IMF Staff Visit to Kazakhstan
July 9-16, 2019

An IMF staff team visited Kazakhstan during July 9-16 to review developments, prospects, risks, and policies. Discussions focused on the growth and inflation outlook, monetary policy and operations, the financial sector, the fiscal framework, and structural reforms. The team thanks the authorities and other counterparts for excellent cooperation and hospitality.

Developments and outlook

1. Growth remained robust in the first half of 2019, despite a slowdown in oil production driven by capital repairs in major fields. A strong pick-up of activity was recorded in manufacturing, services, and construction. Inflation stood at 5.4 percent in June, higher than in previous months, but still within the National Bank's (NBK) 4-6 percent target band. Higher exports and lower FDI-related income payments supported the external current account, which posted a Q1 surplus. Outflows related to government and quasi-sovereign debt repayments and portfolio investments caused NBK reserves to decline in Q1; they recovered partially in Q2. In the absence of shocks, the team projects growth of 3.8 percent in 2019 and slightly higher next year, with recovery in the oil sector. Risks to the outlook stem from commodity prices and geopolitical and trade tensions involving major trading partners.

Monetary and exchange rate (ER) policies

2. The tenge has been broadly stable, supported by favorable external conditions, although there have been occasional short-term pressures. The NBK cut the policy rate in April and left it unchanged in June and July. Credit to the economy has continued to decline, reflecting loan write-offs and weak demand by corporate borrowers. Household credit has grown steadily. Deposit auctions were introduced to replace 7-day NBK notes; other changes have aimed to increase the effectiveness of monetary policy, including increasing the average maturity of NBK notes and longer-end yields and simplifying reserve requirements.

3. Price stability should remain the main focus of monetary policy, especially in the face of rising demand pressures fueled by recent increases of wages and social payments. Further efforts are needed to improve the effectiveness of monetary policy transmission, including phasing out distortionary state financing programs. Subsidized lending support to SMEs and households should come from the budget and not the NBK or pension fund (UAPF), and in the view of the Fund staff, should be scaled back. Adoption of a new program to provide debt relief to disadvantaged borrowers could be beneficial but may also lead to demands for further support. The NBK is rightly monitoring the growth of retail lending and assessing possible prudential measures.

4. Continued commitment to inflation targeting and a flexible ER is key. The period of relative ER stability, combined with movements in NBK reserves and strengthening of the ruble against the dollar, may have contributed to perceptions that the NBK is targeting a specific ER. The NBK should reaffirm the flexibility of the tenge and clearly separate policy interventions in the foreign exchange market from operations on behalf of the National Fund (NFRK) or the UAPF. These operations should be conducted via transparent rules and reported—along with gross intervention data—to limit risks of being perceived as a way to manage the ER. The NBK and IMF will collaborate through technical assistance (TA) later this summer on the inflation-targeting regime (analytical capacity and communications).

Financial sector

5. Despite state support, the banking sector remains weak, with high levels of bad loans. The plan to conduct an external asset quality review (AQR) of medium and large banks is commendable and should set the basis for the long-awaited strengthening of the sector. Clear communications will be needed, along with comprehensive measures to ensure strong balance sheets and profitable and sustainable operations. The AQR may reveal the need for additional capital; any public support should be provided only to systemically-important and viable banks, subject to contributions from existing shareholders, and in the view of the IMF staff, from the budget and not the NBK. The team notes that recent steps—especially revaluation of acquired assets—may provide an impulse to step up sales by the state Problem Loan Fund.

6. The plan to reestablish a separate financial supervisor in Almaty, with the NBK moving to Nur-Sultan, carries risks that should be carefully managed, including possible gaps during the transition and insufficient bank oversight ("regulatory capture") and coordination with the NBK and government. These risks have been addressed in legislative changes creating the new agency and should be addressed in practice as establishment of the agency proceeds. The authorities have embarked on an ambitious agenda over the next several months with the AQR, the relocation of the NBK, and establishment of the new supervisory agency. Plans and actions should be well communicated to the public and markets, and the authorities are encouraged to request Fund TA where needed, as well as a new review under the IMF-World Bank Financial Sector Assessment Program.

Fiscal policy

7. Near-term priorities rightly focus on inclusive growth policies, especially enhanced social support and regional and rural development. Initiatives in the revised 2019 budget include wage increases for lower-paid public employees, housing and other financial support to vulnerable households, debt relief for low-income borrowers, and regional and rural infrastructure investment. Despite higher non-oil revenues from improved administration, these initiatives will boost the deficit in 2019 and over the medium term and require additional financing involving higher NFRK transfers. While the team sees merit in the authorities' increase of support to vulnerable groups, it does not favor the higher non-oil deficit, given the importance of continuing consolidation and further building of buffers.

8. The team supports the authorities' plans to reduce the non-oil deficit going forward. Fiscal consolidation is expected to resume starting 2020 with the goal to reduce non-oil deficit to 5.4 percent of GDP in 2022 from over 8 percent of GDP in 2019 (authorities' presentation). Additional revenues are needed to support consolidation and additional investment and social outlays. Gains are planned to come mainly from improved revenue administration; the Fund will provide TA later this year. The team continues to see scope for tax policy changes to support higher non-oil revenues and improve equity, including VAT improvements and progressive income and property taxes. In addition, plans to assess the coverage, overlap, and effectiveness of spending programs with streamlining where needed are welcome.

9. The authorities rightly recognize the importance of fiscal sustainability and insulating public finances from oil revenue volatility and dependency and are considering ways to strengthen the fiscal framework. The team supports efforts to enhance analytical capacity, the quality and coverage of the fiscal accounts, and fiscal rules, including to guide the use of the NFRK resources, and will work closely with the Ministry of Finance and Ministry of National Economy. Continued efforts are needed to strengthen management of fiscal risks, especially given large quasi-sovereign borrowing and expansion of public-private partnerships (PPPs).

Structural reforms

10. Acceleration of structural reforms is critical for diversification and sustainable, inclusive growth. The team supports priority areas identified during the discussions: increasing competition, productivity, and development of non-extractive sectors, greater regional integration, improving business conditions to encourage entrepreneurship and investment, enhancing the efficiency of public administration and governance, adjusting revenue-sharing arrangements with regional and local governments, and improving health and education policies. Efforts are needed to strengthen protection of property rights and bankruptcy procedures. While small-scale privatization is progressing, a push is needed to advance blue-chip IPOs in oil and gas, telecoms, aviation, energy, and railways.

Concluding remarks

11. The team strongly supports the authorities' efforts to advance reforms and tackle inequality. Social-support initiatives in the revised 2019 budget will provide temporary relief, but for a durable, sustained impact underlying structural constraints that limit emergence of a thriving private sector need to be addressed, particularly in the banking sector. These actions should be complemented by ongoing efforts to strengthen the inflation-targeting regime for monetary policy and enhancement of fiscal framework. Progress is particularly important given conclusion of elections and the favorable external environment. The IMF stands ready to provide continuing policy advice and technical assistance.

12. The team proposes that the 2019 Article IV consultations be held in late October-early November, with a focus on the fiscal framework, tax policy, financial sector

regulation and supervision, infrastructure investment, and diversification. Discussions will also cover governance and corruption vulnerabilities, in line with the IMF's new initiative.

Kazakhstan: Selected Economic Indicators, 2017–21

	2017	2018	2019 (proj.)	2020 (proj.)	2021 (proj.)
Output					
Real GDP growth (%)	4.1	4.1	3.8	3.9	3.7
Real oil	8.7	8.4	-1.4	1.1	1.1
Real non-oil	2.7	2.7	5.6	4.8	4.5
Crude oil and gas condensate production (million tons)	86	90	89	90	91
Employment					
Unemployment (%)	4.9	4.9	4.9	4.9	4.9
Prices					
Inflation (%)	7.3	5.3	5.7	4.8	4.7
General government finances 1/					
Revenue (% GDP)	20.3	22.2	21.3	21.4	21.4
Of which: oil revenue	6.1	7.7	7.8	7.3	6.9
Expenditures (% GDP)	24.7	19.6	20.7	21.1	21.3
Fiscal balance (% GDP)	-4.4	2.6	0.6	0.3	0.1
Non-oil fiscal balance (% GDP)	-10.5	-5.0	-7.2	-7.0	-6.8
Gross public debt (% GDP)	20.3	21.6	21.3	21.5	21.9
Money and credit					
Broad money (% change)	-1.7	7.0	3.9	6.8	6.4
Credit to the private sector (% GDP)	26.5	23.5	21.5	21.6	22.0
NBK policy rate (%, eop)	10.3	9.3	...	...	...
Balance of payments					
Current account (% GDP)	-3.1	0.0	0.0	0.2	0.0
Net foreign direct investments (% GDP)	-2.3	-2.9	-2.8	-2.8	-2.8
NBK reserves (in months of next year's imports of G&S)	8.2	7.9	7.3	7.3	7.3
NFRK assets (in months of next year's imports of G&S)	15.4	14.7	15.3	15.5	15.7
External debt (% GDP)	102.7	93.1	91.9	85.7	80.4
Exchange rate					
Exchange rate (y-o-y percent chage; Tenge per U.S. dollar; eop)	-0.3	15.6	...	...	...

Sources: Kazakhstani authorities and Fund staff estimates and projections.

1/ The fiscal accounts in 2017 include a state support to the banking sector of 4 percent of GDP.