IMF Executive Board Concludes 2013 Article IV Consultation with the Republic of Kazakhstan

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On August 2, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Republic of Kazakhstan, and considered and endorsed the staff appraisal under the lapse of time procedure.[2]

Macroeconomic conditions remain solid, although growth has decelerated of late. Real GDP growth slowed from 7½ percent in 2011 to 5 percent in 2012, and further to a still-solid 4.6 percent year-on-year during the first quarter of 2013. The strong growth has allowed employment to expand at about 2½ percent annually over the last three years. Helped by moderating food prices, headline inflation has fallen to just below the 6-8 percent target range, while core inflation has remained stable at around 5-5½ percent.

Following a cumulative 200-basis points cut in the central bank's official refinancing rate early in 2012, the authorities have kept the rate on hold at 5½ percent since August 2012.

The financial sector is gradually recovering. Banks' profits have improved over the past year, but remain weak, with the return on assets ratio for the largest banks (excluding BTA and Alliance banks) reaching just 1 percent last year. The system's capital adequacy ratio increased from 17 percent to 18 percent in 2012, following the external debt restructuring and state-funded recapitalization of BTA. While private sector credit growth remains moderate overall, consumer lending, concentrated in small- and medium-sized banks, is expanding rapidly (from a low base). Efforts to resolve the large stock of nonperforming loans (NPLs) are ongoing, but with limited impact so far.

Concerning the non-bank sector, Kazakhstan's 11 pension funds, with total assets of US$21.2 billion (11 percent of GDP) are being unified under the partial management of the central bank, following a Presidential decree early in 2013.

The fiscal position worsened somewhat in 2012, mainly due to weaker performance in the oil sector as well as tax exemptions for new oil projects, accompanied by a rise in expenditures of 0.8 percent of GDP. The non-oil deficit deteriorated only slightly from 8.8 to 9.0 percent of GDP, compared to an estimated medium-term sustainable level of 6 percent of GDP. In early 2013, revenue performance was relatively weak while expenditures were also subdued. Over the medium term, the authorities are planning large investment projects in the broader public sector to boost economic development and diversification.

The growth outlook is solid. In 2013, GDP is expected to grow at 5¼ percent, only moderately above 2012, reflecting a recovery in oil and agricultural output. Over the medium term, full scale production in the Kashagan oil field, projected to commence in 2015, will strengthen overall growth. A potential slowdown in the global economy, particularly in Russia and China, and lower oil prices than currently projected are the main downside risks to growth.

Executive Board Assessment

In concluding the 2013 Article IV consultation with Kazakhstan, Executive Directors endorsed staff's appraisal, as follows:

Executive Directors welcomed Kazakhstan's sustained growth performance. They noted that average growth of 8 percent over the past decade, supported by rising oil output and prices, has solidified Kazakhstan's position as a regional economic power. Directors urged the authorities to take advantage of the positive outlook to strengthen the policy architecture with a view to achieving durable and inclusive growth and alleviating vulnerabilities to shocks.

Directors stressed that greater determination is needed to resolve the non-performing loan (NPL) problem and to counter financial stability risks. In particular, in view of slow progress on NPL resolution, the authorities should follow through on their consideration of redesigning the Problem Loans Fund and strictly enforce the new ceilings on NPLs to achieve full compliance. Given rapid growth in consumer lending, Directors called on the authorities to ensure that risk management and lending practices are sufficiently robust to avoid exacerbating the NPL problem. In this regard, further strengthening of supervision and macroprudential tools is critical, including shoring up on-site supervision, enhancing liquidity and credit risk assessments, and stepping up the Early Warning System. Directors cautioned that the planned exit from troubled banks should ensure that transactions are market-based and transparent to bolster the stability of the banking system as a whole and to avoid the emergence of new risks.

Directors welcomed the National Bank of Kazakhstan's (NBK) enhanced regulation of banking system liquidity. They urged the authorities to follow through on their plan to introduce a new policy interest rate that signals better the stance of policy. Directors also stressed that, to anchor expectations about policy intentions and operations, the NBK should communicate more openly and clearly the transition plans to active open market operations (OMOs) and more generally elaborate on the factors guiding the interest rate decisions in its public communications. In addition, they encouraged close collaboration between the NBK and the Ministry of Finance to secure increased financial institutions′ participation in the market for government paper, which would support active OMOs as a cornerstone of the revamped monetary policy framework. Directors added that there is also scope to re-evaluate the role of the exchange rate and how it fits within the broader monetary policy framework, with a view to allowing for greater flexibility over the medium term.

Directors stressed that lowering the non-oil deficit over the medium term is a key priority, which necessitates a credible fiscal consolidation strategy. In this context, they noted that the consolidation plans outlined in the current medium-term fiscal framework will need to be consistent with announced (but non-budgeted) large scale public spending plans related to the government′s development and diversification programs. Furthermore, the assumptions underlying both expenditure and revenue projections need to be fully aligned with a macroeconomic framework that takes into account the effects of envisioned fiscal measures.

Directors welcomed the authorities′ plan to revamp the medium-term fiscal framework, and noted that this required improved coverage and transparency. The authorities should integrate fully the National Fund of the Republic of Kazakhstan (NFRK) with fiscal accounts and use consolidated budget balances to guide fiscal policy. Further, there is a need for improved transparency of quasi-fiscal operations, including those related to the government′s development and diversification programs. In this regard, Directors welcomed the authorities′ intention to monitor more closely the external debt of the broader public sector.

Directors also cautioned that the unification of the private pension funds must avoid exacerbating fiscal risks and undermining earlier reform efforts. In particular, the authorities should adhere to their intention to adopt a clear and sound market-based investment strategy for the assets, while ensuring that individual accounts are maintained.

Directors urged further action to reduce the economy′s dependence on oil. In particular, they noted that successful diversification promoting broad-based and private-sector led growth requires bolstering human capital, the business environment, and institutions. Directors also highlighted the importance of carrying out critical public investment in line with absorptive capacity and high standards of efficiency and oversight.

Kazakhstan: Selected Economic Indicators, 2010–14

	Proj. 1/	Proj. 1/

	2010	2011	2012	2013	2014
	(Changes in percent)				
Real economy					
Real GDP	7.3	7.5	5.0	5.2	5.3
CPI (end-of-period)	7.8	7.4	6.0	6.0	6.2
	(In percent of GDP)				
Public finance					
Government revenue and grants	23.9 3..9	27.7	27.0	25.6	24.3
Government expenditures (and net lending)	22.5	21.8	22.5	21.1	20.6
General government balance [2/]	1.4	5.9	4.5	4.5	3.7
General government non-oil balance	-10.3	-8.8	-9.0 0..0	-8.6	-7.8
General government debt (end-of-period) [3/]	10.7	10.4	12.4	13.4	13.8
	(Changes in percent)				
Money and credit [4/]					
Base money	5.0	10.3	1.9	17.9	15.8
Broad money	13.3	15.0	7.9	10.8	13.8
Credit to the economy [5/]	5.8	15.2	11.3	19.5	12.4
NBK refinance rate (end-of-period; percent)	7.0	7.5	5.5	...	...
	(In percent of GDP)				
Balance of payments [6/]					
Trade balance	19.3	24.9	21.3	18.8	15.7
Current account balance	0.9	6.5	3	3.1	1.9
External debt	79.9	66.7	67.7	66.0	62.8
Excluding intra-company loans	44.5	34.5	34.9	31.8	28.4
Gross international reserves					
In billions of U.S. dollars, end of period	28.3	29.3	28.3	34.4	41.0
In months of next year’s imports of goods	6.6	5.7	5.3	6.1	6.9
and nonfactor services					
	(Changes in percent)				

Exchange rate [7]					
Tenge vs. U.S. dollar (end of period)	-0.7	0.4	1.5	...	...
Real effective exchange rate (p.a) [8]	1.5	0.3	3.6	...	...

Sources: Kazakhstani authorities; and IMF staff estimates and projections.

1 / Staff projections.

2 / Privatization revenues are treated as a financing item.

3 / Gross domestic and external government debt, including government guaranteed debt.

4 / Reflects data available at the time of the mission.

5 / Source: Monetary Survey of the Banking System.

6 / The GDP in U.S. dollars is calculated using the period average exchange rate.

7 / A positive sign indicates appreciation.

8 / IMF staff estimates.

[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.

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

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