorities' commitment to reducing the non-oil deficit to its sustainable level by 2018. More broadly, Directors recommended strengthening fiscal policymaking by reducing off-budget operations and further integrating the annual budget and medium-term fiscal plans into the broader macroeconomic framework. In this context, Directors stressed the importance of prudent and transparent management of resource wealth to safeguard the integrity of the budget process and intergenerational equity.

Directors emphasized the need to stand ready to tighten monetary policy while improving the monetary policy framework and operations. They suggested speeding up the introduction of a new policy rate instrument supported by open market operations, which would aid liquidity management and open the door for a more flexible management of the exchange rate. They also noted that enhancing communications to anchor expectations and gradually widening the exchange rate band would facilitate adoption of inflation targeting over the medium term. Directors took note of the staff assessment that Kazakhstan's real effective exchange rate appeared to be only moderately overvalued at end-2013.

Directors encouraged the authorities to fully implement the recommendations from the recent Financial Sector Assessment Program. They welcomed the authorities' more aggressive efforts to reduce the large stock of nonperforming loans, and highlighted the urgency of supervisory actions to enforce nonperforming loan ceilings and ensure adequate provisions. Directors also underscored the importance of an asset quality review by an independent international entity ahead of the merger of two systemic financial institutions. They also recommended further strengthening risk-based supervisory functions and closely monitoring foreign currency risks associated with increased dollarization.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors commended the authorities' commitment to an ambitious structural reform agenda that would help Kazakhstan become a dynamic emerging market economy and ensure sustainable and inclusive growth. They agreed that priority should be given to strengthening human capital and institutions and lowering the role of the state in the economy. Directors encouraged the authorities to intensify their efforts to reduce labor market skill mismatches, address barriers to starting new businesses, and enforce contracts. Avoiding price controls will also be important. Directors welcomed the authorities' increased cooperation with multilateral institutions to advance structural reforms.

Kazakhstan: Selected Economic Indicators, 2011–15

				Projections 1/	
	2011	2012	2013	2014	2015
Real economy			(Changes in percent)		
Real GDP	7.5	5.0	6.0	4.7	4.8
CPI (p.a.)	8.3	5.1	5.8	8.9	6.6
Public finance			(In percent of GDP)		
Government revenue and grants	27.7	26.9	26.1	26.4	24.6
Government expenditures (and net lending)	21.8	22.4	20.9	22.1	20.4
General government balance 2/	5.9	4.5	5.2	4.3	4.1
General government non-oil balance	-8.8	-8.9	-7.0	-9.0	-8.1
General government debt (end-of-period) 3/	10.4	12.4	13.3	13.6	14.3
Money and credit			(Changes in percent)		
Base money	10.3	1.9	-2.2	12.9	8.8
Broad money	15.0	7.9	10.3	16.8	11.3
Credit to the private sector 4/	14.3	11.6	12.7	16.9	11.3
NBK refinance rate (end-of-period; percent)	7.5	5.5	5.5	…	…
Balance of payments 5/			(In percent of GDP)		
Trade balance	23.8	18.7	15.0	15.7	13.2
Current account balance	5.4	0.5	-0.1	0.6	-0.6
External debt	66.6	67.3	66.3	73.0	74.3
Excluding intra-company loans	33.4	34.1	33.9	35.7	36.8
Gross international reserves 6/					
In billions of U.S. dollars, end-of-period	29.3	28.3	24.7	28.4	29.4
In months of next year's imports of goods and nonfactors services	5.7	5.5	4.7	5.2	5.1
Exchange rate			(Changes in percent)		
Tenge vs. U.S. dollar (end-of-period) 7/	0.4	1.5	2.2	…	…
Real effective exchange rate (p.a.) 8/	0.2	3.6	1.5	…	…

Sources: Kazakhstani authorities; IMF staff estimates and projections.
1/ Staff projections.
2/ Privatization revenues are treated as a financing item.
3/ Gross domestic and external government debt, including government guaranteed debt.
4/ Private sector includes nonbank financial institutions, public and private nonfinancial institutions, non-profit institutions, and households.
5/ The GDP in U.S. dollars is calculated using the period average exchange rate.
6/ Does not include NFRK.
7/ A positive sign indicates depreciation.
8/ IMF staff estimates.