



KAZAKHSTAN

Highlights

- **Economic performance in 2015 and the first half of 2016 has been subdued.** Growth reached 1.2 per cent in 2015, and 0.1 per cent in the first half of the year, reflecting the challenging external environment.
- **The exchange rate is beginning to stabilise after a 46 per cent depreciation over 2015.** This reflects the positive steps taken by the National Bank of Kazakhstan (NBK) to increase trust in the currency, and the improving external environment. The monetary policy rate has been gradually lowered to 13 per cent in July 2016 from 17 per cent in January 2016.
- **Ambitious utilities tariff reform in regulated sectors is progressing.** A new tariff-setting framework for regulated sectors has been adopted over the past year, with pilot projects in several regions under way. While tariffs remain below cost recovery levels, this is a significant step towards overhauling the overall tariff-setting framework towards a more sustainable commercial model.

Key priorities for 2017

- **Adjustment of the economy to lower oil prices is a key priority.** This requires a successful implementation of the government's economy-wide and sector-focused structural reform agenda in such areas as facilitating improvements of the rule of law, a framework for public-private partnerships (PPPs), and tariff setting in the regulated sectors.
- **The role of the state in economy needs to be upgraded to provide a better basis for private sector development.** The governance of the state- and quasi-state-owned enterprises and their procurement processes need to be enhanced; efforts to privatise them, including through implementing a structured pre-privatisation process, need to be stepped up. The structuring, effectiveness of implementation and oversight of the state support and industrialisation programmes need to be improved to provide more effective support to the private sector, particularly in the non-extractive sectors.
- **The banking sector needs to be strengthened, and access to finance improved.** The NBK needs to continue its work on the reduction of non-performing loans (NPLs) and increasing transparency of those NPLs that have been absorbed by off-balance sheet structures. The credit practices at banks need to be improved, including by strengthening approaches to accounting for foreign exchange risk facing borrowers. Development of the domestic money market, combined with continued introduction of various policy tools required for the inflation targeting regime, will be key to facilitating a reduction in the level of dollarisation in the banking sector.

Main macroeconomic indicators %

| | 2012 | 2013 | 2014 | 2015 | 2016 proj. |
|-----------------------------------|------|------|------|------|---------------|
| GDP growth | 5.0 | 6.0 | 4.3 | 1.2 | 0.7 |
| Inflation (average) | 5.1 | 5.9 | 6.7 | 6.7 | 14.8 |
| Government balance/GDP | 4.5 | 5.0 | 1.8 | -2.2 | -2.0 |
| Current account balance/GDP | 0.5 | 0.5 | 2.8 | -3.0 | -2.2 |
| Net FDI/GDP [neg. sign = inflows] | -5.5 | -3.3 | -2.1 | -1.8 | -3.4 |
| External debt/GDP | 63.4 | 61.5 | 69.2 | 83.2 | n.a. |
| Gross reserves/GDP | 33.6 | 17.8 | 13.5 | 11.3 | n.a. |
| Credit to private sector/GDP | 49.6 | 60.9 | 56.8 | 50.6 | n.a. |

Macroeconomic performance

Kazakhstan's economic growth slowed to 1.2 per cent in 2015 and further to 0.1 per cent in the first half of 2016, compared with 4.3 per cent in 2014, with the slow-down due mainly to low oil prices in particular. The decline in the oil price has led to a sharp drop in external earnings, with exports down by 32 per cent year-on-year in the period January to May 2016. Imports were down by 27 per cent over the same period, reflecting weaker domestic demand. The current account went into deficit in 2015 for the first time since 2009 at around 3.0 per cent of GDP. On the fiscal side, the 2015 fiscal deficit stood at 2.2 per cent of GDP, below the expected 3.0 per cent, in 2015. Fiscal policy is expected to remain conservative in 2016 and, based on an oil price assumption of US\$ 30 per barrel, the government is planning a budget deficit of 2.0 per cent of GDP.

Economic conditions have started to stabilise since March 2016. Since March, the exchange rate has stabilised, appreciating by around 10 per cent in February to June 2016, with short-term liquidity gradually returning to the market. As a result, the NBK, in a series of reductions, lowered the monetary policy rate to 13 per cent in July, from 17 per cent in January 2016. The NBK has also maintained a high level of international reserves, up by 9.4 per cent in June compared with the beginning of the year as a result of interventions in the foreign exchange market; National Fund reserves also increased by 3.5 per cent between the beginning of the year and June 2016. In the banking sector, tenge deposits increased by 6.6 per cent in the first half of 2016 and dollarisation slightly decreased from the peak of 70 per cent in January 2016, indicating the stabilisation of currency preferences.

The legacy of high non-performing loans continues to pose problems. The NPL ratio at the end of March 2016 stood at 8.4 per cent, which is well below the 30 per cent or so level that persisted over the period 2008-2013. This reduction is a result of steps taken by the NBK, commercial banks and other stakeholders, including the splitting of BTA-KKB, the bank with the highest level of NPLs, into two banks: a "good" (KKB) bank and a "bad" (BTA) bank, with the banking licence of BTA being rescinded. The most recent fiscal support to the banking sector, which amounted to Tenge 500 billion, is being used primarily to support the work-out of the NPLs of BTA. However, since this support to BTA has been channelled through KKB, the exposure of KKB to the performance of the NPL portfolio of BTA has not been eliminated. Similarly, off-balance sheet structures have absorbed the legacy NPLs in some other banks. Therefore, the underlying asset quality of the system remains a concern.

Growth is expected to reach 0.7 per cent in 2016 and improve to 2.4 per cent in 2017.

Monetary conditions in Kazakhstan have improved, the exchange rate has stabilised and inflation is on a downward trend. However, low oil prices, subdued growth in Russia and economic challenges in China continue to depress growth, which is exaggerated by the negative impact of regional risks and global and domestic security incidents on consumer, business and investor confidence. Moreover, downside risks to growth remain significant. In terms of FDI, a significant expected increase of investment from China, including development of the Belt and Road initiative, combined with the expected recovery of FDI from the European Union and other countries, can be expected to boost growth and, more broadly, provide a platform for creating better connectivity and growth (including in the non-infrastructure sectors) in the country. Inflation can be expected to reach 14.8 per cent in 2016, but return to the NBK target corridor of 6.0 to 8.0 per cent by 2017.

Major structural reform developments

Kazakhstan has reacted to the difficult economic environment by accelerating reforms. The country's accession to the World Trade Organization in November 2015, structural reforms across sectors and the introduction of a US\$ 3 billion a year counter-cyclical investment programme, *Nurly Zhol*, for 2015-17 are all beginning to create a more conducive environment for economic recovery. In the past year, the government has improved PPP legislation, ambitious tariff reform in regulated sectors is under way, the monetary policy framework has been strengthened, and more modern procurement rules at the Samruk Kazyna Holding companies have been introduced. In the World Bank *Doing Business 2017* report Kazakhstan improved its ranking to 35th among 190 countries, with improvements in seven out of 10 areas measured by the report: starting a business, dealing with construction permits, getting electricity, protecting minority investors, trading across borders, enforcing contracts, and resolving insolvency.

The government is implementing Kazakhstan's "100 Concrete Steps" programme, announced by the President in 2015. The programme aims to boost transparency and accountability using structural reforms by: creating a professional government apparatus; strengthening the rule of law; improving industrial policy; and creating a transparent, accountable state. As part of the programme, a new Astana International Financial Centre (AIFC) will be created on the site of the Astana Expo 2017. The AIFC Authority has signed an MoU with the EBRD and TheCityUK to develop the AIFC, with a focus on areas such as capital markets, money/derivative markets and corporate governance.

The government announced an ambitious privatisation plan. The new plan, unveiled in November 2015, aims to offer ownership stakes to foreign investors in the largest state- and quasi-state-owned enterprises. Among the companies planned for privatisation through IPOs are the oil and gas conglomerate, KazMunaiGas; the largest telecommunications company, Kazakhtelecom; the national railway company, Kazakhstan Temir Zholy; and the nuclear holding company, Kazatomprom. The government, Samruk Kazyna Holding and other relevant state entities have started working on pre-privatisation preparation of assets and changes in the regulatory framework required for successful privatisations.

Ambitious utilities tariff reform in regulated sectors is under way. A new tariff-setting framework for regulated sectors has been adopted over the past year; pilot projects moving utility tariffs towards cost recovery levels have been implemented in more than 10 regions. For example, in 2015-16 heating tariffs in Kyzlorda have been increased by 90 per cent, water tariffs in Aktobe have been increased by 42 per cent, and water tariffs in Shymkent have been increased by 30 per cent. While tariffs remain below cost recovery levels, this is a significant step towards overhauling the overall tariff-setting framework towards a more sustainable commercial model.

The NBK continues its efforts to strengthen the monetary policy framework. The current inflation target is 6 to 8 per cent in 2016-17, 5 to 7 per cent in 2018 and 3 to 4 per cent by 2020. However, the monetary policy transmission mechanism remains limited due to, among other factors, the high levels of dollarisation and the lack of effective money markets. The NBK has developed the new monetary policy guidelines to enhance the policy framework and operations for effective inflation targeting. The NBK is taking steps to create confidence in the tenge and the new regime, as well as to improve communication with the public, by regularly publishing data on currency interventions in the foreign market and releases on decisions made regarding the policy rate, as well as changes in inflation expectations.

A US\$ 36.8 billion investment into extending the Tengiz oilfield has been announced. In July 2016, an international consortium led by Chevron announced it would move forward to extend the Tengiz oilfield. The investment will increase production from 27 million to 39 million tonnes per year and prolong the life of the oilfield. The announcement is a positive signal for foreign investors especially in a period of economic slow-down. In addition, the resumption of the Kashagan oilfield, which is now expected at the end of 2016, is another boost for future economic growth.