INTERNATIONAL MONETARY FUND

Kazakhstan: Staff Concluding Statement of the 2022 Article IV Mission

October 10, 2022

A Concluding Statement describes the preliminary findings of IMF staff at the end of an official staff visit (or 'mission'), in most cases to a member country. Missions are undertaken as part of regular (usually annual) consultations under Article IV of the IMF's Articles of Agreement, in the context of a request to use IMF resources (borrow from the IMF), as part of discussions of staff monitored programs, or as part of other staff monitoring of economic developments.

The authorities have consented to the publication of this statement. The views expressed in this statement are those of the IMF staff and do not necessarily represent the views of the IMF's Executive Board. Based on the preliminary findings of this mission, staff will prepare a report that, subject to management approval, will be presented to the IMF Executive Board for discussion and decision.

An International Monetary Fund (IMF) mission led by Mr. Nicolas Blancher conducted discussions for the 2022 Article IV consultation during September 22-October 5 in Almaty and Astana. At the end of the visit, the mission issued the following statement, which summarizes its main conclusions and recommendations:

Repeated shocks this year underscore the importance of well-calibrated macroeconomic policies and structural transformation. Thus far, adverse spillovers from the war in Ukraine have been limited. However, inflation is not contained and threatens macroeconomic stability and hurts the most vulnerable. In this context, further monetary policy tightening is needed to protect the poor, anchor inflation expectations, and preempt risks to monetary policy credibility and future economic growth. Close coordination with fiscal and financial sector policies and strong institutions in key policy areas are essential. Over the longer term, sustained, resilient and inclusive economic growth requires a renewed reform impetus. Building on the authorities' announcements this year, concrete measures are needed to reduce the size of the public sector while strengthening its efficiency and governance, and addressing corruption-related vulnerabilities. Other reforms to support private sector development and increase economic diversification should also continue.

Recent developments, outlook, and risks

1. As a consequence of a series of shocks, economic growth has slowed in 2022, while inflation accelerated further. GDP grew by 3.1 percent year-on-year through August, down from 4 percent in 2021. The slowdown reflects temporary disruptions in oil production. While Russia's war in Ukraine has had limited impact on output, its spillovers have exacerbated inflationary pressures. In September, inflation rose further to 17.7 percent, well above the 4–6 percent target range of the National Bank of Kazakhstan (NBK), driven by both external factors and domestic demand.

2. The authorities have taken various measures to preserve stability and support the economy. The NBK has raised the policy rate by 500 basis points since mid-2021 and intervened in the foreign exchange (FX) market to limit excessive exchange rate volatility. It also restricted exports of physical foreign currency cash and gold by households, while the government introduced a subsidy on tenge deposits to prevent a rise in dollarization. In the face of social demands and the outbreak of the war in Ukraine, initiatives announced by the President led to a revision of the 2022 budget, with increased public spending by about 3 percent of GDP, financed by higher oil revenues. To contain price pressures, the government put in place temporary export restrictions on several goods and extended fuel price freezes introduced in January.

3. Looking ahead, growth is projected to pick up but downside risks remain substantial. Growth is projected at between 2½ and 2.8 percent in 2022 and 4½ percent in 2023-24, and would then stabilize around 3.5 percent. Inflation would peak around 17 percent in early 2023 and remain above 6 percent until 2024. The current account would reach a surplus of about 3 percent of GDP in 2022 and then record modest deficits in the medium term, as oil prices moderate. However, aggravated spillovers from the war in Ukraine may lead to lower growth, higher inflation, and social tensions. Exports could be severely affected by a durable interruption of the Caspian Pipeline Consortium pipeline, while adverse global conditions could lower oil prices and raise borrowing costs. Global decarbonization makes Kazakhstan's reliance on fossil fuels a key long-term concern. On the upside, high commodity prices would support substantial fiscal and external buffers.

Monetary and exchange rate policy

4. Further monetary policy tightening is needed to preserve macroeconomic stability and protect the most vulnerable. Continued increases in inflation, especially food inflation, could severely affect the poor. A higher policy rate is necessary to anchor inflation expectations, bolster the credibility of monetary policy, and reduce the risk of adverse second-round effects arising from wage or exchange rate depreciation pressures. While this may incur short-term economic costs, letting inflation rise and having to intervene more drastically later would inflict higher costs on the economy and population. Reducing price controls and removing exports restrictions, as well as better coordination with fiscal policy, would also help support monetary policy transmission and control inflation.

5. The inflation targeting regime has served Kazakhstan well and efforts to consolidate the framework should continue. As the transition to fully-fledged inflation targeting progresses, the NBK's credibility needs to be further strengthened. The *Monetary Policy Strategy 2030* lays out comprehensive reforms addressing key obstacles. Phasing out non-core and quasi-fiscal mandates (e.g., subsidized lending) and protecting the NBK's independence remain essential priorities. As the NBK envisages launching the digital tenge pilot project later this year, a prudent approach is warranted. The digital tenge could bring both economic benefits, including for financial inclusion, and potential risks, which should be carefully managed.

Financial sector stability

6. **Banks have coped well with the fallout of international sanctions against Russia, but emerging risks require targeted prudential measures**. The authorities have actively cooperated with foreign regulatory bodies to help reduce the presence of subsidiaries of sanctioned Russian banks. Banks have also enhanced their regulatory compliance and maintained correspondent banking relationships. Overall, the banking system continues to benefit from high levels of capital, liquidity, and profitability, and deposit dollarization has further declined. Nonetheless, rapid retail lending growth has resulted in rising household indebtedness, and the authorities have started to address related pockets of vulnerability. In addition, potential risks from increased concentration and reduced competition following the exit of Russian subsidiaries should be closely monitored.

7. **Continued progress in strengthening risk-based bank supervision and the bank resolution framework will limit risks of bank distress.** The financial regulatory agency (ARDFM) has actively built capacity and introduced regular asset quality reviews and supervisory stress tests. The planned adoption of updated (IFRS-based) measures of non-performing loans will help assess bank soundness more accurately. In collaboration with the NBK, the ARDFM should also continue to implement compliance procedures to avoid secondary sanctions, and improve the bank resolution framework, building on the upcoming launch of a distressed asset market. The joint IMF/World Bank Financial Sector Assessment Program, expected in 2023 will be an opportunity to assess Kazakhstan's financial sector policy framework in depth.

Fiscal policy

8. **Fiscal consolidation should contribute to contain inflation while preserving priority social spending.** Despite a significant expansion of public spending, both the overall and non-oil fiscal deficits in 2022 are projected to decline thanks to strong revenue performance. The draft 2023 budget envisages a deceleration of spending growth as the new fiscal rules kick in, contributing to further reduction of the non-oil fiscal deficit. There is significant room to increase the quality of public spending, including by leveraging recent digitalization efforts to better target social expenditures toward those that are most vulnerable to high food prices, and to strengthen public investment management.

9. **The government's medium-term plan to reduce the fiscal deficit is appropriate, and tax reforms should play an important role**. Under the authorities' plan to reduce the non-oil deficit to 5 percent by 2030, fiscal space would remain ample, with low public debt and a positive net asset position of the public sector. However, achieving this goal requires a significant increase in non-oil revenues, through both stronger revenue administration and tax reforms, aiming to broaden the revenue base (e.g., by reducing corporate exemptions and taxing capital income), increase VAT rates, and introduce progressive personal income taxation. The upcoming revision of the tax code is an opportunity to introduce these changes and to simplify the tax system, which should facilitate voluntary compliance.

10. **The new fiscal rules can help achieve medium- to long-term fiscal objectives but a stronger institutional framework is needed**. The new set of rules implemented with the 2023-25 budget will support the objectives of fiscal consolidation and policy counter-cyclicality. To

ensure their effectiveness, key priorities now are to put in place tight monitoring and enforcement mechanisms, including the establishment of an independent monitoring entity, and proper escape clauses to limit the scope for discretionary spending (including transfers from the NFRK). More broadly, enhanced public financial management is needed, and in this regard, the introduction of statements on fiscal risks and long-term sustainability (with the 2023 budget) and the government's decision to conduct a Fiscal Transparency Evaluation are welcome.

Structural reforms

11. To meet Kazakhstan' 2030 climate policy commitments, the government needs to start implementing its climate strategy early on. The finalization of this strategy has been delayed. It should be finalized promptly to provide a clear roadmap, including intermediate targets and investment plans. Fiscal policy will have a key role in supporting economic decarbonization. In particular, reducing substantial energy subsidies and introducing carbon taxation should help finance the needed public investments and social expenditures during the transition. These measures should be phased in gradually, well-explained, and accompanied by targeted support to those most affected by energy price increases.

12. Recent reform announcements are an opportunity to accelerate the fight against corruption. Important steps for political modernization, judicial reform, and increasing the role of the civil society and media were announced by the President earlier this year. The authorities' anti-corruption strategy needs to be supported by further legal and institutional reforms. Rules on access to information and whistleblower protection should be upgraded. An effective asset disclosure system for public officials requires robust verification and sanctions frameworks and the publication of disclosures. The independence of anti-corruption institutions and the judiciary need to be strengthened, including by limiting political influence on appointments and dismissals. The anti-money laundering framework should be enhanced and leveraged to combat high-level corruption. In particular, the definition of Politically Exposed Persons (PEPs) should include domestic PEPs, and Beneficial Ownership requirements should be brought in line with the FATF standard and enforced to prevent the laundering of corruption proceeds. Restricting the immunity from criminal liability enjoyed by certain categories of officials would also make the legal framework against high-level corruption more effective.

13. More broadly, stronger public institutions and governance would help reduce the role of the state in the economy and foster long-term economic growth. A lean, transparent, and rules-based public sector makes public policies more effective and provides space for competition and private sector development. Current efforts to foster fiscal transparency and mitigate fiscal risks should continue and guide further public sector reforms, building on recent progress in digitalizing and automating government services, including public procurement and revenue administration. Numerous public entities, including state-owned enterprises (SOE), the NBK, and off-budget funds, still undertake quasi-fiscal activities, leading to dispersed and uncoordinated public spending, and weakening accountability. Strong fiscal governance requires consolidating all public spending in the budget, subjecting it to parliamentary debate, and complementing this with strong oversight and privatization.

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The staff team is grateful to the authorities and a broad range of public and private sector counterparts for constructive discussions and their hospitality.

Kazakhstan: Selected Economic Indicators, 2019–23

	2019	2020	2021	2022 (proj.)	2023 (proj.)
Output					
Real GDP growth (%)	4.5	-2.5	4.3	2.5-2.8	4.4
Real oil	0.1	-4.7	-0.6	0.0	8.4
Real non-oil	5.9	-2.0	5.5	3.2-3.5	3.3
Crude oil and gas condensate production (million tons)	90.4	85.7	85.7	85.5	92.6
Employment					
Unemployment (%)	4.8	4.9	4.9	4.9	4.8
Prices					
Inflation (eop, %)	5.4	7.5	8.4	18.0	9.0
General government finances					
Revenue (% GDP)	19.7	17.5	17.1	20.5	19.7
Of which: oil revenue	6.9	3.4	5.3	6.6	6.1
Expenditures (% GDP)	20.3	24.6	22.1	22.6	21.6
Fiscal balance (% GDP)	-0.6	-7.1	-5.0	-2.1	-1.9
Non-oil fiscal balance (% GDP)	-7.5	-10.5	-10.3	-8.6	-8.0
Gross public debt (% GDP)	19.9	26.4	25.1	23.3	24.4
Net public debt (% GDP)	-14.0	-8.0	-3.0	-1.5	0.0
Money and credit					
Broad money (% change)	2.4	16.9	20,8	23.9	16.7
Credit to the private sector (% GDP)	21.3	22.0	23.2	23.2	23.8
NBK policy rate (%, eop)	9.3	9.0	9.8	…	…
Balance of payments					
Current account (% GDP)	-4.0	-3.8	-2.9	3.0	1.8
Net foreign direct investments (% GDP)	-3.3	-3.4	-0.9	-1.1	-1.0
NBK reserves (in months of next year's imports of G&S)	7.7	9.0	8.1	8.3	8.4
NFRK assets (in billions of US dollars)	61.8	58.7	55.3	55.5	59.4
External debt (% GDP)	87.8	96.2	83.7	71.7	64.1
Exchange rate					
Exchange rate (y-o-y percent change; Tenge per U.S. dollar; eop)	-0.8	10.4	2.6	…	…

Sources: Kazakhstani authorities and Fund staff estimates and projections.