IMF Staff Visit to Kazakhstan
November 2–13, 2020

An IMF staff team conducted a virtual mission to Kazakhstan during November 2–13, 2020 to review economic developments, prospects, risks, and policies. Discussions focused on the impact of the Covid pandemic and oil price shocks, benefits and challenges of the authorities' policy responses, and post-Covid reform priorities. The team is grateful to the authorities and other counterparts in Kazakhstan for their excellent cooperation.

Economic developments and outlook

1. The economy has been hit by the Covid pandemic and oil price shocks. Output contracted by about 2.8 percent in the first nine months of 2020, due to declining activity in service sectors and oil production cuts under the OPEC+ agreement. However, agriculture, manufacturing, and construction sectors maintained positive growth, supported by government programs. At 7 percent in October, inflation was above the National Bank's (NBK) 4-6 percent target band, reflecting the recent spike in food prices and tenge depreciation. The external current account is expected to post a deficit in Q3, mainly due to weak oil exports, but official reserves have increased, supported by rising gold prices. The team projects that activity will contract overall by 2.7 percent in 2020 and that growth will return to positive territory next year, although significant risks remain regarding the evolution of the pandemic, oil price volatility, and trade tensions involving major trading partners.

Monetary and exchange rate (ER) policies

2. Following the sharp drop in oil prices in March, the NBK raised the policy rate to 12 percent (from 9.25 percent), widened the interest rate corridor, intervened in the FX market, and adjusted regulations for FX purchases to limit short-term exchange rate volatility. As FX market pressures abated and concerns over economic activity started to mount, the NBK lowered the base rate to 9 percent by the summer, expanded existing lending programs at preferential rates, and launched a new program for small and medium-sized enterprises (SMEs). These measures have been successful in maintaining the flow of credit to the private sector.

3. While the monetary and financial policy response to the crisis has been strong and timely, it has increased further the already large role of the state in financing the economy. Given uncertainties around a possible second wave of the pandemic, anti-crisis measures may need to be extended, but it is important to gradually unwind them with a view to scaling down state involvement and laying the foundations for a market-led recovery. More broadly, the medium-term monetary policy strategy currently being discussed will be key to identify and address constraints to effective monetary policy implementation. The NBK's commitment to inflation targeting is to be commended. It implies maintaining a flexible exchange rate to serve as a shock absorber as was demonstrated in the spring, while promoting policies that help reduce dollarization and implementing reforms to gradually reduce the impact of exchange rate volatility on inflation. In this regard, enhanced policy

credibility will benefit from strengthening the NBK's independence, setting a credible target, and improving monetary policy transmission, which would all help better anchor inflation expectations.

Financial sector policy

4. Most banks entered the Covid crisis with relatively strong capital buffers, as confirmed by the asset quality review (AQR) concluded in early 2020, and have remained resilient. During the pandemic, several temporary regulatory forbearance measures were introduced, including reduced capital and liquidity requirements, lower risk weights, and frozen loan classification for certain credit exposures. These measures have helped mitigate the impact of the crisis, but they should be phased out as the economy recovers to limit risks to financial sector soundness. Where relevant, banks should produce credible medium-term plans to restore their capital and liquidity buffers, and address the recapitalization needs identified as part of the AQR.

5. The newly created Agency for Regulation and Development of the Financial Market (the Agency) has already made significant progress in confronting the Covid crisis through strengthened financial oversight, in coordination with the NBK. Going forward, it will have a major role in aligning further Kazakhstan's financial regulatory and supervisory framework with best international standards, and in helping to strengthen banks' risk management practices and business models. To this end, it will be critical to continue the strategy to strengthen the Agency's institutional capacity and independence.

Fiscal policy

6. The authorities have resorted to countercyclical fiscal policy in response to the Covid pandemic. The staff team supports the use of available fiscal buffers in the current circumstances to safeguard the well-being of the population. The overall deficit for the general government (including local governments and the NFRK) is expected to widen to 5½ percent of GDP in 2020, reflecting weaker revenues and additional spending on healthcare, cash and in-kind transfers to vulnerable households, and support to SMEs and the most affected industries. Fiscal policy is expected to remain accommodative in 2021 to support the recovery. The fiscal stimulus will result in an increase in public debt of 4 percent of GDP between 2019 and 2021. Nonetheless, debt levels remain well below the assets accumulated in the NFRK.

7. Rebuilding fiscal buffers will be a medium-term priority. Fiscal consolidation is expected to resume in 2022, aiming to reduce and maintain the non-oil deficit below 6 percent of GDP beyond 2023. To this end, the authorities are working to increase non-oil revenues through improved tax administration, including by leveraging new digital technology, and to raise the efficiency of public spending programs. The team sees scope for tax reforms to support higher non-oil revenues and improve equity, including through VAT improvements and progressive income and property taxation. These reforms will need to be well prepared and accompanied by measures to reduce economic informality.

8. The IMF staff team welcomes the authorities' plan to further strengthen the fiscal framework and fiscal risk management. Efforts are underway to update the rules guiding the use of NFRK resources and introduce a countercyclical mechanism for government

expenditure. The authorities are also working to prepare a fiscal risk statement for the 2022 budget, covering major macroeconomic and long-term risks, including from the quasi-government sector. The team emphasizes that an effective fiscal framework needs to be supported by proper fiscal transparency and public financial management arrangements.

Structural reforms

9. The post-Covid recovery and the subsequent hand-off to sustained and inclusive growth require continued progress in structural reform implementation. The team supports priority areas identified by the authorities in their new development strategy, including: increasing competition, reducing the state's footprint, developing non-extractive sectors, enhancing the efficiency of public administration, strengthening governance, and improving health and education systems. While the pace of these reforms may be affected by the Covid crisis, it remains essential to preserve the gains achieved in recent years and maintain the reform momentum. In particular, progress in privatizing companies in the oil and gas, telecommunications, aviation, energy, and railways sectors will be important. In addition, the team supports the authorities' plans to adopt new digital technologies and to address environmental concerns, which could open new opportunities for future economic growth and job creation.

Concluding remarks

10. The IMF staff team commends the authorities for their prompt policy actions in response to the pandemic and strongly supports their commitment to more sustainable and inclusive growth following the recovery. The revised 2020 budget and continued anti-crisis measures provide crucial relief to vulnerable households and businesses. Looking ahead, continued efforts will also be needed to address underlying structural constraints that limit the emergence of a thriving private sector, growth and job creation. This should build on ongoing efforts to preserve macroeconomic stability and strengthen policy frameworks and institutions. The IMF stands ready to provide policy advice on an ongoing basis and increased technical assistance in all the key policy areas discussed above.

11. The team proposes that the 2021 Article IV consultations be held in the spring of 2021, with a focus on policies to facilitate the post-Covid recovery. Discussions would cover the fiscal framework and tax policy, the monetary and exchange rate policy framework and operations, financial sector regulation and supervision, and structural reforms to promote economic diversification and sustainable and inclusive growth.

Kazakhstan: Selected Economic Indicators, 2018–22

	2018	2019	2020 (proj.)	2021 (proj.)	2022 (proj.)
Output					
Real GDP growth (%)	4.1	4.5	-2.7	3.3	3.8
Real oil	4.5	0.1	-6.0	2.4	3.6
Real non-oil	4.0	5.7	-1.8	3.5	3.8
Crude oil and gas condensate production (million tons)	90	90	85	87	90
Employment					
Unemployment (%)	4.9	4.8	5.5	5.2	5.0
Prices					
Inflation (%)	5.3	5.4	7.5	5.9	5.0
General government finances					
Revenue (% GDP)	21.4	19.7	17.2	18.5	18.8
Of which: oil revenue	7.4	6.9	4.5	5.4	5.4
Expenditures (% GDP)	18.9	20.3	22.6	21.5	20.1
Fiscal balance (% GDP)	2.5	-0.6	-5.4	-3.0	-1.4
Non-oil fiscal balance (% GDP)	-4.9	-7.5	-9.9	-8.4	-6.8
Gross public debt (% GDP)	20.3	19.9	23.6	24.0	24.9
Money and credit					
Broad money (% change)	7.0	2.4	8.8	8.6	7.5
Credit to the private sector (% GDP)	22.7	21.3	23.0	23.6	24.1
NBK policy rate (%, eop)	9.3	9.3	…	…	…
Balance of payments					
Current account (% GDP)	-0.1	-4.0	-3.5	-3.1	-2.9
Net foreign direct investments (% GDP)	-2.6	-3.0	-1.8	-3.0	-3.0
NBK reserves (in months of next year's imports of G&S)	7.2	7.8	9.0	8.8	8.4
NFRK assets (in months of next year's imports of G&S)	13.5	16.5	14.6	13.7	13.6
External debt (% GDP)	89.1	87.3	96.9	91.4	85.3
Exchange rate					
Exchange rate (y-o-y percent change; Tenge per U.S. dollar; eop)	15.6	-0.8	…	…	…

Sources: Kazakhstani authorities' officially reported data and Fund staff estimates and projections.