INTERNATIONAL MONETARY FUND

IMF Country Report No. 15/241

REPUBLIC OF KAZAKHSTAN

2015 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT FOR THE REPUBLIC OF KAZAKHSTAN

September 2015

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 2015 Article IV consultation with the Republic of Kazakhstan, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its Board July 31, 2015 consideration of the staff report that concluded the Article IV consultation with the Republic of Kazakhstan.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on July 31, following discussions that ended on May 25, 2015, with the officials of the Republic of Kazakhstan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on July 16, 2015.
- An **Informational Annex** prepared by the IMF staff.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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COMMUNICATIONS DEPARTMENT

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700 19th Street, NW
Washington, D. C. 20431 U.S.A.

IMF Executive Board Concludes 2015 Article IV Consultation with Republic of Kazakhstan

On July 31, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Kazakhstan and considered and endorsed the staff appraisal without a meeting.[2]

Against the backdrop of external shocks, economic growth and inflation have decelerated, financial conditions have tightened, and external imbalances are emerging. Real GDP growth slowed to an annualized 2 percent during the first quarter of 2015, down from around 4 percent in 2014 and 6 percent in 2013. In addition to weaker external demand, slower growth was driven by the impact of lower income and profitability (resulting from lower oil prices) and confidence effects (reflecting regional developments) on private consumption and domestic investment. The external position has deteriorated largely due to the fall in oil prices, with the current account balance turning negative in the second half of 2014, although there has been some improvement in the current account during the first quarter of 2015. At the same time, Kazakhstan's real effective exchange rate (REER) has appreciated over the past year, mainly reflecting the depreciation of the ruble and sharp appreciation of the U.S. dollar, against which the tenge is managed. In the face of slowing demand and a more stable exchange rate, headline inflation fell from 7.4 percent year-on-year at end-2014 to 3.9 percent year-on-year at end-June, 2015. In mid-July, following the decline in sovereign spreads and reduced

[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.

[2] The Executive Board takes decisions under its lapse-of-time procedure when the Board agrees that a proposal can be considered without convening formal discussions.

currency pressures, the authorities successfully issued a $4 billion sovereign bond and widened the exchange rate band from 170–188 to 170–198 tenge/dollar.

Real GDP growth is projected to decelerate to 2 percent in 2015. Weaker demand from Russia and China, lower oil prices, confidence effects, and continuing delays in the Kashagan oil field are the main factors behind the projected slowdown. Next year, growth is projected to pick up to 3.25 percent, driven by gradual recovery in oil prices and external demand. Still, the medium-term growth outlook is less favorable than projected last year, given the impact of lower oil prices and continued slow growth in Russia on non-oil potential growth in Kazakhstan.

The fiscal stimulus aimed at supporting growth has led to deterioration in the fiscal accounts, with the overall fiscal surplus falling from 5 percent of GDP in 2013 to 1.7 percent of GDP in 2014. Monetary conditions have tightened, which, together with lower economic activity, have slowed lending activity sharply. At the same time, the NBK has made progress in improving its monetary policy framework and operations, while administrative and prudential measures have succeeded in lowering the level of non-performing loans (NPLs). In line with the 2014 FSAP recommendations, the authorities have started to undertake bottom-up stress tests for banks. The NBK has also initiated discussions with bank supervisors in other jurisdictions to strengthen cross-border supervision. The authorities have embarked on an ambitious structural reform program, bolstered by extensive engagement with the Multilateral Development Banks. In June 2015, Kazakhstan completed negotiations to become a formal member of the WTO.

Executive Board Assessment

In concluding the 2015 Article IV consultation with Kazakhstan, Executive Directors endorsed staff's appraisal, as follows:

Amid slower economic growth, tighter financial conditions, and emerging imbalances, policies should balance ensuring sustainability while alleviating the impact of shocks in the near term. In recent years the authorities have successfully harnessed oil resources to bolster economic growth and build buffers. However, economic growth has now decelerated largely as a result of likely long-lasting external shocks and is expected to remain subdued this year and next year. Moreover, the outlook for growth is subject to predominantly downside external risks. In view of weaker growth, the large and likely long-lasting nature of the shocks, and the accumulated buffers, the policy

response in the short term should be geared toward supporting the economic recovery. Over the medium term, there is a need to further strengthen macroeconomic policy frameworks, to bolster resilience to shocks and promote durable growth.

To ensure fiscal sustainability, the stimulus must be accompanied by credible medium-term fiscal consolidation and more transparent fiscal policy framework. The stimulus is justified on countercyclical grounds and is appropriately frontloaded and tailored to support growth. However, to ensure a sustainable path for the non-oil deficit, the stimulus must be accompanied by credible medium-term consolidation measures, especially on the revenue side. In particular, there is scope to strengthen the enforcement of tax collection, reduce tax exemptions, including in the Special Economic Zones, and make income tax rates more progressive. Moreover, enhancing the fiscal policy framework is critical to ensuring transparency and medium-term sustainability. Key priorities include expanding the budget coverage to all fiscal activity, in line with GFSM 2001, and integrating fiscal policy into a broader macroeconomic policy framework.

Greater exchange rate flexibility in tandem with the introduction of new monetary policy instruments is needed to enhance the policy architecture and address imbalances. The authorities have taken confidence-building measures to overhaul the monetary policy framework in support of their medium-term goal of adopting inflation targeting, and have widened the exchange rate band. However, with the aim of more effectively managing liquidity and signaling the stance of policy, the authorities should speed up the planned introduction of a new policy interest rate, supported by open market operations. Moreover, strengthening the policy architecture requires further exchange rate flexibility, which will support a more independent interest rate policy and help reduce imbalances. To avoid undermining financial stability, and anchor expectations about policy intentions and operations, the authorities should communicate their plans openly and consistently.

In view of rising vulnerabilities, further actions are needed to bolster financial sector resilience. Efforts underway to reduce the level of NPLs are paying off. However, more needs to be done to bring down the level of NPLs to sustainable levels, while ensuring that the achievement of the 10 percent prudential ceiling by end-2015 does not compromise proper loan classification and provisioning. In this regard, while the recent plans to refocus the NPL resolution framework at the merged KKB-BTA entity is appropriate, weaknesses in the bank should be addressed and an asset quality review be undertaken within a broad strategy to ensure long-term viability. Strengthening financial sector resilience also requires introducing higher risk weights or exposure caps on corporate lending, limiting FX lending to unhedged borrowers, and tightening net open position limits to mitigate credit risk. Further steps in implementing the FSAP recommendations include adopting risk-

based assessment tools and supervision and finalizing legislative amendments in insurance, pensions, and the securities market.

The structural reform agenda is appropriately ambitious, but effective implementation is essential to achieving sustainable and inclusive growth. Priority areas include strengthening human capital, building institutions, bolstering the rule of law, enhancing financial intermediation, and improving the business climate. Close collaboration with MDBs in these areas should facilitate greater efficiency in the procurement and implementation process. Moreover, diversification away from the oil sector and the reduction of the state footprint in the economy are necessary conditions to ensuring successful implementation of the broader private-sector-led growth strategy.

Kazakhstan: Selected Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections			
				(Annual percent change, unless otherwise indicated)					
National accounts and prices									
Real GDP 1/	5.0	6.0	4.3	2.0	3.2	4.8	4.6	4.4	5.0
Real oil	-2.2	3.2	-1.3	-0.4	0.4	6.4	4.6	3.3	5.5
Real non-oil	8.0	7.0	6.3	2.8	4.1	4.3	4.6	4.7	4.8
Real consumption	9.9	9.8	1.5	0.5	7.1	5.3	5.2	4.4	4.7
Real investment	10.8	5.4	1.7	8.7	-1.5	2.0	2.8	4.8	2.3
Real exports	3.4	-0.9	1.8	2.3	2.3	5.9	4.7	4.1	7.3
Real imports	19.4	5.0	-6.7	5.8	5.9	4.4	4.3	4.5	4.5
Output gap (in percent of potental GDP)	0.1	1.0	0.7	-1.6	-2.6	-1.9	-1.2	-0.6	0.7
Crude oil and gas condensate production (million tons)	79	82	81	81	81	86	90	93	98
Consumer price index (p.a.)	5.1	5.8	6.7	5.2	5.5	5.4	5.7	6.0	6.0
Core consumer price index (p.a.)	5.6	4.3	6.7	4.2	5.0	5.4	5.7	5.7	5.7
GDP deflator	4.8	9.7	7.4	-2.6	7.0	6.0	6.1	6.0	5.5
Exchange rate (tenge per U.S. dollar; eop)	1.5	2.2	18.7	3.1	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP, unless otherwise indicated)					
General government fiscal accounts									
Revenues and grants	26.9	25.3	23.8	19.8	20.8	20.8	20.5	20.0	19.7
Of which: Oil revenues	13.4	11.8	11.3	8.1	8.8	8.7	8.4	8.0	7.6
Expenditures and net lending	22.4	20.3	22.1	23.1	22.3	21.9	21.3	21.1	20.7
Overall fiscal balance	4.5	5.0	1.7	-3.2	-1.6	-1.1	-0.8	-1.0	-1.0
Financing	-4.1	-3.3	1.9	3.2	1.6	1.1	0.8	1.0	1.0
Domestic financing	2.7	2.1	1.5	2.6	2.5	3.4	3.9	4.6	5.0
Foreign financing	0.2	0.2	1.6	0.9	1.7	1.1	1.0	0.6	0.2
NFRK	-7.0	-5.5	-1.3	-0.3	-2.6	-3.4	-4.1	-4.1	-4.2
Gross public debt (percent of GDP)	12.4	12.9	14.5	18.1	20.5	22.9	25.5	28.2	30.7
Non-oil fiscal balance (percent of GDP)	-8.9	-6.8	-9.6	-11.4	-10.4	-9.8	-9.3	-9.0	-8.7
Non-oil fiscal balance (percent of non-oil GDP)	-13.0	-9.4	-13.4	-13.8	-12.6	-11.9	-11.3	-10.8	-10.3
				(Annual percent change, eop, unless otherwise indicated)					
Monetary accounts									
Reserve money	1.9	-2.2	20.8	6.9	7.5	8.3	8.3	8.3	8.3
Broad money	7.9	10.2	2.4	14.5	10.4	11.1	11.1	11.1	11.1
Broad money velocity (annual average)	2.9	3.0	3.3	2.9	2.9	2.9	2.9	2.9	2.9
Credit to the private sector 2/	11.6	12.7	5.7	-5.5	3.7	6.0	11.0	10.6	10.8
Credit to the private sector (percent of GDP) 2/	41.5	40.2	37.9	37.7	37.5	37.5	37.5	37.5	37.5
NBK refinance rate (eop; percent)	5.5	5.5	5.5	…	…	…	…	…	…
				(In billions of U.S. dollars, unless otherwise indicated)					
External accounts									
Current account balance (percent of GDP)	0.5	0.4	2.1	-3.3	-2.9	-1.9	-1.2	-1.1	-0.8
Exports of goods and services	91.8	90.7	85.4	60.0	64.6	70.6	76.1	80.1	86.4
Oil and gas condensate	56.4	57.2	53.6	32.7	35.8	39.7	43.1	44.9	48.1
Imports of goods and services	61.5	63.0	56.2	52.2	55.7	58.6	61.5	64.5	67.5
Foreign direct investments (net, percent of GDP)	-5.8	-3.4	-2.7	-2.5	-2.3	-2.1	-2.0	-1.8	-1.7
NBK gross reserves (eop) 3/	28.3	24.7	28.9	28.9	28.9	28.9	28.9	28.9	28.9
In months of next year's imports of goods and services	5.4	5.3	6.7	6.2	5.9	5.6	5.4	5.4	5.1
NFRK assets (eop)	57.9	70.8	73.6	74.2	80.2	88.9	100.6	113.6	128.2
Total external debt 4/	136.9	149.9	157.1	168.9	181.3	193.1	203.7	214.3	224.2
In percent of GDP	67.3	64.7	71.2	79.8	78.6	75.3	71.6	68.1	64.3
Excluding intracompany debt (percent of GDP)	34.1	32.8	35.3	41.3	42.3	41.8	40.6	39.3	37.7
Memorandum items:									
Nominal GDP (in billions of tenge)	30,347	35,275	39,530	39,285	43,365	48,194	53,502	59,156	65,522
Nominal GDP (in billions of U.S. dollars)	203.5	231.9	220.6	211.7	230.7	256.3	284.6	314.7	348.5
Saving-Investment balance (percent of GDP)	0.5	0.4	2.1	-4.5	-3.4	-2.1	-1.5	-1.3	-0.7
Crude oil, gas cnds. production (millions of barrels/day) 5/	1.65	1.70	1.68	1.68	1.68	1.79	1.87	1.94	2.04
Oil price (in U.S. dollars per barrel)	105.0	104.1	96.2	58.9	64.2	67.1	69.9	71.0	71.5

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.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

July 16, 2015

KEY ISSUES

Context: Over the past two decades, Kazakhstan has successfully harnessed its oil resources to bolster economic growth, increase buffers, and reduce poverty. However, in the face of recent large and likely long-lasting external shocks—lower oil prices, Russia slowdown, and corollary exchange rate (ER) movements (ruble depreciation, dollar appreciation)—growth has decelerated rapidly, financial conditions have tightened, and pressures on the balance of payments and exchange rate have built up. The shocks have also increased financial sector vulnerabilities, where nonperforming loans (NPLs), while declining significantly, remain high, and rising balance sheet risks and tight exchange rate management, have put further drag on banks' lending and economic activity. Nevertheless, more recently, and in response to reduced currency pressures and reduced spreads, the authorities successfully tapped the international capital markets and widened the ER band.

Focus of consultation and key recommendations: The consultation focused on calibrating the policy response to address Kazakhstan's near-term challenges and long-term goals of becoming a dynamic emerging market economy. Principally, there is need to (i) identify credible medium-term fiscal consolidation measures to ensure sustainability; (ii) introduce greater exchange rate flexibility to help the economy absorb current and future external shocks; (iii) bolster financial sector resilience to limit adverse spillovers back to the real sector; and (iv) implement structural reforms to ensure durable growth and shared prosperity.

Previous consultation: During the 2014 Article IV Consultation, Directors stressed the importance of restoring confidence in the post-devaluation environment and further strengthening the policy frameworks to bolster the economy's resilience to shocks. Specifically, Directors (i) urged appropriate supervisory actions to enforce the NPL ceilings effectively, while ensuring adequate provisions; (ii) highlighted the need to speed up the introduction of a new policy interest rate instrument; (iii) stressed the need to enhance fiscal coverage and integration into a consistent macro-fiscal framework; and (iv) noted the priority of strengthening human capital and institutions, and lowering the role of the state in the economy. Since then, the authorities' resolute efforts on lowering NPLs have begun to pay off, and important early steps have been taken to enhance monetary policy operations, ER flexibility, and communication. Progress in bolstering the fiscal policy framework, however, has been slow. The authorities have also embarked on an ambitious structural reform program and recently completed negotiations to join the WTO within 2015.

Approved By
Juha Kähkönen (MCD) and Luis Cubeddu (SPR)

The staff team comprised Hossein Samiei (head), Natan Epstein, Matteo Ghilardi, Yahia Said (all MCD), and Nombulelo Duma (MCM). Discussions were held in Almaty on May 13–18 and in Astana on May 19–25. The mission met with Prime Minister Massimov, Central Bank Governor Kelimbetov, Minister of Finance Sultanov, and Minister of National Economy 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. **Like other countries in the region, Kazakhstan was hit in 2014 by large external shocks that are expected to be mostly long lasting.** Against the backdrop of these shocks, economic growth has decelerated sharply, financial conditions have tightened, and external imbalances are emerging. While both oil prices and the Russian ruble are off their respective lows reached at end-2014, improvements in sentiment are tempered by the realization that low oil prices and uncertainties surrounding the Russian economy are likely to persist.

2. **The authorities' large stimulus package has helped blunt the initial impact of the shocks, but recovery will likely be gradual.** The stimulus package ("Nulrly Zhulu"), which went into effect in 2014 and which involves public investment programs supported by multilateral development banks (MDBs), is partially offsetting the impact of the shocks. The stimulus is enhanced by a structural reform program aimed at improving the business climate and public sector efficiency. However, the extent of the shocks, the appreciation of the tenge in real effective terms, and a weak lending environment could reduce the prospects for quick economic recovery. At the same time, Kazakhstan's upcoming accession to the World Trade Organization (WTO) could provide a boost to investor confidence.

3. **President Nazarbayev won early elections overwhelmingly, and has suggested devolving power to the parliament and the regions.** The elections took place on April 26, 2015 (previously scheduled in 2016). The President won reelection with 98 percent of the vote, and has signaled his interest in strengthening the role of parliament in decision making, including speeding up the process of transferring new powers to parliament and, through it, to the prime minister. The "100 steps" reform program announced by the President shortly after his reelection includes a strong emphasis on decentralization and strengthening the rule of law.

RECENT DEVELOPMENTS

4. **Economic growth has decelerated significantly, but remains positive, as a result of the external shocks.** GDP growth slowed to an annualized 2 percent during the first quarter of 2015, down from around 4 percent in 2014 and 6 percent in 2013. In addition to weaker external demand, slower growth was driven by the impact of lower income and profitability (resulting from lower oil prices) and confidence effects (reflecting regional developments) on private consumption and domestic investment. Private consumption expanded by 0.5 percent in 2014 (vs. 11.8 percent in 2013), while investment contracted by 3.4 percent (vs. 9 percent growth in 2013). The stimulus package has helped absorb some of the impact on consumption and investment. In the face of slowing demand and limited exchange rate movements, headline inflation fell sharply, from 7.4 percent year-on-year at end-2014 to 3.9 percent at end-June, 2015—well below the authorities' objective range of 6–8 percent. The recorded unemployment rate remained at 5 percent in 2014.

5. **The fiscal stimulus aimed at supporting growth has increased financing needs.** The overall fiscal surplus fell from 5 percent of GDP in 2013 to 1.7 percent of GDP in 2014. Among other

factors, the decline reflects a 1.8 percent of GDP increase in expenditures and net lending (partly due to the stimulus) and a 0.5 percent of GDP fall in oil revenues. The non-oil fiscal deficit increased from 6.8 percent of GDP in 2013 to 9.6 percent of GDP in 2014, while the stock of government debt increased from 12.9 percent of GDP to 14.5 percent of GDP over the same period. On July 14, 2015, with aim of financing a growing fiscal deficit and in response to reduced spreads in recent months, the authorities issued $4 billion in 10-year and 30-year global bonds. The issuance was well received and oversubscribed, with spreads of 285 bps and 335 bps, respectively, over U.S. treasuries.

6. **Monetary conditions have been tight for most of the past year, which have reduced pressures on the exchange rate recently, but, together with lower economic activity, slowed lending sharply**. During the second half of 2014, due to rapid depreciation of the ruble, heightened speculation of tenge devaluation, and increased dollarization of bank deposits, domestic money market interest rates rose significantly. Since early 2015, with the use of overnight currency swap and repo instruments, the National Bank (NBK) has managed to stabilize money market rates below 10 percent and dampen pressure on the tenge. As a result, and following the successful global bond issuance, the NBK widened its exchange rate band from 170–188 to 170–198 tenge/dollar, on July 15, 2015. Meanwhile, while Kazakhstan's sovereign bond spreads have declined somewhat, domestic lending rates remain elevated and overall private sector credit has grinded to a halt, contracting by 3.5 percent year-on-year as of May 2015 (vs. annualized growth of 6 percent in 2014 and 13 percent in 2013). Credit conditions are expected to remain anemic in the short term (Box 1 and Annex I).

7. **The external position has weakened largely due to the fall in oil prices.** Kazakhstan's real effective exchange rate has appreciated over the past year, mainly reflecting the depreciation of the ruble and sharp appreciation of the U.S. dollar, against which the tenge is managed. The current account balance turned negative in the second half of 2014, although there has been some improvement in the first quarter of 2015, in part reflecting the recent appreciation in the ruble and the rebound in oil prices. Based on a range of approaches used by staff, the tenge could be considered modestly overvalued by 4–14 percent (Annex II).[1] Based on the IMF's Assessing Reserve Adequacy (ARA) methodology, NBK's gross reserves (which exclude the national oil fund) remain below the suggested adequacy range of 100–150 percent of the ARA composite metric. At the same time, the oil fund, with an accumulated value of around $75 billion (35 percent of GDP), provides a significant buffer for the economy as a whole.

8. **Administrative and prudential measures have succeeded in lowering NPLs significantly, but vulnerabilities in some segments of the financial sector have increased (Box 2 and Annex III).** Recent preliminary estimate indicate that NPLs have fallen from 34 percent of total loans a year ago to 10 percent in July 2015 (preliminary data) following the revocation of BTA's banking license—after the bank absorbed all the bad assets of the merged KKB-BTA entity—and the removal of tax, accounting, and other legal obstacles to write-offs and transfers to special purpose vehicles (SPVs). NPL write-offs lowered the system-wide capital to risk-weighted assets (CAR) marginally, from 18 percent at end-2013 to 17 percent at end-2014, still well above the regulatory

[1] These estimates, derived from the External Balance Assessment (EBA) methodology and CGER calculations, are broadly in line with market indicators, e.g., non-deliverable forward (NDF) rates suggest (as of end-June) depreciation expectations of around 10–15 percent over the next 6–12 months.

minimum of 12 percent. Nevertheless, some vulnerabilities have increased. In particular, deposit dollarization and declining lending activity are impacting banks' profitability and increasing currency and maturity mismatches. Banks are particularly vulnerable to indirect foreign currency risk, due to the prevalence of lending to unhedged borrowers. Moreover, despite limits on credit concentration, lending mostly takes place in a few non-oil sectors that are currently under stress.

9. **Progress has been made in implementing FSAP recommendations (Annex IV).** The NBK has started to undertake bottom-up stress tests for banks. The authorities have also revised legislation to exclude the requirement for depositor and creditor approval in P&A and bridge bank resolution. They are initiating discussions with bank supervisors in other jurisdictions to strengthen cross-border supervision. The authorities have also made legislative amendments to implement recommendations in the insurance sector and on pensions, and drafted a law to address regulatory shortcomings in the securities market. Progress, however, has been limited in adopting risk-based assessment tools and extending supervision beyond compliance with prudential norms.

10. **The authorities have embarked on an ambitious structural reform program, bolstered by extensive MDB engagement.** Public investment under the Nurly Zhulu program aims to address infrastructure bottlenecks and generate jobs. Moreover, following the recent Presidential election, the authorities have launched a wide ranging reform program ("100 steps") aimed at improving the efficiency of public administration and the rule of law, diversifying the economy, and addressing governance challenges. MDBs' increased engagement strengthens the structural reform component of the authorities' crisis response, with projects targeting the labor market, civil service and public expenditure reforms, business climate improvements, and support to small- and medium-sized enterprises (SMEs). In June, 2015, Kazakhstan completed negotiations to become a formal member of the WTO.

OUTLOOK AND RISKS

11. **The growth outlook has weakened, with predominantly downside external risks (Annex V).** Staff projects real GDP growth to decelerate to 2 percent this year despite the fiscal stimulus. Weaker demand from Russia and China, lower oil prices, confidence effects, and continuing delays in the Kashagan oil field are the main factors behind the projected slowdown. Next year, growth is projected to pick up to 3.25 percent driven by a gradual recovery in oil prices and output, and improved external demand. Still, the medium-term growth outlook is less favorable than projected last year, in light of lower projected medium-term oil prices and continued slow growth in Russia. Staff now estimates potential growth at around 4.75 percent (vs. previous estimates of 5.5-6 percent). Against this backdrop, staff has also cut its headline inflation forecasts to 5.2 percent this year and 6 percent over the medium term (from 6 percent and 7 percent, respectively). The current account is expected to gradually improve in the coming years, due to a projected increase in oil exports once Kashagan comes on line, but remain in small deficit over the medium term. Downside risks to the growth outlook are mainly external and related to oil prices and regional uncertainty, although the recent improvements in the outlook for oil prices and the Russian economy lessen the tail risks. The authorities' real GDP growth projection for 2015 is 1.5 percent.

For the medium term, the authorities broadly shared staff's outlook, but viewed the risks as more balanced, including because of the recent stability in oil prices and the Russian ruble.

12. **Under an adverse scenario, with further decline in oil prices, anemic growth and larger imbalances could persist over the medium term.** In a downside scenario, where oil prices are assumed to decline by 25 percent (permanently)[2] relative to staff's baseline projections, growth rates are expected to remain below potential in the medium term. While the deviation from baseline growth is not large, the adverse cumulative impact on the current account, FX reserves, fiscal balance, and public debt is more severe.

Staff's baseline vs. alternative scenarios

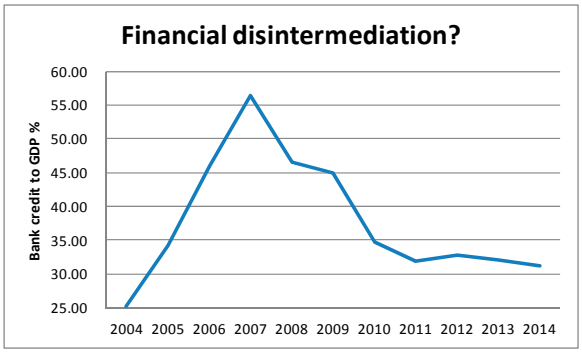
	2016	2017	2020
Growth			
Baseline	3.2	4.8	5.0
Downside	2.7	4.3	4.6
Severe	2.0	3.7	4.0
Current Account (percent of GDP)			
Baseline	-2.9	-1.9	-0.8
Downside	-4.8	-3.8	-2.5
Severe	-7.6	-6.4	-4.9
Fiscal Balance (percent of GDP)			
Baseline	-1.6	-1.0	-1.0
Downside	-3.1	-2.4	-2.2
Severe	-5.1	-4.4	-4.1
Gross Debt (percent of GDP)			
Baseline	20.5	22.9	30.7
Downside	23.8	27.4	37.9
Severe	28.5	33.8	48.9
FX Reserves ($ billion)			
Baseline	28.9	28.9	28.9
Downside	26.6	25.4	23.8
Severe	24.7	23.3	21.6
Oil Prices ($ per barrel)			
Baseline	65.7	69.7	74.0
Downside	48.6	51.5	56.5
Severe	26.7	29.6	34.6

[2] This is equivalent to a permanent oil-price shock applied in 2015 as a 0.5 percent standard deviation from historical oil prices.

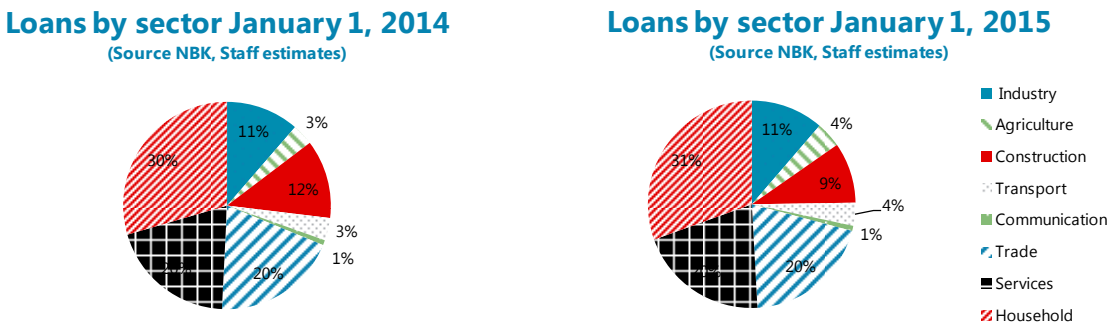
Box 1. Credit Intermediation and Economic Growth in Kazakhstan

Credit market characteristics

Despite occasional bursts of growth, the credit market remains shallow. Financial intermediation has been falling since the 2007/2008 crisis. At 34 percent, Kazakhstan has a low credit to GDP ratio compared to peers.



The credit market is narrow with key sectors relying on other sources of financing. Energy and extractives rely primarily on foreign financing. Construction and real estate relied on wholesale foreign funding until it stopped in 2007. Consumer oriented borrowing (households, trade, services) dominates with over 70 percent of outstanding loans. Most businesses are cut-off from bank credit altogether. According to the latest World Bank survey less than 20 percent of firms have a loan or a line of credit.



Given its limited depth and scope, the domestic credit market has had a modest impact on economic activity. Analysis of quarterly credit data since 2004 reveals some correlation between credit growth and non-oil economic activity and no clear causality. The correlation is stronger in the run up to 2007/2008 crisis as the real estate bubble inflated. Given the limited scope of the credit market the main causality chain may run from oil prices through the economy to credit growth. (Annex I).

Recent developments

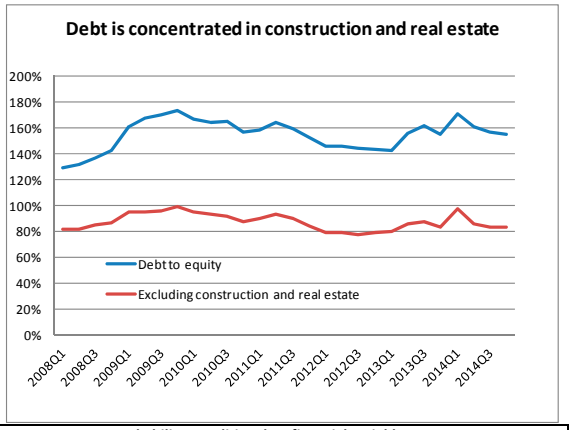
Credit growth slowed significantly over 2014 and so far in 2015. Overall bank credit to the private sector in May 2015 was lower by 3.5 percent in nominal terms relative to a year ago with a shift from foreign to national currency loans and from corporate to individual borrowers.

The slowdown in credit is exacerbated by high interest rates, tight domestic liquidity, dollarization, and, to a lesser extent, prudential policies on unsecured consumer lending. Weighted average interest rates on tenge loans to corporations jumped from 10 percent at the end of 2013 to 18 percent during

Box 1. Credit Intermediation and Economic Growth in Kazakhstan (Concluded)

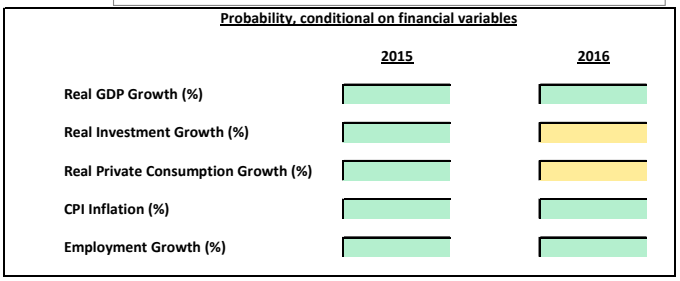
2015Q1. Broad money (M2) shrank by 8 percent in 2014 and a further 2 percent in 2015 mainly due to dollarization of deposits. Dollarization is increasing currency risks (Box 3), further deterring lending. Tight domestic liquidity, high interest rates and dollarization are byproducts of a tightly managed exchange rate in the context of high devaluation expectations. Prudential measures enacted in 2013 to limit the growth of unsecured consumer credit also contributed to the slowdown.

The NPL overhang at 24 percent continues to restrict the banks' ability to extend credit. Trade and services account for the highest share of NPLs (25 percent). The share of NPLs to total credit outstanding remains highest in construction, at almost 40 percent. NPL's tie up client collateral and bank buffers which dampens credit activity.



The few businesses which have access to domestic credit are highly leveraged. Construction and real estate, which are still working though the fallout from the 2007/2008 crisis, have debt to equity ratios three times the average (chart). Real estate prices have remained stagnant.

Short-term prospects and policies



Staff expects credit to contract by 5.5 percent in nominal terms in 2015 but grow moderately, by 3.7 percent, in 2016. The forecast is broadly consistent with economic developments, taking into consideration the limiting factors described above. The IMF Macro-financial Forecast Consistency Template (Annex I) indicates that projected credit growth is broadly consistent with growth in other relevant variables.

Credit activity is likely to remain concentrated in trade and consumer lending. The prospect of a slowdown in real income growth could threaten these sectors and by extension private consumption.

Despite the weak link between credit and growth, anemic credit could trigger second round effects on economic activity and asset prices, further weakening banks' balance sheets. Credit is essential for private sector led growth and diversification. The government's program aimed at extending tenge 500 billion of subsidized loans to SME's of which Tenge 250 billion have been disbursed so far seeks to mitigate the impact of tight credit on the economy. MDBs, including the ADB, are carrying out similar programs. It is too early to measure the impact of these programs. To reverse the fall in credit and strengthen the link between credit and growth it is necessary to address the key obstacle to growth: tight liquidity, high levels of NPL and lack of access to finance.

Box 2. Lower Oil Prices and Financial Sector Vulnerabilities

As an oil exporting economy, lower oil prices have a negative impact on Kazakhstan's financial sector and on economic activity more generally. This box describes the solvency stress test that was performed on Kazakhstan's banks to assess the impact on bank solvency of two shocks: lower oil prices and exchange rate depreciation. Stress tests on bank balance sheets as of end 2014 (latest available) reveal that the banking system is in a weak position to withstand shocks, particularly severe shocks. In the baseline, before any shocks are applied, three banks have capital adequacy ratios (CAR) below the regulatory minimum of 12 percent. The downside scenario would have the same 3 banks below the regulatory minimum. The severe scenario, however, would bring 17 banks (89 percent of banking system assets) below the regulatory minimum, and recapitalization needs would amount to 3 percent of GDP. The results are subject to the usual uncertainties associated with this type of tests.

The assumptions underlying the stress test are:

i) In the *baseline scenario*, estimates of oil prices reflect the WEO baseline, and real GDP growth and the exchange rate are based on staff's macroeconomic projections. The projections assume further weakening in oil prices from the current $62.8pb to $58.9pb. Real GDP growth moderates from 4.3 percent in 2014, to 2 percent in 2015 and rises to 4.4 percent by 2019. The exchange rate depreciates from 179.2 (tenge/dollar) in 2014 to 185.8 in 2015 and to 188 by 2019 (i.e., within the current tenge/dollar exchange rate band).

ii) In the *downside scenario*, a 0.5 historical standard deviation on the oil price is assumed. Under this scenario, oil prices fall to $43.2pb in 2015 and $48.6bp in 2016. Real GDP grows by 1.2 percent in 2015 and by 2.7 percent in 2016. The exchange rate is subjected to a 1.5 standard deviation shock, which implies a depreciation to 198 in 2015 and to 200.5 in 2016. The larger standard deviation shock on the exchange rate compared to oil prices mimics the large currency swings during periods of stress.

iii) In the *severe scenario*, a 1.2 standard deviation from the baseline is assumed. Oil prices fall to $21.3pb in 2015 and $26.7pb in 2017. Real GDP grows by 0.1 percent in 2015 and by 2 percent in 2016. The exchange rate is subjected to a 3.5 standard deviation shock, which puts it at 15.5 percent depreciation from the current level in 2015. It depreciates to 215 in 2015 and to 217 in 2016.

The historical relationship between macroeconomic variables and NPLs is analyzed using a vector autoregression (VAR) model. The variables included in the VAR model are: the ratio of NPLs to total loans (NPL), the percent change in the oil price, Kazakhstan's real GDP growth, partner countries' real GDP growth, and the tenge/dollar exchange rate. Unit root and lag length tests were performed and adjustments made accordingly. The model was estimated on quarterly data from 2000 to 2014. The relationship shows that NPLs respond to shocks in macroeconomic variables. NPLs are most sensitive to changes in domestic activity, followed by the exchange rate and oil prices A percentage point increase in real GDP growth results in a 0.318 percentage point decline in NPLs; a percentage point increase in the oil price results in a 0.006 percentage point decline in NPLs; a percentage point increase (depreciation) in the exchange rate results in a 0.047 percentage point increase in NPLs. Single equation estimation shows similar but slightly larger coefficients on the exchange rate and oil prices.

The tests simulated balance sheets and profit/loss accounts for the individual banks given the NPL forecasts upon applying the effects of the shocks. In the simulation, liabilities are held constant. Given that historical balance sheet data are not available to staff, interest margins on current loans and liabilities,

Box 2. Lower Oil Prices and Financial Sector Vulnerabilities (Concluded)

as well as net non-interest income are based on 2014 data. Given that estimates of collateral are unreliable, new NPLs are assumed to be provisioned for at 100 percent. This further dents profits. When net income is positive, the test assumes that 80 percent of profits are retained and the rest is paid out as dividends. A bank accumulates capital buffers when its capital ratio declined in the previous year. Capital covers the loss when net income is negative.

The results reveal that a number of banks are unable to withstand higher NPLs due the shocks described above. No adjustments were made on capital to take into account of the phase-out of capital instruments ineligible under Basel III as was done in the FSAP. Even without this adjustment, banks are still highly susceptible, especially in the face of severe shocks. The results are presented in the table below. The downside scenario brings system CAR down to 16 percent while the severe scenario brings it down to 6 percent, well below the regulatory minimum. Banks have low levels of profitability, thus, a low buffer against shocks. An exchange rate only shock of a 15.5 percent depreciation from the current level results in 10 banks being below regulatory CAR, while a 25 percent depreciation results in 17 banks below regulatory CAR. A reverse stress test reveals that an increase in NPLs by 16 percent brings the system wide CAR to the regulatory minimum of 12 percent (assuming a 70 percent level of provisioning). At this level, 6 banks would be below the regulatory minimum. NPLs decline over the projection period reflecting improvements in macroeconomic variable over time.

Stress Test Assumptions and Results

	Historical	Baseline			Downside			Severe		
	2014	2015	2016	2017	2015	2016	2017	2015	2016	2017
Assumptions										
Domestic real GDP growth	4.3	2.0	3.2	4.8	1.2	2.7	4.3	0.1	2.0	3.7
Oil price (in U.S. dollars)	96.2	58.9	64.2	67.1	43.2	48.6	51.5	21.3	26.7	29.6
percent change over latest price (62.8)					-31.2	12.4	5.9	-66.0	25.1	10.8
Exchange rate	179.2	185.8	188.0	188.0	198.3	200.5	200.5	214.9	217.1	217.1
percent change over latest rate (186.1)					6.6	1.1	0.0	15.5	1.0	0.0
Impact										
Nonperforming loans (percent of total loans)	32.2	13.0	5.8	1.5	21.7	11.5	3.5	37.6	24.6	9.9
Capital adequacy ratio	17.4	17.0	24.5	23.1	16.1	24.8	30.4	6.0	15.5	26.0
CAR < 8 percent										
Number of banks	1	1	1	1	2	1	1	12	2	1
8 percent < CAR < 12 percent										
Number of banks	2	2	0	0	1	0	0	5	2	0
CAR > 12 percent										
Number of banks	35	35	37	37	35	37	37	21	34	37
Recapitalization to achieve 12 percent CAR										
Million Tenge		97,914	297,288	510,326	138,759	295,659	501,076	1,233,496	442,955	497,869
Percent of 2014 GDP		0.2	0.8	1.3	0.4	0.7	1.3	3.1	1.1	1.3

POLICY DISCUSSIONS

13. **Policy discussions centered on the near-term policy response needed to revive the economy and the progress in strengthening policy frameworks.** Regarding the short run, staff's assessment is that (i) the fiscal stimulus is justified on countercyclical grounds, provided credible medium-term consolidation measures are identified; (ii) the tight monetary policy stance, which helped reduce pressure on the exchange rate, may need to be loosened in view of rapidly falling inflationary pressures; (iii) further steps are needed to lower NPLs and bolster financial sector

resilience; and (iv) more rapid implementation of structural reforms is needed. As for the longer run, staff highlighted the imperative of further bolstering the macroeconomic policy architecture to help the economy absorb current and future shocks and to ensure durable growth and shared prosperity. The authorities agreed with the staff on the proposed short-term policy response and broadly shared the view on the need to enhance macroeconomic policy frameworks.

A. Fiscal Policy

14. **The fiscal stimulus is tailored to support growth.** The 3–5 year Economic Support Package introduced last year includes $12 billion (5.8 percent of GDP) spending from the National Fund of the Republic of Kazakhstan (NFRK) and $7 billion (2.9 percent of GDP) in loans contracted from Multinational Development Banks (MDBs) (see table). The package is aimed at modernizing critical infrastructure, promoting SME lending via quasi-fiscal development institutions, and recapitalizing the PLF. While the large stimulus come at the expense of higher current account deficit and lower reserves in the oil fund, staff supported the package, given its' growth-enhancing, countercyclical, structural, and frontloaded nature. It also urged the authorities to ensure transparency and high quality spending and welcomed the involvement of MDBs in monitoring and selecting the investment projects.

15. **The authorities agreed with staff that medium-term fiscal consolidation should be an essential component for the success of the fiscal stimulus.** Given the size of the stimulus, a credible medium-term plan, especially on the revenue side, is needed to ensure fiscal sustainability. Assuming unchanged policies, total revenues are expected to decline from 23.8 percent of GDP in 2014 to 19.7 percent of GDP in 2020. The non-oil fiscal deficit is expected to rise sharply this year, to 11.4 percent of GDP (from 9.6 percent of GDP in 2014), and to decline only gradually to 8.7 percent of GDP in 2020, or around 3 percentage points of GDP higher than staff's estimated sustainable level of 5.5 percent of GDP. To close the projected gap, the authorities have suggested improvements in tax administration and unspecified large cuts in expenditures (equivalent to 5 percentage points of GDP over three years) that are not based on concrete measures. Staff suggested that to maintain a reasonable and credible path for expenditures, and in view of relatively low tax revenue as a share of GDP, the authorities should aim at raising the revenue base through implementing measures such as (i) strengthening the enforcement of tax collection; (ii) reducing tax exemptions; including in the Special Economic Zones; and (iii) making income tax rates more progressive.

Stimulus Packages 2014–2019

(In percentage of GDP)

	2014	2015	2016	2017	2018	2019
Financed from NFRK	1.6	2.9	0.9	0.4	0.0	0.0
Financed from MDB	0.0	0.0	0.9	0.9	0.8	0.4
Total	1.6	2.9	1.9	1.3	0.8	0.4

16. **To support fiscal transparency and ensure medium-term sustainability, staff emphasized the urgent need to further strengthen fiscal accounting and the fiscal policy framework.** While important steps have been taken in improving fiscal coverage, more work is

needed to bolster the quality of fiscal accounting (Annex VI). Concerns remain regarding the treatment of the oil fund transactions, some revenue and expenditure items, and the definition of the fiscal anchor. Staff underscored the need for bringing fiscal accounts into compliance with the GFS 2001 manual, particularly in the context of the fiscal consolidation strategy. The authorities agreed to consider staff's recommendations and if necessary request TA in this area.

17. **Public debt is expected to rise in the medium term, with increased international borrowing, but overall levels would remain relatively low.** To help finance the fiscal deficit, the government has requested a $2 billion Development Policy Loan from the World Bank and $1 billion Countercyclical Support Facility from the Asian Development Bank. In addition to borrowing from MDBs and domestic debt issuance, the authorities noted their plans to tap international capital markets again this year when external market conditions allowed. The first such issuance took place on July 14. The global issuance also aims at helping build a yield curve in the absence of a well-functioning domestic debt market. According to staff's calculations and assuming unchanged policies, the general government's external debt is expected to rise from 3.8 percent of GDP at end-2014 to 6.4 percent of GDP by 2020. At the same time, total government debt is projected to increase from 14.5 percent in 2014 to 30.7 percent in 2020 (Annex VII).

B. Monetary and Exchange Rate Policy

18. **Tight monetary policy has helped lower inflation, but the authorities concurred with staff that weak output and credit growth require caution about allowing market interest rates to remain too high for long periods.** In view of rapidly declining inflationary pressures, subdued output growth, and weak lending conditions, the authorities are carefully evaluating the tradeoffs between the need for a tightening bias to contain the pressure on the currency and the goal of reviving lending and economic activity and stabilizing inflation around its objective range. Staff also urged efforts to avoiding periodic heightened volatility in money market interest rates.

19. **The authorities have taken important steps to overhaul the monetary policy framework in support of inflation targeting.** These steps include strengthening communication, preparing the grounds for the imminent introduction of new policy interest rate instruments, and enhancing governance. In particular, the recently published monetary policy guidelines for 2015 and 2020 stress the planned introduction of a new policy interest rate, supported by open market operations, during the early phase of the transition to inflation targeting, which the authorities see adopting within 3–5 years. The NBK has also recognized the need to strengthen its governance structure, including by setting up a monetary policy committee (MPC) and achieving greater central bank independence in policy decision making. Moreover, the NBK plans to establish a money market committee responsible for the implementation of monetary policy, including the daily assessment of banking sector liquidity conditions and interbank market developments. Staff noted that modernizing the monetary policy framework will also help the recently announced plans to develop Astana as an international financial center.

20. **Staff has stressed the need to gradually introduce greater exchange rate flexibility in tandem with improving monetary policy instruments, while avoiding a step-devaluation.** Staff emphasized that greater exchange rate flexibility would (i) support a more independent interest rate policy; and (ii) help reduce imbalances. Staff supported the NBK's opposition to another outright step-devaluation, given that previous episodes resulted in increased dollarization, re-fixing the exchange rate, and further expectation of devaluation. A large devaluation would also put immediate stress on private-sector balance sheets of unhedged FX borrowers (Box 3). In contrast, a gradual adjustment would give banks more time to address balance-sheet vulnerabilities, while correcting the exchange rate misalignment over time. In view of this, staff considered that greater flexibility could initially be introduced by gradually widening the exchange rate band, with the aim of removing it altogether when conditions allow.

21. **The authorities agreed that greater flexibility would support the reform efforts underway and alleviate imbalances.** In light of this, and given reduced pressures on the tenge in recent months, on July 15 the NBK widened its exchange rate band from 170-188 to 170-198 tenge/dollar. To ensure stability, the authorities also agreed to communicate their plans consistently and credibly and continue to strengthen monetary policy instruments.

C. Financial Policies

22. **Staff and the authorities broadly concurred on the need to bolster financial sector resilience.** Staff noted the progress made in halting the surge in uncollateralized consumer loans seen in recent years. However, three banks have capital below the regulatory minimum and banks' balance sheets appear to be highly sensitive to shocks. Supervision should be strengthened and corrective actions be taken for the undercapitalized banks to bring their capital above the regulatory minimum. Furthermore, staff urged the authorities to shore up system strength by developing plans to bring capital up to shock resilient levels and improve governance and risk management to help reduce risks. There was agreement that exchange rate risk remains a concern for the banking system, especially given corporate sector exposure. Further, credit concentration remains high. Staff recommended introducing higher risk weights or exposure caps on corporate lending; reducing (or prohibiting) FX lending to unhedged borrowers; and tightening net open position (NOP) limits to mitigate exchange rate risk (Box 3 and Annex VIII). The authorities are considering raising risk weights on loans denominated in foreign currency to help reduce banks' exposure to indirect foreign currency risk. However, they consider the current limit on the NOP to be sufficient in minimizing on-balance sheet currency mismatches and do not see the need to limit or prohibit lending to unhedged borrowers as this, in their view, will curtail lending. Staff shared the concern about the need to avoid undermining an already weak lending environment but stressed the consequences of excessive lending to unhedged borrowers. Staff also urged the authorities to enhance the quality of data on corporate and household balance sheets to allow for a more informed assessment of balance-sheet vulnerabilities. The authorities agreed to further assess vulnerabilities and argued that they are monitoring bank soundness.

23. **There was agreement that further reduction of NPLs, especially of the newly merged KKB-BTA entity, is a necessary condition to improving banking sector soundness.** Staff welcomed the efforts underway to reduce the level of system NPLs, including the efforts to achieve the 10 percent ceiling by end-2015. But it expressed concern that NPL provisioning may be overstated because it relies on underlying loan collateral that is overstated—mainly real estate that has not yet recovered from the 2009 bubble bust—and is not regularly revalued. Staff also welcomed the refocus of NPL resolution at the merged KKB-BTA entity, which accounts for 70 percent of the universe of NPLs and about 25 percent of banking system assets. In this regard, staff advised that the authorities develop a broad strategy to address the factors that resulted in weaknesses in these banks, including conducting an asset quality review (AQR) of the merged bank. The strategy should address the restructuring of the bank to ensure long-term viability and how any capital needs identified by the AQR will be addressed. Regulatory and supervisory standards should also be improved, and consideration should be given to sequencing of reforms with the AQR, and the specific standards against which the banks will be assessed.

24. **Staff welcomed progress made in implementing FSAP recommendations.** It urged for further progress in adopting risk-based assessment tools and supervision, which remains oriented toward compliance. The NBK prefers to maintain the current supervisory approach for the time being. The authorities plan to continue making progress toward finalizing legislative amendments in insurance, pensions, and the securities market.

Box 3. Macroprudential Policies in Kazakhstan

Reducing exchange rate risk: Exchange rate risk remains one of the largest risks for the banking sector. FX risks are especially elevated in the corporate sector—the largest borrowers from the banking system—where leverage and the net open FX position to equity are very high. This sector has also experienced a significant slowdown in activity and is associated with already high NPLs to the banking system. To help limit risks emanating from high exposure to the corporate sector, the NBK should consider introducing risk weights or exposure caps for corporate exposures. This will help the banking system withstand corporate credit losses by building capital buffers (see IMF Staff Guidance on Macroprudential Policy). Risk weights can help build buffers by affecting the supply of credit indirectly while FX exposure caps curtail the supply of credit directly. Reducing FX lending to borrowers whose earnings are not in FX should also be considered. This can be done through higher risk weights on such exposures. Tighter net open position limits are recommended to help reduce exchange rate risk.

Reducing credit risk: Even with concentration limits, credit concentration remains a significant risk to financial stability. Though concentrated large exposures have fallen from levels during the global financial crisis, at 208 percent of capital, they remain large. In 2014, the construction sector received the largest share of new corporate sector credit (24 percent) while it also had the largest share of new NPLs (41 percent, rising from 15 percent the previous year). The NBK should restrict bank exposures to single counterparties or groups of connected counterparties.

Proper implementation and enforcement of macroprudential tools is critical. Inconsistent implementation of macroprudential measures, as has been in the past, could add to regulatory uncertainty and result in ineffective incentive structures and a loss in confidence in the domestic financial system.

D. Structural Reforms

25. **The authorities recognized that the recent shocks to the economy reinforce the urgency of implementing structural reforms, to ensure durable long-term growth and shared prosperity.** Diversification away from the extractive industry and the reduction of the state footprint in the economy are necessary to sustain improvements in public welfare and to help create jobs for the growing population. Addressing infrastructure bottlenecks, strengthening human capital, building institutions, bolstering the rule of law, enhancing financial intermediation, and improving business climate have been identified by both the authorities and development partners as key areas where further improvements are essential to achieve broad and inclusive growth. The authorities' approach of working with MDB's to implement public spending and structural reforms should ensure greater efficiency and focus on priority areas. Staff also noted that additional efforts were needed to reverse the slowdown in key social indicators and protect the most vulnerable from the impact of the economic slowdown. Despite the authorities' declared commitment to ring fence social spending, budget cuts aimed at creating space for capital spending are adversely affecting key social programs (Annex IX).

26. **The public investment and reform program offers an opportunity to balance the short-term need for countercyclical state intervention and the long term goal of private sector-led growth.** Staff stressed that public investment should focus on areas beyond the reach of the private sector without expanding the state's footprint in the economy. Moreover, staff noted that reforms aimed at improving the business climate should include easing liquidity constraints and improving access to finance. The authorities' focus on large scale infrastructure projects and the SME subsidized loan program helps in this regard.

STAFF APPRAISAL

27. **Amid slower economic growth, tighter financial conditions, and emerging imbalances, policies should balance ensuring sustainability while alleviating the impact of shocks in the near term.** In recent years the authorities have successfully harnessed oil resources to bolster economic growth and build buffers. However, economic growth has now decelerated largely as a result of likely long-lasting external shocks and is expected to remain subdued this year and next year. Moreover, the outlook for growth is subject to predominantly downside external risks. In view of weaker growth, the large and likely long-lasting nature of the shocks, and the accumulated buffers, the policy response in the short term should be geared toward supporting the economic recovery. Over the medium term, there is a need to further strengthen macroeconomic policy frameworks, to bolster resilience to shocks and promote durable growth.

28. **To ensure fiscal sustainability, the stimulus must be accompanied by credible medium-term fiscal consolidation and more transparent fiscal policy framework.** The stimulus is justified on countercyclical grounds and is appropriately frontloaded and tailored to support growth. However, to ensure a sustainable path for the non-oil deficit, the stimulus must be accompanied by

credible medium-term consolidation measures, especially on the revenue side. In particular, there is scope to strengthen the enforcement of tax collection, reduce tax exemptions, including in the Special Economic Zones, and make income tax rates more progressive. Moreover, enhancing the fiscal policy framework is critical to ensuring transparency and medium-term sustainability. Key priorities include expanding the budget coverage to all fiscal activity, in line with GFSM 2001, and integrating fiscal policy into a broader macroeconomic policy framework.

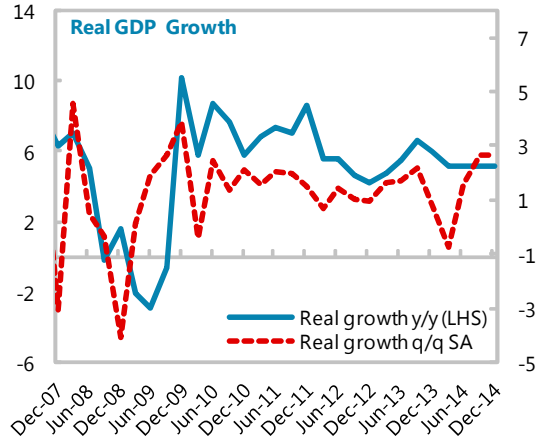
29. **Greater exchange rate flexibility in tandem with the introduction of new monetary policy instruments is needed to enhance the policy architecture and address imbalances.** The authorities have taken confidence-building measures to overhaul the monetary policy framework in support of their medium-term goal of adopting inflation targeting, and have widened the exchange rate band. However, with the aim of more effectively managing liquidity and signaling the stance of policy, the authorities should speed up the planned introduction of a new policy interest rate, supported by open market operations. Moreover, strengthening the policy architecture requires further exchange rate flexibility, which will support a more independent interest rate policy and help reduce imbalances. To avoid undermining financial stability, and anchor expectations about policy intentions and operations, the authorities should communicate their plans openly and consistently.

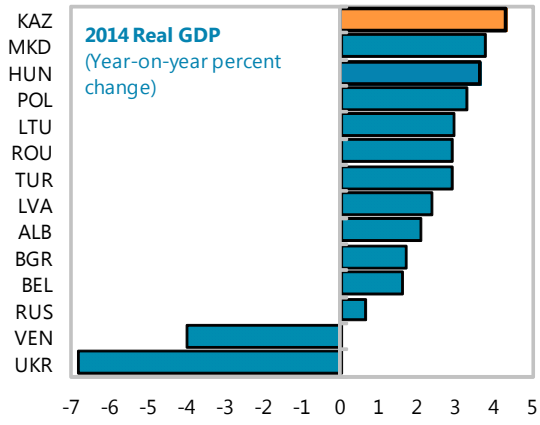
30. **In view of rising vulnerabilities, further actions are needed to bolster financial sector resilience.** Efforts underway to reduce the level of NPLs are paying off. However, more needs to be done to bring down the level of NPLs to sustainable levels, while ensuring that the achievement of the 10 percent prudential ceiling by end-2015 does not compromise proper loan classification and provisioning. In this regard, while the recent plans to refocus the NPL resolution framework at the merged KKB-BTA entity is appropriate, weaknesses in the bank should be addressed and an asset quality review be undertaken within a broad strategy to ensure long-term viability. Strengthening financial sector resilience also requires introducing higher risk weights or exposure caps on corporate lending, limiting FX lending to unhedged borrowers, and tightening net open position limits to mitigate credit risk. Further steps in implementing the FSAP recommendations include adopting risk-based assessment tools and supervision and finalizing legislative amendments in insurance, pensions, and the securities market.

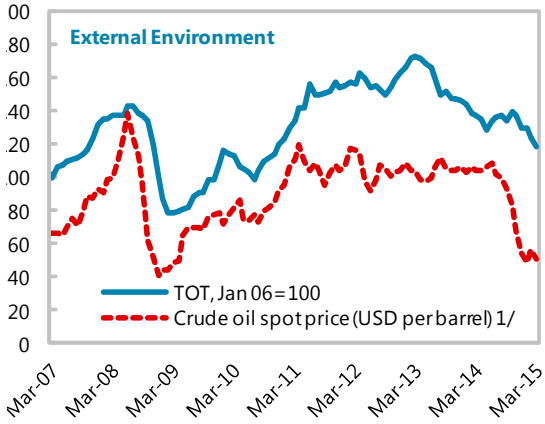
31. **The structural reform agenda is appropriately ambitious, but effective implementation is essential to achieving sustainable and inclusive growth.** Priority areas include strengthening human capital, building institutions, bolstering the rule of law, enhancing financial intermediation, and improving the business climate. Close collaboration with MDBs in these areas should facilitate greater efficiency in the procurement and implementation process. Moreover, diversification away from the oil sector and the reduction of the state footprint in the economy are necessary conditions to ensuring successful implementation of the broader private-sector-led growth strategy.

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

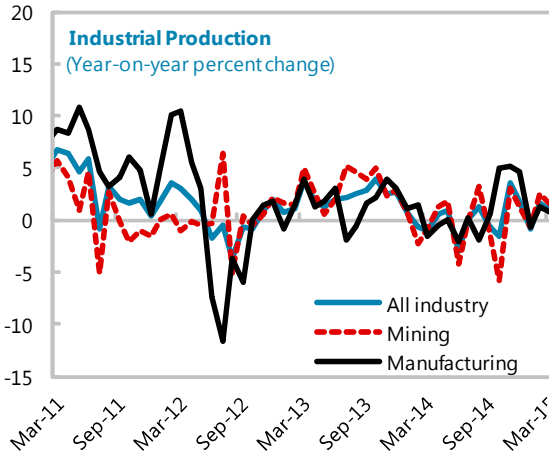
Figure 1. Kazakhstan: Economic Developments

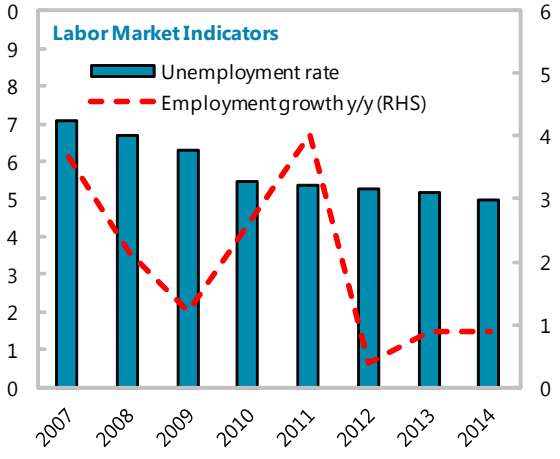


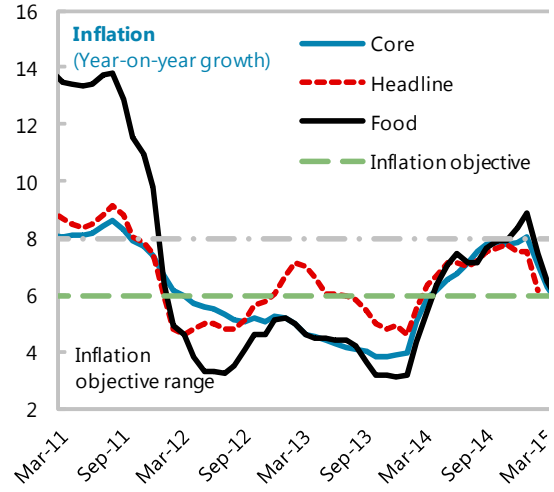




1/ Average petroleum spot price: simple avg. of UK Brent, Dubai Fateh, and West Texas Intermediate

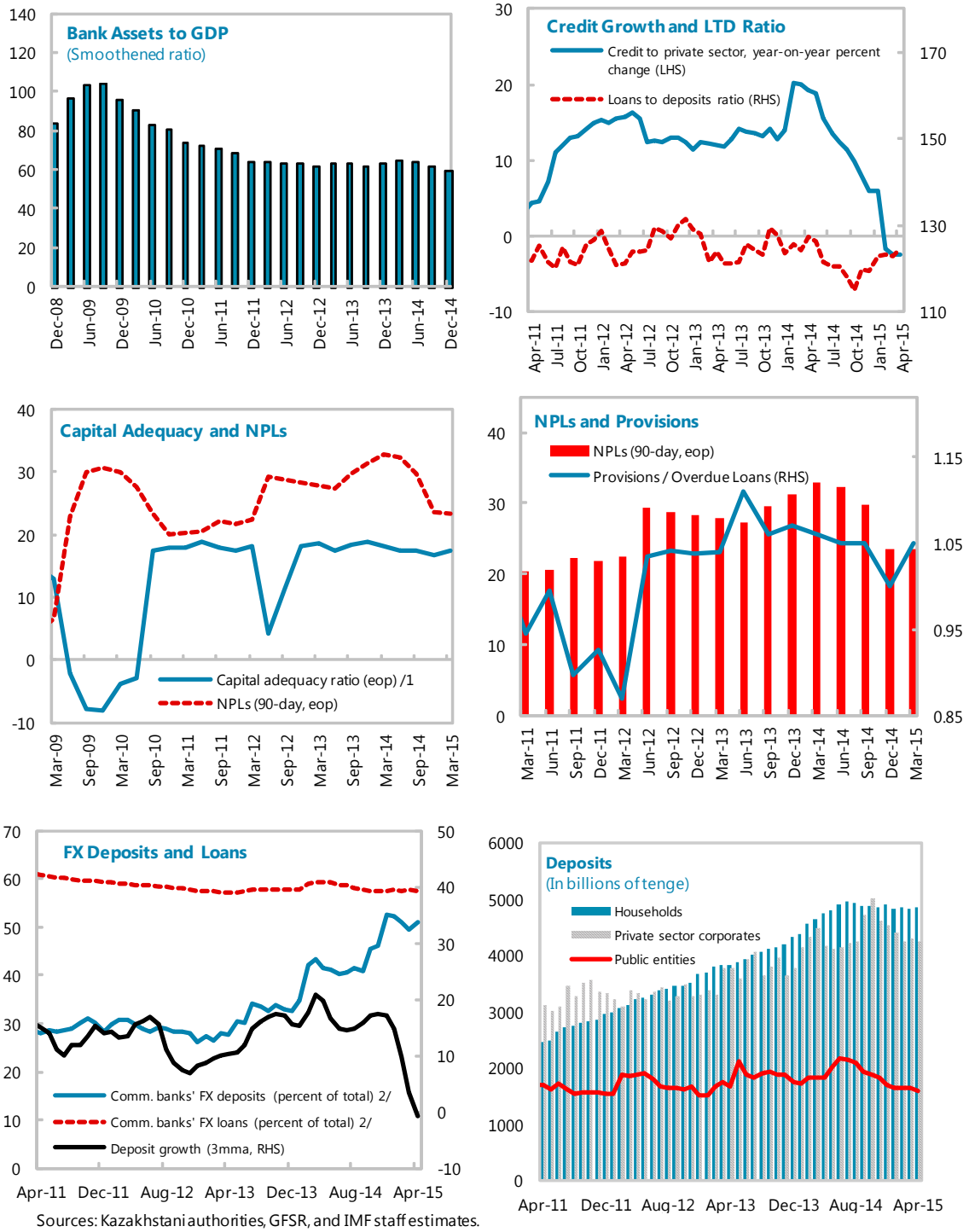






Sources: Kazakhstani authorities and IMF staff estimates.

Figure 2. Kazakhstan: Banking Sector Developments[1/]

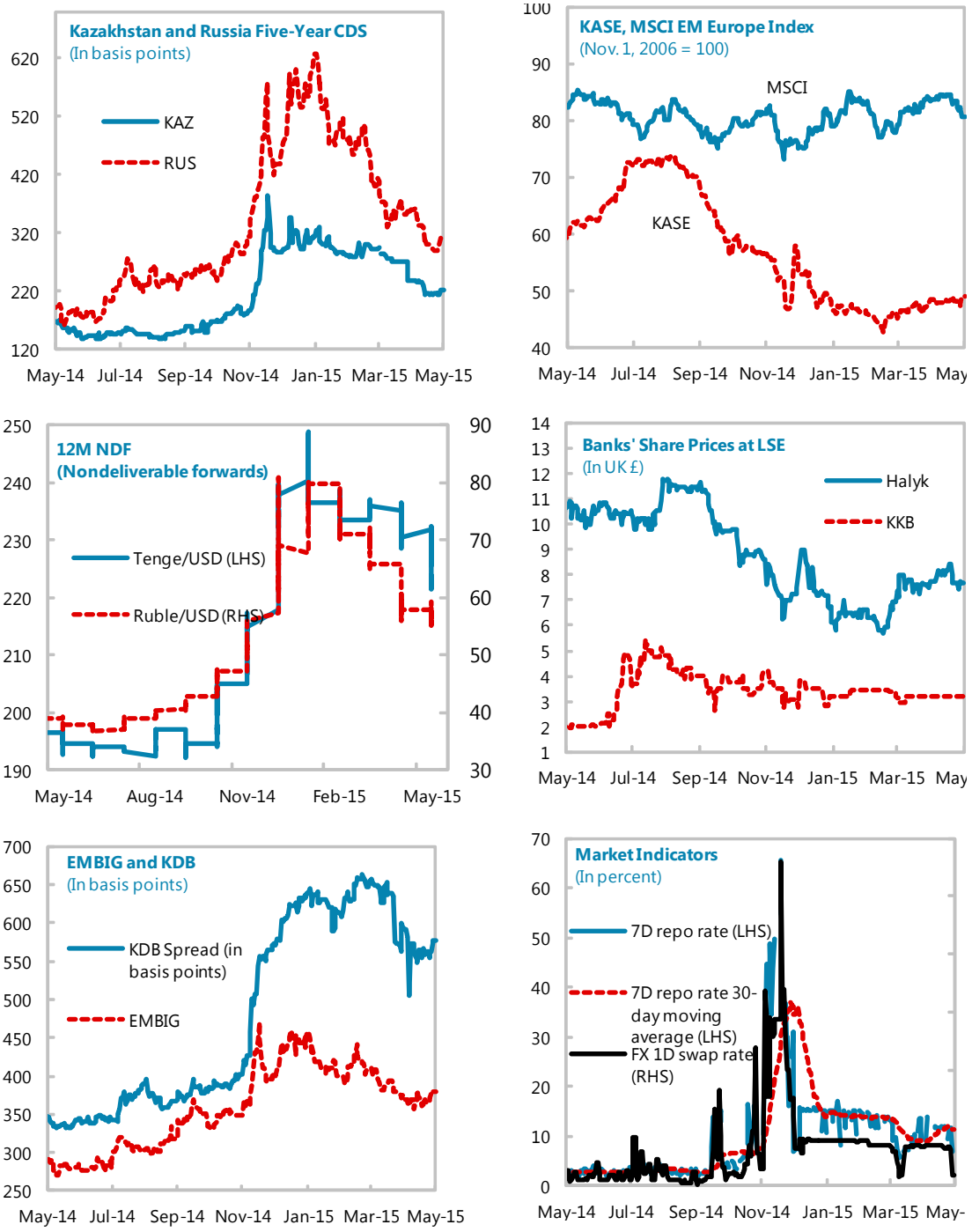


Sources: Kazakhstani authorities, GFSR, and IMF staff estimates.
1/Authorities did not provide systemwide CAR data during BTA's second debt restructuring, hence the gap in the CAR graph.
2/ Accounting for exchange rate valuation effects.

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

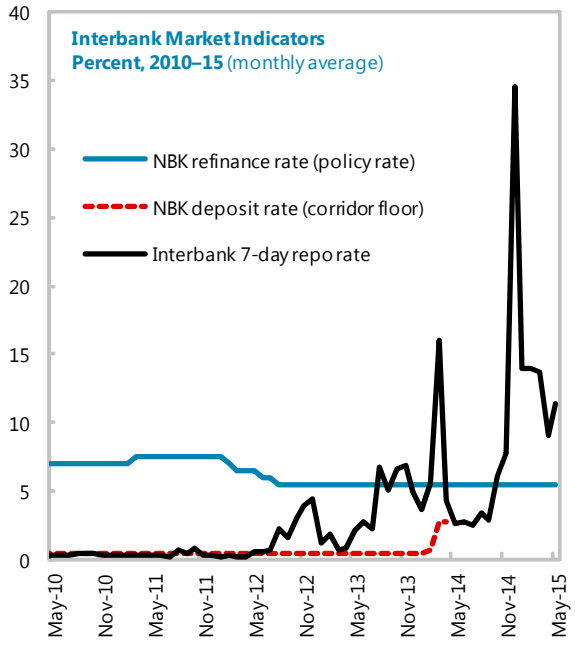
Sources: IMF FSI database and World Economic Outlook.

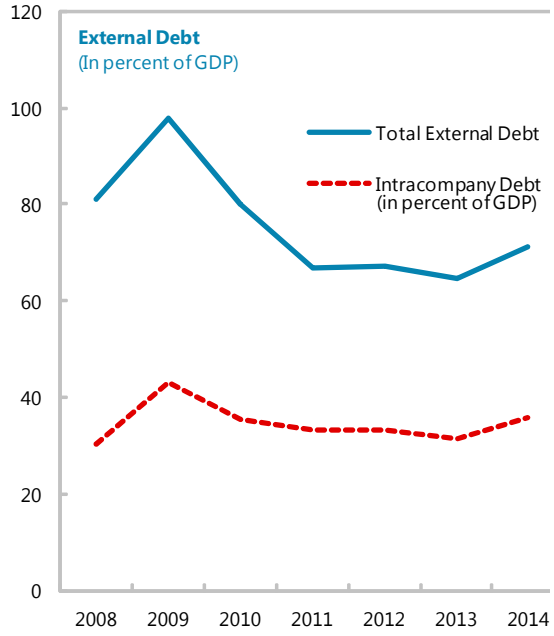
Figure 4. Kazakhstan: Capital Markets and Expected Default

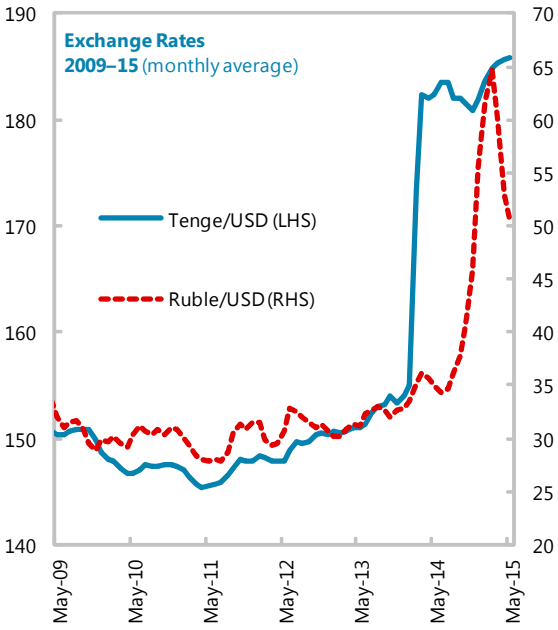


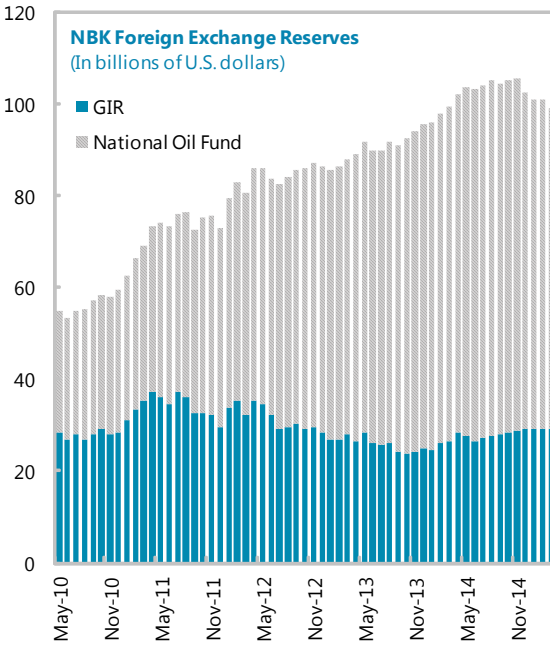
Source: Bloomberg.

Figure 5. Kazakhstan: Monetary and External Sector Developments



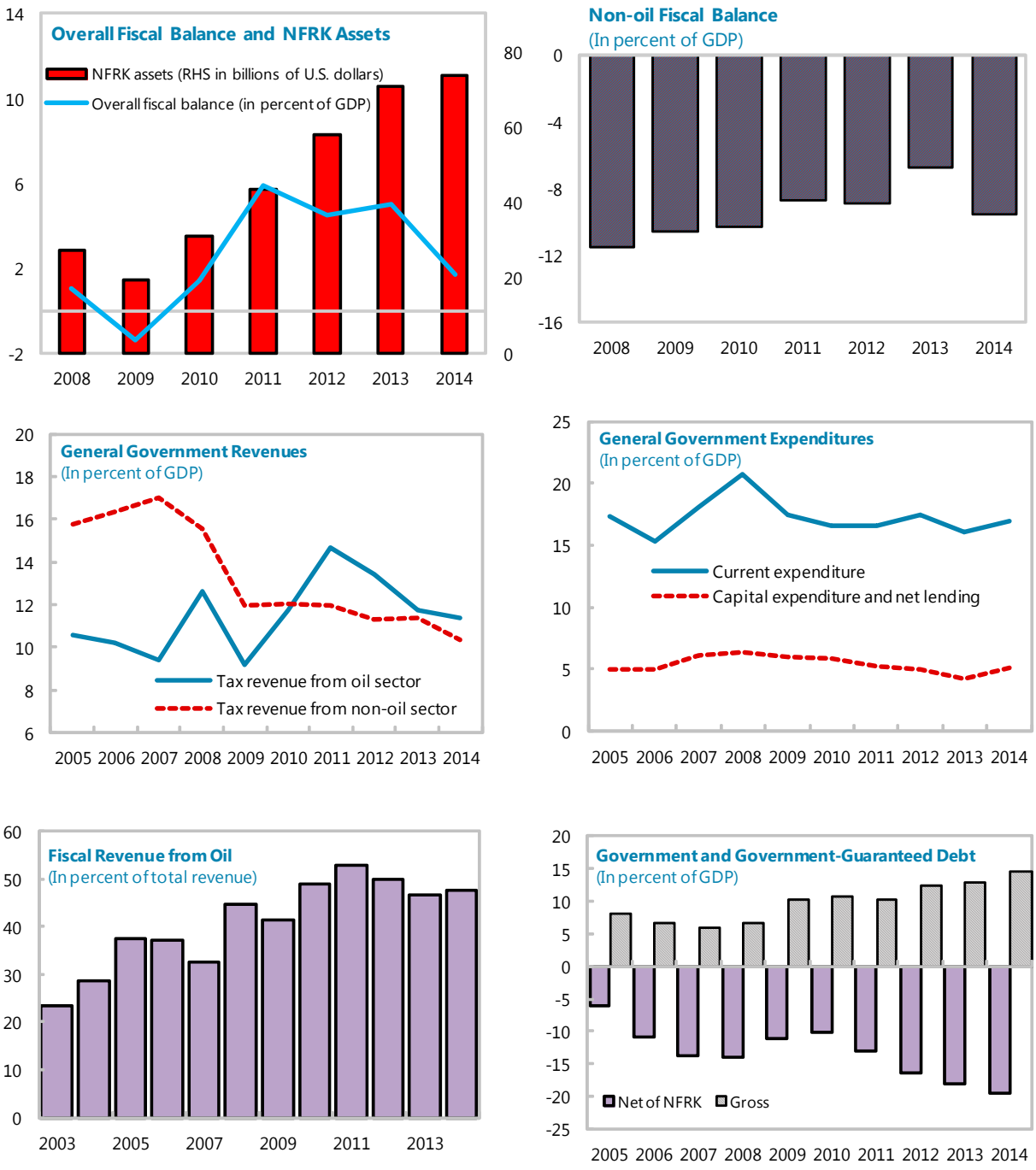






Sources: Kazakhstani authorities, Bloomberg, and IMF staff estimates.

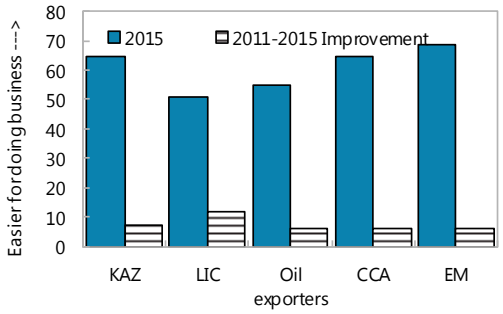
Figure 6. Kazakhstan: Fiscal Sector Developments and Outlook



Sources: Kazakhstani authorities and IMF staff estimates.

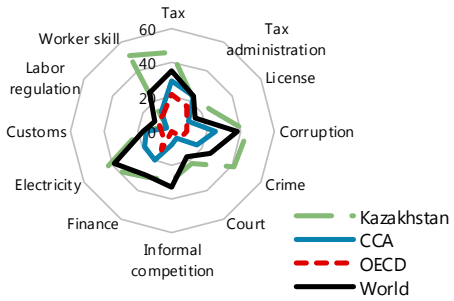
Figure 7. Kazakhstan: Business Environment and Governance Indicators

Ease of Doing Business
(Distance to frontier)



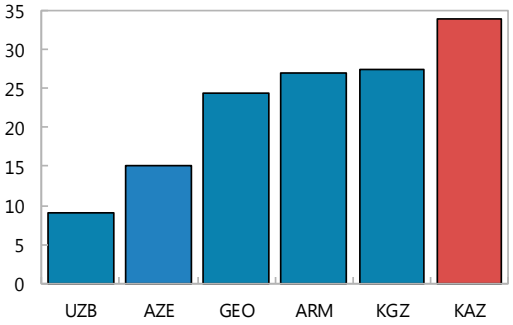
Sources: World Bank Doing Business (2015), and IMF staff

Firm-level Business Constraints
(percentage of firms identifying constraints)



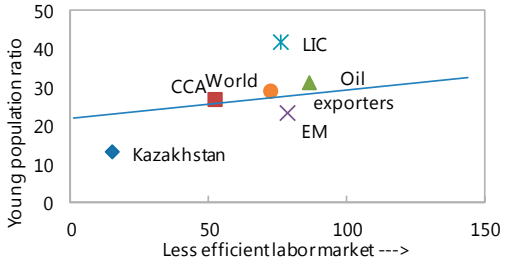
Sources: World Bank BEEP Survey (2008), and IMF staff calculations.

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



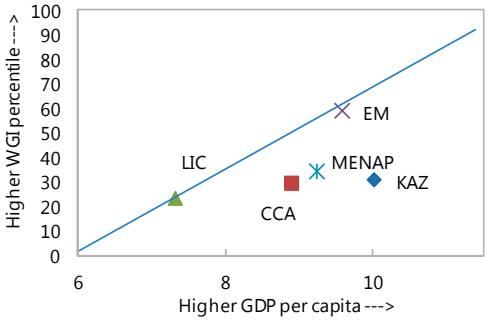
Sources: World Bank BEEPS, and IMF staff calculations.

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



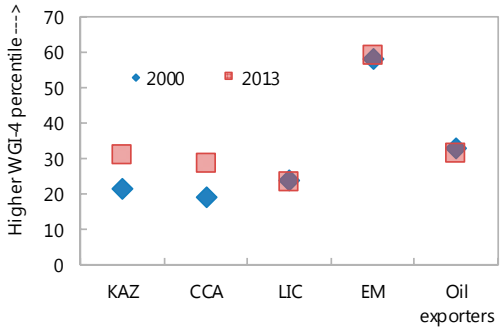
Sources: WEF Global Competitiveness Report (2014-15, pillar 7 without female participation and brain drain), WDI (2013), and IMF staff calculations; trend line is based on across country regression.

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, 2000-2013
(percentile rank)



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

Table 1. Kazakhstan: Selected Economic Indicators, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections			
				(Annual percent change, unless otherwise indicated)					
National accounts and prices									
Real GDP 1/	5.0	6.0	4.3	2.0	3.2	4.8	4.6	4.4	5.0
Real oil	-2.2	3.2	-1.3	-0.4	0.4	6.4	4.6	3.3	5.5
Real non-oil	8.0	7.0	6.3	2.8	4.1	4.3	4.6	4.7	4.8
Real consumption	9.9	9.8	1.5	0.5	7.1	5.3	5.2	4.4	4.7
Real investment	10.8	5.4	1.7	8.7	-1.5	2.0	2.8	4.8	2.3
Real exports	3.4	-0.9	1.8	2.3	2.3	5.9	4.7	4.1	7.3
Real imports	19.4	5.0	-6.7	5.8	5.9	4.4	4.3	4.5	4.5
Output gap (in percent of potental GDP)	0.1	1.0	0.7	-1.6	-2.6	-1.9	-1.2	-0.6	0.7
Crude oil and gas condensate production (million tons)	79	82	81	81	81	86	90	93	98
Consumer price index (p.a.)	5.1	5.8	6.7	5.2	5.5	5.4	5.7	6.0	6.0
Core consumer price index (p.a.)	5.6	4.3	6.7	4.2	5.0	5.4	5.7	5.7	5.7
GDP deflator	4.8	9.7	7.4	-2.6	7.0	6.0	6.1	6.0	5.5
Exchange rate (tenge per U.S. dollar; eop)	1.5	2.2	18.7	3.1	0.0	0.0	0.0	0.0	0.0
				(In percent of GDP, unless otherwise indicated)					
General government fiscal accounts									
Revenues and grants	26.9	25.3	23.8	19.8	20.8	20.8	20.5	20.0	19.7
Of which: Oil revenues	13.4	11.8	11.3	8.1	8.8	8.7	8.4	8.0	7.6
Expenditures and net lending	22.4	20.3	22.1	23.1	22.3	21.9	21.3	21.1	20.7
Overall fiscal balance	4.5	5.0	1.7	-3.2	-1.6	-1.1	-0.8	-1.0	-1.0
Financing	-4.1	-3.3	1.9	3.2	1.6	1.1	0.8	1.0	1.0
Domestic financing	2.7	2.1	1.5	2.6	2.5	3.4	3.9	4.6	5.0
Foreign financing	0.2	0.2	1.6	0.9	1.7	1.1	1.0	0.6	0.2
NFRK	-7.0	-5.5	-1.3	-0.3	-2.6	-3.4	-4.1	-4.1	-4.2
Gross public debt (percent of GDP)	12.4	12.9	14.5	18.1	20.5	22.9	25.5	28.2	30.7
Non-oil fiscal balance (percent of GDP)	-8.9	-6.8	-9.6	-11.4	-10.4	-9.8	-9.3	-9.0	-8.7
Non-oil fiscal balance (percent of non-oil GDP)	-13.0	-9.4	-13.4	-13.8	-12.6	-11.9	-11.3	-10.8	-10.3
				(Annual percent change, eop, unless otherwise indicated)					
Monetary accounts									
Reserve money	1.9	-2.2	20.8	6.9	7.5	8.3	8.3	8.3	8.3
Broad money	7.9	10.2	2.4	14.5	10.4	11.1	11.1	11.1	11.1
Broad money velocity (annual average)	2.9	3.0	3.3	2.9	2.9	2.9	2.9	2.9	2.9
Credit to the private sector 2/	11.6	12.7	5.7	-5.5	3.7	6.0	11.0	10.6	10.8
Credit to the private sector (percent of GDP) 2/	41.5	40.2	37.9	37.7	37.5	37.5	37.5	37.5	37.5
NBK refinance rate (eop; percent)	5.5	5.5	5.5	…	…	…	…	…	…
				(In billions of U.S. dollars, unless otherwise indicated)					
External accounts									
Current account balance (percent of GDP)	0.5	0.4	2.1	-3.3	-2.9	-1.9	-1.2	-1.1	-0.8
Exports of goods and services	91.8	90.7	85.4	60.0	64.6	70.6	76.1	80.1	86.4
Oil and gas condensate	56.4	57.2	53.6	32.7	35.8	39.7	43.1	44.9	48.1
Imports of goods and services	61.5	63.0	56.2	52.2	55.7	58.6	61.5	64.5	67.5
Foreign direct investments (net, percent of GDP)	-5.8	-3.4	-2.7	-2.5	-2.3	-2.1	-2.0	-1.8	-1.7
NBK gross reserves (eop) 3/	28.3	24.7	28.9	28.9	28.9	28.9	28.9	28.9	28.9
In months of next year's imports of goods and services	5.4	5.3	6.7	6.2	5.9	5.6	5.4	5.4	5.1
NFRK assets (eop)	57.9	70.8	73.6	74.2	80.2	88.9	100.6	113.6	128.2
Total external debt 4/	136.9	149.9	157.1	168.9	181.3	193.1	203.7	214.3	224.2
In percent of GDP	67.3	64.7	71.2	79.8	78.6	75.3	71.6	68.1	64.3
Excluding intracompany debt (percent of GDP)	34.1	32.8	35.3	41.3	42.3	41.8	40.6	39.3	37.7
Memorandum items:									
Nominal GDP (in billions of tenge)	30,347	35,275	39,530	39,285	43,365	48,194	53,502	59,156	65,522
Nominal GDP (in billions of U.S. dollars)	203.5	231.9	220.6	211.7	230.7	256.3	284.6	314.7	348.5
Saving-Investment balance (percent of GDP)	0.5	0.4	2.1	-4.5	-3.4	-2.1	-1.5	-1.3	-0.7
Crude oil, gas cnds. production (millions of barrels/day) 5/	1.65	1.70	1.68	1.68	1.68	1.79	1.87	1.94	2.04
Oil price (in U.S. dollars per barrel)	105.0	104.1	96.2	58.9	64.2	67.1	69.9	71.0	71.5

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, 2012–20

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

	2012	2013	2014	2015	2016	2017	2018	2019	2020
				Projections					
Current account	1.1	0.9	4.6	-7.0	-6.8	-4.8	-3.5	-3.3	-2.8
Trade balance	38.1	34.8	35.6	14.0	15.5	18.9	21.6	22.9	26.2
Exports (f.o.b.)	86.9	85.6	79.1	54.6	58.9	64.5	69.5	73.1	78.8
Oil and gas condensate	56.4	57.2	53.6	32.7	35.8	39.7	43.1	44.9	48.1
Non-oil exports	30.5	28.3	25.4	21.9	23.1	24.8	26.4	28.2	30.6
Imports (f.o.b.)	48.8	50.8	43.4	40.6	43.3	45.6	47.8	50.2	52.5
Oil and gas condensate	2.3	2.8	0.2	1.3	1.5	1.5	1.6	1.7	1.8
Non-oil, gas imports	46.5	48.0	43.2	39.2	41.8	44.0	46.2	48.5	50.8
Services and income balance	-36.0	-32.2	-29.3	-19.4	-20.5	-21.8	-23.0	-23.9	-26.4
Services, net	-7.9	-7.1	-6.4	-6.1	-6.6	-6.8	-7.1	-7.3	-7.4
Income, net	-28.1	-25.1	-22.9	-13.2	-13.9	-14.9	-16.0	-16.6	-19.0
Of which: Income to direct investors	24.8	22.5	19.9	10.8	11.5	12.4	13.4	14.0	16.4
Current transfers	-1.0	-1.6	-1.7	-1.6	-1.8	-1.9	-2.1	-2.3	-2.6
Capital and financial account	4.3	-0.3	-7.3	-7.0	-6.8	-4.8	-3.5	-3.3	-2.8
Foreign direct investment	-11.9	-7.9	-5.9	-5.4	-5.3	-5.4	-5.6	-5.7	-5.9
Portfolio investment, net	17.5	6.1	0.8	-0.4	0.3	0.6	0.9	1.0	1.1
Of which: National Fund	14.7	7.9	6.5	-2.7	2.6	5.1	7.6	8.5	9.5
Other investment	-1.3	1.5	-2.2	-1.3	-1.7	0.0	1.2	1.4	2.0
Errors and omissions	-1.1	-3.6	-8.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	4.3	2.4	-3.9	0.0	0.0	0.0	0.0	0.0	0.0
Financing: Net international reserves of NBK	-4.3	-2.4	3.9	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items: 1/				*(In percent of GDP)*					
Current account	0.5	0.4	2.1	-3.3	-2.9	-1.9	-1.2	-1.1	-0.8
Exports of goods	42.7	36.9	35.8	25.8	25.5	25.1	24.4	23.2	22.6
Oil exports	27.7	24.7	24.3	15.4	15.5	15.5	15.1	14.3	13.8
Non-oil exports	15.0	12.2	11.5	10.4	10.0	9.7	9.3	8.9	8.8
Imports of goods	24.0	21.9	19.7	19.2	18.8	17.8	16.8	15.9	15.1
				(Annual growth rate, in percent)					
Exports	2.0	-1.5	-7.6	-31.0	7.8	9.5	7.8	5.2	7.8
Non-oil exports	1.6	-7.0	-10.3	-13.8	5.3	7.4	6.6	6.6	8.8
Volume on non-oil exports	14.8	-4.0	-3.0	2.2	6.1	6.0	6.1	6.2	4.3
Average price of non-oil exports	-11.5	-3.2	-7.6	-15.6	-0.8	1.3	0.5	0.4	0.4
Imports	20.9	4.1	-14.5	-6.6	6.8	5.2	5.0	4.9	4.7
Oil and gas imports	-9.7	25.7	-93.4	606.5	12.0	3.1	4.7	3.3	5.6
Non-oil imports	22.9	3.1	-9.8	-9.2	6.6	5.2	5.0	4.9	4.7
Volume on non-oil imports	32.8	5.4	-6.1	3.0	4.3	4.3	4.5	4.5	4.5
Average price of non-oil imports	-7.7	-2.2	-4.1	-9.3	0.2	0.5	0.3	0.3	0.2
Exports of oil and gas condensate (in MT)	68.1	70.7	68.2	67.9	68.2	72.4	75.4	77.4	82.4
NBK gross international reserves (in billions of U.S. dollars)	28.3	24.7	28.9	28.9	28.9	28.9	28.9	28.9	28.9
In months of next year's imports of g&n.f.s. 2/	5.4	5.3	6.7	6.2	5.9	5.6	5.4	5.4	5.1
National Fund (including interest), e.o.p.	57.9	70.8	73.6	74.2	80.2	88.9	100.6	113.6	128.2
External debt in percent of GDP	67.3	64.7	71.2	79.8	78.6	75.3	71.6	68.1	64.3
Public external debt (percent GDP)	2.7	2.4	3.7	4.7	5.1	5.3	5.3	5.2	5.1
Private external debt (percent GDP)	64.6	62.2	67.5	75.1	73.5	70.0	66.3	62.8	59.2
Excluding intra-company loans (percent GDP)	34.1	32.8	35.3	41.3	42.3	41.8	40.6	39.3	37.7
World oil price (U.S. dollars per barrel)	105.0	104.1	96.2	58.9	64.2	67.1	69.9	71.0	71.5

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, 2008–14[1/]

	2008	2009	2010	2011	2012	2013	2014
Capital adequacy			*(In billions of tenge)*				
Regulatory capital	1948	-914	1821	1956	2072	2346	2629
Of which: Tier 1	1525	-1054	1419	1492	1561	1691	2063
Common shares and retained earnings	974	-1506	3621	2348	2375	2847	2969
Preferred shares	54	87	248	250	213	212	214
Hybrid instruments	103	67	44	43	38	39	46
Of which: Tier 2	495	312	451	515	510	661	641
Of which: Tier 3	1	1	2	2	1	2	2
Risk Weighted assets	13106	11327	10312	11331	11534	12698	15226
Of which: Credit risk	12528	8824	9439	10470	10905	12019	14397
Of which: Market risk	243	2028	296	282	235	296	318
Of which: Operational risk	336	475	578	579	394	384	512
				(In percent)			
Regulatory capital as percent of risk-weighted assets *	15	-8	18	17	18	18	17
Regulatory Tier I capital to risk-weighted assets *	12	-9	14	13	14	13	14
Capital as percent of assets *	12	-8	11	10	14	13	13
Asset quality							
Nonperforming loans (NPL) as percent of gross loans *	5	22	24	31	30	31	24
Provisions as percent of NPL	69	75	63	70	77	83	80
NPL net of provisions as percent of tier I capital *	10	-48	56	65	52	41	32
Large exposures as percent of tier I capital *	166	-279	216	252	264	256	243
(10-largest credit to net credits) 25-largest credit to total loans	27	31	34	36	35	32	35
				(In billions of tenge)			
Written off loans**	43	82	162	153	235	308	2,230
Earnings and profitability				*(In percent)*			
Gross profits as percent of average assets (ROAA) *	0	-24	12	0	2	2	2
Gross profits as percent of average equity capital (ROAE) *	1	-1198	843	-3	13	13	13
Net interest margin (net interest income as percent of interest bearing assets) *	6	4	3	4	4	5	5
Gross income as percent of average assets	7	4	16	5	13	8	8
Net interest income as percent of gross income	77	105	16	71	27	60	57
Non-interest income as percent of gross income	23	-5	84	29	73	40	43
Trading net income as a percent of gross income *	3	-43	0	-2	-3	4	2
Non-interest expenses as percent of gross income *	35	65	21	68	68	38	39
Personnel expenses as percent of non-interest expenses *	32	34	26	31	12	37	37
Liquidity							
Liquid assets as percent of total assets *	14	19	21	21	18	17	18
Liquid assets as percent of short-term liabilities *	49	53	64	58	47	48	53
Foreign currency loans as percent of total loans *	52	57	50	44	38	38	37
Foreign currency liabilities as percent of total liabilities *	60	54	44	40	35	38	51
Deposits as percent of assets (excluding interbank deposits)	39	53	57	61	61	64	62
Of which: Household deposis	13	17	19	22	25	26	24
Of which: Corporate deposits	26	35	38	39	37	38	38
Of which: Interbank deposits	3	2	2	1	1	2	2
Of which: Other	19	16	1	1	1	1	1
Other wholesale/market-based funding as percent of assets	26	38	29	27	22	20	21
Loans as percent of deposits *	198	156	131	132	135	134	124
Sensitivity to market risk							
Off-balance sheet operations as percent of assets	82	79	63	76	76	74	86
Gross asset position in derivatives as a percentage of tier I capital *	12	-8	3	2	5	6	8
Gross liability position in derivatives as a percentage of tier I capital *	9	-7	5	4	5	6	7
Net (long) open position in foreign exchange as a percentage of tier I capital *	6	162	-3	-1	-5	-3	-2

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: Monetary Accounts, 2010–14

	2010	2011	2012	2013	2014
	(End of period, in billions of tenge)				
Monetary Survey					
Net Foreign Assets	4,482	5,261	5,788	6,426	7,408
Net Domestic Assets	4,125	4,964	5,258	5,922	6,578
Domestic Credit	10,037	11,593	13,081	14,789	15,578
Net claims on central government	158	302	482	594	579
Net claims on other government	7	8	7	7	5
Credit to the private sector 1/	9,872	11,283	12,592	14,188	14,993
Claims on households	2,243	2,483	3,026	3,807	4,201
Other items, net	-5,912	-6,629	-7,823	-8,868	-9,000
Broad money	8,483	9,752	10,522	11,598	11,882
Currency in circulation	1,148	1,366	1,528	1,512	1,398
Total deposits	7,334	8,387	8,994	10,086	10,484
Nonliquid liabilities	116	148	169	208	203
Statistical discrepancy	123	473	607	1,163	1,098
Accounts of NBK					
Net foreign assets 2/	4,054	4,269	4,171	3,742	5,199
Net international reserves 2/	4,087	4,269	4,182	3,724	5,100
Net domestic assets 2/	-1,320	-949	-572	-140	-525
Net domestic credit	-527	-79	457	671	871
Net claims on central government	-313	-382	-660	-733	-1,081
Net claims on other government	0	0	0	0	0
Net claims on the private sector 1/	132	147	171	179	292
Net claims on banks	-418	-64	403	553	701
Other items, net	-793	-870	-1,029	-810	-1,396
Reserve money	2,572	2,837	2,890	2,826	3,414
Currency in circulation	1,306	1,548	1,737	1,763	1,382
Liabilities to banks	722	728	724	844	1,500
Required reserves	292	631	665	804	1,399
Other liabilities	429	97	59	39	101
Demand deposits	544	561	429	219	531
Other deposits	0	0	0	0	0
Other liquid liabilities	38	9	102	28	29
Deposit money banks					
Net foreign assets	428	992	1,617	2,683	2,209
Net domestic assets	7,400	7,861	8,479	9,017	11,278
Domestic credit	11,689	12,838	14,046	15,769	17,416
Net claims on central government	399	463	600	656	701
Net claims on other government	7	8	7	7	5
Credit to the private sector 1/	9,740	11,136	12,420	14,009	14,758
Net claims on other financial corporations	346	316	377	560	514
Banks' reserves	1,542	1,231	1,018	1,097	1,951
Other items, net	-4,289	-4,977	-5,567	-6,752	-6,138
Banks' liabilities	7,828	8,854	10,096	11,700	13,487
Demand deposits	2,068	2,762	2,600	2,636	2,971
Other deposits	4,684	5,055	5,864	7,203	8,163
Other liabilities	1,076	1,037	1,632	1,861	2,353
Memorandum items:					
Reserve money (percent change, y-o-y)	5.0	10.3	1.9	-2.2	20.8
Broad money (percent change, y-o-y)	13.3	15.0	7.9	10.2	2.4
Credit to private sector (percent change, y-o-y)	5.6	14.3	11.6	12.7	5.7
Velocity of broad money	2.6	2.8	2.9	3.0	3.3
Money multiplier	3.3	3.4	3.6	4.1	3.5
Foreign currency deposits (in percent of total deposits) 3/	37	33	30	37	58
Foreign currency loans (in percent of total loans) 3/	37	32	28	28	27

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.

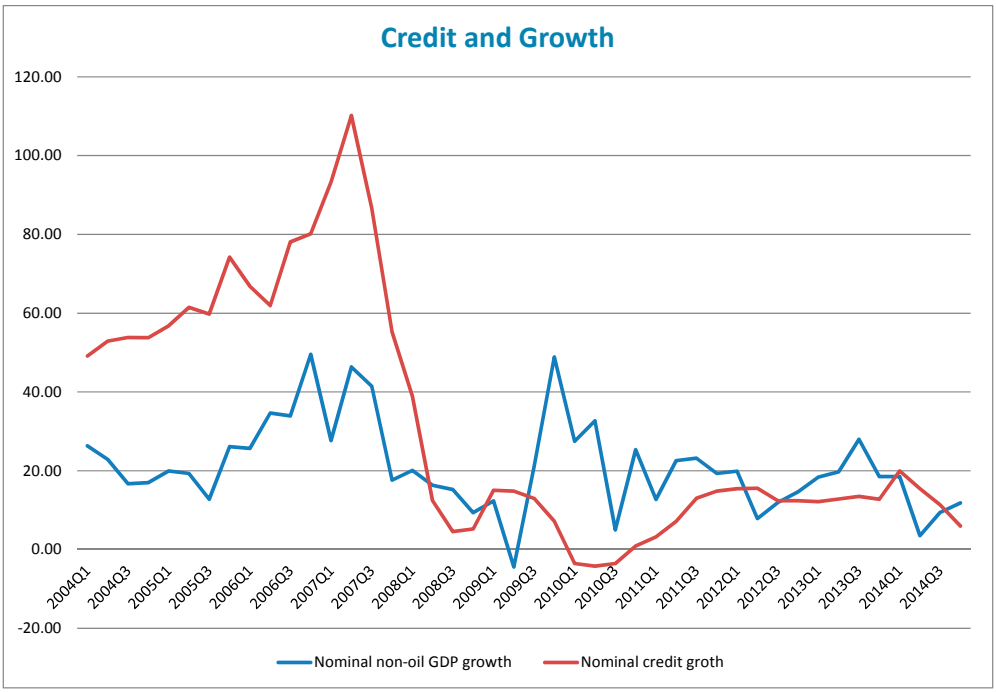
Table 5. Kazakhstan: General Government Fiscal Operations, 2012–20

	2012	2013	2014	2015	2016	2017	2018	2019	2020
						Projections			
				(In billions of tenge)					
Total revenue and grants	8,170	8,911	9,420	7,797	9,009	10,016	10,966	11,851	12,910
Tax revenue	7,507	8,176	8,583	6,917	8,092	9,023	9,868	10,621	11,531
Oil	4,076	4,150	4,486	3,201	3,813	4,188	4,513	4,711	5,001
Non-oil	3,431	4,025	4,097	3,715	4,280	4,835	5,355	5,909	6,530
Income from capital transactions	39	38	51	51	51	51	51	51	51
Nontax revenue	624	698	786	829	865	942	1,046	1,179	1,328
Grants	0	0	0	0	0	0	0	0	0
Total expenditure and net lending	6,810	7,151	8,733	9,056	9,686	10,531	11,413	12,461	13,588
Total expenditure	6,676	7,067	8,367	8,663	9,533	10,421	11,290	12,325	13,437
Current expenditure	5,291	5,668	6,701	6,224	6,989	7,809	8,659	9,644	10,676
Capital expenditure	1,385	1,399	1,666	2,439	2,545	2,612	2,631	2,681	2,761
Net lending 1/	134	83	366	393	153	111	123	136	151
Overall balance	1,360	1,761	687	-1,259	-677	-515	-447	-610	-678
Non-oil balance	-2,716	-2,390	-3,799	-4,460	-4,490	-4,704	-4,960	-5,322	-5,679
Statistical discrepancy	127	595	1,427	0	0	0	0	0	0
Financing	-1,234	-1,166	740	1,259	677	515	447	610	678
Domestic financing, net	817	718	563	1,013	1,050	1,609	2,075	2,688	3,254
Foreign financing, net	68	54	651	345	724	536	536	348	160
Privatization receipts	14	20	21	21	21	21	21	21	21
NFRK 2/	-2,133	-1,957	-496	-120	-1,118	-1,651	-2,185	-2,447	-2,757
				(In percent of GDP)					
Total revenue and grants	26.9	25.3	23.8	19.8	20.8	20.8	20.5	20.0	19.7
Tax revenue	24.7	23.2	21.7	17.6	18.7	18.7	18.4	18.0	17.6
Oil	13.4	11.8	11.3	8.1	8.8	8.7	8.4	8.0	7.6
Non-oil	11.3	11.4	10.4	9.5	9.9	10.0	10.0	10.0	10.0
Income from capital transactions	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Nontax revenue	2.1	2.0	2.0	2.1	2.0	2.0	2.0	2.0	2.0
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	22.4	20.3	22.1	23.1	22.3	21.9	21.3	21.1	20.7
Total expenditure	22.0	20.0	21.2	22.1	22.0	21.6	21.1	20.8	20.5
Current expenditure	17.4	16.1	17.0	15.8	16.1	16.2	16.2	16.3	16.3
Capital expenditure	4.6	4.0	4.2	6.2	5.9	5.4	4.9	4.5	4.2
Net lending 1/	0.4	0.2	0.9	1.0	0.4	0.2	0.2	0.2	0.2
Overall balance	4.5	5.0	1.7	-3.2	-1.6	-1.1	-0.8	-1.0	-1.0
Non-oil balance	-8.9	-6.8	-9.6	-11.4	-10.4	-9.8	-9.3	-9.0	-8.7
Financing	-4.1	-3.3	1.9	3.2	1.6	1.1	0.8	1.0	1.0
Domestic financing, net	2.7	2.0	1.4	2.6	2.4	3.3	3.9	4.5	5.0
Foreign financing, net	0.2	0.2	1.6	0.9	1.7	1.1	1.0	0.6	0.2
Privatization receipts	0.0	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
NFRK 2/	-7.0	-5.5	-1.3	-0.3	-2.6	-3.4	-4.1	-4.1	-4.2
Memorandum items:									
Non-oil balance (in percent of non-oil GDP)	-13.0	-9.4	-13.4	-13.8	-12.6	-11.9	-11.3	-10.8	-10.3
Non-oil revenues (in percent of non-oil GDP)	19.6	18.7	17.4	14.3	14.6	14.8	14.7	14.5	14.4
Gross public debt (percent of GDP) 3/	12.4	12.9	14.5	18.1	20.5	22.9	25.5	28.2	30.7
NFRK assets (in billions U.S. dollars) 1/	57.9	70.8	73.6	74.2	80.2	88.9	100.6	113.6	128.2
Nominal GDP (in billions KZT)	30,347	35,275	39,530	39,285	43,365	48,194	53,502	59,156	65,522

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.

Annex I. Credit Intermediation and Economic Growth in Kazakhstan[1]

1. **Examination of quarterly credit and GDP data for the past ten years shows co-movement of credit and non-oil GDP growth.** Within that dynamic, nominal credit growth outstripped nonoil GDP growth up to the global financial crisis and lagged behind ever since. As a result, financial deepening turned into disintermediation from 2007.



2. **However, a causal link from credit to non-oil GDP is difficult to discern.** Unrestricted VAR of log credit and log non-oil GDP (quarterly data) with a 4 period lag reveals no causality in either direction. The addition of key exogenous, variables such as the oil price and a dummy for the financial crisis does not improve the outcome. The results are consistent with available information. The credit boom in the run up to the financial crisis was driven by wholesale funds from abroad feeding a real estate bubble. Dynamics in the credit market since 2008 have been dominated by the legacy of the crisis especially the NPL overhang.

3. **Credit is found to have a marginal impact on non-oil GDP growth.** To examine the relationship between credit and growth we fitted a regression with the following specification:

$$LNGDP\_XO=C+\alpha LCREIDT\_N+\beta NGDPXO(-4)+\gamma DUM+u$$

[1] Prepared by Yahia Said.

Where LNGDP_XO and LNGDP_XO(-4) are the logs of nominal non-oil GDP for t and t-4. LCREDIT_N is the log of nominal credit outstanding and DUM is a dummy for the 2008 financial crisis. The output below shows that a 1 percent change in nominal credit affects nominal non-oil GDP on average by 0.12 percent.

Dependent Variable: LNGDPXO
Method: Least Squares
Date: 06/29/15 Time: 11:15
Sample (adjusted): 2004Q1 2014Q4
Included observations: 44 after adjustments

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	0.171471	0.597623	0.286922	0.7757
LCREDIT_N	0.123990	0.052664	2.354346	0.0236
LNGDPXO(-4)	0.873092	0.044738	19.51581	0.0000
DUM	-0.074018	0.061429	-1.204933	0.2353

R-squared	0.983637	Mean dependent var	14.87075
Adjusted R-squared	0.982410	S.D. dependent var	0.632069
S.E. of regression	0.083829	Akaike info criterion	-2.033565
Sum squared resid	0.281093	Schwarz criterion	-1.871366
Log likelihood	48.73843	Hannan-Quinn criter.	-1.973414
F-statistic	801.5339	Durbin-Watson stat	1.553109
Prob(F-statistic)	0.000000		

4. **The weak link between credit and growth can be explained by the shallowness and compartmentalization of the credit sector.** The chart below depicts the various segments of the credit sector and the dynamics affecting them.

Credit Is Compartmentalized Into Distinct Markets with Different Sources of Funding

Sectors/Categories of Borrowers	Sources of Funds	Current Dynamics
Energy and extractives, subsidiaries of foreign companies and state owned/quasi-sovereign entities	Wholesale foreign borrowing including syndicated loans and bonds. FDI in the form of intra-company debt. Limited domestic borrowing, mainly short term	Slowdown due to fall in oil and other commodity prices, lower demand from China and to some extent public spending cuts.
Construction and real estate, mainly private sector companies	Wholesale funding from abroad up to 2007, limited domestic borrowing since	Yet to recover from the 2007/2008 crash caused by the sudden stop of external financing. Depressed real estate values, NPL overhang and lack of long term domestic financing continue to weigh on the sector
Manufacturing, agricultures, trade, and services, mainly private sector SME's	Primarily, own resources, some domestic borrowing, including subsidized state and MDB supported loans	Potential for growth hampered by high borrowing costs and shortage of long term domestic financing. Most businesses have no access to finance
Private consumption	Domestic uncollateralized borrowing	Robust demand but risk from slowdown in real income growth

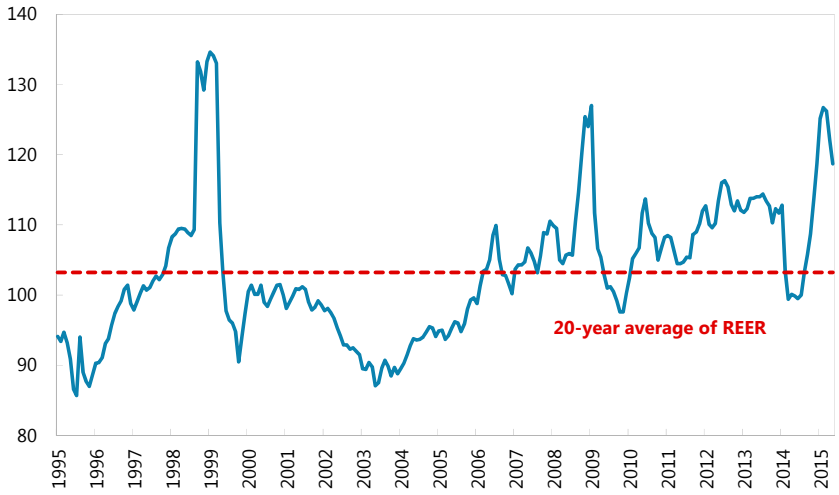
Annex II. Assessment of Kazakhstan's External Position[1]

Kazakhstan's external position has weakened over the past year. This assessment is based on (i) growing estimated exchange rate misalignment; (ii) widening current account deficit; and (iii) worsening reserves-adequacy position.

1. **Staff assesses the real exchange rate as modestly overvalued.** The real effective exchange rate has appreciated over the past year, mainly reflecting the depreciation of the ruble and sharp appreciation of the U.S. dollar, against which the tenge is tightly managed. Based on staff's estimates and projections, the misalignment is judged to be in the range of 4–14 percent depending on what approach is used. The estimates are naturally subject to methodological uncertainties and data limitations. Based on the Fund's External Balance Assessment (EBA-lite) methodology, the tenge's real effective exchange rate is viewed as overvalued by around 14 percent (Table 1). The EBA-lite analysis reflects values for the cyclically adjusted fiscal balance, consistent with medium-term sustainability, and other policy values (e.g., private credit/GDP and the capital control index) that are consistent with established international benchmarks. Based on CGER calculations, the tenge is assessed as overvalued in the range of 4–14 percent (Table 2). The authorities, in contrast, do not view the exchange rate as significantly overvalued, in light of last year's devaluation and the recent rebound in oil prices and Russian ruble appreciation. Moreover, they point out that, given the high volatility of the ruble and the predominantly speculative nature of local money markets, any estimated misalignment should be considered with a great deal of caution. The authorities expect the misalignment to disappear by end-2015.

Real Effective Exchange Rate (REER)

(December 2000=100)



Source: National Bank of Kazakhstan; last data point: May 2015.

[1] Prepared by Matteo Ghilardi and Yahia Said.

Table 1: EBA-lite Assessment

	Current Value	Desirable Value
Current Account (percent of GDP) 1/	-2.5	0.1
Cyclically adjusted fiscal balance (percent of GDP)	-2.9	3.6
Change in reserves (percent of GDP)	0.0	0.0
Private credit (percent of GDP)	33.3	60.0
Capital control index	0.8	0.5
Real Exchange Rate Gap		**14.2**

1/ For the current account, Current Value reflects the last four quarters (2014Q3-2015Q2p), while the Desirable Value reflects staff's estimated current account norm.

Table 2. CGER Assessment [1/]

	Underlying CA (Percent of GDP)	CA Norm (Percent of GDP)	Estimated over(+)/ under(-) valuation
Macroeconomic Balance	-0.9	0.1	5.7
Equilibrium Real Exchange Rate	n.a.	n.a.	4.1
External Sustainability [2/]	-0.9	1.6	13.6

Sources: Kazahkstani authorities and IMF staff estimates and projections.

1/ Based on coefficients estimates for net oil exporters from "*Are Middle Eastern Current Account Imbalances Excessive*" WP/11/195.

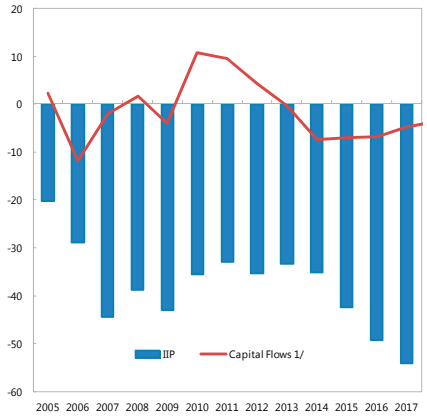
2/ NFRK assets included. The CA norm is the adjusted current account balance needed to stabilize the average 2018-20 NFA position.

2. **The current account position is expected to worsen in the near term.** The current account deficit during the first quarter of 2015 was 0.5 percent of GDP—smaller than previously expected. Still, given the external backdrop (lower oil prices, slowing external demand, strong tenge), staff projects a current account deficit of around 3½ percent of GDP for the full year and 3 percent of GDP next year. Moreover, following sustained current account surpluses in earlier years, the current account position is only expected to gradually improve and remain in small deficit over the medium term. Similarly, Kazakhstan's international investment position is expected to decline over the coming years.

Kazakhstan: Current Account Deficit
(in percent of GDP)

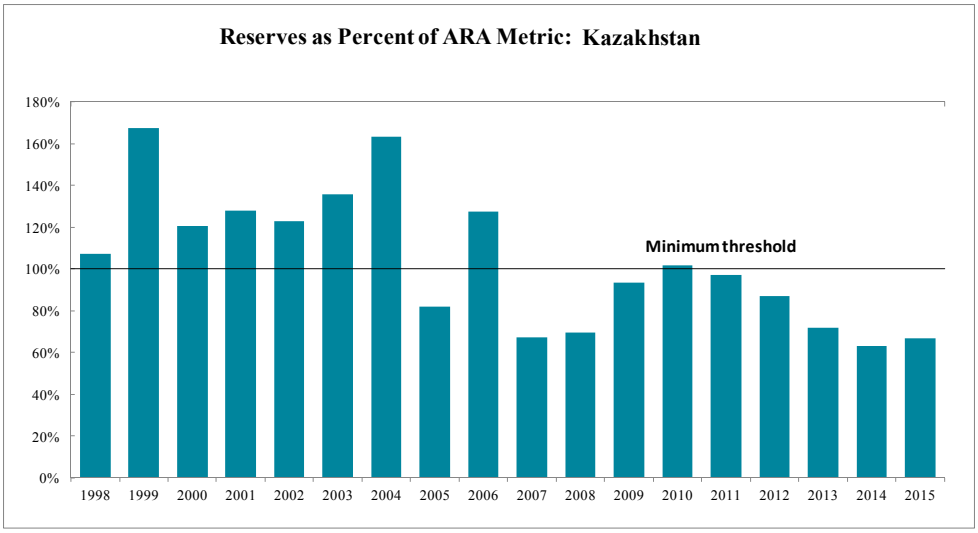
Sources: NBK, and IMF staff estimates.

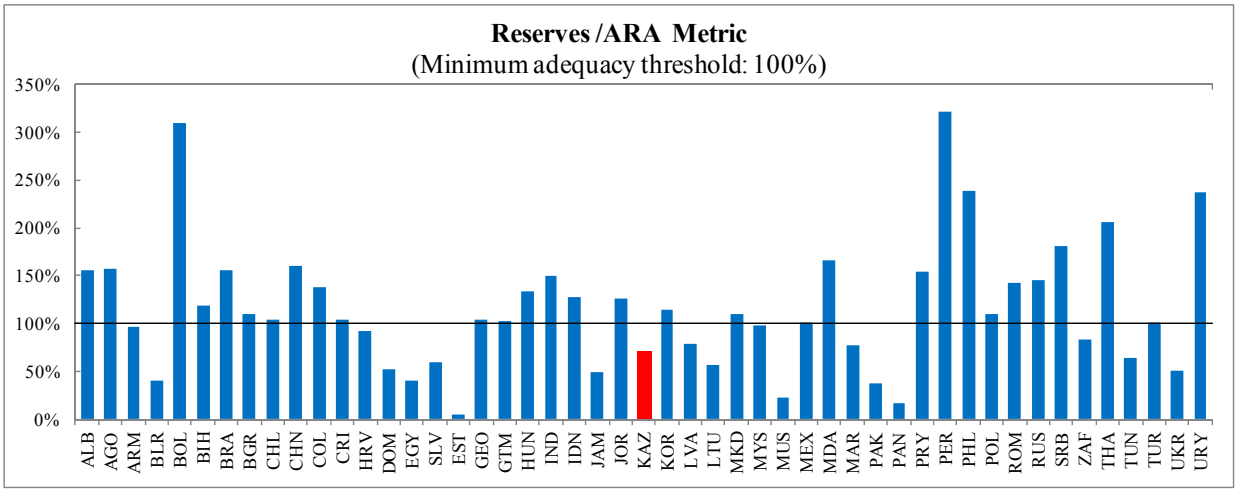
Kazakhstan: International Investment Position (IIP) and Capital Flows
(in USD billion)



Sources: NBK, and IMF staff estimates.
1/ Capital flows include net foreign direct investment, net portfolio investment, and other net investment.

3. **NBK's reserves have been under pressure, while the oil fund remains large.** Based on the IMF ARA methodology,[1] central bank gross reserves (i.e., excluding the national oil fund) remain below the suggested adequacy range of 100–150 percent, and are also below those in emerging markets and CCA peers (Panel Figure). Moreover, while headline gross reserves figures have been stable in recent months (around $29 billion), reserves include increased FX swaps and banks' correspondent accounts with the NBK (the latter reflects the sharp increase in the dollarization of bank deposits). At the same time, the oil fund, with an accumulated value of around $75 billion (35 percent of GDP), provides a significant buffer for the economy as a whole.





[1] The Assessing Reserve Adequacy (ARA) Metric captures the adequacy of central bank reserves in terms of GDP and balance of payments developments, including imports, portfolio and other investment liabilities, and short-term external debt (at remaining maturity). Since Kazakhstan falls into the group of resource dependent countries with oil exports exceeding 50 percent of GDP, this suggests the need for higher buffers to reflect the added volatility in oil prices. Recalculating the ARA metric with oil prices one standard-deviation lower than currently projected results in a wider shortfall from the adequacy threshold.

Annex III. Kazakhstan: Stress Testing the Banking System[1]

As an oil exporting economy, lower oil prices have a negative impact on Kazakhstan's financial sector and on economic activity more generally. This annex describes the solvency stress test that was performed on Kazakhstan banks to assess the impact on bank solvency of two shocks: lower oil prices and exchange rate depreciation. Real GDP growth responds to oil prices given elasticity from staff's macroeconomic framework. Stress tests on bank balance sheets as of end 2014 (latest available) reveal that the banking system is in a weak position to withstand shocks. In the baseline, before any shocks are applied, three banks have capital adequacy ratios (CAR) below the regulatory minimum of 12 percent. The downside scenario has 3 banks below the regulatory minimum. In the severe scenario, 17 banks (89 percent of banking system assets) do not meet regulatory minimum standards and recapitalization needs amount to 3 percent of GDP. The 2014 FSAP also found the banking system unable to withstand shocks (tail risks) based on stress tests on balance sheets as of end 2013. However, system resilience to shocks has decreased further with weaker of bank balance sheets in an environment of low domestic activity and profitability, and the legacy of high nonperforming loans (NPLs) that continue to hamper credit.

A. Insights from the 2014 FSAP Stress Tests

1. **The tests showed that banks are in a weak position to withstand shocks:**

- The initial baseline was adjusted to take account of the 2014 exchange rate devaluation and the phase-out of capital instruments ineligible under Basel III. This adjustment resulted in 7 banks (accounting for nearly half of the system's assets) failing to meet regulatory minimum with a capital shortfall equivalent to 2½ percent of GDP.

- In the Stress scenarios, two additional banks failed to meet capital requirements, bringing the total to 9 banks accounting for slightly more than half of the banking system's assets. Under the more severe scenario, the capital deficiency reaches 5 percent of GDP. An oil price shock with prices at $40 per barrel (pb), assessed in combination with the risk of lower-than-anticipated growth potential in emerging markets—especially in Russia and China resulted in a decline in real GDP of 9 percentage points over two years, corresponding to a one-standard deviation move in two-year cumulative growth, or the highest decline registered since the break-up of the Soviet Union. Nine banks failed to meet the regulatory minima.

- The stress tests revealed the main risks to be foreign exchange (FX) and concentration risks. The exchange rate was found to be a key driver of indirect credit risk for both the corporate and the household/SME sectors, and oil prices are also important determinants of corporate credit quality. Direct FX risk, however, appeared low due to the cap on open positions. Concentration risk, measured by the impact of a default of the largest 3 exposures of each bank, was found to be high as capital ratios fell by around 7 percentage points from their baseline level. 11 banks

[1] Prepared by Nombulelo Duma.

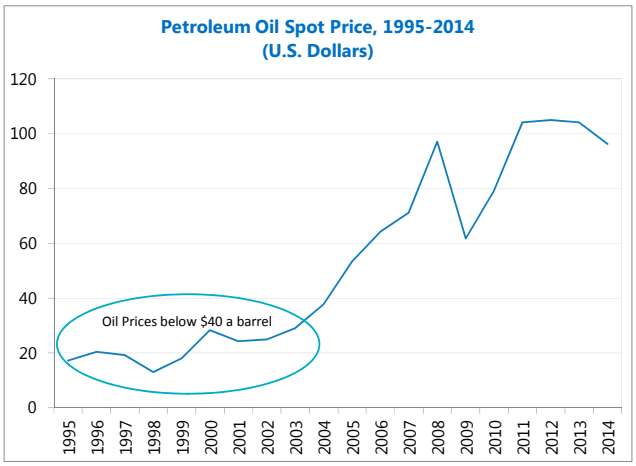
(about a third of the banking system's total assets) would breach current regulatory minimum requirements if their 3 largest exposures defaulted. Sovereign and other market risks were found to be low.

- Despite weaknesses in some banks, Kazakh banks on aggregate were found sufficiently liquid.

B. The Outcome in 2014

2. **The FSAP stress test's oil price assumption was partially realized in 2014 but other assumptions did not quite materialize.** As a result only three, rather than seven, banks breached the regulatory minimum capital:

- While oil prices declined and reached below $40pb briefly in the second half of 2014, the average oil price for the year was high at $96.2pb, compared with the FSAP assumption of $40pb for the year. This was still one of the highest oil price levels of the past 20 years. Thus, the overall impact on macroeconomic variables and NPLs was moderate compared to that assessed by the stress tests. At end-2014, 3 banks (accounting for 18 percent of total banking system assets) were below the capital regulatory minimum of 12 percent. An average annual price below $40 is likely, given historical trends—oil prices were below $40pb on 10 of the last 20 years, and even below $20pb in 1995 and 1998.

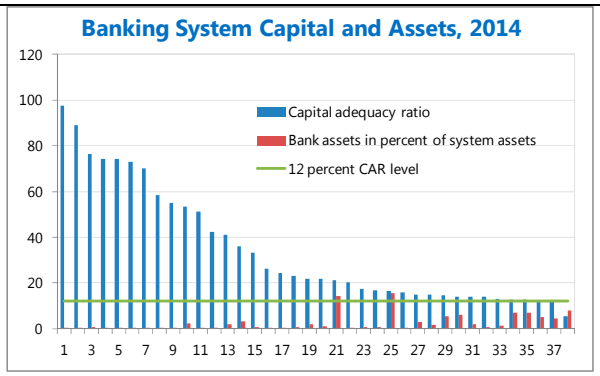


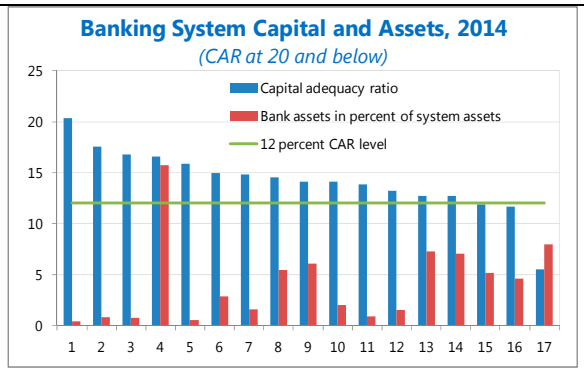
- The oil price shock during the FSAP was assessed in combination with weaker economic activity to a recession and a large depreciation of the exchange rate. In actuality, economic activity was stronger and exchange rate depreciation less. Further, the oil price decline took place in the second half of 2014 and the impact feeding through other macroeconomic variables had not materialized fully as of end-2014.

3. **Banks balance sheets, however, still weakened in 2014.** Capital adequacy declined as profitability weakened but also given that banks began writing off NPLs that were not well provisioned for. Bank profitability declined and banks' level of provisioning for NPLs also dropped (from 83 to 80 percent of NPLs). Provisioning estimates include collateral. In Kazakhstan, collateral is mostly real estate—a sector that experienced a bubble burst in 2009 and is yet to recover. Banks do no regularly revalue collateral and estimates are still largely based on high prices. This results in an overestimation of provisioning and, thus, the strenght of bank balance sheets. As a consequence of the adverse developments over the last year, the impact of the FSAP stress scenario would now be even higher than in 2014.

4. **The distribution of CARs among banks is quite wide.** In the baseline—before shocks are applied—three banks are below the 12 percent CAR minimum while several banks are close to it. There are also a number of banks with CAR far above the minimum. In addition to being close to the minimum CAR, a number of banks also have low levels of profitability. Banks would normally use profits as the first line of defense before dipping into capital. When profits are low, shocks have a larger impact on capital. The environment of a large level of non-performing loans in the banking system (23 percent in May, down from 34 percent a year ago) and weak economic activity (economic growth at 2 percent in the first quarter of 2015, down from 4 percent in 2014 and 6 percent in 2013) has reduced bank profitability. NPLs declined further in July to 13 percent with the revocation of BTA bank's banking license. One bank has a negative return on assets (ROA)—a measure how well bank management is employing the bank's assets to make a profit. About 19 banks are below the 1.5 percent level of ROA that banks generally strive to achieve.

Banking System Capital and Assets





C. The Updated Solvency Stress Test

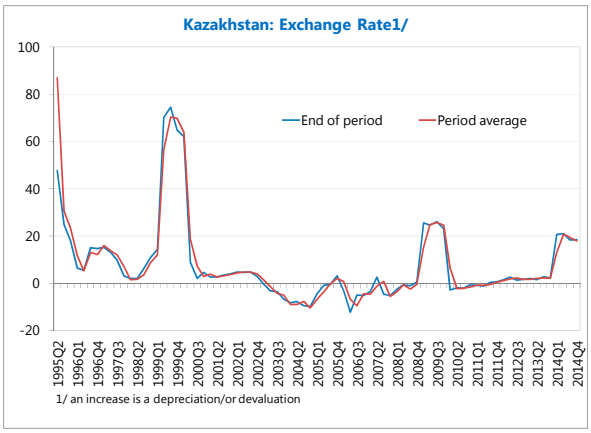
5. **The solvency stress test assesses the impact of lower oil price, an exchange rate depreciation, and weak economic activity on bank solvency.** The assessment of solvency risk is top-down (as was the case in the FSAP) given that bottom-up bank level stress tests are not available. The baseline scenario is based on the latest World Economic Outlook assumptions and projections as well as desk estimations and projections of macroeconomic variables (real GDP and exchange rate for Kazakhstan). The historical relationship between macroeconomic variables and NPLs is analyzed using a vector autoregression (VAR) model. Single equation estimation is also undertaken to assess robustness. Three scenarios are considered: baseline, downside, and severe; over 2015 to 19 and they are presented below:

- *Baseline scenario:* In the baseline scenario, estimates of oil are the WEO baseline and real GDP growth and the exchange rate are based on staff's macroeconomic projections. The projections assume further weakening in oil prices from the current $62.8pb to $58.9pb. Real GDP growth moderates from 4.3 percent in 2014, to 2 percent in 2015 and rises to 4.4 percent by 2019. The exchange rate depreciates from 179.2.4 in 2014 to 185.8 in 2015 and to 188 by 2019.

- *Downside Scenario:* In the downside scenario, a 0.5 historical standard deviation on the oil price is assumed in. Oil prices fall to $43.2pb in 2015 and $48.6bp in 2016. Real GDP grows by 1.2 percent in 2015 and improves to 2.7 percent in 2016. The exchange rate is subjected to a 1.5 standard deviation shock, which puts it at 6.6 percent depreciation from the current level. It depreciates to 198 in 2015 and to 200.5 in 2016. The larger standard deviation shock on the exchange rate compared to oil prices mimics the large currency swings during periods of stress.

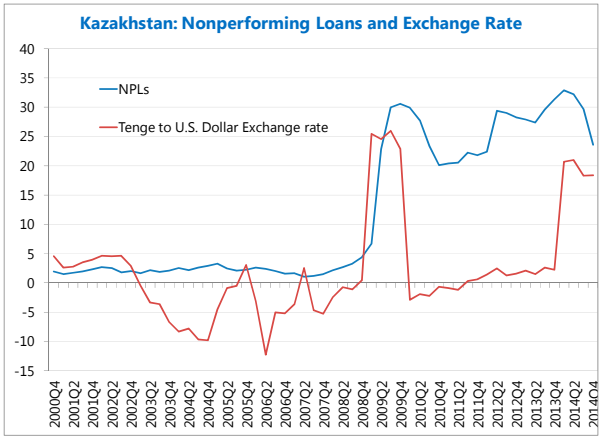
- *Severe Scenario:* In the severe scenario, a 1.2 standard deviation from the baseline is assumed. Oil prices fall to $21.3pb in 2015 and $26.7pb in 2017 and go back to the baseline in 2017. Real GDP grows by 0.1 percent in 2015 and rises to 2 percent in 2016. The exchange rate is subjected to a 3.5 standard deviation shock, which puts it at 15.5 percent depreciation from the current level in 2015. It depreciates to 215 in 2015 and worsening to 217 in 2016.

6. **The exchange rate shocks assessed in the scenarios above are mild given past experiences with the exchange rate in Kazakhstan.** The exchange rate tends to exhibit low levels of volatility with large exchange rate adjustments. The exchange rate devalued by over 25 percent in 2009 and by 20 percent in 2014. There were larger exchange rate adjustments in earlier periods including over 74 percent in 1999. At the same time, the authorities have taken measures to improve banking system sensitivity to exchange rate shocks including by introducing NOP limits and banning foreign wholesale borrowing. The latter contributed significantly in the crisis of 2008/09. The size of fx loans to total loans has declined over the years.



The Macroeconomic Model

7. **A VAR model is used to assess the response of NPLs to macroeconomic variables, which is used in turn to assess the impact of changes in NPLs (in response to macroeconomic variables) on bank solvency.** The variables included in the model are: the ratio of NPLs to total loans (NPL), the percent change in the oil price (OIL), Kazakhstan real GDP growth (KAZG), partner countries real GDP growth (PARTGDP), and the exchange rate (EXCHR). The variables are tested for the presence of a unit root and those with a unit root are first differenced before being included in the model. The model is estimated on quarterly data over 2000 to 2014. The lag length used is 3, selected to minimize the Akaike information criterion, the sequential modified LR test statistic, and the final prediction error.



8. **Upon eyeballing the data, there is a clear pattern of NPLs responding to exchange rate depreciation.** Whenever there was a large depreciation of the exchange rate, NPLs increased. This happened clearly in 2009 and following the devaluation in early 2014.

9. **NPLs are highly sensitive to changes in oil prices and a drop in output albeit with a delayed impact.** An increase in oil prices results in a decline in NPLs in 4-5 quarters. Furthermore, the domestic real GDP impact on NPLs is persistent as the maximum impact happens about 11 to 12 quarters after the initial shock (Table 1). Economic activity in partner countries appears to account for a significant share of movements in NPLs, followed by domestic economic activity and the exchange rate. Translated into coefficients (elasticity), a percentage point increase in domestic real GDP growth results in a 0.318 percentage point decline in NPLs; a percentage point increase in the oil price results in a 0.006 percentage point decline in NPLs; a percentage point increase (depreciation) in the exchange rate results in a 0.047 percentage point increase in NPLs. Oil prices have a much larger effect on the exchange rate and on real GDP growth compared to the impact directly on NPLs, as further revealed through variance decompositions, also presented below. The results also show high dependence of the domestic economy on activity in partner economies.

10. **Similar results to the VAR appear in single equation estimation.** The results show a higher impact of domestic economic activity on NPLs compared to the other macroeconomic variables.

Single Equation Estimation of Determinants of Bank NPLs in Kazakhstan

Variable	Coefficient
NPL (L1)	0.9216***
Domestic GDP growth	0.0235
Domestic GDP growth (L1)	-0.3117***
EXCHR	0.0308
Exchange rate (L1)	-0.0361
Exchange rate (L2)	0.1708*
Exchange rate (L3)	-0.0668**
Oil price change	0.0164*
Oil price change (L1)	-0.0275**
Constant	3.5811**
R-squared	0.9742
Adjusted R-squared	0.9692
F-statistic	197.05
Prob(F-statistic)	0.0000
Prob(Wald F-statistic)	0.0000
Note: *** p < 0.01, ** p < 0.05, * p < 0.1	

11. **The tests simulate balance sheets and profit/loss accounts for the individual banks given the NPL forecasts upon applying the effects of the shocks.** In the simulation, liabilities are held constant. Given that historical balance sheet data is not available to staff, interest margins on

current loans and liabilities, as well as net non-interest income, are given each banks performance in 2014. Given that estimates of collateral are unreliable, new NPLs are assumed to be provisioned at 100 percent. This further dents profits. When net income is positive, the test assumes that 80 percent of profits are retained and the rest is paid out as dividends. A bank accumulates capital buffers when its capital ratio declined in the previous year. Capital covers the loss when net income is negative. NPLs are deducted from total loans and interest income is earned on standard loans that exclude NPLs.

Table 1. Impulse Response Functions for NPLs

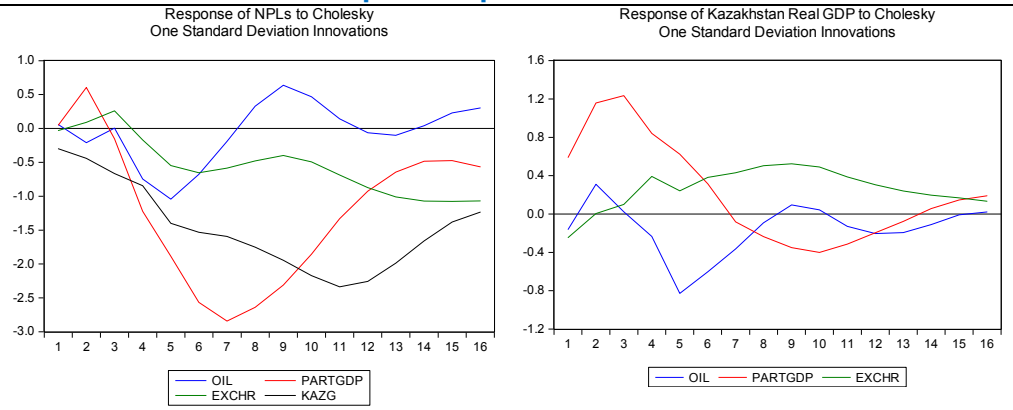
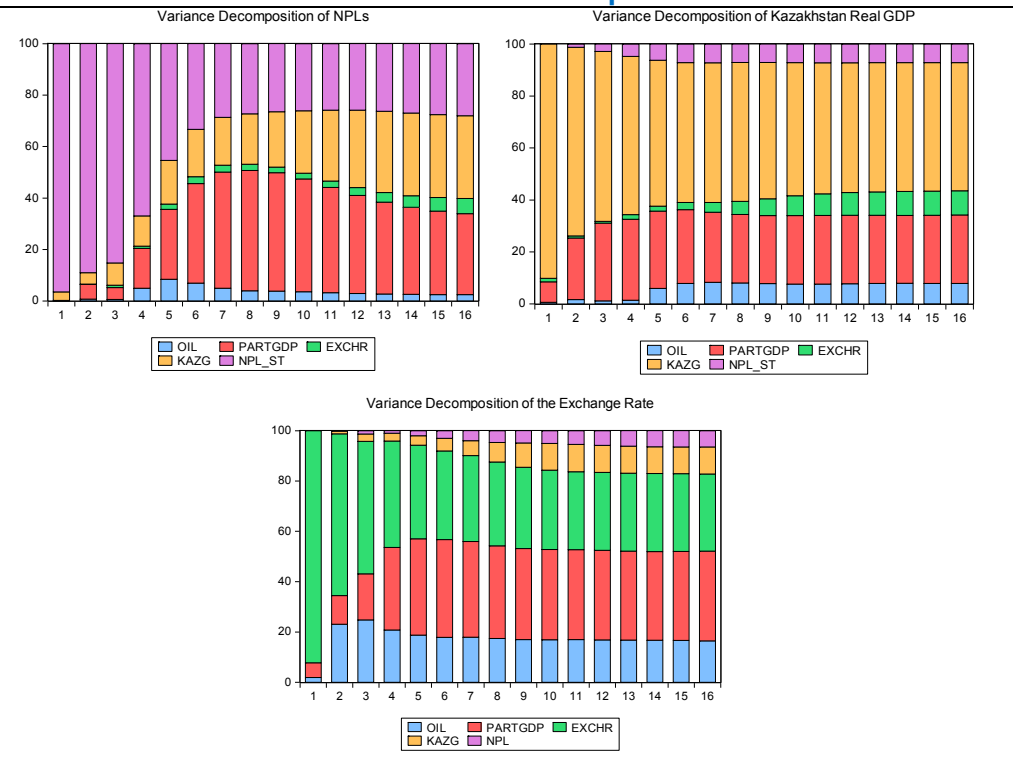


Table 2. Variance Decompositions



The Solvency Stress Test Results

12. **The results reveal that a number of banks are unable to withstand higher NPLs due the shocks described above.** It should be noted that the shocks are applied directly on bank balance sheets. No adjustments have been made on capital to take into account the phase-out of capital instruments ineligible under Basel III as was done in the FSAP neither to correct for provisioning. Even without this adjustment and with very mild shocks, banks are still highly susceptible to shocks. In the downside scenario, one bank goes further below the regulatory minimum CAR. System CAR goes down to 16 percent (from 17.3 percent in the baseline) while the severe scenario brings it down to 6 percent, below the regulatory minimum. In the severe scenario, as much at 17 banks have CAR below the regulatory minimum. Recapitalization needs amount up to 3 percent of GDP. NPLs decline over the projection period reflecting their response to assumptions on macroeconomic variables, which improve over the horizon, and together with favorable assumption on reinvested earnings, capital improves. NPLs by sector reveal that the construction and the trade sectors account for a larger share of NPLs in the system while agriculture as well as trade and communication sectors account for very small shares.

Stress Test Assumptions and Results

	Historical	Baseline			Downside			Severe		
	2014	2015	2016	2017	2015	2016	2017	2015	2016	2017
Assumptions										
Domestic real GDP growth	4.3	2.0	3.2	4.8	1.2	2.7	4.3	0.1	2.0	3.7
Oil price (in U.S. dollars)	96.2	58.9	64.2	67.1	43.2	48.6	51.5	21.3	26.7	29.6
percent change over latest price (62.8)					-31.2	12.4	5.9	-66.0	25.1	10.8
Exchange rate	179.2	185.8	188.0	188.0	198.3	200.5	200.5	214.9	217.1	217.1
percent change over latest rate (186.1)					6.6	1.1	0.0	15.5	1.0	0.0
Impact										
Nonperforming loans (percent of total loans)	32.2	13.0	5.8	1.5	21.7	11.5	3.5	37.6	24.6	9.9
Capital adequacy ratio	17.4	17.0	24.5	23.1	16.1	24.8	30.4	6.0	15.5	26.0
CAR < 8 percent										
Number of banks	1	1	1	1	2	1	1	12	2	1
8 percent < CAR < 12 percent										
Number of banks	2	2	0	0	1	0	0	5	2	0
CAR > 12 percent										
Number of banks	35	35	37	37	35	37	37	21	34	37
Recapitalization to achieve 12 percent CAR										
Million Tenge		97,914	297,288	510,326	138,759	295,659	501,076	1,233,496	442,955	497,869
Percent of 2014 GDP		0.2	0.8	1.3	0.4	0.7	1.3	3.1	1.1	1.3

13. **Several other simulations were done to assess the robustness of the results—a finding that the banking sector is highly susceptible to shocks.** The first assessed only the impact of the exchange rate. The relationship between NPLs and the exchange rate was determined using a single estimation equation. The response of NPLs to the exchange rate is slightly high than in a multiple variable estimation given that the other variables are not present to account for all the movements in NPLs. The results are shown below and reveal that even with a very mild exchange rate shock (15 percent depreciation from the current level of the exchange rate), 10 banks have CAR below the regulatory minimum. This is a mild shock considering that much larger exchange rate adjustments that occurred in the past, including 20 percent in 2014 and a 25 percent one in 2009. A much larger exchange rate adjustment of 70 percent occurred in 1999. A 25 percent exchange rate depreciation results in 17 banks going below minimum CAR and recapitalization needs are estimated at 3.2 percent of GDP. Bank's net open foreign exchange positions (NOP) are small; however, there is

extensive lending to unhedged borrowers (borrowers with income in tenge). Data on bank by bank NOP was not made available to the team. The relationship between NPLs and the exchange rate likely reflects also the indirect impact that the exchange rate has on NPLs.

Exchange Rate Shocks

15.5 percent exchange rate shock

Stress Test Assumptions and Results

	Historical	Baseline			Exchange rate shock		
	2014	2015	2016	2017	2015	2016	2017
Assumptions							
Exchange rate	179.2	185.8	188.0	188.0	214.9	217.1	217.1
percent change over latest rate (186.1)					15.5	1.0	0.0
Impact							
Nonperforming loans (percent of total loans)	32.2	17.6	19.1	19.8	29.4	30.7	31.2
Capital adequacy ratio	17.4	17.1	15.9	14.6	12.0	13.5	15.1
CAR < 8 percent							
Number of banks	1	1	1	1	3	3	2
8 percent < CAR < 12 percent							
Number of banks	2	2	2	2	7	5	4
CAR > 12 percent							
Number of banks	35	35	35	35	28	30	32
Recapitalization to achieve 12 percent CAR							
Million Tenge		96,058	315,613	535,990	473,106	585,577	704,104
Percent of 2014 GDP		0.2	0.8	1.4	1.2	1.5	1.8

25 percent exchange rate shock

Stress Test Assumptions and Results

	Historical	Baseline			Exchange rate shock		
	2014	2015	2016	2017	2015	2016	2017
Assumptions							
Exchange rate	179.2	185.8	188.0	188.0	232.6	234.8	234.8
percent change over latest rate (186.1)					25.0	0.9	0.0
Impact							
Nonperforming loans (percent of total loans)	32.2	17.6	19.1	19.8	37.9	39.0	39.3
Capital adequacy ratio	17.4	17.1	15.9	14.6	5.8	6.8	8.1
CAR < 8 percent							
Number of banks	1	1	1	1	12	9	9
8 percent < CAR < 12 percent							
Number of banks	2	2	2	2	5	7	3
CAR > 12 percent							
Number of banks	35	35	35	35	21	22	26
Recapitalization to achieve 12 percent CAR							
Million Tenge		96,058	315,613	535,990	1,267,279	1,186,475	1,221,174
Percent of 2014 GDP		0.2	0.8	1.4	3.2	3.0	3.1

14. **A reverse stress test also reveals banking system vulnerability.** The test reveals that an increase in NPLs by 16 percent brings the system wide CAR to the regulatory minimum of 12 percent (assuming a 70 percent level of provisioning). At this level, 6 banks would be below the regulatory minimum.

Annex IV. Kazakhstan: Implementation of the 2014 FSAP Key Recommendations[1]

Recommendations and Authority Responsible for Implementation	Time[1]	Status of Implementation
Financial Stability		
Closely monitor quality of foreign currency-denominated loans. [NBK]	I	Limited progress. The NBK reports that it monitors the quality of foreign currency-denominated loans. However, lending in foreign currency to clients with earnings in tenge is still widespread.
Closely monitor banks' concentrated large exposures. [NBK]	I	In progress. The NBK regularly collects information on large exposures to monitor conformity to the prudential limits on concentrated large exposures.
Banking Oversight		
Rebalance the emphasis of supervision towards a more risk-based approach [NBK]	MT	Limited progress. Bank supervision remains largely compliance based. They still rely on the CAMELOS system (as per the guidance number 600 of December 31, 2014 and number 29 from February 26, 2014). However, the NBK reports that it has developed draft Guidelines to off-site supervision of the banking sector that include the principles of risk-based supervision. They have been receiving technical assistance from an international donor to strengthen supervision with the aim of eventually conducting inspections with a risk-based approach.
Support the supervisor's capacity to challenge banks' decisions on provisioning [NBK]	I	In the process of being implemented. The authorities have been working to formulate a technique of determining collateral value and provisioning for second-tier banks and organizations engaged in certain types of banking operations.
Intensify the supervision of the cross-border operations of Kazakh banks and signing MoU [NBK]	NT	In progress. In 2014 and 2015 the NBK took part in drafting Memorandums of Understanding with the following foreign financial regulators: the Reserve Bank of India, the Central Bank of the Islamic Republic of Iran, the Central Bank of the Republic of San Marino, the Central Bank of the Russian Federation, the Polish Financial Supervision Commission, and the Central Bank of Bahrain. In 2015, the NBK plans to hold a joint meeting with representatives of the board of the Central Bank of Russia to discuss consolidated (cross-border) oversight of the banking subsidiaries of Kazakhstan banks, banks participating in banking conglomerates located in the Russian Federation, and the banking subsidiaries of Russian banks in the Republic of Kazakhstan. The NBK plans to conduct a banking college with the regulator board of the Russian Federation.

[1] Prepared by Nombulelo Duma.

Recommendations and Authority Responsible for Implementation	Time[1]	Status of Implementation
Analyze regularly indirect credit risk and market risk, including foreign exchange rate risk [NBK]	I	In progress. As a part of its stress-testing, the NBK analyzes indirect credit risk and market risk. This, however, has not yet been taken up in the supervision of banks.
Monitor the impact of the adopted macroprudential policies and conduct assessments of effectiveness [NBK]	MT	Being implemented. The NBK has been assessing the impact of macroprudential policies that were adopted in early 2014. Overheating in uncollateralized consumer lending declined following the introduction of macroprudential policies. The growth of unsecured consumer lending was 7.9 percent at end 2014, well below the 30 percent limit.
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	Implemented. The NBK reports that a new law was adopted on April 27, 2015 ("On amendments and additions to certain legislative acts of the Republic of Kazakhstan on insurance and Islamic finance"), which includes removal of the requirement for depositor and creditor approval.
Limit emergency liquidity assistance to institutions that are solvent and financially capable of paying a penalty rate of interest [NBK]	NT	Not Implemented
Develop a procedure for documenting financial stability analysis in cases of provision of state support to the financial sector [NBK]	NT	Recommendation is being implemented during the development of the financial stability framework
Implement a multi-track approach for resolving the overhang of NPLs [NBK]	NT	Partially implemented. The authorities have removed legal, tax, and accounting obstacles to NPL write-offs and transfers to special purpose vehicles. However, the authorities are pursuing a different strategy that excludes the PLF in NPL resolution. They plan place funds that were previously intended to capitalize the PLF as a deposit in KKB for liquidity support.
Reduce procedural costs of enforcement obstacles arising from non-registered or junior pledge holders in foreclosures [Government/Legislator].	NT	Legal amendments have been made to help implement this recommendation. The authorities report that they have made amendments in the law on "On amendments and additions to certain legislative acts of the Republic of Kazakhstan on insurance and Islamic finance," adopted on April 27, 2015.
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	In the process of being implemented. The NBK has drafted the amendments to the Law on bankruptcy, the Tax Code, and the Banking Law in order to eliminate the legal barriers identified by the FSAP. Some amendments are also included in the draft law on "On amendments and additions to certain legislative acts of the Republic of Kazakhstan on non-performing loans and assets of banks, provision of financial services, and the activities of financial institutions and the National Bank of the Republic of Kazakhstan." The amendments have been submitted to the government.

Recommendations and Authority Responsible for Implementation	Time[1]	Status of Implementation
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	Partially implemented. Amendments were adopted in the Law "On amendments and additions to certain legislative acts of the Republic of Kazakhstan on rehabilitation and bankruptcy, taxation" dated as of 7 March 2014. The NBK has also drafted the amendments to the Law on bankruptcy, the Tax Code and the Banking Law in order to eliminate the legal barriers identified by the FSAP; and the draft Law "On amendments and additions to certain legislative acts of the Republic of Kazakhstan on non-performing loans and assets of banks, provision of financial services, and the activities of financial institutions and the National Bank of the Republic of Kazakhstan." The amendments have been submitted to the government. The amendments, however, do not address partial forgiveness, bad debt, and collateral sales.
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	Not implemented.
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	Implemented. Amendments were taken in the Law of the Republic of Kazakhstan of April 27, 2015 "On amendments and additions to certain legislative acts of the Republic of Kazakhstan on insurance and Islamic finance."
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	Implemented. The NBK reports that the Pension Assets Management Council approved a Pension Asset Management Concept that outlines that in the long term the investment return on pension assets of UAPF should be at the level or higher than the inflation rate.
Adjust the mandatory worker's compensation to avoid collapse of the insurance sector [Government/ Parliament].	I	Implemented. The NBK reports that legal amendments (in the law "On amendments and additions to some legislative acts on insurance and Islamic finance" and in the law "On compulsory insurance of employees against accidents in the performance of his employment duties.") have been made to improve the system of compulsory insurance of an employee against accidents at the execution of employment duties. They also resolve a number of issues related to the implementation of this type of compulsory insurance.
Reduce uncertainty in continuity of market rules; confirm legal fact and time of settlement finality [Government, NBK].	I	In progress. The NBK has drafted the Law "On payments and payment systems." The draft was included in Government Legislative Drafting Plan for year 2015 and will be sent to Parliament in December 2015. The Draft Law is currently under consideration by relevant government organizations and market participants.

Source: Kazakhstan Financial System Stability Assessment, 2014, IMF.

[1] "I-Immediate" is within one year; "NT-near-term" is 1–3 years; "MT-medium-term" is 3–5 years.

Annex V. Kazakhstan: Risk Assessment Matrix[1]

Nature/Source of Main Threats	Likelihood	Expected Impact on the Economy if Risk Is Realized
Persistently low oil prices	**Medium**	Growth would further decelerate over the medium term due to reduced oil revenues, lower investments in the oil sector, and lower investor confidence in the Kazakh economy in general. *An expansionary fiscal policy response may be adequate to tackle a temporary oil-price shock to address the growth slowdown; but in case of a permanent shock fiscal policy adjustment over the medium term is critical to maintain sustainability.*
Sharp growth slowdown in China in 2015–16	**Low**	Kazakhstan would be adversely affected primarily through lower FDI from China and declining exports to China, both of which have risen in absolute and relative terms in recent years. *Similar to the above, if the sharp slowdown in China is seen as temporary, the expansionary fiscal policy response may be appropriate, subject to measures taken to ensure medium-term sustainability.*
Russia-Ukraine conflict re-intensifies	**Medium**	Further intensification of the conflict may lead to further sanctions against Russia. As a result, Kazakhstan would be negatively affected through lower export demand and investment flows from Russia. Moreover, political uncertainly may increase, putting further downward pressure on the tenge. *Similar to the above, if the conflict intensification is seen as temporary, the expansionary fiscal policy response may be appropriate, subject to measures taken to ensure medium-term sustainability.*
Tighter or more volatile global financial conditions: **Sharp asset price adjustment and decompression of credit spreads**	**High**	Impact expected to be limited given the small scale external borrowing by Kazakhstan's government and corporates. That said, the yield spreads on existing Kazakhstan's sovereign and quasi-sovereign bonds are expected to rise in line with other emerging

[1] 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	Expected Impact on the Economy if Risk Is Realized
		market yields. *Consideration should be given to speeding up the enhancements of the monetary policy framework and operations, including allowing greater exchange rate flexibility to absorb the shocks. Coupled with enhanced communication strategy, these will help boost confidence in central-bank policy making.*
Persistent dollar strength	**High**	The severity of the impact of persistent dollar strength depends on the degree to which the tenge continues to be tightly managed against the dollar. Under the prevailing tight exchange rate arrangement, the tenge could continue to come under pressure, especially if dollar strength is combined with sustained lower growth and oil prices. *Consideration should be given to speeding up the enhancements of the monetary policy framework and operations, including allowing greater exchange rate flexibility to absorb the shocks. Coupled with enhanced communication strategy, these will help boost confidence in central-bank policy making.*

Annex VI. Comparison in the Authorities and Staff's Fiscal Accounting Frameworks[1]

1. **The authorities and staff use different methodologies to track fiscal accounts.** In the authorities' approach: (i) most national oil fund accounts, including most oil export revenues are kept off-budget; (ii) oil export revenues are only recognized when funds are transferred from the national fund to the budget; (iii) tax on oil exports is treated as non-oil revenues; (iv) capital gains on national oil fund assets, including the effects of devaluation are treated as revenues; (v) direct lending (on-lending) from the national oil fund to quasi-sovereign entities is not recognized as expenditure; and (vi) only a fraction of quasi-sovereign entity's foreign loans, which is directly guaranteed by the government, are recognized as contingent liabilities.

2. **Staff, on the other hand, follows the Government Finance Statistics Manual (GFSM) 2001 framework with revenues and expenditures consolidated into single general government budget.** In particular: (i) oil revenues, including oil export duty, are recorded on a cash basis; (ii) interest income of the national oil fund is recognized as revenues but not capital gains or valuation differences; (iii) lending to SOEs is treated as expenditure; (iv) net transfers from the national oil fund are recorded below the line; and (v) debts of SOEs, where there is expectation that the state may become liable for repayment in case of default, are treated as contingent liabilities.

3. **The different methodologies result in diverging estimates and forecasts.** This is illustrated below for the 2014 fiscal figures and the projected medium-term path for the non-oil fiscal deficits. In particular, the authorities' approach underestimates oil revenues, and consequently the non-oil deficit, by half relative to GFSM.

Non-oil fiscal deficits as share of GDP

	2015	2016	2017	2018	2019	2020
IMF	-11.4	-10.4	-9.8	-9.3	-9.0	-8.7
Ministry of Economy	-9.7	-7.6	-6.7	-5.3	-4.3	-4.1

Source: Kazakhstani authorities and IMF staff estimates

[1] Prepared by Matteo Ghilardi and Yahia Said.

2014 Fiscal Figures (In billions of tenge)				
	Authorities		**IMF staff**	
On-budget				
Total revenues		**7,372**		**7,330**
Oil revenues	Transfers from the oil fund	**1,955**	Oil revenues, of which:	**4,220**
			Proceeds from the sale of oil and	3,503
			Oil export duty	717
Non oil revenues	of which:	**5,417**		**3,110**
	Oil export duty and	717		
	Interest income and capital gains of oil fund including unrealized devaluation effect.	1,862	Only interest income of the oil fund is included in revenues	
Expenditures		**8,460**	Expenditures, of which:	**8,935**
			on-lending from national oil fund resources.	475
Overall balance		**(1,088)**		(1,605)
Non-oil balance		(3,043)		**(5,825)**
Below the line			Net change in oil fund assets	**3,402**
Off-budget				
	Oil fund income, of which:	**5,366**		
	Proceeds from oil sale of oil	3,503		
	Profits including	1,862		
	Other	1.4		
	Oil fund expenditure, of which:	**1,964**		
	Transfers to national budget	1,955		
	Other	9		
	Change	**3,402**		

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Annex VII. 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/]

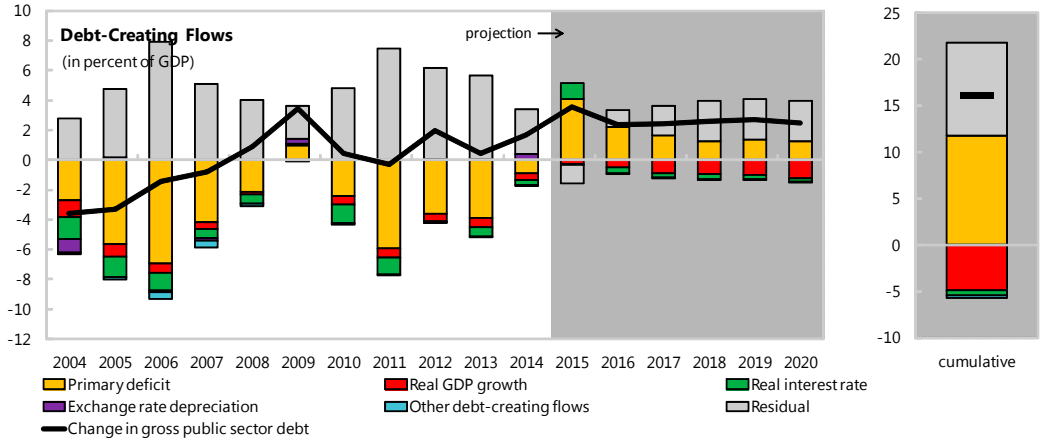
	Actual			Projections					
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020
Nominal gross public debt	9.2	12.9	14.5	18.1	20.5	22.9	25.5	28.2	30.7
Public gross financing needs	-2.3	-4.1	-0.8	3.3	1.7	1.2	0.9	1.1	1.1
Public debt (in percent of potential GDP)	9.2	13.0	14.7	17.8	19.9	22.4	25.2	28.0	30.9
Real GDP growth (in percent)	7.0	6.0	4.3	2.0	3.2	4.8	4.6	4.4	5.0
Inflation (GDP deflator, in percent)	15.4	9.7	7.4	-2.6	7.0	6.0	6.1	6.0	5.5
Nominal GDP growth (in percent)	23.6	16.2	12.1	-0.6	10.4	11.1	11.0	10.6	10.8
Effective interest rate (in percent) [4/]	5.4	4.7	5.1	4.7	4.8	4.7	4.7	4.8	4.9

As of April 07, 2015

Sovereign Spreads		
Bond Spread (bp) 3/		435
5Y CDS (bp)		286
Ratings	Foreign	Local
Moody's	Baa2	Baa2
S&Ps	BBB	BBB
Fitch	BBB+	BBB+

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.3	0.5	1.7	3.5	2.4	2.4	2.6	2.7	2.5	16.1	
Identified debt-creating flows	-5.3	-5.1	-1.3	4.8	1.3	0.4	-0.1	0.0	-0.3	6.1	
Primary deficit	-3.6	-3.9	-0.9	4.1	2.2	1.6	1.3	1.4	1.2	11.8	-1.5
Primary (noninterest) revenue and gra	26.2	23.7	22.4	18.3	19.3	19.4	19.1	18.6	18.2	112.9	
Primary (noninterest) expenditure	22.5	19.8	21.5	22.4	21.5	21.0	20.4	20.0	19.5	124.7	
Automatic debt dynamics [5/]	-1.5	-1.2	-0.4	0.8	-0.9	-1.2	-1.3	-1.3	-1.5	-5.4	
Interest rate/growth differential [6/]	-1.4	-1.2	-0.8	0.8	-0.9	-1.2	-1.3	-1.3	-1.5	-5.4	
Of which: real interest rate	-0.8	-0.6	-0.3	1.1	-0.4	-0.3	-0.4	-0.3	-0.2	-0.5	
Of which: real GDP growth	-0.6	-0.6	-0.5	-0.3	-0.5	-0.9	-0.9	-1.0	-1.3	-4.9	
Exchange rate depreciation [7/]	-0.1	0.1	0.4	...	...	...	...	...	...	...	
Other identified debt-creating flows	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.3	
Please specify (1) (e.g., privatization r	-0.2	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	0.0	-0.3	
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/]	5.0	5.6	3.0	-1.3	1.1	2.0	2.7	2.7	2.7	10.0	



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 rate; 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).

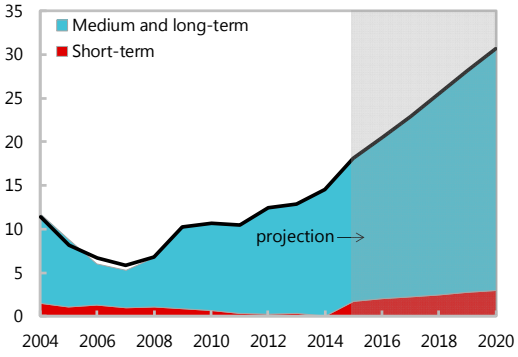
8/ Includes asset changes in the oil fund.

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.

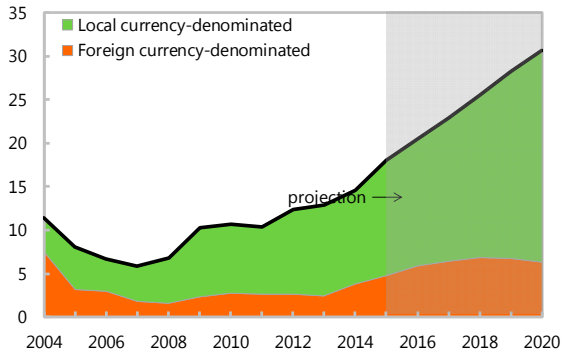
Kazakhstan Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

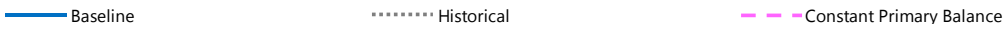
By Maturity
(in percent of GDP)



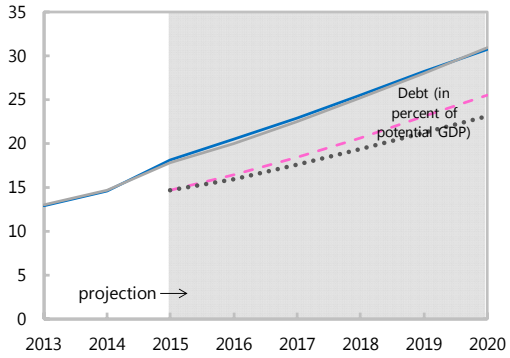
By Currency
(in percent of GDP)



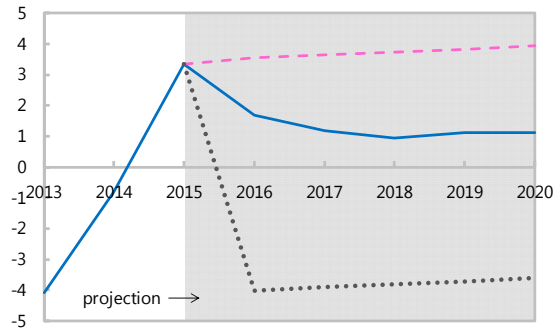
Alternative Scenarios



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



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	2.0	3.2	4.8	4.6	4.4	5.0
Inflation	-2.6	7.0	6.0	6.1	6.0	5.5
Primary Balance	-4.1	-2.2	-1.6	-1.3	-1.4	-1.2
Effective interest rate	4.7	4.8	4.7	4.7	4.8	4.9
Constant Primary Balance Scenario						
Real GDP growth	2.0	3.2	4.8	4.6	4.4	5.0
Inflation	-2.6	7.0	6.0	6.1	6.0	5.5
Primary Balance	-4.1	-4.1	-4.1	-4.1	-4.1	-4.1
Effective interest rate	4.7	5.9	5.8	5.8	5.9	6.0

Historical Scenario	2015	2016	2017	2018	2019	2020
Real GDP growth	2.0	6.4	6.4	6.4	6.4	6.4
Inflation	-2.6	7.0	6.0	6.1	6.0	5.5
Primary Balance	-4.1	3.5	3.5	3.5	3.5	3.5
Effective interest rate	4.7	5.9	5.8	5.8	5.9	6.0

Source: IMF staff.

Kazakhstan: External Debt Sustainability Framework, 2010–2020

(In percent of GDP, unless otherwise indicated)

Kazakhstan: External Debt Sustainability Framework, 2010-2020
(In percent of GDP, unless otherwise indicated)

		Actual							Projections						
		2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
1	**Baseline: External debt**	79.9	66.6	67.3	64.7	71.2			**79.8**	**78.2**	**74.5**	**70.5**	**66.8**	**62.9**	**-6.8**
2	Change in external debt	-18.0	-13.2	0.6	-2.6	6.5			8.6	-1.6	-3.6	-4.0	-3.7	-3.9	0.0
3	Identified external debt-creating flows (4+8+9)	-25.1	-27.0	-11.2	-12.1	-1.4			-0.7	-1.6	-3.6	-3.8	-3.5	-3.9	0.0
4	Current account deficit, excluding interest payments	-3.0	-7.3	-2.6	-2.0	-3.9			1.9	1.6	0.7	0.1	0.0	-0.2	6.8
5	Deficit in balance of goods and services	-14.4	-20.3	-14.8	-11.9	-13.2			-3.7	-3.9	-4.7	-5.1	-5.0	-5.4	
6	Exports	44.2	47.6	45.1	39.1	38.7			28.4	28.0	27.6	26.7	25.5	24.8	
7	Imports	29.9	27.3	30.2	27.2	25.5			24.6	24.1	22.9	21.6	20.5	19.4	
8	Net non-debt creating capital inflows (negative)	-2.6	-4.6	-5.6	-3.4	-2.6			-2.5	-2.3	-2.1	-1.9	-1.8	-1.6	-1.6
hide	Net foreign direct investment, equity	2.5	4.6	5.8	3.4	2.7			2.5	2.3	2.1	2.0	1.8	1.7	
hide	Net portfolio investment,equity	0.1	0.0	-0.2	0.0	-0.1			-0.1	-0.1	-0.1	0.0	0.0	0.0	
9	Automatic debt dynamics 1/	-19.6	-15.1	-3.0	-6.6	5.1			-0.1	-1.0	-2.2	-2.0	-1.7	-2.0	-5.2
10	Contribution from nominal interest rate	2.1	1.9	2.1	1.6	1.8			1.4	1.3	1.2	1.1	1.0	1.0	1.0
11	Contribution from real GDP growth	-5.6	-4.7	-3.1	-3.5	-2.9			-1.5	-2.3	-3.4	-3.1	-2.8	-3.0	-2.8
12	Contribution from price and exchange rate changes 2/	-16.1	-12.3	-2.0	-4.7	6.2			...	...	...	...	...	...	-3.3
13	Residual, incl. change in gross foreign assets (2-3) 3/	7.1	13.8	11.8	9.5	8.0			9.3	0.0	-0.1	-0.2	-0.2	-0.1	0.0
	External debt-to-exports ratio (in percent)	180.5	140.0	149.2	165.3	183.9			281.3	279.1	270.4	263.9	262.5	253.8	
	Gross external financing need (in billions of US dollars) 4/	19.2	13.4	21.5	24.4	21.8			35.4	39.0	39.1	39.8	41.4	42.6	
	in percent of GDP	13.0	7.1	10.6	10.5	9.9	10-Year	10-Year	16.7	16.9	15.3	14.0	13.1	12.2	
	Scenario with key variables at their historical averages 5/								**79.8**	**65.2**	**52.5**	**40.9**	**30.5**	**21.0**	**-8.9**
	Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						For debt stabilization	
	Real GDP growth (in percent)	7.3	7.5	5.0	6.0	4.3	6.4	3.0	2.0	3.2	4.8	4.6	4.4	5.0	5.0
	GDP deflator in US dollars (change in percent)	19.7	18.2	3.1	7.5	-8.8	11.6	14.3	-5.9	5.6	6.0	6.1	6.0	5.5	5.5
	Nominal external interest rate (in percent)	2.7	3.0	3.3	2.7	2.6	2.8	0.6	1.8	1.8	1.7	1.7	1.6	1.7	1.7
	Growth of exports (US dollar terms, in percent)	36.4	36.7	2.5	-1.1	-5.9	15.6	27.6	-29.7	7.6	9.3	7.7	5.3	7.9	
	Growth of imports (US dollar terms, in percent)	13.5	16.0	19.9	2.4	-10.8	10.6	18.4	-7.2	6.7	5.2	5.0	4.9	4.7	
	Current account balance, excluding interest payments	3.0	7.3	2.6	2.0	3.9	1.7	3.9	-1.9	-1.6	-0.7	-0.1	0.0	0.2	
	Net non-debt creating capital inflows	2.6	4.6	5.6	3.4	2.6	6.1	3.2	2.5	2.3	2.1	1.9	1.8	1.6	

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.

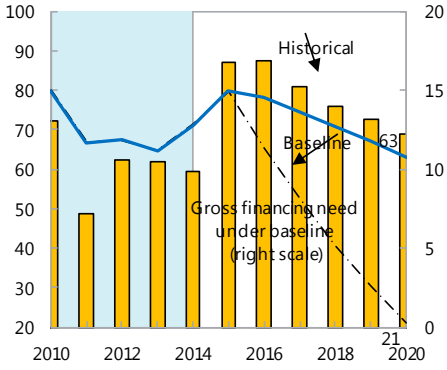
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

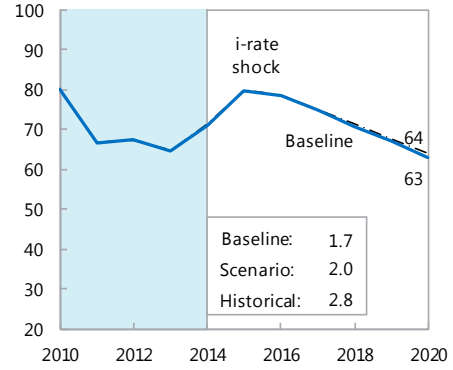
6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

Kazakhstan: External Debt Sustainability; Bound Tests[1/2/]

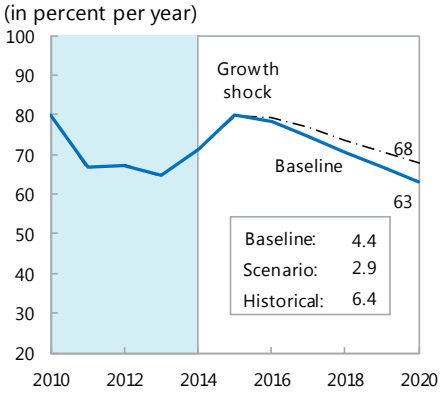
Baseline and historical scenarios



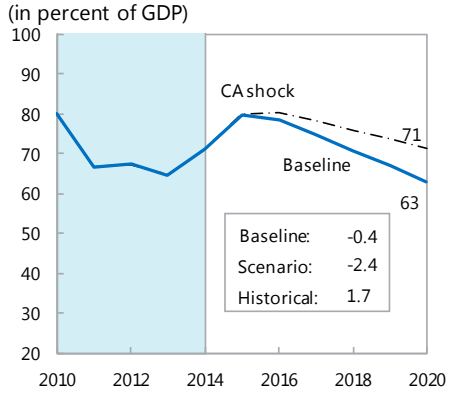
Interest rate shock (in percent)



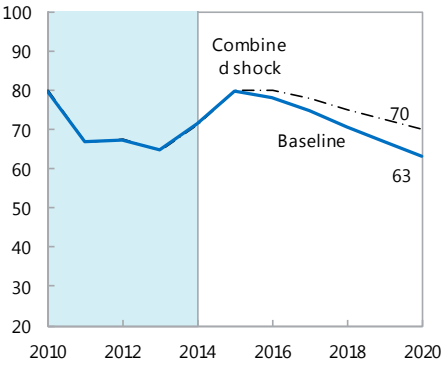
Growth shock
(in percent per year)



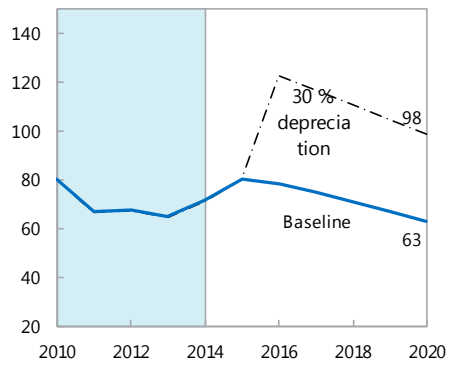
Non-interest current account shock
(in percent of GDP)



Combined shock 3/



Real depreciation shock 4/



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 2010.

Annex VIII. Macroprudential Policies in Kazakhstan[1]

Background

1. **The NBK has introduced several prudential and macroprudential tools, mostly following the 2009 financial crisis.** The tools aim to address some of the risks already facing the banking sector and some tools will be implemented over the coming years. The existing macroprudential and prudential tools are presented below:

To reduce exchange rate risk and dollarization:

- **Differentiated reserve requirement ratios (RR)***:* Minimum RRs on the share of bank liabilities associated with cash in vault and correspondent accounts with the NBK were introduced in May 2006. There were amendments in November 2012 to differentiate minimum RRs between domestic and foreign liabilities and further in 2015 to refine the structure. The 2012 amendments aimed at limiting the inflow of short-term speculative capital; diversifying the portfolio of banks; developing the market of long-term bank instruments; and reducing pressure on the foreign exchange market. The RR ratios are currently (i) 2 percent on tenge short-term domestic liabilities; (ii) 4 percent on tenge short-term foreign liabilities; (iii) 0 percent on tenge long-term domestic liabilities; (iv) 2 percent on tenge long-term foreign liabilities; (v) 2 percent on FX short-term domestic liabilities; (vi) 6 percent on FX short-term foreign liabilities; (vii) 0 percent on FX long-term domestic liabilities; and (viii) 2 percent on FX long-term foreign liabilities.

- **Limits on the net open FX positions (NOFP) or currency mismatches***:* Limits on the net open FX position were introduced in 2002, as follows: (i) 12.5 percent for currencies of countries with the S&P rating of at least "A" (or equivalent); (ii) 12.5 percent for euro; (iii) 5 percent for currencies of countries with the S&P rating below "A" (or equivalent); and (iv) a 25 percent net foreign currency position limit. There is also a 30 percent limit on open FX off-balance sheet positions, effective from July 2014. The measure is aimed at preventing speculative pressure in the spot and FX swap market and to control foreign exchange risk off-balance sheet on a net basis.

To reduce credit risk:

- **Measures in non-collateralized consumer lending:** Effective from April 1, 2014, the NBK introduced: (i) a 50 percent cap on debt-to-income ratio; (ii) an increase in the retail lending risk weight for capital adequacy to 100 percent (from 75 percent); and (iii) a 30 percent limit for growth in consumer loans for each bank. The measures were aimed at minimizing risks associated with rapid growth in consumer lending.

To contain concentration risk:

[1] Prepared by Nombulelo Duma.

- **Credit concentration limits:** The NBK has the following limits on exposure to a single borrower: i) 10 percent of a bank's capital for related counterparties except for subsidiaries acquiring bank's doubtful and loss claims in order to manage them. The aggregate amount of risk for borrowers related to bank insiders should not exceed an amount of bank's capital; ii) 25 percent of a bank's capital for other counterparties (10 percent for unsecured lending, unsecured contingent liabilities related to borrower or to third parties). Banks are also required to submit on a monthly basis reports to the NBK on maximum exposure to a single counterparty and group of connected counterparties.

To reduce liquidity risk:

- **Liquidity Requirements:** Introduced in 2005, amended in 2009 and in 2012. Maximum value of liabilities of non-residents to equity (authorities' κ9 ratio) was relaxed from 2 to 3, starting in July 2009. The current liquidity ratio (average monthly highly liquid assets of a bank to average monthly demand liabilities; k4) was introduced to differentiate between tenge and foreign currency liquidity, with the regulatory value set at 0.3. In 2012, liquidity ratios were tightened, from July, 2012—at least 0.08, and from July, 2013—at least 0.09, adding contingent liabilities to the calculation of capital adequacy ratio (k1-1).

To strengthen solvency:

- **Dynamic Provisioning (DP):** DP was introduced in January 2013 to smooth provisioning costs over the business cycle by gradually building a countercyclical loan-loss reserve in good times and then using it to cover losses as they arise in bad times. The DP has been suspended since January 2014, while retaining its volume in the structure of capital as accumulated at end-2013.

- **General Countercyclical Capital Buffer (CCB):** The CCB is planned to be introduced from 2016.

- **Capital Surcharges on SIFIs:** Capital surcharges are planned to be introduce from 2016.

Assessment

2. **The assessment of effectiveness of the macroprudential tools needs to be put in the historical context.** Prior to the 2009 financial crisis there was significant foreign wholesale borrowing by banks (at 44 percent of GDP between 2005 and 2007). This borrowing helped finance a boom in credit to the non-tradable sector (mainly construction). The tightening in external financial conditions forced aggressive deleveraging; resulting in a bust in asset prices (particularly real estate). The 20 percent devaluation in 2009 added to FX pressures, spreading to unhedged FX borrowers. Since then, measures have been taken to significantly limit foreign wholesale borrowing and unhedged FX borrowing has also declined. Banks had large net open FX positions at the time of the crisis and they have declined significantly as supervision began to enforce the existing NOFP limits. However, the NOP has widened again in 2014—though not to the extent of 2009—and liabilities this time are mostly funded from deposits rather than foreign wholesale borrowing.

3. **Recommendations to improve the macroprudential toolkit are aimed at addressing the major risks on financial stability.** These are mainly on reducing exchange rate and credit risks. The planned implementation of the CCB and the phasing in of Basel III capital requirements should help enhance resilience of the banking sector.

Exchange rate risk:

- *The risk:* Exchange rate risk, however, remains the largest risk for the banking sector. Fears of devaluation are still looming and are contributing to a rise in FX liabilities relative to FX loans as the net open FX position of banks is negative. Essentially, liabilities upon which interest must be paid exceed interest earning assets. FX risks are especially elevated in the corporate sector—the largest borrowers from the banking system—where leverage and the net open FX position to equity are extremely high.

- *The recommendation:* To help limit risks emanating from high exposure to the corporate sector, the NBK should consider ***introducing risk weights or exposure caps for corporate exposures***. This will help the banking system withstand corporate credit losses by building capital buffers (see IMF Staff Guidance on Macroprudential Policy). Risk weights can help build buffers by affecting the supply of credit indirectly while FX exposure caps curtail the supply of credit directly. ***Reducing FX lending to borrowers*** whose earnings are not in FX should also be considered. This can be done through higher risk weights on such exposures. Tighter net open position limits are also recommended to contain exchange rate risk.

Credit risk:

- *The risk:* Even though there are concentration limits, credit concentration remains a risk to financial stability. Though concentrated large exposures have fallen from levels during the global financial crisis, at 208 percent of capital, they remain large. The FSAP found that if three largest bank exposures were to default, about 11 banks would breach the regulatory minimum capital requirement. In 2014, the construction sector received the largest share of new corporate sector credit (24 percent) while it also had the largest share of new NPLs (41 percent, rising from 15 percent the previous year). On the other form of credit risk, macroprudential measures introduced by the NBK to contain consumer credit were effective in reducing such lending.

- *The recommendation:* The NBK should ensure compliance with exposure limits to restrict bank exposures to single counterparties or groups of connected counterparties.

4. **Proper implementation and enforcement of macroprudential tools is critical.** The FSAP warned that inconsistent implementation of macroprudential measures, as has been in the past (including forbearance for some banks resulting in ineffective incentive structures), could add to regulatory uncertainty and result in ineffective incentive structures and a loss in confidence in the domestic financial system.

Annex IX. Kazakhstan: Inclusive Growth[1]

Kazakhstan's economic growth has been broadly inclusive, but further efforts are needed to reduce growing income gaps. Efforts to reduce income inequality by promoting faster employment growth have been relatively weak, in part because the enclave nature of extractive industries leaves wide welfare gaps among regions and along the urban-rural divide. The twin priorities of economic diversification and private sector development require addressing key structural weaknesses, namely human capital and institutions—areas where Kazakhstan lags behind emerging market peers. Staff carried out an analysis on inclusive growth, focusing on income inequality and employment, under the 2014 Article IV consultations.[2] Important challenges highlighted by the analysis are resource dependence, public sector dominance, and governance.

Income Inequality

1. **Based on available data, poverty has declined considerably over the past decade, from 47 percent in 2001 to 3 percent in 2013, with urban and rural poverty falling, respectively, from 36 percent to 1.3 percent and from 59 percent to 5 percent**. Urban-rural disparity, however, remains relatively high: the rural poverty gap—defined as rural poverty rate minus the national poverty rate—is wider than in some poorer neighboring countries. Regional disparities are also high with poverty ranging from 1.7 percent in Astana to over 10 percent in south Kazakhstan. High poverty rates are observed in both non-oil and oil-rich regions, reflecting the enclave nature of the oil industry, which is capital intensive and thus does not create significant economic spillover effects.

Employment

2. **Thanks to robust economic growth, the unemployment rate in Kazakhstan has declined rapidly, from over 10 percent in the early 2000s to around 5 percent today.** High female labor force participation (67 percent) is another positive feature of the labor market in Kazakhstan. Yet, given the high level of self-employment, which reflects in many ways informal part-time employment, the low recorded level of unemployment needs to be treated with caution. Moreover, job creation has not been commensurate with economic growth (especially since the global financial crisis), particularly in the manufacturing sector where it is anemic, despite the accelerated industrialization program. Employment in the agricultural sector has continuously fallen, because of the unproductive farm structure, which reflects limited access to commercial credit and lack of long-term investment. The low degree of job creation also reflects a capital intensive economy dominated by the oil and public sectors. In 2012, in part as an attempt to address some of these gaps, the authorities introduced new labor market policies such as (i) supporting job search assistance and intermediation services; (ii) development of entrepreneurship in rural areas through

[1] Prepared by Yahia Said.

[2] See IMF Country Report No. 14/243 Republic of Kazakhstan—Selected Issues "Assessment of Inclusive Growth."

micro-credits; (iii) free training and retraining, including support for relocation; and (iv) provision of employment through infrastructure and communal service programs.

Business climate and governance

3. **Kazakhstan scores relatively low on several business environment and governance indicators.** For example, while it has seen some improvement in the World Bank's Doing Business indicators, the diagnostic of firm-level business constraints reveals important weaknesses in labor skills, taxation, and corruption. Governance issues are mostly rooted in weak transparency prevalent in off-budget operations, including through large quasi-fiscal institutions. The large role of the state in the economy—for example, the size of the state investment holding company Samruk Kazyna (SK) has grown over time, reaching roughly 50 percent of GDP (in assets)—represents an additional barrier to enhanced private-sector led business environment. The government is launching a number of programs in cooperation with MDB to strengthen governance indicators, including through greater transparency of quasi fiscal institutions.

Fiscal policy

4. **The scale of government spending on critical social sectors (including health, education and social protection) has been broadly adequate in Kazakhstan compared to countries with similar income per capita.** In addition, the government has attempted to protect critical spending (as a share of GDP) during times of fiscal adjustment. However, the 2015 budget cuts have affected some important social programs including the reduction of the budget for Health and Social Services ministry by 15 percent. Quality of social spending, as measured by outcomes, on the other hand, needs improvement. The World Bank has identified some areas of concern, especially related to education. In particular, Kazakhstan's students' performance on PISA (Program for international Student Assessment) has been below their peers' in comparator countries. Finally, there are significant disparities in educational enrollment across residence and income status within the country. Staff will deepen the analysis of these issues in the context of its future diagnostic of inclusive growth in Kazakhstan.

INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

July 16, 2015

Prepared By

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

CONTENTS

RELATIONS WITH THE FUND

(As of June 29, 2015)

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	427.80	100.00
Fund holdings of currency	412.28	96.37
Reserve position in the Fund	15.53	3.63

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 (SDR million)	Amount Drawn (SDR million)
ECF	12/13/99	3/19/02	6/04/96	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 U.S. 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. In September 2014, the band was asymmetrically widened to T170-188/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 July 21, 2014 (see IMF Country Report No. 14/242).

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 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, ADB, 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.

5. September 2004: Bringing banking prudential regulation up to EU standards.
6. September 2004: Implementing inflation targeting: next steps.
7. November 2007: Strengthening banking supervision and risk assessment.

   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.
8. November 2010: Reducing nonperforming loans in the banking system (joint with LEG).

9. 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).
10. November 2014: Enhancing the monetary policy framework (needs assessment mission).
11. March 2015: Liquidity forecasting.
12. March-April 2015: Enhancing the monetary policy framework.
13. June-July 2015: Modeling and forecasting.

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.

14. April 2003: Customs administration.
15. September 2004: Treasury reform process.
16. 2011–14: Technical assistance provided by IMF regional advisor on public financial management.
17. May 2014: HQ-led PFM mission on fiscal risk management, IPSAS and accrual accounting.
18. September-October 2014: Accrual accounting and reporting for tax and customs revenues.
19. May-June 2015: Accrual budgeting and public-private partnership (PPP) issues.

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.

20. January 2006: Real sector and balance of payments statistics.
21. August 2006: Real sector statistics.
22. December 2006: ROSC update mission (and DQAF).
23. April 2008: GFSM 2001 implementation.
24. January 2009: Monetary statistics.
25. April 2011: BOP statistics.
26. July 2013: Government finance statistics.
27. November 2014: Government finance statistics.
28. April 2015: Monetary and financial statistics.

29. June 2015: National accounts statistics.

Legal Department

30. April 2008: Reforms to tax law.

    April 2010: Anti-money laundering and combating the financing of terrorism (jointly with the World Bank and United Nations Office on Drugs and Crime).

31. November 2010: Reducing nonperforming loans in the banking system (joint with MCM).

32. 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 June 20, 2015)

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 June 2015, the IBRD loan program comprised seventeen projects with a total commitment of US$3.9 billion, of which US$2.1 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 fifteen projects are: SME Competitiveness, technology commercialization, fostering productive innovations, customs development, tax administration reform, health sector technology transfer and institutional reform, technical and vocational education modernization, Youth Corp, skills and jobs, statistical capacity building, Ust-Kamenogorsk environmental remediation, forest protection and reforestation, energy efficiency, second irrigation and drainage, and justice sector institutional strengthening.

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 FY15 amounted to over US$10.5 million and comprised 35 largely interrelated and programmatic activities focusing on the Government's strategic priorities in financial sector development, strengthening of the private sector, fostering of science and innovations, development of skills for the labor market, attraction of investments into economy and development of PPP, sustainable environmental development, implementation of institutional reforms in public administration, and regional cooperation.

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 June 2015, 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 June 16, 2015)

Kazakhstan is one of the largest countries of operations of the EBRD, with about US$ 7 billion invested over the last 21 years, and is demonstrating strong reform momentum. In June 2014, EBRD signed the Enhance Partnership Framework Arrangement with the Government of Kazakhstan for re-energizing reforms. This has enabled EBRD to deliver increased transition impact through policy dialogue and a higher level of investment within EBRD's country strategy.

In Kazakhstan, EBRD has the following priorities:

Diversification and support for the non-resource sector. The EBRD is already the largest investor in the non-oil and gas sector of the economy. We will continue to support the development of other sectors by financing projects that enhance productivity in the corporate sector, improve the business environment, promote modernization of the agribusiness sector along the entire value chain and facilitate growth of the SME sector. The EBRD will also work to further develop the banking and non-banking financial sectors.

Balancing the role of the state and the market. The EBRD will seek to assist the Kazakh authorities in balancing the roles of the state and the market by supporting growth of private sector enterprises. The EBRD will also support policies aimed at commercializing public enterprises and making them more efficient, as well as upgrading infrastructure ensuring appropriate sharing of risks between the private and public sectors.

Promoting low-carbon growth and energy efficiency. The Government's recently announced Green Economy Strategy is a top national priority and the EBRD will assist in implementing key aspects of the strategy through projects in energy, renewables, agriculture, water, waste management, transport, and other sectors.

The EBRD is already working to address these issues. Thanks to the EBRD's support, nearly 60 percent of Almaty's urban transport is now environmentally friendly. We are working with clients in agribusiness sector such as RG Brands; supporting private sector's involvement in infrastructure, such as Olzha and Eastcomtrans, the rail car providers; helping to contribute to the energy efficiency of the power sector by financing clients like CAEPCO; and working on renewable energy both in terms of policy dialogue and project financing. The EBRD's Small Business Support program has provided consulting support to over a thousand two hundred private enterprises, and with donor funds from the Kazakh government is now present in 7 regions of Kazakhstan—expanding to 9 by the end of 2015. The EBRD is working on expanding its program of SME financing through local partner banks.

As well as being a country where the EBRD works, Kazakhstan is also an EBRD donor. In 2013 the Kazakh government signed a €6 million agreement for Technical Cooperation funding, principally supporting policy dialogue objectives in Kazakhstan with a primary focus on transport, telecommunications, and energy efficiency. The fund has a co-financing arrangement with the EBRD Shareholder Special Fund. In 2015 EBRD received Euro 41 Million for technical advisory and support of the Small Business Program under the Enhanced Partnership Framework.

EBRD activity in Kazakhstan to date

Last updated 31 December 2014

182
No. of projects

€5.7 billion
Cumulative EBRD investment

€3.7 billion
Cumulative EBRD disbursements

70%
Private sector share of cumulative investment

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

(As of June 16, 2015)

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 June 2015, cumulative public sector loan commitments to Kazakhstan amounted to about US$3.1 billion, of which about US$2.2 billion has been disbursed. Commitments cover 26 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 80 technical assistance (TA) projects amounting to about US$33.1 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.

Both, the PFA and ADB's current country partnership strategy (CPS) for 2012–16, aim to support economic diversification, sustainable development and inclusive growth. ADB's focus is in the transport, finance, urban, and energy sectors. As knowledge solutions are central to the CPS, the government and ADB established a joint Knowledge and Experience Exchange Program (KEEP) in 2013. The KEEP commits the parties to a cost-sharing arrangement with a total financing of US$2.5 million for 2013–17.

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. This is complemented by 2 stand-alone loans in the total amount of $220 million. Five 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$122 million was approved in December 2013, and tranche 3 amounting to US$130 million was approved in December 2014 with an additional financing of US$98 million currently being processed. 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.

In addition to the KEEP, 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$24.2 billion, over the period 2001–14. 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 July 7, 2015)

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 and national accounts.
National accounts: The Committee on Statistics (CS) has made considerable progress in improving the statistical infrastructure and updating the business register with full coverage of legal entities and individual entrepreneurs. Annual estimates of oil and gas sector are compiled and disseminated—but only in Russian, following international standards. However, the contribution of the oil sector to the GDP is understated since taxes on oil and gas products have not been included. Addressing also other tax-related issues identified by the last STA TA mission would increase the absolute value of GDP. The CS also compiles quarterly GDP, but on a cumulative basis—instead of discrete basis and using "comparable prices" instead of fixed base or previous year prices.
Price Statistics: 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 non-controlled 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). Over the last two years the authorities have expanded coverage of data reported for the Government Finance Statistics Yearbook to include both the National Fund of the Republic of Kazakhstan and State Social Insurance Fund, and consequently are now able to report annual data for to the whole of the consolidated general government, including a financial balance sheet. However, statistics on the enlarged government (including public enterprises) is not available.
Monetary statistics: The National Bank of Kazakhstan (NBK) reports the Standardized Report Forms (SRFs) 1SR for the central bank and 2SR for other depository corporations (ODCs) on a monthly basis for publication in IMF's *International Financial Statistics (IFS)* with a lag of about one month. The last mission on monetary and financial statistics, which took place in April 2015 assisted the NBK to develop a framework for compiling SRF 4SR for other financial corporations (OFCs). The NBK agreed to report quarterly SRF 4SR for publication in *IFS* by end-December 2015. While good progress has been made on data compilation and dissemination, more efforts are required to address the remaining inconsistencies in the reporting of inter-bank positions, which are due to the lack of information on the counterpart sector of certain transactions. **Financial sector surveillance:** Kazakhstan participates in the IMF's Coordinated Direct Investment Survey (CDIS), and Coordinated Portfolio Investment Survey (CPIS). The country reports 34 financial

soundness indicators (FSIs) for posting on the IMF's FSI website on a quarterly basis—all 12 core FSIs and 11 of the 13 encouraged FSIs for deposit takers, and 11 encouraged FSIs for other sectors and markets (two FSIs for OFCs, four FSIs for nonfinancial corporations, two FSIs for households, and three FSIs for real estate markets).
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. The NBK is reporting quarterly BOP and IIP data, Reserves Template, and participates in the World Bank's Quarterly External Debt Statistics (QEDS). Deficiencies remain in 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, including coverage of external debt of publicly-owned corporations. 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	
Kazakhstan subscribes to the Special Data Dissemination Standard (SDDS) since March 2003.	Data ROSC published in 2008.

Kazakhstan: Table of Common Indicators Required for Surveillance

(As of July 7, 2015)

	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]	05/31/15	06/30/15	M	M	M		
Reserve/Base Money	05/31/15	06/30/15	M	M	M	O, O, LO, LO	O, O, O, O, O
Broad Money	05/31/15	06/30/15	M	M	M		
Central Bank Balance Sheet	05/31/15	06/30/15	M	M	M		
Consolidated Balance Sheet of the Banking System	05/31/15	06/30/15	M	M	M		
Interest Rates[2]	05/31/15	06/30/15	M	M	M		
Consumer Price Index	3/31/15	…	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]	04/30/15	05/15/15	M	M	M		
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	Q3/2014	01/20/2015	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.