January 7, 2022
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 20/9-1

10:00 a.m., January 27, 2020

1. Republic of Kazakhstan—2019 Article IV Consultation

Documents: SM/19/287, and Cor. 1, and Sup. 1, SM/20/4, and Cor. 1, and Cor. 2

Staff: Horton, MCD, Sommer SPR

Length: 41 minutes

Executive Board Attendance

T. Zhang, Acting Chair

Executive Directors	Alternate Executive Directors
	J. Essuvi (AE), Temporary
	F. Sylla (AF)
	R. Morales (AG), Temporary
	C. White (AP)
	P. Fachada (BR)
	Z. Huang (CC), Temporary
	E. Cartagena Guardado (CE), Temporary
	P. Mooney (CO), Temporary
R. Kaya (EC)	
	P. Rozan (FF)
	K. Merk (GR)
	B.Singh (IN), Temporary
	M. Psalidopoulos (IT)
	M. Shimada (JA), Temporary
	M. El Qorchi (MD)
	M. Merhi (MI), Temporary
	Z. Zedginidze (NE), Temporary
	J. Sigurgeirsson (NO)
	L. Palei (RU)
	F. Rawah (SA), Temporary
M. Anwar (ST)	
P. Inderbinen (SZ)	
	O. Haydon (UK), Temporary
	R. Farber (US), Temporary

G. Bauche, Acting Secretary
J. Morco, Summing Up Officer
B. Zhao, Board Operations Officer
M. McKenzie, Verbatim Reporting Officer

Also Present
Legal Department: K. Kao. Middle East and Central Asia Department: N. Blancher, M. Horton, J. Kahkonen, K. Mathai, S. Mirzayev, W. Shi. Strategy, Policy, and Review Department: M. Sommer. World Bank Group: I. Oleinik. Executive Director: P. Trabinski (SZ). Advisors to Executive Directors: M. Bangrim Kibassim (AF), A. Biriukv (RU), X. Cai (CC), S. Evjen (NO), I. Fragin (GR), G. Khurelbaatar (AP), E. Ondo Bile (AF), T. Persico (IT), F. Rivadeneira (BR), A. Tola (SZ), A. Zaborovskiy (EC).

1. REPUBLIC OF KAZAKHSTAN—2019 ARTICLE IV CONSULTATION

Mr. Inderbinen and Mr. Danenov submitted the following statement:

Introduction

On behalf of the Kazakh authorities, we would like to thank staff for the productive discussions during the mission and the well-crafted report, as well as the insightful Selected Issues papers. The authorities are grateful for the consistent cooperation and advice that they have benefited from in the course of the Article IV cycle. The authorities look forward to continued close cooperation, which is expected to be enhanced further by the forthcoming establishment of the Regional Capacity Development Center for CCAM countries in Almaty. The authorities broadly concur with staff's policy recommendations.

Economic Developments and Outlook

The economic upturn in Kazakhstan has remained robust, with 4.4 percent GDP growth in the first eleven months of 2019. The outcome exceeds previous forecasts, and is mainly due to positive dynamics in consumer and investment demand, trade, manufacturing, construction and transport. Over the last few years, Kazakhstan's economy grew at a high pace (with expansion averaging 5.3 percent over the 2005-2018 period). Economic and social policies are being implemented according to the Kazakhstan 2050 Strategy, which sets the target of reaching the top 30 of the most developed countries globally. The smooth political transition in the first half of 2019 allowed for continued implementation of reforms and provided reassurance to long-term investors. Citing Kazakhstan's increased economic resilience, robust growth prospects in both oil and non-oil sectors, as well as rising incomes, international rating agencies have confirmed the sovereign rating of Kazakhstan at investment grade, with Moody's upgrading the outlook from stable to positive in August 2019.

According to the National Bank of Kazakhstan's data, total international reserves increased to USD 90.9 billion. This includes NBK gross reserves (USD 29 billion, representing more than seven months of imports) and the National Fund (USD 61.9 billion). The balance of payments deficit for the first nine months of 2019 augmented to USD 4.3 billion, due to an increase in imports and a reduction in exports, which was mainly due to lower prices of the main export goods. Imports grew due to the implementation of significant investment projects, such as the gas pipeline Sary-Arka, and the modernization of oil field equipment. FDI registered a 4.8 percent increase in the first nine months of 2019. The current account deficit is at a level of 2.2 percent of GDP (2019) and is projected to decrease to 1 percent of GDP in 2022. Public debt, as of October 1, 2019, is equivalent to 23.6 percent of the forecast GDP.

Going forward, sustainable growth in neighboring countries and major trading partners should provide favorable effects through increased trade, investments and transit volumes. As a result, given Kazakhstan's strategic geographical location, transportation, transit and logistics industries are expected to be among the fastest growing sectors of the economy. Risks and challenges remain, including volatility in global commodity markets, economic performance of key trading partners and geopolitical tensions in the region that may impact Kazakhstan via investment flows and exchange rate fluctuations.

Monetary Policy

Monetary policy is being conducted in accordance with the principles of inflation targeting. Exchange rate dynamics reflected market forces. In March 2019, the NBK and the Government of Kazakhstan signed an Agreement on the coordination of macroeconomic policy measures. Annual inflation has fallen from double digits in 2016 to 5.4 percent in November 2019, and currently remains within the NBK's target band of 4 to 6 percent. After a prolonged period of slower inflation and a positive external environment in the first half of the year, the NBK decided to raise the base rate in September 2019 from 9.00 percent back to 9.25 percent amid significant fiscal stimulus, an increase in global food prices, inflationary pressure from business activity, and the deterioration of the current account. The NBK kept the base rate unchanged in December 2019. Any further tightening would be conditioned on the need to take preemptive measures to limit the impact of the growing current account deficit on inflationary and exchange rate expectations.

According to the NBK forecast, inflation will continue to slow over the medium term and should stabilize at around 5-5.5 percent. The favorable external inflationary environment, including lower than targeted levels of inflation in Russia, the EU and China, as well as decreased pressure from internal demand, should be conducive to decelerated inflation.

The monetary policy toolkit has been improved, as indicated by staff. The necessary steps are being taken to further build the yield curve, and the NBK has continued to increase its transparency and to improve its communication policies. On a regular basis, and following a pre-notified schedule, all the base rate decisions are explained in detail, Governor's press-conferences are held, as are meetings of NBK management with independent experts.

Going forward, in 2020, the authorities will continue to follow the inflation targeting principles, as well as efforts to improve the monetary policy transmission mechanisms and transparency. The NBK will keep its focus on improving the inflation forecasts and modelling toolkit, including in the framework of the close cooperation with the Fund and within bilateral relations with other central banks.

Fiscal Policy

Kazakhstan’ fiscal policy has been accommodative and has focused on creating long-term growth factors with increased investments into infrastructure and human capital. The fiscal position remains strong. Adequate international reserves, in conjunction with the free-floating exchange rate regime, bolster the fiscal buffers and the flexibility for the country to absorb economic shocks, if the need arises. Going forward, sustained economic conditions should provide additional oil and non-oil tax revenues.

Since the increase in living standards was declared as the main policy objective by the newly elected President Kassym-Zhomart Tokayev, measures have been taken to increase the incomes of the broad population, with a special focus on the vulnerable, as well as on low paid civil servants in the education and health public sectors. The Government is planning to provide special support to projects in agriculture, infrastructure, transport and utilities.

At the same time, fiscal consolidation is expected to resume in 2020 on the back of the enhanced tax administration and spending moderation. The authorities agree on the need to strengthen public financial management. The scrutiny of non-efficient planning and use of budgetary resources in the public and quasi-state sectors will be increased. An assessment of the effectiveness of the SOEs is under consideration, and a moratorium on the creation of new SOEs has been declared. The authorities are considering the options to improve the National Fund’s framework, as well as the fiscal framework more broadly. In this context, staff’s suggestions to request a Fiscal Transparency Evaluation is well noted.

The Government is promoting digitalization processes in all public spheres, including revenue administration, which should contribute to increased tax collections and reduce the informal economy. The introduction of electronic invoices and the risk management system have already increased the revenue intake. The total volume of non-cash operations and card money transfers has increased more than two-fold in the first nine months of 2019. The total number of payment cards issued has reached 30.6 million as of October 1, 2019, which represents a 43 percent increase over the same period of the previous year.

Financial Sector

The situation in the banking sector improved after the implementation of the Bank Recovery Program and is considered to be stable. At the beginning of 2019, the authorities started implementing risk-based supervision. Going forward, this will contribute to improve the business-models and credit policies, and prevent related-party transactions.

The NPL level decreased to 8.2 percent as of December 1, 2019. The level of available liquidity in the banks is equal to 37 percent of their assets. The loan portfolio has increased by 2 percent, while consumer loans grew by around 23 percent. Dollarization of the economy has decreased further, to 43 percent in November 2019 (from 48.4 percent at the beginning of 2019), but it is still impacting the effectiveness of the monetary policy mechanisms.

With an aim to continue the recovery of the banking sector, an Asset Quality Review has been conducted in the second half of the year by an independent international consultant and audit firms, in compliance with the European Central Bank methodology that was adapted to domestic economic conditions. It involved 14 major banks, representing 87 percent of banking sector assets. At present, the recommendations and the scope of corrective measures are being discussed with each of the banks. The AQR results will have wide supervisory implications, and the methodology and acquired knowledge will be integrated in the conduct of supervision.

Starting January 1, 2020, financial sector oversight is, following the separation from the National Bank of Kazakhstan, under the responsibility of the newly created Agency for Regulation and Development of Financial Markets.

The authorities will take due consideration of staff's suggestion to request an FSAP.

Structural Reforms

The Kazakh authorities are aiming to continue to implement structural reforms, with a special emphasis on further improving the business and investment climate, supporting the SMEs, reducing the state's role in the economy, increasing diversification, and strengthening human capital.

Kazakhstan moved up three spots to 25th rank in the World Bank Doing Business 2020 report, thanks to improvements in issuing permits, ease of getting a loan, and starting a business. Special attention is given to improving the environment for micro and small enterprises, including via tax exemptions and a ban on tax audits for a three-year period starting January 2020. The launch of the Astana International Financial Center as a regional financial hub is expected to contribute to further improvement of the investment environment. The recently adopted visa-free policies, as well as the adoption of the Open Skies policy, should contribute to investment and tourism.

The Government has launched the National Privatization Program that, amongst other targets, envisages IPOs for many blue-chip SOEs. The example of Kazatomprom will be gradually and sequentially followed by national companies in energy, communication and transports. All privatization proceeds are transferred to the National Fund.

Kazakhstan has demonstrated comparatively modest diversification progress so far, with oil and gas' share in GDP and exports at 20.4 and 58.3 percent, respectively (for the first nine months of 2019). The optimal diversification strategy for Kazakhstan would be to develop industries along the upper value chain, while at the same time nurturing already existing non-resource sectors. This includes the development of refining and chemical industries, food production, mechanical engineering, complex metal products, transports and logistics. The authorities are considering a review of the effectiveness of previous industrialization programs, as well as an audit of all agricultural sectors and water resources.

Further development of Kazakhstan's regional connectivity and transport infrastructure under national programs and the Belt and Road initiative is expected to contribute positively to external trade and transit volumes. Attracting additional cargo flows will increase transit freight volumes by all means of transport from the current 17.5 million tons to 33 million tons in 2020, and 50 million tons in 2030. The construction of the gas pipeline Sary-Arka, which brings gas from the south of Kazakhstan up to the north of the country, has been completed at the end of 2019 and is expected to have a multiplier effect on economic activity.

The authorities put special emphasis on human capital development (Kazakhstan ranks 50th globally in the Human Development Index) and they aim to further strengthen human capital through reforms in education, health and labor. Finally, within the framework of Kazakhstan's national priorities and with the support of multilateral institutions, the authorities are committed to strengthening governance and institutions, as well as addressing social vulnerabilities and inequalities.

Mr. Kaya and Mr. Zaborovskiy submitted the following statement:

We thank staff for the well-written set of papers and Messrs. Inderbinen and Danenov for their insightful Buff statement. We welcome the strong performance of the Kazakh economy underpinned by sound policies and ample financial buffers. We concur with the thrust of staff's appraisal and positively note the broad agreement between staff and the authorities.

Growth-friendly fiscal consolidation complemented by a stronger fiscal framework would preserve the intergenerational equity. We note that staff assessed the fiscal stance in 2019 as procyclical and called for fiscal consolidation in the medium term. While we see merit in targeting the non-oil budget deficit which is consistent with long-term sustainability and equity objectives, we would like staff to further elaborate why the authorities' fiscal impulse amidst the challenging external environment has been considered as pro-cyclical. As shown in the comprehensive SIP on the fiscal framework, advancing the existing system by reducing complexity, broadening institutional coverage, introducing flexibility elements, and ensuring enforceability can bolster the effectiveness of fiscal policy. We support staff's recommendations to enhance transparency and communications on the budget policies and performance of the National Fund of the Republic of Kazakhstan. Measures to broaden the tax base, improving progressivity and efficiency of the tax system, strengthening tax administration, as well as the broader public financial management reforms should be well-sequenced and aligned with the fiscal framework modernization. Stronger focus on fiscal risk analysis and management, including Public Private Partnerships, would help preventing "debt surprises."

Efforts to further advance the inflation-targeting framework while maintaining the exchange rate flexibility should be pursued. We agree with staff's appraisal that the monetary policy stance is appropriate, and the central bank should remain vigilant about inflationary risks. More broadly, the framework of inflation targeting with the flexible exchange rate regime was instrumental in absorbing external shocks and lowering inflation. However, a further fine-tuning of the framework and strengthening its institutional foundations is warranted. We underline the importance of improving coordination between fiscal and monetary policies, financial market development, and increasing the central bank's independence. We also note the growing excess liquidity in the banking system (figure 3) which poses additional challenges to the monetary transmission. Could staff elaborate more on this issue, including their policy advice and the main priorities to address this problem? We also agree with staff that increasing transparency and predictability of the central bank's FX interventions is important to improve market participants' understanding of the exchange rate policy.

Addressing pockets of vulnerabilities within the financial system is critical to reinvigorate credit growth to the private sector. We welcome the Asset Quality Review which will provide a strong basis for the policy actions to boost financial stability. We positively note from the Buff statement that the authorities are planning to introduce comprehensive follow-up actions in line with good international practices. More broadly, strengthening the banking regulation and supervision while enhancing competition among banks and efficiency-based resource allocation remain critical to support private-sector-led economic growth. The reform of the financial supervisory architecture, if properly executed and underpinned by strong inter-agency coordination, will boost confidence and contribute to financial stability. We positively note the authorities' plans to further buttress the AML/CFT framework, including the independence of key agencies.

We commend the authorities for pressing ahead with the comprehensive structural reforms formulated in the “100 Concrete Steps” initiative. With 68 steps having been completed already, these reforms yielded gains in international rankings and should contribute to creating a more conducive environment for the private sector and entrepreneurship. Could staff comment on how the already implemented reforms influenced staff’s estimates of Kazakhstan’s growth potential? We are encouraged to learn that staff’s recommendations on governance and anti-corruption are well-received by the authorities. Reducing the state’s footprint in the economy, increasing the efficiency of infrastructure investments, and further enhancing the protection of property rights remain critical for sustainable and inclusive economic growth.

With these remarks we wish the Kazakh authorities every success in their reform endeavors.

Mr. Sun and Ms. Cai submitted the following statement:

We thank staff for the comprehensive set of reports and Mr. Inderbinen and Mr. Danenov for their informative Buff statement. We welcome the strong economic performance, supported by the pick-up of consumption and investment, in Kazakhstan. The authorities have made notable progress in addressing the vulnerabilities, including floating the tenge, to help with the economic adjustment. We also welcome the forthcoming establishment of the Regional Capacity Development Center for CCAM countries in Almaty. Going forward, it remains important for the authorities to modernize the fiscal and monetary policy frameworks, address financial sector vulnerabilities, and accelerate structural reforms. As we broadly agree with staff’s assessment, we would limit our comments to the following for emphasis.

Fiscal consolidation should proceed gradually to support growth, while the fiscal policy framework needs to be further enhanced to improve transparency and medium-term sustainability. We welcome the measures to support vulnerable groups through new social and regional initiatives, particularly by increasing wages for lower-paid public employees, providing housing and other support to vulnerable households, as well as enhancing regional and rural infrastructure. Meanwhile, continued fiscal consolidation is needed to maintain fiscal and debt sustainability. Given Kazakhstan’s infrastructure gap, fiscal consolidation should be mainly achieved through enhancing revenue mobilization. We take positive note that efforts to strengthen VAT administration and customs control have yield positive results and encourage the authorities to further enhance the efficiency of tax collection.

Strengthening monetary policy framework and promoting development of domestic financial markets are key to improving the effectiveness of monetary policy. We welcome the authorities' commitment to inflation targeting and exchange rate flexibility, which are crucial for building credibility in the new monetary policy regime. Exchange rate flexibility should continue to be a main shock absorber, and interventions should be guided by the need to limit excessive volatility. More needs to be done to strengthen the liquidity management to enhance the effectiveness of policy transmission, including further reducing the stock of the National Bank of Kazakhstan (NBK) notes.

Decisive actions are needed to address the remaining vulnerabilities in the financial sector, especially the non-performing loans (NPLs). The authorities need to further strengthen the regulatory framework and prudential oversight of the banking sector, in line with international best practices. More needs to be done to improve reporting standards. The Problem Loan Fund (PLF) should operate in line with international best practices to ensure independence, transparency, and accountability. We join staff in encouraging the authorities to request an FSAP to take stock of substantial changes, benchmark to best practices and guide reform efforts.

Well-targeted Structural reforms can promote diversification and enhance broad-based and inclusive growth. The reform agenda should be prioritized, sequenced and implemented in a timely manner, with focus on improving the business environment, strengthening competition, upgrading infrastructure, and addressing institutional weaknesses.

We commend staff for the insightful Selected Issues Paper especially the analysis regarding infrastructure investments and firm level performance. We associate ourselves with staff that infrastructure investment can be an important lever for promoting economic diversification and raising growth potential, and that efficiency is critical to maximize benefits from investments. Therefore, we encourage the authorities to put more efforts to enhance investment efficiency with the help of the Fund and other development partners. We also take note that there is less evidence regarding the investment's effects on employment and more time might be needed for the effects to materialize. We encourage staff to follow up on this issue in the future to have a better assessment. We also encourage staff to do similar analysis in other countries' Article IV discussions where infrastructure investment plays a significant role.

With these remarks, we wish the authorities every success in their policy endeavors.

Mr. Sigurgeirsson and Mr. Evjen submitted the following statement:

We thank staff for the good report and Mr. Inderbinen and Mr. Danenov for their informative Buff statement. Kazakhstan's economy has performed well in a challenging environment. Growth among trading partners has slowed, and trade tensions affect investments and capital flows. Still, the economy has maintained momentum due to domestic demand. We broadly agree with staff's assessment and have the following comments for emphasis.

We see merit in the authorities' intention to upgrade the fiscal framework and improve its transparency. The current system of rules and targets seems complex. The upgraded system should provide few, clear, and mutually consistent rules to guide policy. We agree that a medium-term fiscal policy be guided by an anchor on gross public debt and an operational target on non-oil deficit. We emphasize the importance of aiming at delinking expenditure from oil revenues in the short run to avoid macroeconomic instability. We note that compliance with the fiscal rules has been mixed, which could be conducive to reduced credibility. We appreciate staff's SIP on the fiscal framework.

We welcome the intention to resume fiscal consolidation from 2020, with a focus on assessing the efficiency and effectiveness of spending programs. Although we note positively that the political transition has increased the focus on social conditions, procyclical fiscal policy should be avoided.

We see merit in the authorities' plan to assess the framework in order to strengthen transparency, credibility and effectiveness, drawing from international experience. We note positively that the inflation targeting framework, including a flexible exchange rate, has served Kazakhstan well. Going forward, increasing central bank independence remains key to enforce credibility.

We welcome that the authorities are undertaking a bank asset quality review (AQR). The AQR can provide better understanding of the financial conditions of banks. We agree that state support to the banking sector should not come from the central bank (NBK). Central Bank support could undermine both credibility and perceived independence of the central bank. Moreover, on one hand the split of the NBK in order to establish an independent financial sector regulator could help sharpen the focus on supervision of the financial sector, while on the other it carries risks that need to be addressed. It is crucial that supervision remains independent, the communication lines with the Central Bank need to be robust, and the financial regulator should be well-staffed. We agree that a new FSAP assessment would be important to take stock of the new financial supervisory architecture.

The authorities should continue their efforts promoting private sector growth and diversification of the economy. State credit-support initiatives should be scaled back so the growth impetus moves firmly to the private sector. However, we note that Kazakhstan has several strategies and programs that underpin long-term development goals, including the long-term vision

"Kazakhstan 2050", 15 state programs, and various government strategies. Given that the state already plays a strong role in the economy, we wonder whether the authorities put sufficient emphasis on policies that enhance private sector-led growth and improve the business climate. Staff comments are welcome.

We strongly encourage the authorities to continue reducing corruption risks. We welcome Annex IV of the report on addressing corruption vulnerabilities. While we are pleased to see that Kazakhstan has developed an ambitious reform agenda to address these challenges, we note that areas for further work remain. We welcome the authorities' commitment to strengthening the AML/CFT regime and recognition of the important role these measures play in corruption enforcement.

Mr. Villar and Mr. Cartagena Guardado submitted the following statement:

We thank staff for a candid and well-informed Article IV report and Selected Issues. We also thank Mr. Inderbinen and Mr. Danenov for their informative Buff statement. We mostly agree with the thrust of the staff appraisal and want to emphasize a few points.

Despite a fall in oil prices – one of Kazakhstan's main commodities – in 2018, a political transition in government in 2019, and a bank clean-up during 2018-2019, Kazakhstan's economy has sustained a growth rate above 4 percent driven by strong domestic demand while debt remains sustainable, although vulnerable.

We welcome the authorities' commitment to continue structural Reforms. We agree with staff on the need and opportunity for the authorities to create more space for private activity and to diversify the economy. The steps been taken in the execution of the National Privatization Program go in the right direction to create a more diversified and inclusive economic base. We also commend the authorities' efforts to diversify the economy to non-oil products. The "100 Concrete Steps" plan presented in Box 1 of the report is a good guide for projects and activities that the country can undertake in the short run.

We welcome the authorities' commitment to strengthen the Kazakh financial system. The overhaul of the financial architecture provides an opportunity to strengthen independence of the National Bank of Kazakhstan as well as the supervisory capabilities of the new specialized agency for financial regulation, supervision and development. We encourage authorities to facilitate a smooth transition and ensure effective inter-agency coordination. We also welcome the commitment shown by authorities in promoting stability and soundness of the banking system through the Bank Recovery Program and with the Asset Quality Review launched in August 2019. Implementation of the risk-based supervision will be key to continue strengthening banking soundness. Staff comments on the additional costs on the fiscal stance of the Asset Quality Review will be welcomed.

We welcome the authorities' commitment to improving governance and addressing corruption. We agree with Annex IV of the report on "Addressing Corruption Vulnerabilities and Improving the Rule of Law". The set of recommendations contained in that annex provides clear guidelines for authorities in their endeavor to strengthening governance and the rule of law.

We also welcome the authorities' commitment to upgrade the fiscal framework, as well as their focus on fiscal sustainability and higher non-oil revenues following the accommodative fiscal policy undertaken in 2019. We agree that ensuring fiscal sustainability and promoting higher non-oil revenues are challenges for the short term.

Mr. Merk and Mr. Fragin submitted the following statement:

We thank staff for their informative set of reports and Mr. Inderbinen and Mr. Danenov for their helpful Buff statement.

We recognize that Kazakhstan's economy has performed well in a challenging environment, underpinned by strong domestic demand on the back of fiscal support. Nonetheless, key challenges remain, including in the banking sector and related to governance issues as well as to private sector development and economic diversification. Implementing reforms to support framework conditions for growth and investment will be important to achieve productivity gains and support long-term growth. As we largely agree with staff's analysis and recommendations, including on fiscal policy, we would like to offer the following points mainly for additional emphasis:

Addressing long-standing weaknesses in the financial sector will be key to detach banks from state support. As outlined by staff, state support to banks has been large. We therefore agree with staff that banks should aim to build sustainable business models with less reliance on funding through SOE deposits and on subsidies. In this context, any state support should be subject to safeguards in line with good practices, higher transparency and strict oversight. Furthermore, staff rightly states that state support should not come from the NBK.

We concur with staff that there is scope for greater monetary policy effectiveness through enhanced NBK independence. NBK's independence can also be conducive to building confidence in the tenge. In this context, we support the authorities' efforts in developing a long-term monetary policy strategy based on international experience with a view to improving transparency and credibility. We further join staff in encouraging the authorities to request a new FSAP review.

Finally, prudent monetary policies are needed to safeguard price stability in light of high core inflation and large wage increases in 2019 (18 percent through Q3). In this context, we would welcome additional staff comments on the implications of the increase in the minimum wage (by 50 %) earlier this year.

Mr. Psalidopoulos, Mr. Rashkovan, Mr. Persico and Mr. Zedginidze submitted the following joint statement:

We thank staff for the informative set of papers and Mr. Inderbinen and Mr. Danenov for the helpful Buff statement. We welcome the resilience of Kazakhstan's economic growth amid political transition and the authorities' comprehensive reform agenda. Nevertheless, risks stemming from governance and corruption vulnerabilities, fiscal framework, financial sector, and arrangements of the central bank need to be tackled going forward. We agree with the staff assessment and would like to make the following comments for emphasis.

We welcome the progress of the flagship "100 Concrete Steps" to advance structural reforms and support private sector lead growth. In the staff projections, we see robust and close to potential growth of the non-oil economy and welcome the reliance of overall economic growth on the non-oil sector. However, following through with the committed reform agenda is important to speed up potential growth for non-oil sector and achieve diversification of economy.

As we understand, the main concern of the economy is governance and especially corruption vulnerabilities, which should be addressed by the authorities. In this regard, we welcome the authorities' commitment to the National Anti-corruption Strategy. Improvements in tax administration and procurement procedures, as well as harmonization of the legal framework with international standards, are important steps. On enforcement, targeting high-level corruption should be a high priority on the agenda of the authorities.

Fiscal prudence should be maintained to reign vulnerabilities coming from public finances in the medium term. We note that the fiscal position improved in 2018, including structural non-oil balance, but it was short-lived. We agree with staff that the procyclical stance should be avoided. The authorities' plan to improve revenue collection and public management is important to increase the efficiency of spending. We commend staff for the comprehensive analysis of the fiscal framework in the Selected Issue Papers, including the fiscal transparency issues. We also highlight the importance of the decarbonization scenario analysis and disclosure, as part of the long-term fiscal sustainability analysis.

We welcome the transparent and comprehensive AQR and the authorities' commitment to follow up with decisive measures. However, the high budget costs (7 percent of GDP) to support the banking sector weights on fiscal risks and are concerning. We agree with staff on the importance of an exit strategy, amongst other measures, which should accompany state support.

The financial supervisory architecture should be carefully redesigned to harness synergies between NBK and the supervisory authority. The new architecture should comply with best practices and core principles of effective supervision and is key to maintain financial stability. While best international practices are not conclusive whether supervision should be inside or outside the central bank, it is imperative that effective coordination among agencies on macroprudential oversight and contingency issues must be ensured. We agree with staff's advice for careful consideration of the split of the central bank. Could staff comment on what specific arguments the authorities have for separating central bank and supervision?

With these comments, we wish Kazakh people success in their future endeavors.

Mr. Palei and Mr. Biriukov submitted the following statement:

We thank staff for the insightful set of papers on Kazakhstan and Mr. Inderbinen and Mr. Danenov for their informative Buff statement. Last year the Board considered the Article IV report on Kazakhstan on a lapse of time basis, which showed that staff did not see any major or new policy challenges worth debating at the Board. We welcome the authorities' continuing good performance and broadly share most of the policy recommendations in the staff report.

Kazakhstan is one of the few economies that managed to avoid recessions over the past 20 years. In response to significant domestic and external shocks, the authorities were able to limit the damage to growth to relatively short slowdowns. Mr. Inderbinen and Mr. Danenov appropriately reminded in their BUFF statement that Kazakhstan's economy grew at a high pace averaging 5.3 percent over the 2005-2018 period. Hence, Kazakhstan's growth track record is very strong, as the economy demonstrated better performance than the growth leaders in the EU and in the group of commodity exporters. While staff prudently estimate potential growth in Kazakhstan at about 4 percent annually, we note that the authorities remain more optimistic in their expectations. This robust performance is even more remarkable, since the level of per-capita income in PPP terms in Kazakhstan is already high, close to those in the Baltic states, Poland, Romania, Chile, Colombia, Mexico, and Russia.

Over the past two years, the National Bank of Kazakhstan (NBK) has kept inflation within the target range as per its updated inflation targeting mandate (4-6 percent annually). More recently, facing an uptick in core inflation, the central bank delivered a timely and well-calibrated response to increased demand-side pressures. Liquidity management continued to improve, and further progress was made in building the yield curve. The NBK achieved progress in improving its transparency and communication policies, and we encourage the monetary authorities to persevere with reforms in this area. While the NBK conducted one-off FX sales to limit excessive volatility, according to staff, the exchange rate regime is flexible. In light of the experience over the past decade, we believe that transition to a flexible exchange rate regime was a systemic reform and a key contributor to stronger resilience of the economy to shocks. Going forward, we see merit in taking further steps to improve the monetary policy transmission mechanism and transparency We would also welcome additional information from staff on FX transactions conducted by the NBK on behalf of the NFRK and UAPF. We are also interested to hear about the reasons for the authorities' decision to adjust the definition of the inflation target. We agree with staff that the monetary policy transmission mechanism should also be enhanced by phasing out subsidized credit.

In order to remove impediments to monetary policy effectiveness, the NBK needs to tackle more actively the still high dollarization of the economy. In this area, many countries in the region are implementing comprehensive de-dollarization programs. Could staff elaborate on what specific additional measures the NBK can take in this area and whether they discussed this topic with the authorities?

We commend the NBK for the recent asset quality review in the banking sector in line with best international practices. Additional capital requirements necessary to cover risks are estimated at 3 percent of assets, or 450 billion tenge for the 14 banks that participated in the review. We expect this to be the last round of significant recapitalization for the struggling banking sector. It has been more than 10 years since the property price bubble burst in Kazakhstan causing a lasting damage to the banking sector. In the aftermath of the crisis of 2007, the authorities could not rebuild the resilience of the banks and the overall confidence in the sector. The oil price shocks combined with the rigid exchange rate regime led to destructive currency devaluations in the past. Could staff elaborate on how the new round of banks recapitalization is going to be structured?

In this respect, we welcome the transparent presentation of the costs of recapitalization of the banking sector in the staff report. It is important to show the overall deficit including these costs and provide the numbers for the deficit without them. We note, however, that for other countries in similar situations the country teams, including in Ukraine, failed to reflect such costs in the headline fiscal numbers. A more consistent and transparent presentation of fiscal accounts by the Fund should be in line with the advice to the authorities to improve fiscal transparency more broadly. Staff comments on the proper and comparable treatment of these costs would be welcome.

Staff called on the Kazakhstani authorities to resume fiscal consolidation to maintain medium-term fiscal sustainability and safeguard intergenerational equity. Fiscal policy was more expansionary in 2019 than in the previous year, with budget spending rising notably faster than in 2018 as the near-term priorities focused on social support.

We note that the Fund endorsed a different approach to defining the optimal fiscal targets in Kazakhstan than, say, in many Latin American commodity exporters. Kazakhstan has adequate foreign exchange reserves, and, in addition, its rather large sovereign wealth fund has assets close to 35 percent of GDP. At the same time, the Latin American commodity exporters do not have meaningful assets in their sovereign funds, even if they have such funds. Instead, the authorities in this region maintain adequate FX and fiscal buffers, but tend to invest almost all revenues from commodities into domestic infrastructure and development of the human capital. The Kazakhstani authorities and staff agree on the need to further strengthen and simplify the fiscal framework. In this respect, we welcome the SIP chapter on fiscal rules as a useful contribution to the policy discussions, but we feel that the chapter could have paid more attention to the differences in practices in various commodity exporters, some of which do not save commodity revenues, while the Fund endorses and praises their fiscal frameworks. What, in staff's opinion, makes Kazakhstan different from countries like Chile, Colombia, Mexico, Peru, and Ecuador?

We welcome the authorities' efforts to streamline public employment and make taxes more equitable and efficient. The current framework has provided guidance and helped sustain buffers, yet it could be further improved. In this respect, we join staff's proposal for Kazakhstan to take an IMF PFM assessment and Fiscal Transparency Evaluation. Other countries in the region benefited from such technical assistance and improved policies. Did the authorities express any views on the desirability of such TA?

On the structural reform side, maintaining momentum is important for diversification and strong, sustainable, inclusive growth. Kazakhstan has very high ranking in the 2020 Doing Business database and has improved its scores on the World Economic Forum's Competitiveness Index. According to the indicators and charts provided in the staff report, Kazakhstan is well ahead of most emerging market economies in the EU and the CIS in many areas. The Kazakhstani economy is ranked 25 out of 190 in the most recent edition of the Doing Business database. Most of the flagship "100 Concrete Steps" have already been completed. We share the authorities' focus on the areas like competition and investment, productivity, further improving the business climate, and governance and public administration. At the same time, we note that, given the advanced state of structural reforms in Kazakhstan and in light of its already high growth rates, any promises of additional growth spurt should be modest.

We welcome the estimates in the SIP of the Government investment gap in Kazakhstan of about 2-3 percent of GDP (Appendix I, page 16). We also welcome the attempt to quantify the effects of “Nurly Zhol” program. The estimates in this chapter bode well for infrastructure investment facilitating exports diversification and boosting economic growth. Given that industrialization and growth measures constitute about half of the measures in the “100 concrete steps”, additional information on why they require more time would be useful (Box 1 in the main report). We note some elements of the industrial policy or its modern version Technology and Innovation Policy advocated by some IMF staff. At the same time, it was not entirely clear to us why staff singled out the agriculture sector as the one in need of special attention. Do the authorities see other sectors in the economy, which may help in diversification and boosting growth? Staff comments would be appreciated.

With these comments, we wish the Kazakhstani authorities success in their future endeavors.

Mr. Bhalla and Mr. Singh submitted the following statement:

We thank the staff for the analytical reports and Mr. Inderbinen and Mr. Danenov for their highly informative Buff statement.

Kazakhstan, one the largest economies in central Asia, is marked by reasonable macroeconomic stability, which is mirrored in the modest current account deficit, moderate general government deficit and debt and inflation within the central bank’s target band. The economy has, however, witnessed significant slowdown in GDP growth from an average of 8.5 per cent in 2000s to 4.7 per cent in 2011-15 period and further to 4.1 per cent in 2019 (staff projections). Does the staff think that the movement towards a lower growth trajectory has been structural in nature? If so, what are the drivers of the growth process which are underlying this structural slowdown?

Low tax revenue continues could be a potential hindrance to stepping up public investment in Kazakhstan given that average government investment to GDP ratio continues to be much below its peers in emerging and developing countries as well as the Commonwealth of Independent State (CIS) countries. IMF’s own research shows that once the tax-to-GDP level of a country reaches a tipping point of round 13 percent, its real GDP per capita increases sharply and in a sustained manner over several years.[1] The special issue note of the Staff shows that personal income tax revenue in Kazakhstan

[1] Tax Capacity and Growth: Is there a Tipping Point? by Vitor Gaspar, Laura Jaramillo and Philippe Wingender, IMF Working Papers, WP/16/234, November 2016.

is the lowest among its Caucasus and Central Asia (CCA) peers. This is despite much higher level of per capita income vis-à-vis its peers. Could the staff explain whether this implies weak compliance or greater exemptions or both? Similarly, the goods and services tax-GDP ratio remains significantly lower than its central Asian peers. In our view, these should be the key policy focus in order to create incremental space for higher social and capital spending. An increase in tax-GDP ratio would enhance the country's ability to spend to bridge the infrastructure gap, and augment health and education investment, while also helping in redistribution of wealth to a wider section of the population.

A major challenge for most developing economies is the high NPL burden, which in turn, leads to generalized risk aversion and reduces flow of lending even to the productive sectors of the economy. The Staff report indicates that though the soundness indicators portray well-capitalized, liquid, and profitable banks, concerns remain, given the past evergreening and transfer of bad assets to off-balance sheet entities. The AQR should help Kazakhstan move away from costly state support to banks and may also help in understanding the financial health of banks and identifying needed actions.

The authorities seem to have seized on most of these challenges. The authorities have formulated Kazakhstan 2050 Strategy, which sets the target of reaching the top 30 of the most developed countries globally and we wish them all success in their endeavors.

Mr. Mojarrad and Mr. Alavi submitted the following statement:

We thank staff for a well-articulated set of papers and Mr. Inderbinen and Mr. Danenov for their informative Buff statement. We broadly agree with the thrust of the staff appraisal and offer the following for emphasis.

Kazakhstan's economic recovery has maintained momentum reflecting robust performance in construction and services and continued expansion in business and household spending. We commend the authorities for their sound economic management which successfully weathered the impact of slower growth in the country's major trading partners and lower oil prices in late 2018. The authorities have also made steady progress in strengthening macroeconomic frameworks, reducing infrastructure gaps, and improving business environment. Nonetheless, relatively large state footprint in the economy continues to crowd out private sector activity while high dependency on oil revenues has been a driver of elevated macroeconomic volatility. In this context, we welcome the authorities' medium-term focus on promoting diversification, raising non-oil revenues, and strengthening the resilience of the banking sector. Policy and reform continuity are needed to ensure long term sustainability and support intergenerational equity.

Resumption of fiscal consolidation, which was eased in 2019 to support the authorities' social programs, is a welcome step towards long term fiscal and debt sustainability. In this regard, we take positive note of the lower non-oil deficit envisaged in the draft 2020-22 budget and support the ongoing initiatives to mobilize non-oil revenues, rationalize state support programs, and enhance spending efficiency. The well-functioning and forward-looking fiscal framework has effectively provided policy guidance and helped the authorities safeguard policy buffers. We welcome the intention to bring the framework further in line with best international practices particularly in terms of coverage and transparency.

Monetary policy's focus on price stability has been appropriate and helpful in containing inflation within the National Bank of Kazakhstan's target band. At the same time, NBK's commendable commitment to Inflation Targeting and flexible exchange rate have been effective in absorbing shocks and lowering demand-driven inflationary pressures. Modernizing monetary policy operations and reducing dollarization will further enhance monetary policy transmission and effectiveness. Greater central bank independence and improved communications will also boost policy credibility and transparency.

We welcome the authorities' determination and efforts to address the financial sector weaknesses, including through the recent clean-up of banks. We find staff's concern regarding the high cost of the state support to the banking sector valid. We look forward to the findings of the AQR and agree that a new IMF-WB FSAP may be warranted to help provide a comprehensive picture of the overall health and soundness of the financial sector. Staff comment on the news that the first stage of AQR has identified additional capital shortfall totaling $1.2 billion are welcome. Reorganization of the financial supervisory architecture can offer an opportunity to better monitor and mitigate risks and ensure stability by building a well-resourced dedicated and focused oversight aligned with best practices on effective supervision.

Finally, we commend the authorities for their adherence to an ambitious structural reform agenda to reduce the role of the state in the economy and facilitate greater private sector participation and we congratulate them on progress so far, including the completion of many of the flagship 100 Concrete Steps. The improved scores in the World Bank's Ease of Doing Business and WEF's Global Competitiveness rankings epitomize the authorities' firm commitment to creating a conducive climate for private investment and economic competition. Greater focus on infrastructure, SMEs, and agriculture should substantially contribute to non-oil growth, boost employment, and foster rural development.

We wish the authorities continued success.

Mr. Chikada, Mr. Tan, Mr. White, Mr. Anwar, Mr. Khurelbaatar and Mr. Shimada submitted the following joint statement:

We thank staff for an informative set of papers and Mr. Inderbinen and Mr. Danenov for their insightful buff statement.

We commend the Kazakhstani authorities for their efforts in restoring stability and growth after the sharp decline in oil prices in 2014-2015. The Kazakhstani economy is demonstrating an encouraging recovery supported by high domestic demand that was driven by major oil and gas investment, and government and household consumption. We also welcome its smooth political transition. We note that non-oil growth is expected to remain strong going forward but economic growth is projected to slow down in the medium-term with risks tilted to the downside. Against this backdrop, we encourage the authorities to strengthen their macroeconomic policies and to accelerate structural reforms to promote strong, sustained and inclusive growth. We broadly agree with the staff report and have the following comments for emphasis.

Upgrading the fiscal framework is critical to maintain fiscal sustainability, increase non-oil revenue, enhance spending efficiency and close infrastructure gaps. Under the upgraded framework, we agree with staff that the medium-term fiscal policy should be guided by an anchor on gross public debt and encourage the authorities to maintain policy space for priority expenditures. In this context, we invite staff to elaborate key efforts toward addressing the public debt. We also concur with staff on resuming fiscal consolidation by reducing the non-oil fiscal deficit to levels consistent with long-term fiscal sustainability. Revenue enhancing measures such as tax policy changes, accompanied by reforms to streamline expenditures together with targeted infrastructure investments, are welcome to support growth. Staff was concerned that the ambitious revenue targets may not be met. We would like staff to comment on the impact to the economy of missing these targets and the options available to the authorities to minimize the risks. Given that the reforms on expenditure are complex and far reaching, we support staff's view on the provision of TA to the authorities' efforts.

The authorities should remain committed to the process of strengthening monetary and exchange policy effectiveness. We welcome the adequate level of foreign reserves and the increase in policy rate in September to tackle rising inflation risk. We also commend the authorities' commitment to inflation targeting and exchange rate flexibility and support their efforts to develop a new, long-term monetary policy strategy. We agree with staff that increasing NBK independence and reducing dollarization are warranted to make domestic monetary and exchange policies more effective. We would like staff to elaborate the main reasons for the stubbornly high level of dollarization (45 percent) in the country. Further comments are also welcome on the new, long-term monetary policy strategy.

Decisive actions to effectively implement the Asset Quality Review (AQR) and the redesign of the financial supervisory architecture are needed to address financial sector vulnerabilities. We look forward to the completion of the planned AQR, which should be supported by a concrete action plan to address the weaknesses flagged. The authorities should also handle the AQR disclosure process with care to avoid undue market volatility and instability. Importantly, we agree with staff that any state support should be targeted at systemic and viable banks, and that NBK funds should not be used for this purpose. Can staff share their views on the challenges facing banks in moving toward a new, sustainable business model following the AQR and outline the next steps in this regard? While the creation of a new financial regulatory and supervisory agency could be an opportunity to strengthen both the independence of NBK and improve the supervisory and regulatory framework, the transition risks should be carefully managed. As staff has rightly noted, it is critical to ensure that the new agency is sufficiently staffed, and proper governance rules and organizational structures are in place.

Structural reforms to improve the business environment and diversify the economy need to be implemented. We welcome the implementation of structural reforms undertaken to date under the "100 concrete steps" program to improve the business climate in the country. There is an untapped opportunity in the non-oil sectors: the agricultural sector has strong potential with abundant arable land and proximity to major markets. However, we note that outdated and depreciated technology and irrigations systems, low productivity, inefficient support mechanisms and lack of financing are preventing the agricultural sector from performing to its potential. Structural reforms to address impediments for growth in the agricultural and non-oil sectors could support economic growth, and more importantly, could assist the authorities with resolving social and regional developmental issues.

We note that Fund TA could be helpful in addressing many of the implementation challenges that Kazakhstan faces across a range of issues including infrastructure investment, the fiscal framework, central bank reform, financial sector supervision and privatization of state assets. Each of these areas will present unique challenges and potential pitfalls. Can staff comment, and indicate the top priority areas where they expect the Fund will or should provide TA?

With these remarks, we wish Kazakhstan and its people every success in their future endeavors.

Mr. Farber, Ms. Pollard and Mr. Shenai submitted the following statement:

We thank staff for their report and Selected Issues Paper, as well as Mr. Inderbinen and Mr. Danenov for their helpful Buff statement. The recent political transition has increased the focus on social conditions and developments. We welcome the authorities' commitment to upgrade the fiscal and monetary policy frameworks, jumpstart structural reforms, reduce the role of SOEs, and tackle financial sector and governance vulnerabilities. This agenda is critical to laying a foundation for private sector-led growth and improving the living conditions for the people of Kazakhstan.

We welcome the authorities' focus on strengthening spending efficiency and improving revenue administration while improving social outcomes. Going forward, the authorities should reduce fiscal pro-cyclicality and enhance the fiscal framework to rebuild space, increase transparency, and promote inter-generational equity. Greater fiscal transparency can complement Kazakhstan's existing rules-based framework, and we see benefits from an IMF Fiscal Transparency Evaluation. Greater clarity on the finances and transfers between the central government and NFRK, as well as more regular financial statements and data disclosure of public enterprises, can further improve fiscal management, boost spending efficiency, and improve social outcomes. We would appreciate a greater staff focus in subsequent analytical work on Kazakhstan's sovereign wealth funds, including the oil fund, and efforts to promote transparency in these government bodies.

We welcome the authorities' commitment to an inflation-targeting framework and a flexible exchange rate and encourage further strengthening of the framework. Reducing the liquidity overhang and dollarization while divesting non-core NBK assets can improve transmission and central bank independence. We are concerned that potential purchases by the NFRK and UAPF could feed perceptions of active exchange rate management and undermine investor confidence in the floating exchange rate. In this context, we support staff's recommendation that the authorities publicly report these transactions and introduce regular, pre-announced auctions for NFRK conversions. Does staff have any information on the size and frequency of NFRK and UAPF purchases?

Financial sector vulnerabilities present fiscal risks and limit structural transformation. Although system-wide capital adequacy and liquidity have improved, measures of asset quality remain volatile. We support conclusion of the AQR and urge that further state support should be limited to systemically important institutions with safeguards and burden sharing. While there could be efficiency and reputational gains from the planned redesign of the financial supervisory architecture, we encourage the authorities to proceed cautiously and to ensure the new supervisory agency is in line with international best practices.

The authorities should reduce the state's large role in the economy and undertake reforms to boost agriculture productivity. Further steps to create an enabling environment for private sector activity, including via IPOs and full privatizations of SOEs, can raise productivity, increase diversification, and enhance inclusiveness. Kazakhstan's strategic location and arable land imply significant agriculture potential, but measures to address bottlenecks have been limited. Commercializing agriculture can further improve Kazakhstan's external sustainability as well.

We welcome staff's discussion of corruption and agree with staff's governance-related recommendations. We encourage the authorities to criminalize additional corruption offenses and revisit immunity for high-level officials. Improving the rule of law and reducing corruption are essential to support private sector growth. We hope staff can provide an update on these developments in the 2020 Article IV staff report.

Mr. Raghani, Mr. Sylla and Mrs. Boukpessi submitted the following statement:

We thank staff for the well-written reports and Mr. Inderbinen and Mr. Danenov for their informative Buff statement.

The Kazakh economy has continued to grow after the external shocks experienced in 2014-2015. Real GDP grew by 4.1 percent in 2019 thanks to strong domestic demand, including investment in oil and gas activities, and is expected to remain moderately solid over the medium-term. Inflation remained within the target band. However, the current account position deteriorated reflecting mainly higher imports and lower hydrocarbon exports. In addition, we note that the economy is facing significant challenges due to its high dependency on oil sector, limited private sector as well as vulnerabilities in the financial sector and governance. These challenges need to be forcefully addressed including through the implementation of well-targeted structural reforms to further sustain the growth momentum and reduce inequalities. We broadly concur with staff's assessment and would like to provide the following comments for emphasis.

We welcome the authorities' commitment to resume fiscal consolidation to help reduce external debt and preserve buffers. We agree on the need to continue implementing both revenue and expenditures measures, with a view to increasing non-oil revenues, reducing the number of state-owned enterprises (SOEs), making spending more efficient and enhancing fiscal buffers to address the infrastructure gap. On the revenue side, we encourage actions to enhance tax compliance and streamline exemptions to broaden the tax base. We welcome the Selected Issues Paper on "Personal Income Tax and Other Taxes on Labor in Kazakhstan" which highlights the potential of labor taxes in significantly contributing to the non-oil fiscal revenue over the medium to long term. We would appreciate staff's elaboration on the authorities' views on the proposed targeted strategy underscored in the paper. Moreover, measures to improve the National Fund's framework and more broadly the fiscal framework and transparency are also commendable. We also encourage an increased Fund TA to support the authorities' efforts in the fiscal area.

Further enhancing the monetary and exchange rate frameworks is essential to bolster the resilience of the economy to external shocks. We agree with staff' that the monetary policy stance is appropriate, and the central bank should remain vigilant about inflationary risks. The NBK's efforts to strengthen the monetary policy framework should continue. We welcome its plans to improve transparency, capacity building and communication policies. The ongoing development of a long-term strategy to enhance the effectiveness and credibility of the monetary policy is also an important step in the right direction. Most notably, we see merit in the strategy's objectives of strengthening the independence of the NBK, reinforce the monetary policy transmission, limiting the state lending, and preserving the de-dollarization trend. At the same time, as the authorities are committed to a flexible exchange rate, we encourage them to limit forex interventions only to prevent disorderly exchange rate movements and allow it to serve as an effective shock absorber.

Despite improvements, the banking system in Kazakhstan continues to face significant vulnerabilities which need to be addressed steadfastly. Banks are well-capitalized, liquid, and profitable, and progress continues to be made in their cleaning up, including through additional financial funding from the state. To ensure the stability of the system, we agree that the ongoing asset quality review (AQR) presents an opportunity to address long-standing banking issues, notably the state support for banks. We take note of the newly created Agency for Regulation and Development of Financial Markets and would appreciate an update on its operationalization. In addition, could staff comment on Fund technical assistance (TA) envisioned, if any? Noting that the last FSAP assessment took place in 2014, we urge the authorities to consider a new FSAP assessment, following the creation of the new agency and the AQR.

Increasing the pace of reform agenda implementation to foster private sector development, promote economic diversification, and ameliorate the business environment is essential to sustain economic growth. We welcome the emphasis on improving the business environment to bolster entrepreneurship which could lead to private sector development. Moreover, in order to accelerate rural development and increase employment, we agree that prioritizing the agriculture sector would be essential. The authorities' ongoing efforts to raise the efficiency of SOEs – with the reviews of the Samruk Kazyna's operations – are also reassuring steps. We also concur with staff that addressing the governance weaknesses, including in public administration, towards reducing vulnerabilities to corruption is of paramount importance to boost the prospects of the private sector investment. Furthermore, we encourage the authorities to pursue their anti-corruption efforts while strengthening the AML/CFT framework.

With these remarks, we wish the Kazakh authorities success in their endeavors.

Mr. Buisse, Mr. Rozan and Mr. Sode submitted the following statement:

We thank staff for the quality of its documents and Mr. Inderbinen and Mr. Danenov for an insightful Buff statement. The economic reform momentum remains strong and the increased focus on social conditions and rural development is welcome. Promoting private sector growth, strengthening governance, further reforming the monetary and exchange rate frameworks and reinforcing the banking sector are key reforms whose implementation will be challenging. While we agree with the thrust of staff report, we would like to highlight the following points for emphasis:

We commend the authorities for their efforts to strengthen the monetary framework and to ensure financial stability. The transition to an inflation targeting regime and a flexible exchange rate since 2015 has been well implemented and has helped to improve the country macroeconomic outcomes. Further developing financial market and continued exchange rate flexibility will help reduce dollarization and improve monetary policy transmission. We strongly support staff's call for well-designed follow-up measures to the AQR. Public support should only be granted to systemic and viable banks and the business of model of weak banks should be modernized. Given the numerous changes of the financial sector supervision architecture over the last years, we encourage the authorities to request a new WB-IMF FSAP.

On fiscal policy, while the increase in social spending is commendable, we encourage the authorities to simultaneously contain the wage bill and to increase public revenues through a more equitable and efficient tax system. Could staff elaborate on the measures which they think could have benefited from further consideration (debt relief, three-year ban on SME tax audits, new income tax exemption)? We share staff's concerns that the ambitious non-oil revenues announced by the authorities will not be met without additional tax policy changes. We thank staff for the insightful SIP on the fiscal framework and we encourage the authorities to consider further reforms. We encourage the authorities to seize IMF TA opportunities in terms of public investment management.

On structural reforms, we commend the authorities for their ambitious plan and the implementation of several flagship measures. We encourage pursuing efforts on key reforms notably to promote private sector growth, reduce dependency on oil and strengthen governance. While improvements in international rankings is a positive sign, they are not an end in themselves and authorities should make sure that reforms undertaken do improve the business climate.

We regret the absence of any policy discussion regarding climate change. While the authorities recognized the need to transition to a greener future, the continued dependence on fossil exploitation implies a high carbon emission trajectory. Has staff assessed the climate change mitigation policies of Kazakhstan?

We thank staff for its work on governance and the recommendations made in Annex IV to address corruption vulnerabilities and improve the rule of law. While we welcome the measures already taken, we encourage the authorities to consider staff recommendations, notably to publish declarations of high-level officials and political appointees, to improve the targeting of mitigation efforts toward high-level and grand corruption and to criminalize additional corruption offences (e.g., offering or soliciting bribes) and to revisit immunity for some high-level officials and entities. Strengthening the AML/CFT framework is also key to support anti-corruption efforts.

Mr. Chodos and Mr. Morales submitted the following statement:

We would like to thank staff for well-written reports and Mr. Inderbinen and Mr. Danenov for their informative Buff statement. We commend the authorities for having embarked on reform initiatives on several fronts during the country's political transition, contributing to generate a positive momentum for the Kazakh economy.

Growth has been strong in 2019 despite a complicated external environment. Robust domestic demand boosted by wage hikes and retail lending triggered high growth in construction and services. Looking ahead, in anticipation of the flattening of oil production in 2023-24, Kazakhstan should take advantage of its strategic geographical location to expand regional activities of transportation, transit and logistics industries. Sound economic policies would help contain risks from commodity price volatility, and slow growth in key trading partner countries.

Kazakhstan intends to adopt a prudent fiscal stance. Revisions to the 2019 budget aimed at accommodating social and regional initiatives that turned the fiscal stance procyclical and compromised fiscal space. Although government debt remains sustainable, we are concerned that higher spending on wages, debt relief and new subsidies appear to have been partly financed through a Eurobond, which indirectly constrains the financing of pro-growth investment. We welcome the authorities' intention to tighten the fiscal stance in 2020, which would help stabilize debt, limit reliance on oil revenues, and help contain external imbalances, while maintaining existing fiscal space as a buffer. We agree with staff that revenue administration measures would not be enough to ensure sufficient resources to support these efforts, and therefore we encourage the authorities to consider revisions to the VAT and personal income tax proposed by staff, as well as the removal of some tax exemptions and holidays to broaden the tax base.

We support the authorities' intention to strengthen the fiscal framework. We welcome the comprehensive assessment of Kazakhstan's fiscal framework in the Selected Issues Paper and agree with staff's recommendations to simplify the current fiscal rules system, expand coverage, enhance flexibility, and strengthen transparency. This should be complemented by decisive steps on public finance management reforms (PFM), with support from the Fund, ideally through a Fiscal Transparency Evaluation and a PFM assessment. Regarding structural fiscal measures, we advise caution on the introduction of new institutional arrangements to decentralize capital investment, including devolving greater fiscal responsibility to local governments. Such measures would need to be accompanied by strong accountability provisions, including controls, disclosure requirements, and risk management arrangements.

Inflation stayed within the 4-6 percent target band. However, core inflation (excluding fruit, vegetables, fuels, and utilities) exceeded 7 percent for the 12 months up to October 2019, suggesting underlying inflationary pressures. The NBK appropriately raised its policy rate in the face of a positive output gap, still-strong domestic demand, and wage hikes in the public sector. Looking forward, Kazakhstan's monetary policy framework should be upgraded to make its inflation-targeting framework more effective, while maintaining exchange rate flexibility. In particular, NBK should move ahead on divesting non-core assets, phasing out credit subsidies, and assessing measures to reduce dollarization, currently at 45 percent of deposits. Moreover, legal provisions supporting NBK independence should be enhanced as part of the new institutional arrangements to transfer its supervisory functions to the newly created Agency for Regulation and Development of Financial Market (ARDFM). Staff's comments on the necessary amendments and their feasibility are welcome.

We welcome the authorities' ongoing efforts to clean up the banking system. We encourage the authorities to take advantage of the overhaul of the financial supervisory framework to promptly introduce best practices for financial regulation and supervision. Moreover, a proper credit risk assessment should be conducted following the conclusion of the current asset quality review that covers the 14 largest banks. The ARDFM should enforce proper accounting of banks' assets and liabilities following the ongoing asset quality review, with the view to withdraw government support of troubled banks. In this regard, eventual support of large viable banks by the government, as recommended by the staff, should take place within a well-structured framework for the banking resolution, including emergency liquidity assistance provisions. However, recent experience with widespread state credit support programs suggests that conditions for such a structured approach may not be optimal. Could staff comment on this? On a related point, we believe that all forms of state credit-support programs, including debt-relief initiatives, create perverse incentives and should be replaced by adequate non-distorting measures.

We encourage the authorities to continue making progress in the implementation of its 2015-2025 National Anti-Corruption Strategy. Recent progress on e-governance, procurement, and identification and seizure of corruption proceeds is commendable. Next steps should include publishing declarations of high-level officials and political appointees, criminalizing corruption offences, and using AML/CFT tools more effectively.

With these comments, we wish the authorities and people of Kazakhstan every success in their future endeavors.

Mr. Mouminah and Mr. Rawah submitted the following statement:

We thank staff for the well-focused set of reports and Mr. Inderbinen and Mr. Danenov for their helpful Buff statement. We are in broad agreement with staff's analysis and policy recommendations and would limit our remarks to a few issues.

We take positive note that Kazakhstan's economy has performed well amid a challenging environment. We are also encouraged that structural reforms are advancing as many measures under the authorities' plan (100 Concrete Steps) have been completed. That said, private sector growth has been impeded, including from governance vulnerabilities and long-seated banking sector issues. In this connection, the authorities should aim to achieve strong, sustainable and inclusive growth. To this end, it is important to continue efforts toward creating conducive private sector environment and supporting economic diversification, including by ensuring the development of the agriculture sector to help unlock its potential. Also, improving governance and addressing corruption risks are important in this regard.

We welcome the indication that fiscal consolidation will resume in 2020 following the easing in 2019. Here, we see merit in anchoring the medium-term fiscal policy on gross public debt and an operational target on non-oil deficit. This could help in supporting long-term fiscal sustainability and intergenerational equity. Also, we welcome the authorities' intention to upgrade the fiscal framework. In this connection, we agree with staff that this is a complex undertaking and reforms could be guided by key principles, including simplicity, flexibility and enforceability.

Finally, we encourage the authorities to continue their efforts to address the long-standing weaknesses in the banking system. While state support to banks has contributed to stability, it had been costly. Therefore, launching asset quality review (AQR) is a step in the right direction, which should help in assessing the financial health of banks and better identifying the needed actions. At the same time, state support should not come from the National Bank of Kazakhstan (NBK), as underlined by staff. On overhauling the financial supervisory architecture, we agree with staff that this arrangement should be carefully considered in line with international principles of effective supervision. We encourage the authorities to consider a new FSAP assessment to help guide their reform efforts.

With these remarks, we wish the authorities further success.

Ms. Levonian, Ms. McKiernan and Mr. Mooney submitted the following statement:

We thank staff for their report and Messrs. Inderbinen and Danenov for their informative Buff statement. Economic growth in Kazakhstan remains strong, mainly due to domestic demand. Inflation has increased but remains within the target band, while progress is being made in the area of governance. Risks include slower trading partner growth, volatility in global commodity markets, and slow structural reform progress. In addition, the state plays a strong role in the economy and challenges remain in promoting private sector growth. We agree with the thrust of staff's assessment and offer the following points for emphasis.

We support the authorities' intention to upgrade the fiscal framework and agree with staff that a PFM assessment would be advisable. The public finances have depended heavily on oil sector receipts. Higher non-oil revenue can create fiscal space for additional social and capital spending. We agree with the conclusion in the Selected Issues Paper that reforms are needed to make labor taxes more equitable and efficient, and welcome the President's call to improve the efficiency of public administration, which should be accompanied by associated reforms to wage policy. We positively note the government's promotion of digitalization processes in all public spheres, as outlined in the Buff, which should contribute to increased tax collections and a reduction in the informal economy.

We agree with staff that the National Bank of Kazakhstan's relocation and split pose challenges, including the potential for post-transition reductions in supervisory capacity. The new architecture should comply with best practices and core principles of effective supervision, and we concur with the recommendation that the authorities request a new FSAP review. The Asset Quality Review covering the 14 largest banks provides an opportunity to address long standing issues in the banking sector, and we encourage the authorities to disclose the results and follow up on the actions, where appropriate. We welcome the authorities' high-level commitments to improve governance and combat corruption, including the strengthening of the AML/CFT regime.

We encourage the authorities to maintain structural growth momentum to ensure sustainable and inclusive growth. We note the findings in Box 3 of the report, which illustrates the potential for Kazakhstan to use its large availability of arable land as an opportunity to export to larger neighboring states, thereby increasing non-oil exports. We note the analysis carried out by staff in the Selected Issues Paper around the impact of the "Nurly Zhol" program on the profits of firms located close to new roads and railways. Will staff carry out further analysis on future missions regarding the employment effects of the program? Can staff elaborate on the results of the EBRD study around the potential impact on Kazakhstan's fiscal revenues from a long-term "green" scenario? Finally, did staff undertake any analysis around gender pay gaps in the Kazakh economy?

The Acting Chair (Mr. Zhang) made the following statement:

In general, the 2019 Article IV consultation with the Republic of Kazakhstan went smoothly. During the last year, as you know, the country went through a significant political change, including a new presidential election. At this moment, we are very pleased and grateful for the authorities to conduct the consultation with us. We particularly thank the authorities for agreeing to host the new Regional Technical Assistance Center in the country.

As staff has reported, Kazakhstan's growth performance remains robust, and progress is being made in many of the important reform areas. On the other hand, as also highlighted in your gray statements, in order to unlock the country's significant potential, more needs to be done, particularly in the areas of promoting private sector growth, reducing the dependence on oil and state support, resolving outstanding issues in the banking sector, and strengthening governance. And, of course, the fiscal and monetary policy framework also will play a critical role. All of these are quite important areas. I am sure in later discussions, we will cover all of these issues. With that, I look forward to a good discussion.

The staff representative from the Middle East and Central Asia Department (Mr. Horton), in response to questions and comments from Executive Directors, made the following statement:[2]

I will answer a few questions, focusing first on the financial sector, then on fiscal policy, structural reforms, and growth.

First, I would like to provide one update and note that inflationary pressures have not increased in recent months. Headline inflation was 5.4 percent in both November and December. That is down slightly from 5.5 percent in October, the last month cited in the staff report. The National Bank of Kazakhstan (NBK) left its base rate unchanged at 9.25 percent in its most recent meeting on December 9.

[2] Prior to the Board meeting, SEC circulated the staff's additional responses by email. For information, these are included in an annex to these minutes.

Turning to the questions. Several Directors asked about a follow-up to the asset quality review (AQR). The first two parts of the AQR, the design and preparatory work and the onsite inspections by international audit firms have been completed. The banks will now send their proposals on corrective measures to the new regulator by mid-February. We understand that shortly thereafter, the results are to be presented publicly.

Staff does not have an estimate of possible capital requirements or costs arising from the AQR. There have been some published estimates by rating agencies and others, but these have not been made with the rigor of the AQR itself. We would caution basing judgment on those preliminary estimates.

Some Directors have asked about the form of possible additional support coming from the AQR. Staff have indicated on several occasions to the authorities that additional costs should be borne by shareholders and that any further state support should be only for large viable banks, with safeguards in terms of management changes, restructuring and exit plans, oversight, and public disclosure.

The authorities to date have taken a variety of funding approaches, including asset purchases at par value by the state's "problem loan" fund, with financing for that either from the oil fund or from a special purpose vehicle of the National Bank. Another modality has been long-term low interest rate subsidized loans from the National Bank to banks. The asset purchases involved new owners and new up-front capital. The subordinated loans did not. During the discussion, staff noted ongoing and possible new impacts on the NBK's balance sheet and urged that further state support should not come from the NBK.

Turning to fiscal policy. One Director noted a reference in the staff report to debt relief for poor households, a three-year ban on tax audits, and new tax exemptions, and asked staff to elaborate on which 2019 spending measures may have benefited from further consideration. Staff felt that all of these measures cited would have benefited from additional consideration. While the measures were rightly targeted to vulnerable individuals, families, and small and medium-sized enterprises (SMEs), they have design features that could have been improved. For example, the debt forgiveness initiative did not account for low-income borrowers who had already made debt payments. And the income cutoff for the measure, staff felt, could lead to nonpayment by other households just above the cutoff. Staff also noted that the moratorium on tax audits and new tax exemptions could hamper the State Revenue Committee and tax compliance at a time of ambitious revenue targets.

One Director asked for the authorities' views on a public financial management (PFM) assessment and an IMF Fiscal Transparency Evaluation.

As Mr. Inderbinen and Mr. Danenov noted in their buff statement, the authorities are considering options to improve the fiscal framework and have taken note of staff's suggestions for technical assistance (TA). The support from several Directors on this TA is welcome. The new IMF Regional Technical Assistance Center, which we are calling Caucasus, Central Asia, and Mongolia Technical Assistance Center (CCAMTAC), to be established later this year in Almaty, will have resident advisors covering PFM and macro-fiscal areas. We expect a strong engagement of the authorities with the center.

Turning to structural reforms. There was a question on whether the authorities have placed sufficient emphasis on policies to enhance private sector-led growth. The authorities have, indeed, put an emphasis on these actions, as shown by the improvement in Kazakhstan's Doing Business indicators. This is very positive, but the state's footprint remains large, well above comparator countries. And the authorities continue to utilize policy levers that prolong strong state involvement, especially credit support. Other actions have lagged, especially the strengthening of the financial sector and additional initial public offerings (IPOs) for big blue chip state enterprises. Overall, it is something of a mixed picture, and continued efforts are needed to put in place the necessary infrastructure and supportive business conditions for the private sector.

One Director asked why staff singled out agriculture as needing special attention. We have a few explanations. First, despite ample resources and huge markets in neighboring Russia and China, the sector has been a drag on growth and exports, and rural poverty remains high. Debt in some subsegments of the sector contributed to problems at Kazakh banks, notably, the collapse of Tsesnabank, which was the second largest at the time. We wanted to dig deeper.

Mr. Inderbinen and Mr. Danenov's buff statement gives an answer to the second question from this Director: Do the authorities see other sectors or industries that may drive diversification and growth? Staff agrees with the buff statement, that these include logistics, transport, metals, chemicals, engineering, machinery, and also agriculture.

In response to another question, staff has not yet assessed in detail the climate change mitigation policies of the Kazakh authorities. We will do so in the future. There are policies in place, ranging from a switch from coal to natural gas for electricity generation to targets on the increased use of renewable energy sources, notably, wind and solar. Kazakhstan is particularly vulnerable to climate change, given its reliance on oil and gas and grain production, its relatively limited water resources, and its ambitions to be a transport and logistics hub.

Finally, other Directors suggested additional areas for future engagement, employment effects from infrastructure projects, and gender pay gaps. We will look at these.

Mr. Palei made the following statement:

We issued a comprehensive gray statement, and we thank staff for answering many of our questions. Broadly, we agree with the range of issues raised in the staff report. I would like to make a few remarks just in addition to our gray statement and to follow up on some of the answers provided by staff.

Kazakhstan's economy has an excellent growth track record. Overall, the authorities were successful in facing major economic shocks, including the real estate price collapse, with a major damage to the banking sector in 2007. Then they faced the consequences of the global financial crisis, the volatility in the oil prices in 2008-2009 and later in 2014-2015, major external shocks. The authorities have already implemented many reforms to make their economy more resilient to these shocks in the future. One example is, of course, a move to a more flexible exchange rate and toward an inflation-targeting framework. Of course, they still have room for improvement. Two of the main challenges they have to address include, first, improvements in their fiscal framework, and second, strengthening the financial sector and making it much more efficient.

On the fiscal framework, we have invited staff to think about why the Fund almost never proposed larger savings in sovereign wealth funds for commodity economies in Latin America and even praised their fiscal frameworks as very strong or strong. None of these countries have any substantial assets in sovereign wealth funds. When we look at cases of Colombia, Chile, or Peru, these countries do not have accumulated assets in their sovereign wealth funds, and they do not pay attention to intergeneration issues the way staff propose the Kazakhstani authorities to do. So this is a question for us, and we raised it in our gray statement. However, the answer we received was that the economies may be different. Well, of course, they may be different, but they also may be very similar. In this case, I think there are many similarities between Kazakhstan and other commodity exporters. And maybe in future papers, this issue could be addressed in greater detail. It is a part of the challenges the authorities are facing in building up their fiscal framework.

Staff repeated several times in their written answers that there are no fiscal sustainability issues in Kazakhstan, as some Directors implied in their gray statements. From this point of view, the nature of the fiscal challenges for Kazakhstan is entirely different. It is not about fiscal sustainability. Kazakhstan has a national fund with assets in the amount of about 35 percent of GDP. It also has another sovereign wealth fund, Samruk-Kazyna, with even larger assets, which are estimated at about 42 or 43 percent of GDP. According to the buff statement by Mr. Inderbinen and Mr. Danenov, the proceeds from the privatization of the stakes in Samruk-Kazyna will be transferred to the national fund, so there is a link between the two funds.

Overall, Kazakhstan has about 80 percent of GDP in sovereign wealth fund assets. Those are huge assets. And, of course, there is no issue with fiscal sustainability. However, there is an issue with the level of public debt. Staff insists that it should be around 20 percent of GDP, the current level. We are talking, of course, about gross debt, not net debt. To me, it is not clear why it should remain at a level of 20 percent, because we have other examples of successful countries--say, the example of Norway. Norway has a huge sovereign wealth fund, but its gross public debt is about 40 percent of GDP. Another example is Singapore, which has sovereign wealth funds and great assets; still, the authorities have I think about 100 percent of GDP in gross public debt.

So for gross public debt, it is not just the financing of the budget. It is also the development of the financial sector. For Kazakhstan, it may be a priority because they have issues with the financial sector. It could be an alternative to financing development, and the development of the bond market may be no less important than the development of the financial sector.

Just to conclude very briefly, we do support the proposals on a Fiscal Transparency Evaluation, public financial management, technical assistance, and also at some point, the Financial Sector Assessment Program (FSAP) proposed by staff as well. Certainly, we welcome the creation of the Regional Technical Assistance Center. It has been long in the making, and we hope it will be very successful. Certainly, my authorities will support it and will try to contribute to its success.

Mr. Kaya made the following statement:

We thank Mr. Inderbinen and Mr. Danenov for their insightful buff statement and staff for the comprehensive and important answers to our questions.

We commend the Kazakhstan authorities for their sound policies and ambitious reform agenda, which are bearing fruit. We appreciate staff’s response showing that the reforms already implemented under the authorities’ program have helped secure non-oil potential growth of 4 percent from just 2.5 percent five years ago. While the diversification of the economy is underway, there are still some areas that further reforms can contribute to higher growth, and we welcome that staff and the authorities broadly agree on the necessary policy actions. We would like to emphasize two areas.

First, fine-tuning the coordination between monetary and fiscal policies, while solving the complex task of restraining the fiscal and inflation targeting frameworks, as outlined in the buff statement. Last year, central bank and government signed an agreement on the coordination of macroeconomic policy measures. This is a good basis for the more advanced reforms which the authorities are considering, including fiscal rules, budget transparency, and financial sector reform. A well-sequenced and carefully design approach is critical for the successful implementation of these reforms. We agree that the IMF is well positioned to provide practical advice on some very specific but important issues related to these challenging reform endeavors.

Second, on the state-owned sectors reform, we support the approach chosen by the authorities to carefully move in reducing the state's footprint in the economy, placing a higher emphasis on corporatization and IPOs. Private investor participation can help boost accountability and reduce fiscal risks. These reforms require a sustained political commitment and determined efforts over time to deliver the best results.

With these remarks, we wish the authorities every success.

Mr. Farber made the following statement:

We thank staff for the well written staff report, as well as Mr. Inderbinen and Mr. Danenov for their detailed and well-written buff statement.

We believe that the current environment of relatively easy global financial conditions and the recent change in government provide the authorities with a unique window of opportunity to push for structural reforms, reduce state involvement in the economy, and create space for the private sector to thrive. The authorities continue to improve their Ease of Doing Business rankings, and the National Privatization Program has the potential to boost competition and enhance productivity.

In addition, this chair finds the five major reform initiatives of industrialization and growth, civil service, rule of law, national identity and unity, and accountability, should provide a good framework with which to implement the IMF's policy recommendations.

Like Ms. Levonian, Ms. McKiernan, and Mr. Mooney, we agree that increasing domestic value added in the oil and gas supply chain, while diversifying into agriculture and other key industries, can enhance employment and growth, boost non-oil fiscal revenues, and strengthen the external position.

With respect to fiscal transparency, we strongly welcome the authorities’ focus on increasing the incomes of the broad population and believe that prudent financial policy can support this objective. The authorities’ commitment to enhancing revenue administration while strengthening spending efficiency can create fiscal space for priority programs. The moratorium on new SOEs is an excellent step. Like Mr. Chodos and Mr. Morales, we hope that the authorities will consider conducting a Fiscal Transparency Evaluation.

Lastly, on monetary policy and interventions, we appreciate the authorities’ commitment to inflation targeting and the market-determined exchange rate. We thank staff for their answer to our question on National Fund of the Republic of Kazakhstan (NFRK) purchases. We understand that the NBK has told staff that disclosure will begin this year. We think that regular disclosure is a critical step to avoid feeding perceptions of active exchange rate management. Going forward, it would be helpful if staff would continue to provide updates on the investment activities of the NFRK. We appreciate the authorities’ commitment to the transparency of this vehicle and other sovereign funds.

With that, we wish the authorities well in their reform efforts.

Mr. Inderbinen made the following concluding statement:

On behalf of the Kazakh authorities, I would like to thank staff for a balanced report and the very useful selected issues paper. Many thanks also to Directors for the candid assessments that they have offered in their gray statements, including the recommendations, and also their interventions this morning.

As we state in our buff statement, the economic upturn has remained robust in Kazakhstan. According to data released last Friday, GDP growth in 2019 has reached 4.5 percent. More than 85 percent of this increase is accounted for by non-extractive industries, in particular, construction, trade, and transport.

The Kazakh authorities confirm their commitment to pursue the inflation-targeting regime. The medium-term monetary policy strategy should be finalized in the second quarter of the year and will seek to find the right balance between maintaining low inflation and enabling economic growth. The inflation target band for the current and the next year will remain at 4 to 6 percent, with a further reduction to 3 to 5 percent, as staff mentioned in the written responses.

The National Bank is putting a special emphasis on improving transparency and communication policies. Some Directors have shown a particular interest in the transparency of official foreign exchange transactions. The NBK has already been publishing information on the management of its reserves on a monthly basis, in particular, with connection to any interventions to smooth abrupt hikes in the exchange rate without impacting the overall market-driven trend or targeting the exchange rate level.

Since the beginning of the current year, the NBK is, as also stated by staff, planning to disclose on a monthly basis the data on FX transactions related to the use of the national fund, as well as the pension fund transactions that are conducted via the Kazakhstan Almaty Stock Exchange.

The newly created Agency for Regulation and Development of the Financial Market is responsible for the supervision of the entire financial sector since the beginning of the year, including banks, insurance, securities, and new financial technologies. After the completion of the AQR, which has been elaborated on this morning by staff again, the major focus of the new agency will, of course, be to ensure financial sector stability.

The authorities agree that an FSAP might well help in providing a comprehensive picture of the soundness of the financial sector. They will consider very closely requesting an FSAP as part of the further reform agenda, as encouraged by many Directors. So far, and prior to the final results of the AQR, the authorities have not discussed any need for financial support of the banking sector. Indeed, the president has emphasized that any support to banks, should the need arise, be considered on market terms.

The authorities will continue to pursue the fight against the shadow economy. The level of cashless operations has more than doubled over a one-year period, and the volume is set to increase further on the back of the current digitalization efforts that we mention in the buff statement, the developments of the banking services, and internet coverage across the territory of Kazakhstan.

On the fiscal side, consolidation is expected to resume in 2020. There will be cuts in secondary spending. And the whole range of tax exemptions that have led to the decrease in revenues over the last 15 years will be reviewed for their efficiency and pertinence. Targeted transfers from the national fund were brought to a halt, while the guarantee to transfers will be decreasing by 200 billion tenge each year, starting from 2023. More generally, fiscal policy will follow the main goal of ensuring stable revenues and a fair distribution of national income, as well as improving the structure and quality of economic growth. This was pointed out by Mr. Kaya and Mr. Zaborovsky in their gray statement. It will be important that fiscal reforms are well sequenced and aligned with the modernization of the fiscal framework.

The authorities are considering the introduction of a new countercyclical fiscal rule. In this regard, cooperation with the Fund via technical assistance or a Fiscal Transparency Evaluation is being considered by the government.

The Kazakh authorities acknowledge the existence of some longstanding structural issues, and they confirm their ambition to take the necessary steps to provide an additional impetus to advance the structural reforms. In order to decrease the role of the state economy, the authorities are advancing the privatization process. The list for privatizations will be further enlarged, and proceeds will be transferred to the national fund.

Kazakhstan has progressed in the 2020 World Bank Doing Business rankings, as alluded to by Mr. Farber in his statement this morning, reaching the 25th place globally. But the authorities are well aware of the many areas that need to be further improved as far as the business climate and private sector development is concerned.

High levels of concentration and other market distortions, as well as deficiencies in public procurement will be addressed. One of the key issues is the strengthening of public administration that will undergo a deep reform. Further efforts in human capital development will also be pursued.

On behalf of the Kazakh authorities, I would again like to thank staff. I would like to emphasize the high level of trust and cooperation between staff and the authorities which is, in large measure, due to the high professionalism of the team and also of its leadership by Mr. Horton.

The Acting Chair (Mr. Zhang) noted that Kazakhstan is an Article VIII member and no decision is proposed.

The following summing up was issued:

Executive Directors agreed with the thrust of the staff appraisal. They noted Kazakhstan's robust economic growth performance in 2019 supported by strong consumption and investment. They also welcomed the progress made in addressing longstanding financial sector issues and implementing structural reforms aimed at promoting private sector development and inclusive growth. At the same time, Directors recognized the challenges and risks the economy of Kazakhstan is facing, including from commodity price volatility.

Directors noted the pick-up of inflationary pressures in 2019 and concurred that the focus of monetary policy should remain on inflation. They noted that inflation targeting and exchange rate flexibility have helped to absorb shocks. Directors encouraged the National Bank of Kazakhstan to continue to strengthen its monetary and exchange rate framework, including through greater independence, better coordination with the government, reducing dollarization, and improved effectiveness of monetary policy transmission. Increasing the transparency of policy and operations and further strengthening communications would boost credibility.

Directors supported the recently completed asset quality review, which will help understand better the financial situation in the banking sector and identify corrective measures. Such measures could help lead to a strengthening of the sector. Directors underscored that any additional state support should go only to large and viable banks, subject to robust safeguards and in line with international best practices. Directors noted that Kazakhstan’s banks need to adopt a new business model with less reliance on state programs and funding and improved risk management and lending practices. Directors welcomed the formation of the new Agency for Regulation and Development of the Financial Market of the Republic of Kazakhstan. They noted that reorganization of the financial supervisory architecture could entail risks in the transition period, which should be managed carefully. Independence and adequate resourcing are key to establishing a strong financial regulator. Directors encouraged the authorities to request an FSAP assessment.

Directors agreed that a return to growth-friendly fiscal consolidation is necessary—following an easing of the fiscal stance in 2019 to accommodate social support and regional development outlays—while underscoring the importance of improving spending and investment efficiency. They supported the efforts to increase revenue collections through tax and customs administration reforms and urged the authorities to consider complementing these measures with tax policy changes to broaden the tax base and enhance progressivity. The authorities’ intentions to upgrade Kazakhstan’s fiscal policy framework are welcome and should be guided by the principles of simplicity and clarity, broad coverage, flexibility, and enforceability. The revamped framework would benefit from supporting public financial management (PFM) reforms and greater transparency. Directors noted that a PFM assessment and a fiscal transparency evaluation would be useful.

Directors reiterated the importance of decisive structural reform implementation in the context of the authorities’ economic diversification agenda. They emphasized the pivotal role of continuing improving the business climate, investing in infrastructure, strengthening property rights, enhancing competition, and streamlining state support. Further improvements in governance and reducing corruption vulnerabilities would help to attract additional investment and promote private-sector-led inclusive growth.

It is expected that the next Article IV consultation with the Republic of Kazakhstan will be held on the standard 12-month cycle.

APPROVAL: January 14, 2022

CEDA OGADA
Secretary

Annex

The staff circulated the following written answers, in response to technical and factual questions from Executive Directors, prior to the Executive Board meeting:

Growth

1. *Does the staff think that the movement towards a lower growth trajectory has been structural in nature? If so, what are the drivers of the growth process which are underlying this structural slowdown?*

- There are some structural aspects of the growth moderation. First-wave transition reforms boosted growth at the early stage of Kazakhstan's transformation into a market economy. This was supported by a long period of high oil prices and hydrocarbon revenues. Subsequent reforms (financial sector repair, reducing state footprint, etc.) have been more complex and difficult to implement, while sustained, lower oil prices in recent years put constraints on overall growth.

Fiscal Policy

2. *While we see merit in targeting the non-oil budget deficit which is consistent with long-term sustainability and equity objectives, we would like staff to further elaborate why the authorities' fiscal impulse amidst the challenging external environment has been considered as pro-cyclical.*

- Despite a challenging external environment, overall GDP recovered to 4.1 percent in 2017-18, supported by substantial fiscal stimulus during 2014-17. A further acceleration of growth was observed in 2019, with non-oil growth of over 5½ percent. This compares with staff's estimate of non-oil potential growth of 4 percent. New fiscal initiatives were a major driver. The structural fiscal balance was weaker by over 2 percent of GDP. There was a positive output gap, with pressure on inflation (core inflation exceeding 7 percent). Therefore, staff assesses that the 2019 fiscal stance has been pro-cyclical.

3. *We welcome the SIP chapter on fiscal rules as a useful contribution to the policy discussions, but we feel that the chapter could have paid more attention to the differences in practices in various commodity exporters, some of which do not save commodity revenues, while the Fund endorses and praises their fiscal frameworks. What, in staff's opinion, makes Kazakhstan different from countries like Chile, Colombia, Mexico, Peru, and Ecuador?*

- Staff's assessments and advice on savings and investment are guided by a wide range of factors. These include the starting position for the deficit and debt, the size and expected duration of both shocks and natural resource revenues, the importance of natural resources in the economy and the extent of diversification, demographics, infrastructure gaps, absorption capacity, market access, and the local institutional set-up. Kazakhstan built large savings and a stabilization-and-savings fund due to its difficult experience with shocks, limited resources, and arrears in the early and mid-1990s and due to its relatively limited absorption capacity at that time—both macroeconomic absorption and project-level absorption. Also, resource revenues were expected to be relatively large for an extended period of time, suggesting savings for future generations. Other countries have different characteristics, and policy assessments and staff's advice is therefore likely be different.

4. ***The special issue note of the Staff shows that personal income tax revenue in Kazakhstan is the lowest among its Caucasus and Central Asia (CCA) peers. This is despite much higher level of per capita income vis-à-vis its peers. Could the staff explain whether this implies weak compliance or greater exemptions or both?***

- The relatively low collection of personal income tax revenues reflects issues in both tax design and administration. The tax system features mainly a flat rate on wages and relatively light tax burden on capital income. There is room to raise revenues by tapping the potential of high-income households. There are also exemptions for sectors such as agriculture and SMEs that could be made more efficient. There is room to improve the various simplified regimes for the self-employed to make sure that high-earning self-employed individuals are well covered. Finally, compliance enforcement could be significantly strengthened.

5. ***Under the upgraded framework, we agree with staff that the medium-term fiscal policy should be guided by an anchor on gross public debt and encourage the authorities to maintain policy space for priority expenditures. In this context, we invite staff to elaborate key efforts toward addressing the public debt.***

- Gross public debt of around 20 percent of GDP does not trigger sustainability concerns. Fiscal buffers are strong, given savings in the NFRK of around 35 percent of GDP. Nonetheless, the authorities aim at gradual fiscal consolidation over the medium term to preserve buffers and ensure a fair share of oil wealth for future generations. They are also actively working to improve the fiscal framework, including better asset-liability management and more efficient use of the NFRK resources.

6. ***Staff was concerned that the ambitious revenue targets may not be met. We would like staff to comment on the impact to the economy of missing these targets and the options available to the authorities to minimize the risks.***

- Revenue underperformance relative to ambitious targets would likely result in a higher non-oil deficit (or expenditure restraint in discretionary spending areas). However, given the low level of debt and the strong fiscal buffers, a higher deficit is unlikely to raise sustainability concerns or become an obstacle to growth. One concern is that lower revenues will be lower spending in key areas—infrastructure, human capital development, and support to vulnerable groups. The authorities are promoting digitalization and are pursuing reforms to improve revenue administration, including through strengthening tax compliance risk management, supported by FAD TA, which should help mitigate the risks.

7. ***The Selected Issues Paper on "Personal Income Tax and Other Taxes on Labor in Kazakhstan" highlights the potential of labor taxes in significantly contributing to the non-oil fiscal revenue over the medium to long term. We would appreciate staff's***

elaboration on the authorities' views on the proposed targeted strategy underscored in the paper.

- The authorities welcomed staff's analysis and suggested policy options to enhance the equity and revenue potential of labor taxes. However, the authorities pointed out, and staff agreed, that near-term priorities are to conclude ongoing efforts to modernize tax administration via digitalization and the introduction of declarations and risk-based approaches. Tax reforms require deeper and more thorough analysis and are typically medium-term priorities.

8. ***Could staff elaborate on the measures which they think could have benefited from further consideration (debt relief, three-year ban on SME tax audits, new income tax exemption)?***

- Staff will respond to this question during the Board meeting.

Monetary and Exchange Rate Policies

9. ***We would also welcome additional information from staff on FX transactions conducted by the NBK on behalf of the NFRK and UAPF.***

- The NBK is agent and manager of the National Fund and the Unified Accumulative Pension Fund. The NFRK accumulates dollars from oil revenues, while the Pension Fund accumulates tenge from contributions by employers and employees. The NFRK must provide the tenge equivalent of around $7 billion to the government to finance the non-oil deficit; the NBK therefore converts dollars from the NFRK at the request of the government to provide this tenge financing. The timing and specific sales amounts have not been made public in the past. For the Pension Fund, the asset management strategy is to gradually accumulate assets abroad. So, the NBK buys dollars on behalf of the Pension Fund and places these funds with international asset managers. Lack of disclose of operations have meant that the NBK has been perceived on occasion as using these agency transactions to influence the exchange rate. Staff has therefore advised in favor of greater transparency; the NBK has assured staff that disclosure will begin in 2020.

10. ***Does staff have any information on the size and frequency of NFRK and UAPF purchases?***

- *Please see the answer to Question #9.*

11. ***We are also interested to hear about the reasons for the authorities' decision to adjust the definition of the inflation target.***

- The objective of 4 percent inflation (point target) in 2020 was set back in 2016, shortly after the introduction of inflation targeting. Recently, the NBK reconsidered the pace at which this goal should be reached. The target band for 2020 and 2021 will remain 4-6 percent, with subsequent reduction to 3-5 percent. The modification of the target band will help to avoid tightening that would hurt the growth momentum.

12. ***Many countries in the region are implementing comprehensive de-dollarization programs. Could staff elaborate on what specific additional measures the NBK can take in this area and whether they discussed this topic with the authorities?***

- In addition to underscoring the importance of pursuing credible macroeconomic policies and ensuring two-side exchange rate flexibility, staff discussed targeted measures that could make the tenge more attractive for borrowers and lenders. These include higher reserve requirements on FX liabilities and prudential policies that make would borrowing in foreign currencies more costly.

13. ***We would like staff to elaborate the main reasons for the stubbornly high level of dollarization (45 percent). Further comments are also welcome on the new, long-term monetary policy strategy.***

- The level of dollarization largely reflects a history of exchange rate depreciations and confidence in the tenge. Yet, dollarization has declined considerably relative to peak levels in late 2015-early 2016. Decreasing it further will entail maintaining credible policies over a sustained period of time *(see also response to Question #12).*

- The long-term monetary policy strategy is still in a process of preparation.

14. ***Legal provisions supporting NBK independence should be enhanced as part of the new institutional arrangements to transfer its supervisory functions to the newly created Agency for Regulation and Development of Financial Market (ARDFM). Staff's comments on the necessary amendments and their feasibility are welcome.***

- Staff sees scope for enhancing NBK's independence in several dimensions: (i) operational, to improve the central bank's governance structure; (ii) personal, to increase management autonomy; and (iii) financial, to strengthen the NBK's balance sheet by minimizing involvement in quasi-fiscal activities and divesting non-core assets.

15. ***Prudent monetary policies are needed to safeguard price stability in light of high core inflation and large wage increases in 2019 (18 percent through Q3). In this context, we would welcome additional staff comments on the implications of the increase in the minimum wage (by 50 %) earlier this year.***

- The minimum wage in Kazakhstan is subject to an annual adjustment which usually occurs at the beginning of the year. The 2019 adjustment (50 percent) was sizable compared to previous years (e.g., 16 percent in January 2018) and affected about 10 percent of the employed population. This boosted domestic demand—especially for basic food items—and raised prices of some services sensitive to wage changes (education, health).

Financial Sector

16. ***We also note the growing excess liquidity in the banking system (figure 3) which poses additional challenges to the monetary transmission. Could staff elaborate more on***

this issue, including their policy advice and the main priorities to address this problem?

- Tenge liquidity in the banking system has increased substantially in the past several years as result of a rapid de-dollarization in 2016 and sizeable financial support to banks in 2017-19 in an environment of sluggish credit. Surplus liquidity is managed by the NBK mostly through central bank notes and more recently, deposit auctions. The current liquidity situation reflects, among other factors, continuing bank difficulties and relatively limited investment opportunities domestically. The financial market is relatively narrow, and there is relatively low demand for loans from creditworthy corporate borrowers. As noted in the Staff Report, a significant share of SMEs have low capital and are highly indebted. Staff's advice has focused on addressing structural issues that are impediments to private-sector development, including enhancing competition and strengthening property rights and bankruptcy procedures. With implementation, credit demand should pick up and excess liquidity moderate.

17. ***Staff comments on the additional costs on the fiscal stance of the Asset Quality Review will be welcomed.***

- *Staff will respond to this question during the Board meeting.*

18. ***Could staff comment on what specific arguments the authorities have for separating central bank and supervision?***

- The authorities have expressed the view that the NBK had a wide range of powers and responsibilities that sometimes came into conflict. Notably, financial stability considerations may affect conduct of monetary policy. These considerations earlier led the NBK to divest of the Problem Loan Fund, transferring it to the Ministry of Finance. Another, practical consideration was the long-discussed move of the NBK to Nur-Sultan; Kazakhstan's banks and financial markets remain largely based in Almaty.

19. ***Could staff elaborate on how the new round of banks recapitalization is going to be structured?***

- *Staff will respond to this question during the Board meeting.*

20. ***In this respect, we welcome the transparent presentation of the costs of recapitalization of the banking sector in the staff report. A more consistent and transparent presentation of fiscal accounts by the Fund should be in line with the advice to the authorities to improve fiscal transparency more broadly. Staff comments on the proper and comparable treatment of these costs would be welcome.***

- The Fund aims to have a consistent approach across countries for the treatment of bank recapitalization costs, with guidance given by the *Government Finance Statistics Manual*. Individual banking recapitalization transactions are often complex and differ from country to country. If a recapitalization transaction is made with strong and realistic expectation that state funding will be recovered later, there would be a case to record the transaction as an acquisition of financial assets ("below the line," and not affecting the headline deficit). By contrast, if it appears that the support will not be recovered later (or in full), it would be more appropriate to show it as a transfer ("above the line," and affecting the headline deficit). There are other considerations. Financing for transactions may involve different units of the public sector that are not ordinarily consolidated with the general government accounts. While there is a consistent framework in place, the specifics of the context and transaction are important. Most importantly, the costs and assumptions about repayment should be made transparent, and augmented balances may be presented to help.

21. ***Staff comment on the news that the first stage of AQR has identified additional capital shortfall totaling $1.2 billion are welcome.***

- *Staff will respond to this question during the Board meeting.*

22. ***Can staff share their views on the challenges facing banks in moving toward a new, sustainable business model following the AQR and outline the next steps in this regard?***

- Banks face a number of challenges in moving toward a new, sustainable business model following the AQR. The Kazakh economy has been subject to significant external shocks, especially from oil volatility. There have been other pressures and policies for the sector have had impacts, including an array of state financial institutions and programs, the importance of state enterprise deposits, and moral hazard from past state support. The banks need to significantly strengthen their governance and operations, particularly long origination and risk management practices. An important challenge will be to strengthen macro financial linkages, with banks playing a more active role in supporting the economy. As discussed in a selected issues paper from last year‘s Article IV consultation, Kazakh banks are relatively small in relation to the economy. A strengthened financial sector would not only lead to fiscal savings, but importantly, contribute to emergence of a more vibrant non-oil sector.

23. ***We take note of the newly-created Agency for Regulation and Development of Financial Markets and would appreciate an update on its operationalization. In addition, could staff comment on Fund technical assistance (TA) envisioned, if any?***

- The new financial regulatory agency began operations on January 1. The director of the agency is a former Vice Governor of the NBK; the First Deputy Director is the former NBK vice governor in charge of supervision. The new agency would benefit from significant Fund TA, and the Agency's leadership has already indicated that it will pursue such support. The new CCAMTAC is expected to have a resident advisor on financial regulation and supervision.

24. ***Recent experience with widespread state credit support programs suggests that conditions for such a structured approach may not be optimal. Could staff comment on this?***

- Various credit-stimulating initiatives are in place that involve a subsidy element from the government, government-finance institutions, or the NBK. These create distortions, including complications for an effective monetary policy transmission and sound practices for credit risk management by banks.

Structural Reforms

25. ***Could staff comment on how the already implemented reforms influenced staff's estimates of Kazakhstan's growth potential?***

- Staff estimates of Kazakhstan's growth potential have focused on non-oil growth. Following the sharp decline of commodity prices and the slowing of trading partner growth, non-oil growth was sluggish in 2015-2018—just 2½ to 3 percent. The reforms already implemented under 100 Concrete Steps have helped secure non-oil potential growth of 4 percent and contributed to the gradual pick-up of non-oil growth in recent years and the strong performance in 2019. With continued reform implementation and corresponding changes on the ground in terms of investment, hiring and other business decisions, non-oil potential growth could be higher.

26. ***Given that the state already plays a strong role in the economy, we wonder whether the authorities put sufficient emphasis on policies that enhance private sector-led growth and improve the business climate. Staff comments are welcome.***

- *Staff will respond to this question during the Board meeting.*

27. ***It was not entirely clear to us why staff singled out the agriculture sector as the one in need of special attention. Do the authorities see other sectors in the economy, which may help in diversification and boosting growth? Staff comments would be appreciated.***

- *Staff will respond to this question during the Board meeting.*

28. ***Given that industrialization and growth measures constitute about half of the measures in the "100 concrete steps", additional information on why they require more time would be useful (Box 1 in the main report).***

- Some of the goals under industrialization and economic growth pillar are longer-term by nature. Besides legislative or regulatory changes, some of those goals require sustained follow-up implementation. Other goals under this pillar involve stage-by-stage implementation of changes.

Fund Engagement and Other Issues

29. ***We join staff's proposal for Kazakhstan to take an IMF PFM assessment and Fiscal Transparency Evaluation. Other countries in the region benefited from such technical assistance and improved policies. Did the authorities express any views on the desirability of such TA?***

- *Staff will respond to this question during the Board meeting.*

30. ***We note that Fund TA could be helpful in addressing many of the implementation challenges that Kazakhstan faces across a range of issues including infrastructure***

investment, the fiscal framework, central bank reform, financial sector supervision and privatization of state assets. Each of these areas will present unique challenges and potential pitfalls. Can staff comment, and indicate the top priority areas where they expect the Fund will or should provide TA?

- Key areas are supporting the formation of a strong independent regulator, strengthening the foreign exchange framework, improving the fiscal framework and fiscal rules, enhancing fiscal transparency and PFM arrangements, and strengthening macro-fiscal analytical capacity at the finance and economy ministries. The RTAC will play a key role.

31. *Has staff assessed the climate change mitigation policies of Kazakhstan?*

- *Staff will respond to this question during the Board meeting.*

32. *Will staff carry out further analysis on future missions regarding the employment effects of the program? Can staff elaborate on the results of the EBRD study around the potential impact on Kazakhstan's fiscal revenues from a long-term "green" scenario? Finally, did staff undertake any analysis around gender pay gaps in the Kazakh economy?*

- According to EBRD estimates, a green scenario in line with the SDGs and the Paris climate agreement could lead to a 40-percent reduction of Kazakhstan's fiscal revenues, despite an increase in oil production. However, the most significant impact is expected to occur in the 2030s, leaving the authorities a window of opportunity for transformation to diversify their economy, develop the non-resource sector, and identify new sources of fiscal revenues.

- *Staff will respond to the question on further analysis of the employment effects from the Nurly Zhol program and the gender pay gap during the Board meeting.*