July 2005
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Republic of Kazakhstan: 2005 Article IV Consultation—Staff Report; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2005 Article IV consultation with the Republic of Kazakhstan, the following documents have been released and are included in this package:

- the staff report for the 2005 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on April 5, 2005 with the officials of the Republic of Kazakhstan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 8, 2005. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- a Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 1, 2005 discussion of the staff report that concluded the Article IV consultation.

The documents listed below have been or will be separately released.

Selected Issues Paper
Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

To assist the IMF in evaluating the publication policy, reader comments are invited and may be sent by e-mail to publicationpolicy@imf.org.

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INTERNATIONAL MONETARY FUND

REPUBLIC OF KAZAKHSTAN

Staff Report for the 2005 Article IV Consultation

Prepared by the Staff Representatives for the
2005 Consultation with the Republic of Kazakhstan

Approved by Juan Carlos Di Tata and Donal Donovan

June 8, 2005

- Article IV consultation discussions were held in Astana and Almaty during March 23–April 5, 2005. The mission met with Assistant to the President Massimov, National Bank of Kazakhstan Governor Saidenov, Minister of Economy Kelimbetov, Minister of Finance Dunayev, Minister of Labor Karagussova, Financial Supervision Agency Chairman Zhamishev, other government officials, parliamentarians, and the private sector.
- The team consisted of Mr. Husain (head), Messrs. Davoodi, Sumlinski, Lohmus (all MCD), and Ms. Ter Martirosyan (FIN). Messrs. Di Tata (MCD) and Saudabaev (OED) joined some of the discussions.
- In the last consultation, concluded on July 21, 2004, Directors welcomed the more relaxed fiscal stance. They encouraged close monitoring of spending efficiency and higher social and infrastructure spending. In view of the surge in foreign exchange inflows, and the difficulties the NBK was encountering in sterilizing them, Directors urged greater upward flexibility of the tenge. They also urged acceleration of structural reforms to boost long-term growth.
- Kazakhstan accepted the obligations of Article VIII, Sections 2, 3, and 4 in 1996 and maintains an exchange system free of restrictions for current international transactions. Capital account restrictions are administered liberally.
- Kazakhstan undertook fiscal and data module ROSCs in 2002; an FSAP update was completed in 2004. The authorities subscribe to the SDDS.

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Executive Summary

Background and outlook

Kazakhstan's economy continued to grow rapidly in 2004, boosted by expanding oil output and high world oil prices. Real incomes and employment rose, key social indicators improved, and non-oil output growth was strong. Economic activity is expected to remain buoyant in 2005, although some moderation in real GDP growth to about 8 percent is projected on account of a deceleration in the pace of oil production coming onstream. Inflation could edge up further to over 7 percent, although the outcome will depend on the authorities' willingness to allow nominal appreciation of the tenge. The fiscal policy stance was eased significantly in 2004, and a further moderate easing is planned in 2005. Social spending rose in relation to GDP last year and is projected to increase further this year.

Policy discussions

Discussions focused on the following issues:

- The non-oil budget deficit remains sustainable. However, staff cautioned that the large increase in government salaries could intensify inflationary pressures.

- The challenges facing monetary policy are unlikely to abate in the near term with increased spending of oil revenue and continued capital inflows. In the face of the inevitable real appreciation of the currency, the National Bank of Kazakhstan should allow for sufficient nominal appreciation to keep inflation in check.

- Booming bank credit, particularly to the property sector and financed in part by external borrowing, carries significant risks. The Financial Supervision Agency (FSA) is planning a series of measures to curb banks' property lending and external borrowing. These will need to be supplemented by vigorous supervision.

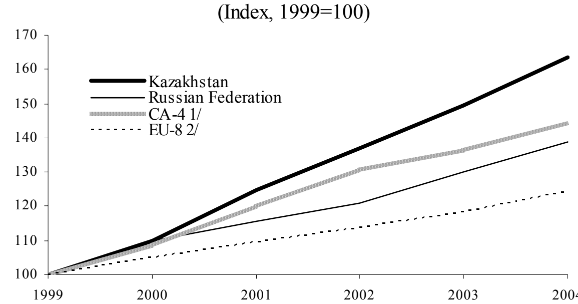
- Rules governing the National Fund of the Republic of Kazakhstan are being redesigned with the aim of establishing a long-term strategy for the use and accumulation of oil revenues. Staff recommended targeting the non-oil deficit on the basis of a fiscal sustainability framework grounded by prudent assumptions regarding longer-term oil prices and production.

- Diversification of the economy will be best achieved by reinvigorating structural reforms, which have slowed in recent years. Priorities include acceleration of WTO accession discussions and improvement of the investment climate, especially in the areas of competition policy and enterprise restructuring.

I. Economic Background

1. **Kazakhstan's considerable natural resource endowment has helped underpin rapid economic growth over the past half decade.** Driven by an expansion in hydrocarbon production, real GDP grew at an average rate of 10½ percent a year, while employment—which had declined sharply in the 1990s—recovered. Inflation moderated to single-digit levels and confidence in the banking system strengthened, leading to rapid remonetization and significant dedollarization. The budget has remained in surplus and a sizable portion of the oil revenue has been saved. Despite the impressive gains on the macroeconomic front, considerable regional disparities persist and social indicators remain weak.

Real GDP
(Index, 1999=100)

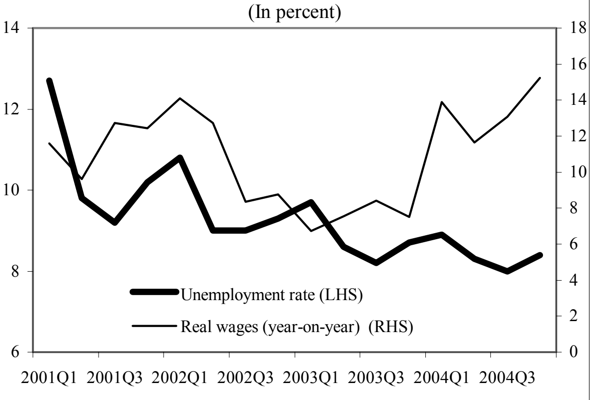


Sources: FSU; and AMECO databases.

1/ CA-4 comprises the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
2/ EU-8 comprises the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

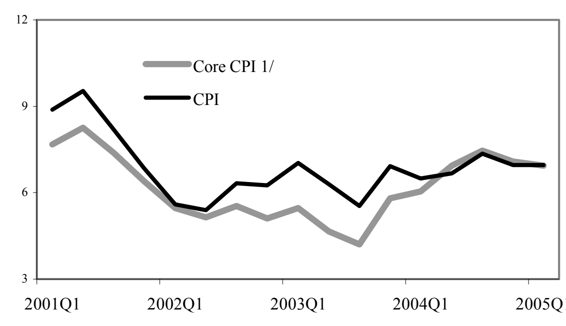
2. **Real GDP growth remained robust at an estimated 9.4 percent in 2004.** Increased hydrocarbon production continued to underpin growth (Box 1), although the output of nonhydrocarbon sectors also expanded at a rapid pace (Table 1).[1] Consumer price inflation picked up to 6.9 percent, near the upper end of the National Bank of Kazakhstan's (NBK) band of 5–7 percent. Labor market conditions tightened, with real wages increasing by 14 percent, the unemployment rate declining to 8.4 percent (from 8.8 percent in 2003 and 12.8 percent in 2000), and a marked pickup in immigration of documented as well as undocumented workers. Activity remained strong in early 2005, and inflation rose to an average of 7.1 percent during January–April.

Real Wage and Unemployment Rate
(In percent)



Source: Kazakhstani authorities.

CPI and Core CPI
(y-o-y percentage change)



Source: Kazakhstani authorities.

1/ CPI excluding fruits and vegetables.

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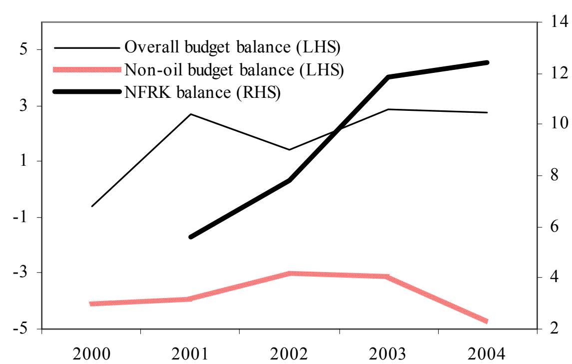
[1] Chapter I of the 2005 Selected Issues Paper (forthcoming) assesses the size of the non-oil sector and analyzes its recent growth trends.

Box 1. Kazakhstan's Hydrocarbon Sector

- According to production-based national accounts data, hydrocarbon output made up 8 percent of real GDP in 2004. Staff estimates that, including the output of the construction, transportation, and other sectors (that are directly related to crude oil and gas extraction), the share of hydrocarbons in GDP could be over 15 percent.
- The share of crude oil and natural gas output in industrial production has almost tripled since 1998, reaching 45 percent in 2004.
- Oil and gas exports accounted for over 55 percent of total export earnings last year. Data on imports related to investment in oil production capacity are not available, but their share in total imports is likely to be substantial.
- Investment in the hydrocarbon sector constituted about a third of total investment and one half of FDI in 2004.
- Oil revenue accounted for almost 30 percent of total fiscal revenue last year, compared with about 5 percent in 1999.

3. **Fiscal policy imparted stimulus to the economy.** While the overall budget surplus remained broadly unchanged at 2.7 percent of GDP, the non-oil deficit widened by about 1½ percentage points to 4.7 percent of GDP in 2004 (Table 2). On the revenue side, the impact of tax cuts was partly offset by higher nontax revenue and one-off receipts, including back taxes and penalties stemming from intensified tax inspections.[3] As a result, non-oil revenues increased broadly in line with non-oil GDP, but declined by 0.8 percentage point in relation to overall GDP. Public expenditures increased by 0.8 percent of GDP, reflecting a rise in social spending by 0.4 percentage point as well as sizable increases in the housing, agriculture, and energy areas. Assets of the National Fund of the Republic of Kazakhstan (NFRK) rose by $1.4 billion (3.4 percent of GDP) to $5 billion, although the rate of accumulation slowed from 2003 on account of changes to the regulations guiding the fund, including a reduction in the number of contributing companies.

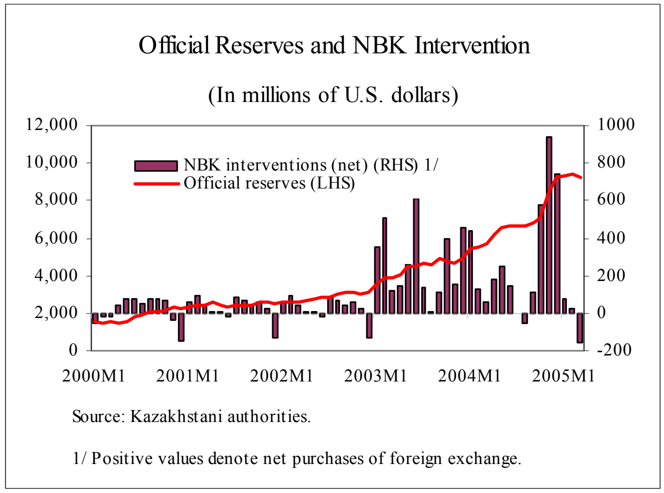
Fiscal Developments
(In percent of GDP)



Source: Kazakhstani authorities.

[3] The tax changes included reductions in the VAT rate from 16 percent to 15 percent and in the highest personal income tax rate from 30 percent to 20 percent. The social (payroll) tax rate was reduced from a flat 21 percent to a range from 7 percent to 20 percent.

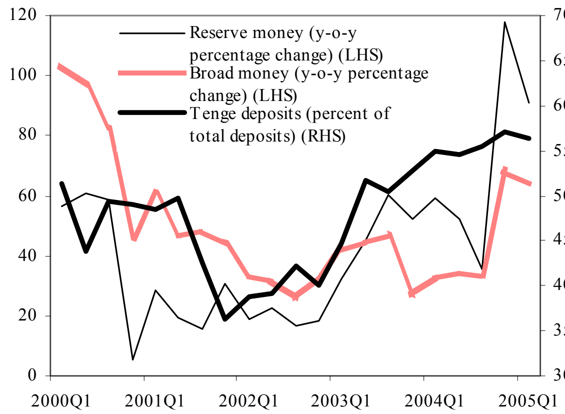
4. **The external position strengthened further in 2004, supported by high oil prices and large-scale external borrowing by banks.** The current account swung into surplus (1.8 percent of GDP), with the rise in hydrocarbon export receipts more than offsetting a very rapid expansion of imports and higher profit remittances abroad (Table 3). Non-oil exports—mainly metals and other raw materials—also expanded rapidly (almost 50 percent in dollar terms), aided by buoyant nonfuel commodity prices (Box 2). The capital account surplus widened, reflecting continued large foreign direct investment (FDI) inflows and an increase in private sector external borrowing, as banks took advantage of low international interest rates and favorable investor perception of Kazakhstan to mobilize funds abroad through syndicated loans and eurobond issuance.[3] As a result, official reserves (excluding NFRK assets) rose to $9.3 billion at end-2004, equivalent to six months of imports, with a marked pickup in the pace of accumulation during the last quarter of the year.



5. **The conduct of monetary policy has been complicated by the inflows of private capital, surging oil earnings, and buoyant demand conditions.** In an effort to stem upward pressure on the tenge while containing money growth, the NBK supplemented its exchange market intervention with continued large-scale sterilization operations. In the event, with sterilization costs mounting, the increase in the NBK's reserves was not fully sterilized. As a result, reserve and broad money growth accelerated (to 118 percent and 68 percent, respectively, at end-2004), with the tenge appreciating by 9 percent against the U.S. dollar and 4 percent against the ruble over the course of the year (Table 4). Despite a decline in short-term interest rates on account of ample liquidity in the banking system, the NBK incurred substantial sterilization costs and unrealized revaluation losses in 2004, experiencing a net loss of about T 60 billion for the year (0.9 percent of 2005 GDP and close to one third of its combined capital and reserves at end-2003). Of this, T 6.4 billion was covered by reserve capital, and the remainder by special reserves, which include previous unrealized revaluation gains.

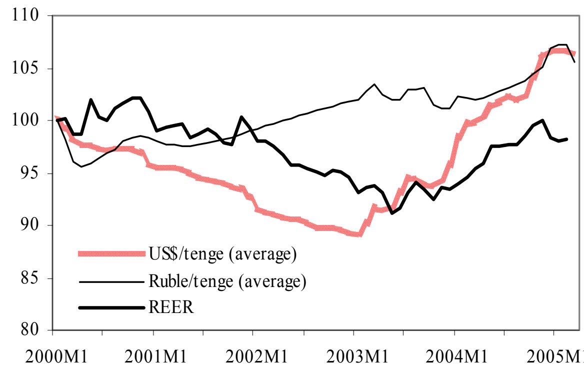
[3] Two major rating agencies upgraded Kazakhstan's sovereign external obligations to investment grade in 2004.

Monetary Developments



Source: Kazakhstani authorities.

Exchange Rate Developments
(January 2000=100)



Source: Kazakhstani authorities; and INS database.

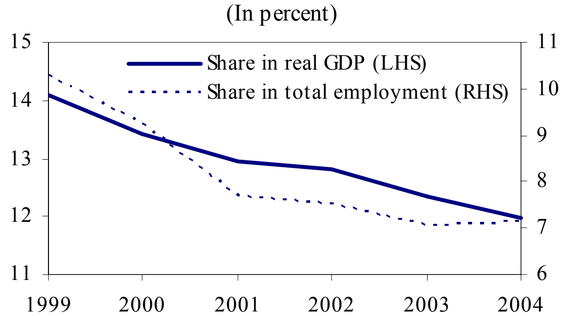
Box 2. Kazakhstan: Non-oil Sector Growth and Competitiveness

Kazakhstan's non-oil output has increased by an impressive 8 percent a year in real terms, on average, since 1999. Part of this rapid growth, however, reflects the expansion of output directly related to the hydrocarbon sector, such as the construction of extraction facilities and transport of petroleum.

A number of external competitiveness indicators suggest that the non-oil sector remains broadly competitive. The real effective exchange rate is presently more than 10 percent more depreciated than its 1999 level, and labor productivity growth in Kazakhstan's non-oil sector has broadly kept pace with that in other large CIS economies. Non-oil export growth has been robust, averaging about 16 percent a year during 1999–2004. It should be noted, though, that Kazakhstan's non-oil exports comprise mainly of metals and other raw materials, which also benefited substantially from higher world prices in 2003–04. Moreover, rapid wage growth in recent years, especially in construction and finance, has likely pushed up unit labor costs.

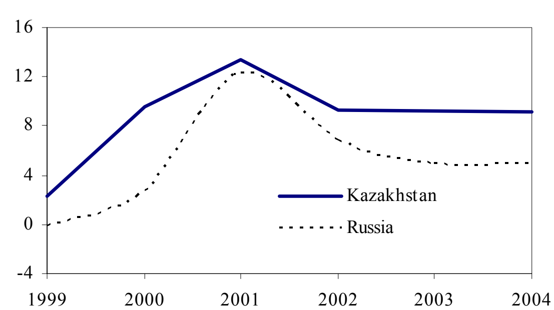
The composition of the non-oil sector has changed The share of the manufacturing sector has declined significantly, both in terms of value-added and employment. At the same time, traditional "nontradable" sectors, services and construction, have expanded and now account for 54 percent of employment and 57 percent of value added.

Manufacturing Sector: Value-Added and Employment
(In percent)

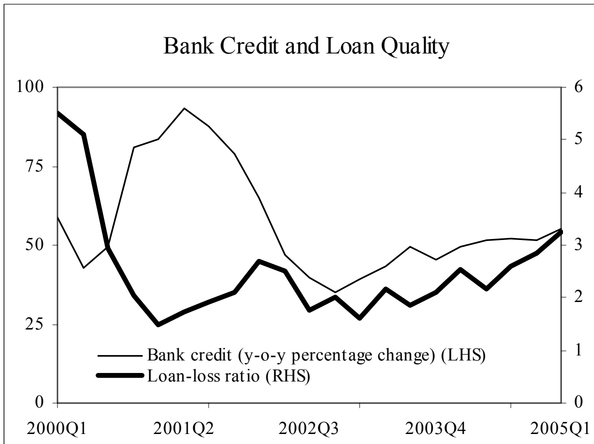


Source: Kazakhstani authorities.

Real Non-Oil Output Growth, 1999–2004
(In percent)



Sources: Kazakhstani authorities; and Fund staff estimates.



Source: Kazakhstani authorities.

6. **With the deposit base expanding and external funding readily available at attractive terms, bank lending has boomed.** Credit surged by over 50 percent in 2004, while deposits increased by about 70 percent, with the share of tenge deposits rising markedly. Notwithstanding the persistence of relatively high lending interest rates,[4] property-related lending has expanded especially rapidly, and by end-March 2005 accounted for 20 percent of bank credit. Banks have also become increasingly active internationally on the assets side, through branch operations, acquisitions of financial entities in neighboring countries, and a pickup in cross border lending operations (Box 3). The banking system's ratios of classified loans and loan losses have edged up (Table 5).[5]

7. **Although Kazakhstan has made considerable progress in the structural area since the early 1990s, the pace of reform implementation has slowed in recent years.** Privatization of small- and medium-sized enterprises (SMEs) is basically complete, prices have been liberalized, and a framework for prudential regulation and supervision of the financial sector is in place, including with the establishment of the Financial Supervision Agency (FSA) in 2004. However, the EBRD's transition indicators show little improvement in recent years, and the gap in relation to more advanced reformers has widened (Box 4).

8. **Rapid growth has translated into lower poverty, but social indicators remain weak.** The share of the population living below the poverty line fell from 34 percent in 1998 to 16 percent in 2004. However, the World Bank estimates that over a quarter of the population lives in crowded conditions and more than 10 percent is poorly educated. Moreover, life expectancy at birth is lower than the CIS average, and access to safe water remains limited.[6] The World Bank's latest Country Economic Memorandum also notes that Kazakhstan's education programs need far more flexibility, the basic health care system should be significantly enhanced, and water and sewerage facilities are in dire need of rehabilitation.

[4] Bank lending rates averaged over 15 percent for tenge loans and 11 percent for foreign currency loans.

[5] The classified loan ratio was 41 percent at end-2004. However, about 90 percent of classified loans listed as doubtful are actually being serviced on a timely basis.

[6] See World Bank, "Dimensions of Poverty in Kazakhstan," Poverty Reduction and Economic Management Unit, Europe and Central Asia Region, June 14, 2004.

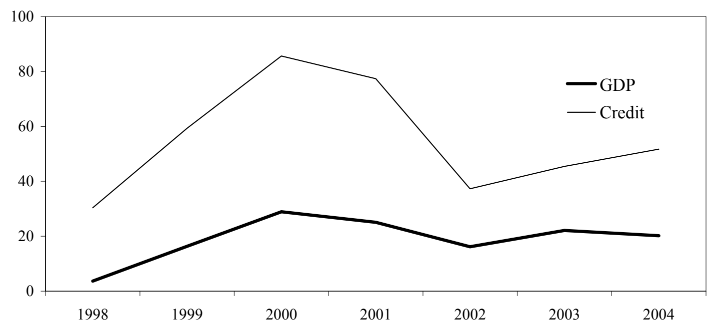
Box 3. Kazakhstan's Banking Sector

Banks balance sheets have expanded rapidly over the past five years. Banking system assets have grown on average by 50 percent a year and amounted to almost 50 percent of GDP in 2004, compared with 17 percent of GDP in 1999. This expansion has been accompanied by a process of consolidation. The number of banks has declined, with the three largest banks presently accounting for over 60 percent of total banking sector assets. The spread between average lending and deposit interest rates has narrowed but remains high (10 percent in 2004). There has also been some de-dollarization. As of end-2004, foreign currency deposits and loans accounted for 43 percent and 52 percent of total deposits and loans, respectively, compared with 61 percent and 71 percent at end-2001.

Banks' international borrowing and lending has increased rapidly in recent years. Cross border lending—mainly in other CIS countries—rose by 225 percent in 2004 and now accounts for almost 10 percent of the total assets of the banking system. Mobilization of funding from abroad has grown rapidly, and by end-2004 net foreign liabilities accounted for 40 percent of the total liabilities of the banking system.

Banks are profitable, well capitalized, and presently have ample liquidity. As of end-2004, the average risk weighted capital adequacy ratio was 16 percent, significantly above the required minimum of 12 percent. Banks' return on assets has ranged from 1 percent to 3 percent over the past 6 years, and their return on equity from 8 percent to 14 percent. At end-2004, the ratio of the banking system's liquid assets (mainly t-bills and cash) to short-term liabilities (mainly demand deposits) was over 100 percent, more than three times the regulatory minimum.

Nominal GDP and Credit Growth
(In percent)



Sources: Kazakhstani authorities; and Fund staff estimates.

II. Policy Discussions

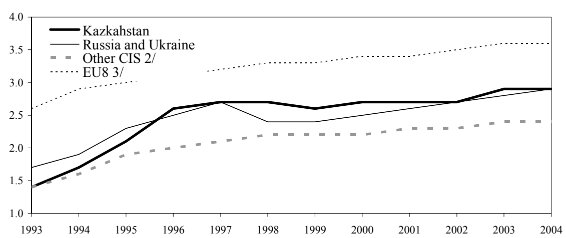
9. **Fund surveillance in recent years has focused on policies that harness Kazakhstan's natural resource wealth and sustain rapid development of the economy.** The macroeconomic policy mix has been largely in line with the staff's advice—an easing of the tight fiscal stance with increased social spending, accompanied by greater exchange rate flexibility to keep inflation stable—although the authorities have resisted further tenge appreciation, particularly in the last quarter of 2004. Staff has also called for structural reforms to improve the investment climate and diversify the economy. Progress in this area has been mixed, however. Important steps have been taken in some areas, including financial sector regulations and supervision, but the implementation of the other structural reforms, particularly in the competition policy and enterprise restructuring areas, has been slow.

Box 4. Kazakhstan: Structural Reform and Business Climate Indicators

The EBRD's Transition Indicators, which measure liberalization and reform in a number of structural areas, indicate rapid progress in Kazakhstan in the early and mid-1990s. Since the late 1990s, however, progress has been much slower and the gap relative to the EU-8 has widened, although Kazakhstan still compares favorably with most CIS countries. Within the structural areas, Kazakhstan ranks relatively high in banking sector reforms but relatively low in competition policy and enterprise restructuring.

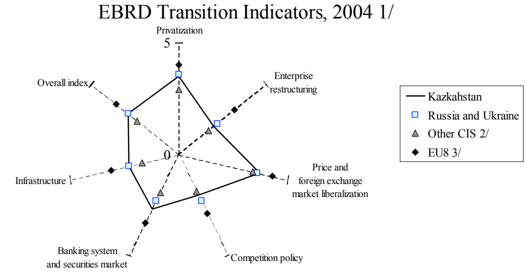
The World Bank's Doing Business 2005, which measures the extent of business regulation and enforcement, ranks Kazakhstan above the regional and OECD averages in the area of labor hiring and firing, and between the two in terms of challenges faced by entrepreneurs in launching businesses, disclosure of ownership and financial information, and property registration. However, Kazakhstan ranks behind both comparator averages in many of the indicators relating to contract enforcement and closing a business.

EBRD Overall Transition Index 1/



Sources: EBRD; and Fund staff estimates.
1/ The index ranges from 1 to 4+ with higher values representing more progress on structural reforms.
2/ CIS countries excluding Kazakhstan, Russia, and Ukraine.
3/ EU8 comprises the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

EBRD Transition Indicators, 2004 1/



Sources: EBRD; and Fund staff estimates.
1/ Transition indicators range from 1 to 4+ with higher values representing more progress on structural reforms.
2/ CIS countries excluding Kazakhstan, Russia, and Ukraine.
3/ EU8 comprises the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

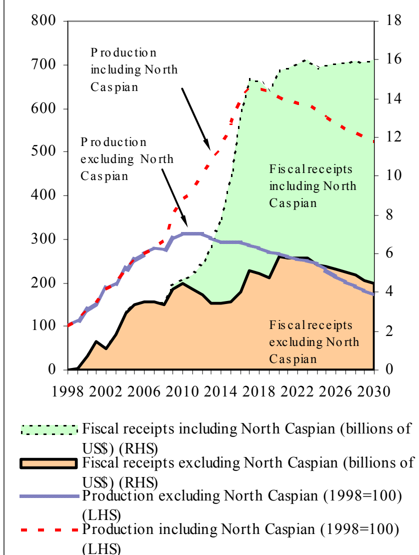
10. **Near- and medium-term policy challenges in an environment of sustained high oil prices were again the core theme this year.** The discussions focused on the fiscal stance, the composition of increased spending, the appropriate monetary/exchange rate policy response, emerging risks in the banking system, the strategy for the use of oil revenue over the longer term, and structural reform priorities.

A. Outlook

11. **Economic activity is expected to remain buoyant in 2005,** despite some moderation in GDP growth on account of a deceleration in the pace of oil production coming onstream. Staff estimates that inflation is likely to stay above 7 percent, although the outcome will depend on the authorities' willingness to tolerate further nominal appreciation of the tenge (see below). Continued high oil prices (in line with the March 29 WEO baseline) are expected to increase the external current account surplus. With oil sector FDI remaining large and banks continuing to borrow overseas as international financing conditions tighten only gradually, the capital account is likely to register another strong surplus.

12. **The medium-term outlook for the Kazakhstan economy is promising.** Despite the projected easing of oil prices, the rising volume of oil production implies considerable fiscal receipts from the hydrocarbon sector over the next three decades and, consequently, the availability of significant financial resources to support the growth and development of the rest of the economy. In line with this longer-term outlook, real GDP growth is projected to average about 7½ percent a year over the medium term. Large-scale FDI-related imports and increased earnings of foreign investors are expected to move the external current account into a moderate deficit which, notwithstanding larger intracompany debt amortization, should easily be financed by the projected positive net capital account balance. The main risks to the outlook relate to global oil prices and domestic credit market conditions.

Medium-Term Petroleum Outlook



Sources: Kazakhstani authorities; and Fund staff estimates.

Medium-Term Macroeconomic Indicators, 2004–10

	Prel.	Projections					
	2004	2005	2006	2007	2008	2009	2010
	(Annual changes in percent)						
CPI (eop)	6.7	7.6	6.9	7.1	6.4	5.9	5.5
Real GDP growth	9.4	8.0	7.7	7.2	6.9	9.4	7.0
Crude oil and gas condensate production	15.4	7.8	6.3	5.9	5.6	22.7	8.7
Reserve money growth	117.7	40.0	21.5	20.5	19.5	18.5	17.5
Broad money growth	68.2	30.0	23.5	22.0	21.0	20.0	19.0
Broad money velocity (annual average)	4.3	4.0	3.2	2.8	2.6	2.4	2.3
	(In percent of GDP)						
General government balance	2.7	2.6	1.5	0.5	0.0	0.4	0.4
Non-oil balance	-4.7	-5.3	-5.4	-5.6	-5.4	-5.0	-4.6
Revenues and grants	26.0	25.8	25.1	24.7	23.8	23.4	23.3
Of which: oil revenue 1/	7.4	8.0	6.9	6.1	5.3	5.4	5.0
Total expenditures and net lending	23.3	23.2	23.6	24.3	23.8	23.0	22.9
Allocated to NFRK (-=increase)	-2.8	-2.8	-0.3	-0.1	-0.3	-0.5	-0.6
External current account balance	1.3	3.3	1.8	-0.4	-1.7	0.2	-0.1
FDI, net	10.5	3.5	3.0	2.6	2.9	2.7	2.4
	(In millions of U.S. dollars)						
NBK gross reserves	9,277	11,708	14,369	16,548	18,066	20,896	23,596
NFRK	5,131	6,540	7,128	7,339	7,702	8,254	8,858
Public and publicly guaranteed external debt	3,366	3,274	3,299	3,327	3,348	3,365	3,377
Memorandum items:							
Nominal GDP (in billions of tenge)	5,543	6,752	7,477	8,205	9,042	10,335	11,464
Oil price (in U.S. dollars per barrel)	37.8	49.5	48.8	46.5	45.3	44.5	44.0

Sources: Kazakhstani authorities; and Fund Staff estimates and projections.

1/ Includes one-off payments, such as discovery bonuses.

13. **External debt indicators are expected to remain comfortable.** The bulk of external obligations is long term, and in large part comprised of intracompany loans without specified repayment schedules.[11] Under the baseline scenario and standard stress tests, external debt ratios are projected to decline steadily on account of continued high economic growth, tenge appreciation, and the projected amortization profile, particularly of intracompany loans in an environment of sustained high oil prices (Table 6).[12] However, banks' large-scale external borrowing, much of which is conservatively classified as short term in the monetary accounts, has increased risks in the banking sector (Table 7).[13]

B. Fiscal Policy

14. **Continued high oil prices have intensified pressures to increase spending further.** A supplementary budget (1½ percent of GDP) has recently been passed by parliament. As a result, the non-oil fiscal deficit is expected to ease by a further ½ percentage point (in relation to 2004) to 5.3 percent of GDP, implying a somewhat expansionary fiscal stance. The overall budget, however, will remain in surplus (2.6 percent of GDP).The additional spending comprises: the introduction of a basic pension for all retired citizens that will raise average pensions by about one third; increases in the wages of education and health workers and in base civil service salaries by about 30 percent; a capital injection for the development fund for small- and medium-sized enterprises; and increased scholarships and stipends for students.[14] As a result, public spending on the social sectors—including health, education, and social security—will increase further in relation to GDP.

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[11] About one half of all external debt obligations at end-2004 were intracompany loans (mainly in the oil sector), almost one quarter represented obligations of banks, about 10 percent were government or government-guaranteed obligations, and about 7 percent were trade credits.

[12] While a sharp depreciation of the tenge would lead to a sizable increase in the overall external debt ratio, the effect on external debt excluding intracompany obligations and net of NFRK assets—the relevant measure for vulnerability analysis—would be relatively muted. A very sharp fall in oil prices—through its impact on growth and the current account—would result in a much slower decline in the external debt ratio over the medium term, but the debt situation would be expected to remain manageable. In view of the low level of domestic public debt, including NBK obligations, a separate sustainability analysis for domestic public debt was not conducted.

[13] Due to tax advantages, banks' eurobond obligations, though of a medium- or long-term maturity, have generally been undertaken via special purpose vehicles registered in western Europe that onlend the bond proceeds to Kazakhstani banks.

[14] Development priorities were outlined in the president's February 2005 speech "Kazakhstan on the Road to Accelerated Economic, Social, and Political Modernization."

Social and Capital Spending

(In percent of GDP)

	2003	Prel. 2004	Proj. 2005
Social spending	10.3	10.7	11.0
Education affairs and services	3.2	3.4	3.4
Health affairs and services	1.9	2.4	2.4
Social security and welfare affairs and services	5.2	4.9	5.2
Capital spending	4.8	5.6	5.2
Memorandum items:			
2005 supplementary budget	...	...	1.7
Pensions	...	...	0.4
Wages of education and health workers	...	...	0.5
Wages of civil service	...	...	0.4
SME Development Fund	...	...	0.2
Others	...	...	0.2

Sources: Kazakhstani authorities; and Fund staff estimates.

15. **The authorities emphasized that the spending increases were aimed at improving living standards in an equitable fashion.** They also observed that large differentials between government and private sector salaries had made it difficult to attract and retain qualified staff in the civil service. In the education and health sectors, where salaries are less than half the average for the entire nonagricultural economy, the wage increase is based on equity considerations and should help improve the quality of services.[11] The authorities also noted that social sector programs are being broadened in an effort to improve living standards of the financially vulnerable members of society. The pension system is being reorganized, and social benefits for the disabled are being expanded through enhancements to the disability insurance program. Under the social jobs program, local governments are helping support temporary employment for the socially vulnerable, thereby improving their prospects for securing permanent employment. Professional and vocational training programs are also in place to assist in skills acquisition.

16. **While welcoming the increase in social spending, staff cautioned that large across-the-board pay increases are not the most effective way to remedy difficulties faced by the civil service.** In addition, the pay increases could intensify inflationary pressures, especially if they lead to an acceleration in private sector wages.[12] Moreover, in

[11] The government wage bill, which includes salaries of health and education workers, will rise from 3.8 percent of GDP in 2004 to 4.1 percent in 2005.

[12] The authorities estimate that the supplementary budget will raise inflation by about ¼–½ percentage point in 2005, although there are significant uncertainties. In particular, the impact of the minimum wage—which is also being increased by about one third with the supplementary budget—is difficult to judge.

view of the planned further 30 percent increase in civil service salaries from 2007, these commitments will have longer-term fiscal implications that could require a compression in social or infrastructure spending to ensure fiscal sustainability. The authorities recognized the need to address issues relating to the structure of the civil service and its pay, and are receiving technical assistance from the World Bank on designing a strategy. This will likely include steps to better target pay increases; rationalize ministries' discretion to award bonuses; link remuneration more closely to performance, merit, and regional cost of living differences; and address employment redundancies in some areas.

17. **The longer-term fiscal strategy is being refined through changes in the rules governing the NFRK to help guide the decision of how much of the oil income to save.** Under the new rules, which will likely be implemented with the 2007 budget, all central government oil revenue is expected to accrue to the NFRK, and the authorities are considering linking the release of funds from the NFRK to the budget with the amount of development spending (which broadly corresponds to capital expenditure), while keeping the rest of the budget in balance (Box 5). In their view, such a link would help ensure adequate saving by tying the amount of oil income spent to public investment aimed at enhancing the future productivity of the economy. Staff welcomed the plans to integrate the NFRK with the budget, but noted that setting the non-oil deficit equal to development spending was not sufficient to anchor fiscal policy, and that the non-oil deficit would need to be set in a medium-term fiscal framework to ensure sustainability. The authorities agreed that sustainability considerations would have to guide fiscal policy.[13]

18. **The new NFRK rules should also enhance the transparency of oil revenues and their use.** The authorities indicated that they would request a fiscal ROSC reassessment, which they thought would aid the formulation of the new rules. They also indicated that a decision on Kazakhstan's participation in the Extractive Industries Transparency Initiative (EITI) would be taken soon, following consultation with oil companies operating in Kazakhstan on their willingness to participate.

19. **The authorities saw some scope for further tax cuts over the medium term.** They noted that a reduction in the tax burden could help diversify the economy by boosting investment in the non-oil sector. However, they did not anticipate any major changes to the tax system in the near term because of the limited fiscal space afforded by their ambitious social program. Moreover, they emphasized that the full impact of the 2004 tax cuts needed to be assessed before decisions on further changes were taken.

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[13] Chapter II of the 2005 Selected Issues Paper (forthcoming) assesses the sustainable long-term path for the non-oil deficit that would maintain Kazakhstan's oil wealth in real per capita terms.

Box 5. Kazakhstan: Oil Revenue Management and the NFRK

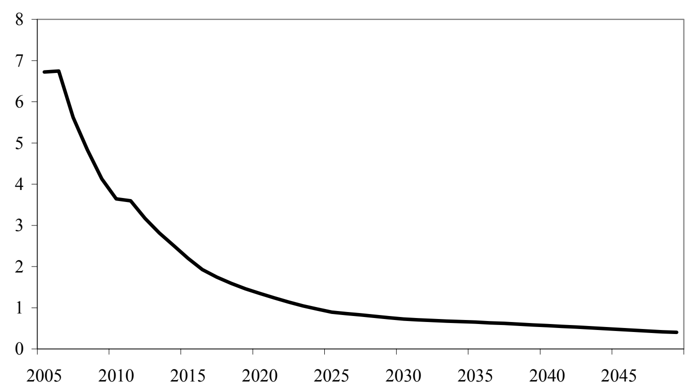
The NFRK was established in 2001 to reduce the economic impact of volatile oil prices and serve as a vehicle for saving part of Kazakhstan's oil income for future generations. A significant portion of fiscal revenue from oil—which increased from $0.2 billion in 1999 to over $3 billion (7.4 percent of GDP) in 2004—has been saved in the NFRK. The NFRK balance, which is invested abroad, amounted to $5.2 billion at end-April 2005.

The rules governing the NFRK are complex and have changed over time. Under the current system, fiscal payments from identified companies in the natural resources sector are subject to transfer to the NFRK. The number of companies was reduced in 2004, and the transfer of their fiscal payments is calculated on the basis of a reference oil price. Privatization receipts, special bonus payments, and royalties from certain natural resource companies have also been allocated to the NFRK.

The authorities are presently in the process of redesigning the NFRK rules. They aim to fully integrate the NFRK with the budget, and devise a rule to guide the use of oil revenue, possibly by linking the non-oil fiscal deficit to the amount of development spending.

As the experience in other countries indicates that the existence of an oil fund by itself does not ensure fiscal discipline, staff recommended setting the non-oil deficit in a long-term fiscal sustainability framework. Based on the current outlook for world oil prices and Kazakhstan's oil production, a non-oil deficit of about almost 7 percent of GDP in 2005 would be consistent with maintaining oil wealth—accumulated NFRK assets plus the present value of oil under the ground—at the present level in real per capita terms. Over time, however, the "sustainable" non-oil deficit will decline in relation to GDP as the economy grows. The calculation of the sustainable deficit depends, of course, on the underlying strategy. Moreover, the high degree of uncertainty surrounding long-term oil price and production prospects suggests that any rule for determining the non-oil deficit should retain sufficient flexibility to respond to significant changes in these prospects.

Sustainable Non-Oil Deficit 1/



Source: Fund staff estimates.

1/ Non-oil deficit that would maintain oil wealth in real per capita

C. Monetary and Exchange Rate Policy

20. **The choice of a looser fiscal stance implies further real exchange rate appreciation.** Staff recommended accepting this through nominal appreciation rather than higher inflation. As regards intervention policy, the NBK does not have an official target for the real exchange rate, as evidenced by the significant appreciation of the tenge in real effective terms (5 percent) in 2004. However, their intervention policy appears to be guided by real exchange rate developments. The authorities indicated that intervention had been scaled back sharply in recent months and the NBK had actually sold foreign currency on a

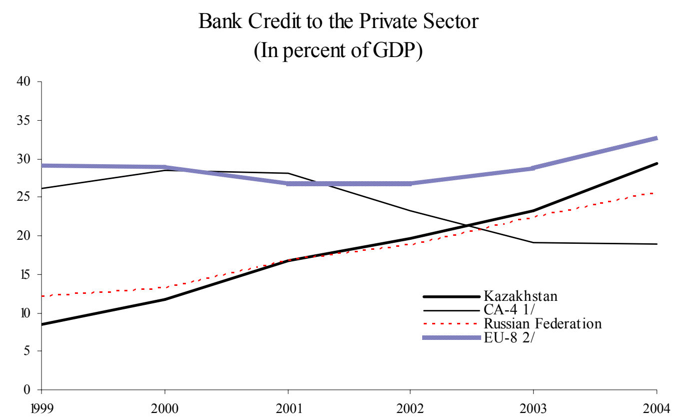
net basis in the first quarter of 2005. They reiterated their commitment to maintaining low inflation and noted that no change in the NBK's inflation objective (a band of 4.9–6.5 percent for average inflation for the year) had so far been announced, although they acknowledged that the supplementary budget could push inflation slightly above the band. However, in light of the significant appreciation of the tenge last year, the authorities were concerned that further strengthening of the currency could hamper competitiveness. Some officials saw scope for containing real appreciation, at least over the near term, by limiting nominal appreciation.

21. **The NBK's ability to combat inflation is being strengthened.** Draft legislation, currently with parliament, will put in place a mechanism to recapitalize the NBK to offset losses from monetary operations. In addition, existing ambiguity over which agency—the NBK or the FSA—has the authority to adjust reserve requirements will be removed in favor of the NBK. Staff supported the planned recapitalization, recommending that it be in the form of tradable securities at market interest rates and suggesting that further profit transfers from the NBK to the budget—which amounted to 0.3 percent of GDP in 2004—not take place until the NBK posted positive net profits. The mission noted that continued large-scale exchange market intervention to resist nominal appreciation could encourage even greater capital inflows and require still higher sterilization, and encouraged the authorities to move quickly to extend the current reserve requirement—which applies only to short-term domestic liabilities—to foreign liabilities and all domestic liabilities. NBK officials indicated that they did not envisage profit transfers to the budget in 2005. They said that various options regarding the coverage, rate, and remuneration of reserve requirements were under consideration.

22. **The authorities aim to move to inflation targeting over the medium term.** However, the relatively shallow money market, limited instruments, and unpredictable money demand amidst ongoing rapid remonetization preclude moving to such a framework in the near term. Noting progress at the NBK in modeling inflation and the monetary transmission process, staff encouraged continued efforts to prepare for inflation targeting and observed that greater exchange rate flexibility would facilitate the eventual transition.

23. **Remaining capital account restrictions are to be removed by 2007.** Existing regulations and restrictions are administered liberally, and their removal is not expected to result in major shifts in the pattern of capital flows. Nevertheless, the authorities see a free capital account regime as an important step in Kazakhstan's integration with international financial markets. The mission noted that while existing restrictions mainly govern capital outflows, their removal could well attract increased inflows if investors find the new policy environment more attractive. A more flexible exchange rate regime would help cushion the economy from volatile capital flows while reducing speculative flows associated with perceptions of one-sided exchange rate risk. Staff also emphasized the importance of a strong and well-supervised banking system to limit risks stemming from sudden shifts in capital flows.

D. Financial Sector Policies



Sources: FSU; IFS; and AMECO databases.

1/ CA-4 comprises the Kyrgyz Republic, Tajikistan, Turkmenistan, and Uzbekistan.
2/ EU-8 comprises the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

24. **Continued rapid credit growth poses a key near-term policy challenge.** As bank lending remains relatively low in relation to GDP, part of the rapid expansion of credit may well represent the sort of "catch up" seen in other transition economies.[14] However, easy credit availability may also be fueling lending without proper risk assessment, and the quality of banks' loan portfolios could deteriorate sharply if credit conditions were to tighten abruptly. Although the banking system remains well capitalized—the risk-weighted (Tier I plus Tier II) capital adequacy ratio was 15.9 percent at end-2004—signs of some deterioration in loan quality even as credit booms raise concern. FSA officials noted, however, that loan classification rules are conservative, as most of the loans that are classified as substandard continue to be serviced on a timely basis.

25. **The authorities recognize the risks in the banking sector and are taking measures to mitigate them.** A number of measures are under consideration, including higher liquidity ratios, tighter asset classification rules, and steps to close gaps in prudential regulations over related-party lending. In addition, Kazakhstan's first credit bureau has been established, which FSA officials expect will increase the availability of credit information on households and small enterprises and thereby facilitate the application of appropriate scoring methods for classifying—for prudential and provisioning purposes—loans to individuals and small firms. The FSA has also announced the incorporation of market and operational risks in capital adequacy requirements, using elements of the Basle II framework.

26. **Specific measures to reduce risks associated with banks' real estate lending are under consideration.** FSA officials saw heightened risk stemming from the rapid growth in mortgages and consumer lending, which had more than tripled and doubled, respectively, over the past year. Based on a broad definition that includes consumer loans actually used for property-related purposes, they estimate that up to 37 percent of banks' loan portfolios is exposed to the real estate sector. While direct limits on banks' property exposure were not

[14] Chapter III of the 2005 Selected Issues Paper (forthcoming) analyses recent credit growth and compares it with that in other transition economies.

regarded as useful because they could be easily circumvented—for example by disguising mortgage loans as consumer lending—FSA officials indicated that they were considering applying tighter loan concentration ratios for banks with higher property exposure and tougher asset classification rules for property and consumer loans. In addition, the extension of income disclosure requirements—which presently apply only to mortgages—to commercial property loans (including construction) was under consideration. Such a step would help curb credit demand, thereby cooling the real estate market. Consideration is also being given to developing an index of real estate prices, which would help in monitoring property market developments and associated risks.

27. **Increased bank borrowing abroad to fund domestic credit expansion also warrants close attention.** To guard against currency mismatches on banks' balance sheets, open foreign currency position limits have been reduced from 50 percent of bank capital to 30 percent.[15] A tightening of classification rules for foreign currency loans to borrowers with limited foreign currency cash flow is also under consideration. Staff recommended close scrutiny over long-term bonds issued by banks to ascertain whether the associated contracts contain options that would permit creditors to exercise early repayment, thus affecting the bonds' maturity profile. FSA officials indicated that banks' long-term foreign borrowing was under standard loan contracts that did not contain such options, but agreed that close attention was warranted. They also indicated that they planned to incorporate country risk in the calculation of capital adequacy ratios to stem risks associated with banks' cross-border lending, and observed that broadening reserve requirements to include foreign liabilities would help contain foreign borrowing.

28. **Intensified supervisory activity to complement the regulatory initiatives is critical.** Regular in-depth bank examinations will be needed to ensure compliance with regulations, supported by continuous off-site monitoring and analysis of bank balance sheets. The rapid growth of the banking sector calls for increased supervisory resources to assess risks and vulnerabilities, and care should be taken to avoid overstretching existing supervisory capacity. The authorities agreed that an elevated degree of supervisory vigilance was appropriate and increasing resources available to the FSA was a high priority.

29. **The authorities are keen to develop Almaty into a regional financial center over the medium term.** In light of Kazakhstani banks' increased activity overseas and the lower funding costs faced by Kazakhstani borrowers in relation to entities in neighboring countries, the authorities see scope for an expanded role for Kazakhstani institutions as financial intermediaries for the region. A number of measures are being considered to establish supporting legal and regulatory infrastructure, including a contract enforcement system with related courts and draft legislation in the areas of anti-money laundering and combating the financing of terrorism, protection of minority shareholder rights, and insider trading and market manipulation. In addition, a draft securitization law is under consideration to facilitate

[15] Open position limits include tenge assets and liabilities indexed to foreign currencies.

the development of the securities market. Staff welcomed plans to enhance the financial sector's regional role by upgrading infrastructure and regulatory standards, but cautioned that this places even higher priority on developing a suitable legal framework and a strong supervisory system, and on enhancing cooperation with supervisory agencies in other countries.

E. Structural Reforms

30. **Structural reform is critical for sustained growth of the non-oil sector.** Noting Kazakhstan's relatively low ranking in the areas of competition policy and enterprise restructuring in the EBRD's transition indicators, staff recommended an acceleration of reforms to promote competition and thereby lower user costs for infrastructural services. In addition, reforms to reduce excessive regulation, cumbersome inspection procedures, and restrictions on procurement and immigrant employment will lower the cost of doing business. Staff also underscored the importance of institutional reform—including with regard to procurement systems, public investment planning and monitoring, and the development of a sound mechanism for transferring resources to local governments—to improve economic governance. The authorities indicated that significant progress had been achieved over the past year, including the preparation of draft legislation to boost competition and investment in the telecommunications, railroad, and electricity sectors. They acknowledged, however, that the reform momentum had slowed in recent months but indicated that they were aware of the need to press ahead with further reforms, especially since the ongoing upward pressure on the real exchange rate could lead to an erosion in the non-oil sector's competitiveness.[16]

31. **WTO accession will also enhance growth potential.** Staff welcomed recent steps to make national legislation and foreign trade policy enforcement practices compliant with the WTO, and recommended an acceleration in bilateral market access negotiations. The authorities noted that bilateral negotiations were progressing and, meanwhile, the government had intensified its campaign to apprise domestic stakeholders of the benefits of WTO accession. Further trade liberalization is also underway; nontariff barriers have been reduced, a comprehensive review of import tariffs has been launched with a view to reducing specific tariffs rates and rate dispersion, and a number of agreements have been signed with neighboring countries to enhance regional trade.[17]

32. **The authorities are seeking to further boost the non-oil sector through sectoral initiatives and expanded lending by specialized financial institutions.** They explained that

[16] Chapter IV of the 2005 Selected Issues Paper (forthcoming) assesses long-term prospects for the real exchange rate of the tenge.

[17] The average tariff—at about 8 percent (excluding specific tariffs) since 1998—is relatively low.

the "clusters" initiative, which is being piloted in seven industries, aims to establish a dialogue between business and government in order to enhance companies' productivity. Government support will focus on infrastructure provision and ensuring the availability of suitably skilled labor. They also indicated that the role of the development institutions was to fill a void in the availability of long-term financing, and emphasized that safeguards were in place to ensure that project selection was on a strictly commercial basis and free from political influence.

III. Staff Appraisal

33. **Kazakhstan's economy continues to grow rapidly and, underpinned by high oil prices, the outlook remains highly favorable.** This presents an opportunity for Kazakhstan to address pressing social needs and improve living standards. Securing such gains, however, will depend critically on continued management of petroleum wealth in an efficient and sustainable manner while keeping inflationary pressures in check and reinvigorating structural reform to promote diversification of the economy.

34. **The fiscal position in 2005 remains within the sustainable level implied by the current outlook for oil prices and production, and the further increase in social spending is welcomed.** The planned increases in civil service salaries, however, could exacerbate inflationary pressures and, in the context of the longer-term policy to narrow the public-private wage gap, it will be essential to reexamine reforms to improve the structure of the civil service. More generally, in light of the continued rapid expansion of government expenditures, intensified scrutiny over spending efficiency is required.

35. **Greater exchange rate flexibility is needed to dampen inflationary pressures.** Resisting nominal appreciation may postpone somewhat the inevitable adjustment of the real exchange rate to the increased spending of oil revenue, but will push up inflation eventually. It would be important, therefore, to allow sufficient upward exchange rate flexibility in order to bring inflation down to comfortably within the NBK's band. Achieving the inflation objective will also demonstrate that the pursuit of price stability is the primary goal of monetary policy, consistent with the authorities' intention to move to inflation targeting over the medium term. To the extent that the authorities give priority to maintaining a stable nominal exchange rate, the fiscal stance would need to be reassessed.

36. **Increased exchange rate flexibility will also facilitate the conduct of monetary policy in an environment of large capital inflows.** In the near term, however, while the necessary infrastructure to support a full inflation targeting regime is being developed, some exchange market intervention and accompanying sterilization may still be needed. In this connection, reserve requirements should quickly be extended to cover foreign liabilities as well as longer-term domestic liabilities in order to aid the conduct of monetary policy. The authorities should also move ahead with the planned recapitalization of the NBK. This will transparently place sterilization costs on the budget and help convince markets that monetary policy will not be constrained by income considerations.

37. **Emerging risks in the banking system require heightened vigilance.** While the continuing rapid remonetization and significant dedollarization reflect confidence in the system, the recent surge in bank lending warrants close monitoring of the quality of loan portfolios. Staff recommends early implementation of the measures under consideration, including enhanced monitoring of property price developments, to stem risks related to banks' foreign borrowing and property-related lending. Efforts to close gaps in prudential regulations over related-party lending are also welcome, as are plans to mitigate risks associated with cross-border lending by incorporating country risk in capital adequacy requirements.

38. **Vigorous banking supervision will need to supplement regulatory measures.** Supervisory resources should keep pace with the growth and development of the financial system, particularly in view of the planned capital account liberalization and efforts to promote Almaty as a regional financial center. Enhanced procedures for the exchange of information with central banks and supervisory agencies in neighboring countries will facilitate effective consolidated supervision of financial institutions. Prompt approval and implementation of enhanced legislation to meet international standards in combating money laundering and the financing of terrorism is also critical.

39. **The initiative to redesign the longer-term oil wealth management strategy and the rules governing the NFRK is timely.** Full integration of the NFRK with the budget will improve the transparency of oil revenue and inform fiscal policy decisions. To safeguard oil wealth and protect the economy from fluctuations in world oil prices, the release of funds from the NFRK to the budget should be determined on the basis of a medium-term fiscal sustainability framework—grounded by prudent assumptions regarding longer-term oil prices and production—that targets the non-oil deficit. Adoption of the EITI would further enhance transparency.

40. **Decisions on further sizable tax cuts should be aligned with the new oil wealth management strategy.** A reduction in the tax burden of the non-oil sector may spur non-oil growth over the medium term. However, caution is required in this area, as further cuts should be based on the availability of sufficient budgetary resources once priority spending needs have been met, and should await a full assessment of the impact of the 2004 tax cuts. Proposals to differentiate tax rates across sectors, particularly VAT rates, would be highly distortive and should be resisted.

41. **Reinvigoration of structural reforms is necessary to improve the investment climate and enhance economic governance.** In particular, there is a need to speed up institutional development, especially in relation to procurement systems and public investment monitoring. In addition, an acceleration of reforms in the areas of competition policy and enterprise restructuring will improve the provision of basic infrastructural services and lower the cost of doing business in Kazakhstan. Early WTO accession and further trade liberalization, particularly through a reduction in tariff dispersion and further steps to facilitate regional trade, will also boost the non-oil sector's growth prospects.

42. **The expansion of development institutions and industrial promotion initiatives warrants caution.** Staff urges a high degree of vigilance to ensure that the clusters initiative remains focused on labor training and infrastructure provision, and that development institutions' lending is well-targeted and restricted to addressing genuine market failures in the availability of long-term financing. Tax incentives and credit provision on subsidized terms or to projects of uncertain commercial viability should be avoided. International experience suggests that special incentives and subsidies carry significant risk of resource misallocation, reduction in fiscal revenue, and extension of the government's role in the economy.

43. **While data provision is adequate for surveillance purposes, better data disaggregation into the oil and non-oil sectors would aid macroeconomic analysis.** Staff therefore recommends adopting a more analytically rigorous separation of national accounts data (including imports) into the oil and non-oil sectors of the economy. Technical assistance in this area would be helpful.

44. It is proposed that the next Article IV consultation with Kazakhstan take place on the standard 12-month cycle.

Table 1. Kazakhstan: Selected Economic Indicators, 2001–07

				Prel.	Projections		
	2001	2002	2003	2004	2005	2006	2007
	(Annual percent change; unless otherwise indicated)						
National accounts and prices							
Real GDP	13.5	9.8	9.3	9.4	8.0	7.7	7.2
Crude oil and gas condensate production	13.5	17.9	8.8	15.4	7.8	6.3	5.9
Consumer price index (eop)	6.4	6.6	6.8	6.7	7.6	6.9	7.1
Consumer price index (p.a)	8.4	5.9	6.4	6.9	7.4	6.9	7.0
Exchange rate (tenge per U.S. dollars; eop)	5.1	3.3	-8.0	-9.3	...	...	...
Exchange rate (tenge per Russian rubles; eop)	-3.0	-2.1	-0.8	-4.0	...	...	...
Real effective exchange rate (p.a) 1/	-1.7	-3.0	-3.0	4.5	...	...	...
	(In percent of GDP; unless otherwise indicated)						
General government fiscal accounts							
Revenues and grants	25.7	22.5	25.4	26.0	25.8	25.1	24.7
Of which: oil revenues	6.6	4.4	6.0	7.4	8.0	6.9	6.1
Expenditures	23.0	21.0	22.5	23.3	23.2	23.6	24.3
Overall fiscal balance	2.7	1.4	2.9	2.7	2.6	1.5	0.5
Statistical discrepancy	-0.2	-0.4	0.2	-0.1	0.0	0.0	0.0
Financing	-2.9	-1.8	-2.7	-2.8	-2.6	-1.5	-0.5
Domestic financing, net	-0.7	1.7	1.6	0.8	0.2	-1.4	-0.6
Foreign financing, net	0.9	-1.5	0.2	-0.8	0.0	0.1	0.1
Privatization receipts	2.5	0.5	1.3	0.1	0.0	0.0	0.0
National Fund of the Republic of Kazakhstan (NFRK)	-5.6	-2.5	-5.6	-2.8	-2.8	-0.3	-0.1
Other capital operations	0.0	0.0	-0.2	-0.1	0.0	0.0	0.0
Non-oil fiscal balance	-3.9	-3.0	-3.1	-4.7	-5.3	-5.4	-5.6
Non-oil fiscal balance (percent of estimated non-oil GDP)	-5.5	-3.9	-4.3	-6.9	-8.2	-7.9	-7.9
Expenditures (percent change)	27.8	6.3	30.5	24.4	21.3	12.7	13.0
	(Annual percent change; unless otherwise indicated)						
Monetary accounts							
Reserve money	30.9	18.2	52.2	117.7	40.0	21.5	20.5
Broad money	42.8	34.1	27.0	68.2	30.0	23.5	22.0
Broad money velocity (annual average)	6.7	5.7	5.3	4.3	4.0	3.2	2.8
Credit to the economy	78.9	34.9	45.6	51.8	30.0	22.3	21.0
Credit to the economy (in percent of GDP)	16.8	19.6	23.3	29.5	31.4	34.7	38.3
NBK refinance rate (eop; percent)	9.0	7.5	7.0	7.0	...	...	...
Interest rate on NBK notes (eop; percent)	5.8	5.9	5.2	4.0	...	...	...
	(In billions of U.S. dollars; unless otherwise indicated)						
External accounts							
Current account balance (in percent of GDP)	-5.3	-4.1	-0.9	1.3	3.3	1.8	-0.4
Exports of goods and services	10.4	11.6	14.9	22.6	28.7	31.0	32.8
Oil and gas condensate	4.5	5.0	7.0	11.4	16.2	17.1	17.4
Imports of goods and services	10.6	11.6	13.3	18.8	22.5	25.0	27.8
Foreign direct investments (net, in percent of GDP)	13.8	10.5	6.8	10.5	3.5	3.0	2.6
NBK gross reserves (eop) 2/	2.5	3.1	5.0	9.3	11.7	14.4	16.5
In months of imports of goods and services	2.8	3.3	4.5	5.9	6.2	6.9	7.1
NFRK (eop) 3/	1.2	1.9	3.7	5.1	6.5	7.1	7.3
Public and publicly guaranteed external debt (in percent of GDP)	17.2	14.2	11.8	8.3	6.3	5.6	5.0
	(In percent of GDP)						
Final consumption	73.3	72.4	68.3	67.6	66.0	67.4	69.5
Net exports of goods and non-factor services	-0.9	0.9	6.1	9.0	12.0	10.2	7.4
Gross capital formation = gross savings	27.6	26.7	25.6	23.4	22.1	22.4	23.0
Domestic savings	22.3	22.5	24.8	24.7	25.3	24.2	22.6
Government	6.8	5.1	8.7	8.8	7.9	6.6	5.2
Private sector	15.5	17.4	16.1	16.0	17.4	17.6	17.5
External savings	5.3	4.1	0.9	-1.3	-3.3	-1.8	0.4
Memorandum items:							
Nominal GDP (in billions of tenge)	3,251	3,776	4,612	5,543	6,752	7,477	8,205
Crude oil and gas condensate production							
(in millions of barrels per day) 4/	0.81	0.97	1.06	1.22	1.32	1.40	1.48
Oil price (in U.S. dollars per barrel)	24.3	24.9	28.9	37.8	49.5	48.8	46.5

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

1/ A positive sign indicates a real appreciation.
2/ Excludes deposits of the National Fund.
3/ Excludes transitory domestic currency deposits.
4/ Based on a conversion factor of 7.5 barrels of oil per ton.

Table 2. Kazakhstan: General Government Fiscal Operations, 2001–07

	2001	2002	2003	Prel. 2004	Proj. 2005	Proj. 2006	Proj. 2007
			(In billions of Tenge)				
Total revenue and grants	833.9	847.8	1,169.2	1,441.1	1,740.1	1,874.8	2,030.8
Total revenue	833.9	847.8	1,169.2	1,441.1	1,740.1	1,874.8	2,030.8
Oil revenue	215.2	165.4	274.8	412.7	537.8	514.8	499.7
Non-oil revenue	618.7	682.4	894.4	1,028.4	1,202.4	1,359.9	1,531.1
Current revenue	824.6	838.3	1,156.7	1,420.6	1,715.5	1,847.5	2,000.9
Capital revenue	8.8	9.5	12.5	20.5	24.6	27.3	29.9
Tax revenue	724.0	792.6	1,070.9	1,306.9	1,647.2	1,785.1	1,933.8
Non-oil tax revenue	…	627.1	812.0	911.2	1,096.1	1,270.3	1,434.1
Nontax revenue	100.3	45.8	85.8	113.7	66.7	62.4	67.1
Income from capital transactions	9.0	9.5	12.5	20.5	24.6	27.3	29.9
Grants	0.5	0.0	0.0	0.0	1.7	0.0	0.0
Total expenditure and net lending	746.9	794.0	1,036.3	1,289.3	1,563.3	1,761.7	1,991.4
Total expenditure	726.0	775.6	985.7	1,266.0	1,556.6	1,745.9	1,975.2
Current expenditure	635.0	649.4	763.6	954.5	1,208.8	1,381.6	1,606.2
Capital expenditure	91.0	126.2	222.0	311.6	347.8	364.3	369.0
Net lending	20.9	18.4	50.7	23.3	6.7	15.8	16.2
Extension of credits	33.6	31.7	68.3	41.7	20.8	30.0	32.0
Repayment of credits	12.7	13.3	17.7	18.4	14.1	14.2	15.8
Net transfers to other levels of government	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall budget balance	87.0	53.8	132.9	151.8	176.8	113.1	39.5
Statistical discrepancy	-6.0	-13.3	8.0	-4.3	0.0	0.0	0.0
Financing	-93.0	-67.1	-124.8	-156.1	-176.8	-113.1	-39.5
Domestic financing, net	-23.0	64.7	74.1	45.0	11.6	-103.6	-46.9
Foreign financing, net	29.0	-55.6	8.5	-46.3	2.0	10.3	11.1
Disbursements	45.0	18.3	30.4	28.1	22.2	29.5	74.5
Amortization	16.0	73.9	21.9	74.4	20.3	19.3	63.4
Privatization receipts	82.0	18.9	59.1	7.1	2.0	1.4	1.0
National Fund of the Republic of Kazakhstan	-181.0	-95.0	-258.1	-154.2	-192.4	-21.2	-4.7
Other capital operations	0.0	0.0	-7.7	-7.7	0.0	0.0	0.0
			(In percent of GDP)				
Total revenue and grants	25.7	22.5	25.4	26.0	25.8	25.1	24.7
Total revenue	25.7	22.5	25.4	26.0	25.8	25.1	24.7
Oil revenue	6.6	4.4	6.0	7.4	8.0	6.9	6.1
Non-oil revenue	19.0	18.1	19.4	18.6	17.8	18.2	18.7
Current revenue	25.4	22.2	25.1	25.6	25.4	24.7	24.4
Capital revenue	0.3	0.3	0.3	0.4	0.4	0.4	0.4
Tax revenue	22.3	21.0	23.2	23.6	24.4	23.9	23.6
Non-oil tax revenue	…	16.6	17.6	16.4	16.2	17.0	17.5
Nontax revenue	3.1	1.2	1.9	2.1	1.0	0.8	0.8
Income from capital transactions	0.3	0.3	0.3	0.4	0.4	0.4	0.4
Grants	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total expenditure and net lending	23.0	21.0	22.5	23.3	23.2	23.6	24.3
Total expenditure	22.3	20.5	21.4	22.8	23.1	23.3	24.1
Current expenditure	19.5	17.2	16.6	17.2	17.9	18.5	19.6
Capital expenditure	2.8	3.3	4.8	5.6	5.2	4.9	4.5
Net lending	0.6	0.5	1.1	0.4	0.1	0.2	0.2
Extension of credits	1.0	0.8	1.5	0.8	0.3	0.4	0.4
Repayment of credits	0.4	0.4	0.4	0.3	0.2	0.2	0.2
Overall budget balance	2.7	1.4	2.9	2.7	2.6	1.5	0.5
Statistical discrepancy	-0.2	-0.4	0.2	-0.1	0.0	0.0	0.0
Financing	-2.9	-1.8	-2.7	-2.8	-2.6	-1.5	-0.5
Domestic financing (net)	-0.7	1.7	1.6	0.8	0.2	-1.4	-0.6
Foreign financing, net	0.9	-1.5	0.2	-0.8	0.0	0.1	0.1
Privatization receipts	2.5	0.5	1.3	0.1	0.0	0.0	0.0
National Fund of the Republic of Kazakhstan (NFRK)	-5.6	-2.5	-5.6	-2.8	-2.8	-0.3	-0.1
Other capital operations	0.0	0.0	-0.2	-0.1	0.0	0.0	0.0
Memorandum items:							
Non-oil balance (in billions of tenge)	-127.6	-111.7	-141.9	-260.9	-360.9	-401.8	-460.2
(In percent of GDP)	-3.9	-3.0	-3.1	-4.7	-5.3	-5.4	-5.6
Total revenues to estimated non-oil GDP (percent)	33.6	30.0	35.7	38.0	39.5	36.9	34.7
Non-oil revenues to estimated non-oil GDP (percent)	24.9	24.2	27.3	27.1	27.3	26.7	26.2
Oil price (U.S. dollar per barrel)	24.3	25.0	28.9	37.8	49.5	48.8	46.5

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

Table 3. Kazakhstan: Balance of Payments, 2001–07

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

	2001	2002	2003	2004	Proj. 2005	Proj. 2006	Proj. 2007
Current account	-1,176	-1,021	-270	533	1,691	1,080	-262
Trade balance	1,179	1,987	3,679	6,786	9,941	10,128	9,399
Exports (f.o.b.)	9,124	10,027	13,233	20,603	26,524	28,581	30,100
Oil and gas condensate	4,463	5,037	7,023	11,417	16,235	17,109	17,379
Non-oil exports	4,661	4,990	6,209	9,186	10,289	11,472	12,720
Imports (f.o.b.)	-7,944	-8,040	-9,554	-13,818	-16,583	-18,453	-20,701
Services and income balance	-2,594	-3,121	-3,784	-5,765	-7,738	-8,509	-9,095
Services, net	-1,375	-1,998	-2,040	-2,986	-3,727	-4,104	-4,474
Income, net	-1,220	-1,123	-1,744	-2,779	-4,011	-4,405	-4,622
Of which: Income to direct investors	-1,142	-1,007	-1,431	-2,267	-3,281	-3,787	-3,915
Current transfers	238	114	-165	-488	-513	-538	-565
Capital and financial account	2,216	1,236	2,756	4,593	740	1,581	2,441
Capital transfers, net	-185	-120	-28	-20	-21	-22	-23
Foreign direct investment	3,071	2,164	2,210	5,548	2,544	3,306	3,441
Amortization of intra-company liabilities	-1,792	-1,518	-2,253	-4,233	-2,738	-2,789	-2,817
Portfolio investment, net	-1,317	-927	-1,891	-422	-1,062	-289	132
Of which: National Fund 1/	-1,270	-327	-1,745	-1,397	-1,262	-253	170
Public sector Eurobonds, net	-103	-237	54	21	0	0	0
Financial derivatives, net	0	0	16	-46	0	0	0
Other investment	648	118	2,449	-467	-721	-1,414	-1,110
Medium- and long-term loans and credits, net	385	720	2,197	1,690	640	339	305
Short-term and other capital, net	263	-602	253	-2,157	-1,361	-1,754	-1,415
Errors and omissions	-654	320	-952	-1,126	0	0	0
Overall balance	385	535	1,534	3,999	2,431	2,661	2,179
Financing	-385	-535	-1,534	-3,999	-2,431	-2,661	-2,179
Net international reserves of the NBK (increase -)	-385	-535	-1,534	-3,999	-2,431	-2,661	-2,179
Memorandum items: 2/							
Current account (in percent of annual GDP)	-5.3	-4.1	-0.9	1.3	3.3	1.8	-0.4
Exports in percent of GDP	41.2	40.8	42.9	50.6	51.1	48.4	45.3
Of which: Oil exports	20.2	20.5	22.8	28.0	31.3	28.9	26.2
Imports in percent of GDP	35.9	32.7	31.0	33.9	31.9	31.2	31.2
Annual growth rate (in percent)							
Exports	-3.6	9.9	32.0	55.7	28.7	7.8	5.3
Non-oil exports	-7.5	7.1	24.4	47.9	12.0	11.5	10.9
Imports	11.6	1.2	18.8	44.6	20.0	11.3	12.2
Exports of crude oil and gas condensate (in millions of tons)	32.4	39.3	44.3	52.4	56.9	60.9	64.8
NBK gross international reserves (in millions of U.S. dollars)	2,508	3,140	4,962	9,277	11,708	14,369	16,548
In months of imports of goods and nonfactor services	2.8	3.3	4.5	5.9	6.2	6.9	7.1
National Fund (including interest), end of period stock	1,240	1,915	3,663	5,131	6,540	7,128	7,339
External debt in percent of GDP	68.5	74.1	74.1	78.6	68.0	63.6	59.2
excluding intra-company loans	28.4	30.5	35.2	37.7	35.7	35.4	34.3
Public external debt service in percent of exports of gnfs	4.8	7.9	3.2	3.3	1.8	1.6	2.8
World oil price (U.S. dollars per barrel)	24.3	24.9	28.9	37.8	49.5	48.8	46.5

Sources: Kazakhstani authorities; and Fund staff estimates.

1/ For 2001 and 2002, the numbers also reflect the effect of market valuation, in addition to transactions. The start-up assets in 2001 included $660 million from the sale of a 5 percent government share in TCO. The remaining balance was from oil revenue.

2/ Estimates and projections are based on GDP at market exchange rates. Import data have been revised for the period 2000–04 in light of revisions to NBK's cif coefficients in March 2005. Reported figures for 2001 curent account have been adjusted for staff estimates of the underinvoicing of exports.

Table 4. Kazakhstan: Monetary Survey, 2001–07

(In billions of tenge; end-period stocks unless otherwise indicated)

	2001	2002	2003				2004				2005	2006	2007
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Projections		
National Bank of Kazakhstan													
Net foreign assets	377.9	489.2	595.3	664.5	733.3	715.3	789.7	905.0	918.2	1,205.6	1,516.4	1,849.0	2,114.9
Net domestic assets	-201.6	-280.9	-388.9	-409.0	-436.0	-398.2	-460.9	-516.4	-514.0	-515.3	-550.0	-674.8	-699.9
Domestic credit	-71.9	-111.4	-231.4	-264.7	-279.7	-245.8	-342.0	-446.2	-435.9	-444.8	-500.0	-624.8	-649.9
Net credit to government	-59.5	-54.1	-120.3	-85.6	-74.4	-49.6	-75.1	-132.3	-138.1	-71.7	-267.1	-508.5	-722.6
Credit to banks	-5.4	-24.6	-62.3	-107.7	-99.8	-88.6	-146.2	-156.1	-144.5	-187.8	-29.0	107.9	319.3
Credit to the rest of the economy	-7.0	-32.7	-48.9	-71.5	-105.5	-107.6	-120.8	-157.8	-153.4	-185.3	-203.9	-224.2	-246.7
Other items (net)	-129.7	-169.5	-157.5	-144.3	-156.3	-152.4	-118.9	-70.2	-78.0	-70.5	-50.0	-50.0	-50.0
Reserve money	176.3	208.3	206.4	255.5	297.2	317.0	328.8	388.6	404.3	690.3	966.4	1,174.2	1,414.9
Currency outside NBK	145.5	177.9	175.8	206.1	238.6	262.1	265.0	303.2	338.7	410.9	835.7	1,032.9	1,242.6
Deposits with NBK	30.8	30.4	30.6	49.4	58.6	55.0	63.9	85.4	65.6	279.4	130.8	141.3	172.3
Banking system													
Net foreign assets	313.8	402.8	476.7	480.5	519.4	426.5	471.6	510.5	495.8	712.6	901.8	1,109.4	1,253.3
Net domestic assets	267.1	398.9	369.2	487.4	576.6	658.7	709.9	855.3	977.5	1,115.0	1,447.2	1,761.2	2,219.2
Domestic credit	560.1	781.2	756.4	876.9	1,017.0	1,133.9	1,189.6	1,301.9	1,487.9	1,688.8	2,183.8	2,615.6	3,146.5
Net credit to government	8.8	40.6	-15.2	13.0	49.3	55.2	39.1	-0.7	21.0	53.1	57.7	16.3	2.2
Credit to the economy	547.6	738.8	767.2	858.0	963.4	1,075.7	1,146.4	1,299.1	1,463.2	1,632.4	2,122.1	2,595.3	3,140.3
Claims on local government	3.8	1.8	4.4	5.9	4.2	3.0	4.1	3.5	3.7	3.4	4.0	4.0	4.0
Capital accounts and other items net	-293.0	-382.3	-387.2	-389.5	-440.4	-475.2	-479.8	-446.6	-510.4	-573.8	-736.6	-854.4	-927.3
Broad money	570.4	765.0	793.0	892.3	984.9	971.2	1,053.5	1,199.9	1,312.1	1,633.9	2,124.0	2,623.2	3,200.3
Currency in circulation	131.2	161.7	159.2	190.0	218.0	238.7	244.9	281.5	312.2	379.4	489.4	604.5	738.6
Deposits	439.2	603.3	633.8	702.3	766.9	732.5	808.5	918.3	999.9	1,254.5	1,634.6	2,018.7	2,461.6
Tenge deposits	173.4	241.7	283.6	363.7	387.3	387.1	444.2	501.6	554.9	714.8	1,073.3	1,390.1	1,757.5
Foreign exchange deposits	265.9	361.6	350.1	338.6	379.6	345.3	364.4	416.7	445.0	539.7	561.3	628.6	704.1
NBK notes outside the banking system	10.6	36.8	53.0	75.5	111.2	114.0	127.9	165.9	161.2	193.8	225.0	247.5	272.3
Memorandum items:													
Net international reserves (in millions of U.S. dollars)	2,506	3,140	3,923	4,493	4,929	4,961	5,688	6,635	6,828	9,276	11,708	14,369	16,548
NFRK (in millions of U.S. dollars) 1/	1,240	1,915	1,999	2,688	2,774	3,663	3,745	3,701	3,884	5,131	6,540	7,128	7,339
Annual growth rates (in percent)													
Broad money	42.8	34.1	42.2	44.9	46.6	27.0	32.8	34.5	33.2	68.2	30.0	23.5	22.0
Currency in circulation	23.3	23.3	28.5	40.8	54.2	47.6	53.8	48.1	43.2	58.9	29.0	23.5	22.2
Reserve money	30.9	18.2	32.5	45.2	60.2	52.2	59.3	52.1	36.0	117.7	40.0	21.5	20.5
Credit to the economy	78.9	34.9	38.9	43.1	49.6	45.6	49.4	51.4	51.9	51.8	30.0	22.3	21.0

Source: National Bank of Kazakhstan.

1/ Transitory deposits in tenge not included.

Table 5. Kazakhstan: Selected Prudential Indicators of the Banking Sector, 1998–2004

	1998	1999	2000	2001	2002	2003	2004
Percent, unless otherwise indicated							
Capital adequacy ratio (K2)	29.5	27.6	25.7	18.6	17.2	16.9	15.9
Tier I capital (K1, percent of risk-weighted assets)	21.9	13.5	13.6	11.0	9.0	9.0	8.0
Growth in banks' total assets	15.9	74.1	54.8	54.7	40.2	46.4	60.4
Off-balance sheet items (percent of total assets)	71.3	45.6	43.5	53.4	56.8	60.8	69.1
Growth in banks' loans 1/	28.6	59.3	85.6	77.3	37.3	45.5	51.7
Growth of claims on private non-financial institutions 1/	29.9	60.3	86.0	75.5	33.7	39.5	37.8
Growth of claims on households 1/	38.0	43.8	78.1	110.4	90.2	107.8	149.7
Classified assets to total assets 2/	21.1	22.4	21.6	19.8	18.3	25.9	29.9
Classified loans to total loans 2/	31.7	39.2	21.2	28.9	26.7	36.8	41.0
Loans classified as loss ("unattended," percent of total loans) 2/	5.4	5.5	1.9	2.1	2.0	2.1	2.9
Loan loss provisions (percent of total sum of loans) 2/	8.1	9.5	6.2	4.7	5.9	6.2	6.7
Net foreign currency assets (percent of total assets)	1.7	5.1	-0.3	6.6	6.1	1.7	-3.5
Net open position in foreign exchange (percent of Tier I+II)	...	...	19.4	18.9	7.7	4.5	12.8
Share of deposits denominated in foreign exchange 3/	37.0	47.2	51.0	60.5	59.9	47.1	43.0
Share of loans denominated in foreign exchange 4/	43.2	53.9	51.0	71.2	68.5	55.5	51.9
Securities (percent of total assets)	12.7	13.1	4.2	6.2	17.0	19.6	17.3
Liquidity ratio (K4)	0.7	1.0	1.0	0.8	0.9	0.9	1.1
Loan to deposit ratio, excluding deposits of nonresidents	117.1	87.3	95.1	110.1	111.5	133.4	118.2
Loan to deposit ratio, excluding deposits of nonresident legal entities	115.3	86.4	93.9	109.8	110.2	132.0	128.3
FX loan to FX deposit ratio, excluding deposits of nonresidents	136.8	99.8	94.3	131.1	127.4	157.1	169.3
Return on assets, before tax (percent of assets end of period)	1.9	2.8	1.5	0.9	2.0	2.0	1.4
Return on equity, before tax (percent of equity)	8.0	13.8	7.9	5.4	13.8	14.2	11.2

Sources: NBK reports various issues, FSA, FSAP, and staff calculations.

1/ Loans of second tier banks.
2/ New classification scheme introduced in early 2003. It is, thus, difficult to compare over time the level of classified assets, but both the FSA and banks are of the opinion that the new policy is stricter.
3/ Deposits in the banking system.
4/ Commercial bank loans.

Table 6. Kazakhstan: External Debt Sustainability Framework (Total Debt Outstanding at Year-End), 1998–2010

(Percent of GDP unless otherwise indicated)

	Actuals							Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
A. Total external debt outstanding at year-end													
Baseline	44.8	71.3	69.3	68.5	74.1	74.2	78.6	68.0	63.6	59.2	54.8	48.7	44.5
Stress tests:													
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2005–10								74.8	77.1	75.0	71.0	68.3	64.8
2. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								58.9	56.3	52.3	48.4	42.9	39.0
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								64.4	67.3	62.7	58.0	51.7	47.3
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								92.0	121.7	113.5	105.7	95.1	88.2
5. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								71.3	78.2	72.9	67.6	60.4	55.5
6. Combination of 2-5 using one standard deviation shocks								93.1	119.2	111.1	103.5	93.1	86.3
7. One time 30 percent nominal depreciation in 2005								83.8	78.0	72.7	67.4	60.2	55.3
B. External debt, excluding intra-company debt													
Baseline	29.5	35.0	31.4	28.4	30.5	35.2	37.7	35.7	35.4	34.3	32.5	29.5	27.4
Stress tests:													
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2005–10								35.9	40.9	41.8	40.4	40.2	39.2
2. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								26.5	27.4	26.8	25.4	23.0	21.1
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								28.7	32.1	31.2	29.6	26.8	24.8
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								39.6	54.7	52.6	49.8	45.4	42.5
5. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								38.7	49.2	47.4	44.9	40.9	38.2
6. Combination of 2-5 using one standard deviation shocks								45.3	63.8	61.2	57.9	52.9	49.6
7. One time 30 percent nominal depreciation in 2005								36.4	36.0	34.9	33.1	30.0	27.9
C. External debt, net of NFRK													
Baseline	44.8	71.3	69.3	62.7	66.3	62.3	66.1	55.4	51.5	48.1	44.5	39.2	35.3
Stress tests:													
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2005–10								35.9	40.9	41.8	40.4	40.2	39.2
2. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								26.5	27.4	26.8	25.4	23.0	21.1
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								28.7	32.1	31.2	29.6	26.8	24.8
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								39.6	54.7	52.6	49.8	45.4	42.5
5. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								38.7	49.2	47.4	44.9	40.9	38.2
6. Combination of 2-5 using one standard deviation shocks								45.3	63.8	61.2	57.9	52.9	49.6
7. One time 30 percent nominal depreciation in 2005								36.4	36.0	34.9	33.1	30.0	27.9
D. External debt, excluding intra-company debt and net of NFRK													
Baseline	29.5	35.0	31.4	22.6	30.5	23.4	25.3	23.1	23.3	23.3	22.2	19.9	18.2
Stress tests:													
1. Real GDP growth, nominal interest rate, dollar deflator, non-interest current account, and non-debt inflows are at historical average in 2005–10								27.2	31.6	32.7	31.3	31.0	29.9
2. Nominal interest rate is at historical average plus two standard deviations in 2005 and 2006								18.8	19.3	19.4	18.5	16.4	14.7
3. Real GDP growth is at historical average minus two standard deviations in 2005 and 2006								20.8	23.5	23.5	22.4	20.1	18.4
4. Change in US dollar GDP deflator is at historical average minus two standard deviations in 2005 and 2006								29.6	41.6	41.1	39.5	36.3	34.2
5. Non-interest current account is at historical average minus two standard deviations in 2005 and 2006								31.4	42.2	41.7	40.1	36.9	34.8
6. Combination of 2-5 using one standard deviation shocks								35.4	51.5	50.7	48.9	45.2	42.9
7. One time 30 percent nominal depreciation in 2005								27.0	27.0	26.8	25.7	23.3	21.4

Source: Data provided by the Kazakhstani authorities; and staff estimates.

Table 6 (continued). Kazakhstan: External Debt Sustainability Framework (Total Debt Outstanding at Year-End), 1998–2010

(In percent of GDP, unless otherwise indicated)

	Actuals							Projections					
	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
							Baseline Medium-Term Projections						
1 **External debt (total debt outstanding at year-end)**	44.8	71.3	69.3	68.5	74.1	74.2	78.6	68.0	63.6	59.2	54.8	48.7	44.5
2 Change in external debt	4.0	26.5	-2.0	-0.9	5.6	0.1	4.4	-10.6	-4.4	-4.4	-4.4	-6.0	-4.3
3 Identified external debt-creating flows (4+8+11)	2.5	10.7	-12.0	-11.6	-0.7	-18.0	-21.8	-26.2	-13.9	-9.5	-7.6	-10.3	-7.6
4 Current account deficit, excluding interest payments	4.1	-1.6	-7.3	1.9	1.2	-1.7	-3.8	-6.5	-4.8	-2.6	-1.1	-2.8	-2.3
5 Deficit in balance of goods and services	4.8	-1.8	-8.5	0.9	0.0	-5.3	-9.3	-12.0	-10.2	-7.4	-5.6	-7.2	-6.5
6 Exports	30.7	41.6	57.5	46.9	47.0	48.5	55.5	55.3	52.5	49.3	46.7	46.6	45.1
7 Imports	35.5	39.8	49.0	47.8	47.1	43.2	46.1	43.4	42.3	41.9	41.1	39.4	38.6
8 Net non-debt creating capital inflows (negative)	-3.0	-2.9	-3.7	-4.9	-1.4	-4.0	-2.4	-3.2	-3.1	-2.8	-2.7	-2.7	-2.5
9 Net foreign direct investment, equity	3.0	2.9	3.6	4.6	1.3	3.8	2.5	3.3	3.1	2.8	2.8	2.7	2.5
10 Net portfolio investment, equity	0.0	0.0	0.1	0.3	0.2	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
11 Automatic debt dynamics 1/	1.4	15.2	-1.0	-8.6	-0.5	-12.3	-15.6	-16.5	-5.9	-4.1	-3.7	-4.8	-2.8
12 Contribution from nominal interest rate	1.3	1.7	4.2	3.4	3.1	2.6	2.5	3.1	3.0	3.0	2.8	2.6	2.4
13 Contribution from real GDP growth	0.8	-1.6	-6.5	-7.7	-6.4	-5.5	-5.3	-4.7	-4.6	-4.1	-3.6	-4.4	-3.0
14 Contribution from price and exchange rate changes 2/	-0.7	15.1	1.3	-4.3	2.7	-9.4	-12.8	-14.8	-4.3	-3.0	-3.0	-3.0	-2.2
15 Residual, incl. change in gross foreign assets (2-3)	1.5	15.9	10.1	10.7	6.3	18.2	26.2	15.6	9.4	5.1	3.2	4.2	3.3
External debt-to-exports ratio (in percent)	145.8	171.3	120.6	146.0	157.5	153.0	141.6	122.9	121.2	120.1	117.3	104.5	98.5
Gross external financing need (in billions of US dollars) 3/	3.9	3.6	3.7	4.5	4.8	19.4	7.6	12.7	15.3	17.7	18.0	16.3	15.6
in percent of GDP	17.6	21.3	20.2	20.5	19.4	63.0	18.5	24.4	25.9	26.7	24.1	18.8	16.1
Key Macroeconomic and External Assumptions													
Real GDP growth (in percent)	-1.9	2.7	9.8	13.5	9.8	9.3	9.4	8.0	7.7	7.2	6.9	9.4	7.0
GDP deflator in US dollars (change in percent)	1.7	-25.2	-1.7	6.6	-3.9	14.6	20.9	23.2	6.8	5.0	5.3	5.8	4.6
Nominal external interest rate (in percent)	3.1	2.8	6.4	6.0	4.9	4.4	4.4	5.2	5.0	5.3	5.4	5.5	5.5
Growth of exports (US dollar terms, in percent)	-12.5	4.1	49.1	-1.3	11.4	29.2	51.3	27.1	7.9	5.6	6.5	15.6	8.3
Growth of imports (US dollar terms, in percent)	-5.7	-13.8	32.9	17.9	9.4	14.9	41.3	19.7	10.9	11.4	10.5	10.9	9.6
Historical Statistics for Key Variables (1997-2004)		Historical Average		Standard Deviation				Average 2005-10					
Current account deficit, excluding interest payments		-0.6		3.7				-3.4					
Net non-debt creating capital inflows		3.3		1.1				2.8					
Nominal external interest rate (in percent)		4.5		1.2				5.3					
Real GDP growth (in percent)		6.8		5.3				7.7					
GDP deflator in US dollars (change in percent)		2.2		13.8				8.4					

Source: Data provided by the Kazakhstani authorities; and staff estimates.

1/ Derived as [r - g - ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock, with r = nominal effective interest rate on external debt; ρ = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-ρ(1+g) + εα(1+r)]/(1+g+ρ+gρ) times previous period debt stock. ρ increases with an appreciating domestic currency (ε > 0) and rising inflation (based on GDP deflator).

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

Table 7. Kazakhstan: Indicators of Vulnerability, 1999–2004

(In percent of GDP unless otherwise indicated)

	1999	2000	2001	2002	2003	Prel. 2004
Financial indicators						
Broad money, M3 (12-month percentage change)	84.4	45.6	42.8	34.1	27.0	68.2
Private sector credit (12-month percentage change)	51.5	81.0	78.9	34.9	45.6	51.8
Refinance rate (period average, in percent)	22.3	15.2	11.7	8.1	7.3	7.0
Average yield on 3-month T-bill (in percent)	22.2	12.2	5.5	5.3	6.0	3.3
External indicators						
Competitiveness-related						
Merchandise exports (nominal percentage change, 12-month basis in US$)	4.3	54.6	-3.6	9.9	32.0	55.7
Of which: Non-oil exports (percentage change, 12-month basis)	-6.4	27.6	-7.5	7.1	24.4	47.9
Imports (nominal percentage change, 12-month basis in US$)	-15.4	26.1	11.6	1.2	18.8	44.6
Terms of trade (12-month percentage change)	11.1	32.1	-7.3	-0.1	2.0	12.0
Current account balance	-0.1	3.1	-5.3	-4.1	-0.9	1.3
Capital and financial account balance	5.3	4.4	10.0	5.0	8.9	11.3
Of which: Foreign direct investment (in millions of US$)	1,583	1,278	3,071	2,164	2,210	5,548
Exchange rate (per US$, period average)	118.9	142.3	146.9	153.5	149.5	136.0
REER appreciation (+) (eop, CPI-based)	-26.8	-0.6	-1.5	-4.8	-1.1	5.5
Annual REER appreciation (+) (CPI-based, p.a.)	-9.8	-10.2	-1.7	-3.0	-3.1	4.5
Reserves-related						
Gross official reserves						
- In millions of US$	2,003	2,096	2,508	3,140	4,962	9,277
- In months of imports	3.6	2.8	2.8	3.3	4.5	5.9
- In percent of short-term external debt 1/	111.0	145.3	112.3	115.6	102.6	116.7
- In percent of total external debt	16.6	16.5	16.5	17.2	21.7	29.0
- Excluding intra-company loans	33.8	36.4	40.0	41.8	45.7	60.4
Gross official reserves/broad money (M3)	1.0	0.8	0.7	0.6	0.7	0.7
Gross official reserves/reserve money	2.2	2.3	2.1	2.3	2.2	1.7
Debt-related						
Central bank short-term foreign liabilities (in millions of US$)	462.5	2.1	1.8	0.6	0.9	1.0
Short-term foreign liabilities of commercial banks (in millions of US$) 2/	97	159	440	680	1,901	4,522
Short-term external debt 1/						
- In millions of US$	1,805	1,442	2,234	2,717	4,837	7,949
- In percent of GDP	10.6	7.9	10.1	11.0	15.7	19.5
- In percent of total external debt	14.9	11.4	14.7	14.9	21.2	24.8
Total external debt						
- In millions of US$	12,089	12,684	15,158	18,221	22,859	32,017
- Excluding intra-company loans	5,926	5,753	6,278	7,512	10,860	15,366
- In percent of GDP	71.3	69.3	68.5	74.1	74.1	78.6
- Excluding intra-company loans	35.0	31.4	28.4	30.5	35.2	37.7
- In percent of exports of goods and services	171.3	120.6	146.0	157.5	153.0	141.6
- Excluding intra-company loans	84.0	54.7	60.5	64.9	72.7	68.0
Public external interest payments (in percent of exports of good and services)	2.9	2.4	2.3	2.0	1.3	0.8
Public external amortization payments (in percent of exports of good and services)	9.0	6.2	2.5	5.9	1.9	2.5
Net public external debt (in millions of US$) 3/	2,053	1,833	52	-1,554	-4,994	-11,042
National Fund (NFRK) assets (in millions of US$) 4/	…	…	1,240	1,915	3,663	5,131
Financial market indicators						
Foreign currency debt rating						
Moody's	B1	B1	Ba2	Baa3	Baa3	Baa3
Standard and Poor's	B+	BB-	BB	BB+	BBB-	BBB-
Spread over benchmark bonds (basis points, period average) 5/	567	326	235	93	100	56

Sources: The Kazakhstan authorities, and Fund staff estimates.

1/ The National Bank of Kazakhstan does not compile short-term debt statistics on a remaining maturity basis. Before 2000, the short-term debt data are on an "original maturity" basis. From 2000 onward, the short-term debt is estimated by Fund staff on a remaining maturity basis.

2/ Includes deposits from Special Purpose Vehicles, which are set up and owned by Kazakhstani commercial banks abroad and used for channeling foreign financing to Kazakhstan.

3/ Total external public debt minus gross official reserves, and minus NFRK assets.

4/ Excludes transitory domestic currency deposits.

5/ Kazakhstan eurobonds are mostly held by domestic investors who have limited investment opportunities abroad. Therefore, bond spreads of Kazakhstan are not comparable to those of other countries and do not fully reflect country risks.

Kazakhstan—Relations with the Fund

(As of April 30, 2005)

I. Membership Status: Joined: 07/15/92; Article VIII

II. General Resources Account

	SDR Million	Percent of Quota
Quota	365.70	100.0
Fund holdings of currency	365.70	100.0
Reserve position in the Fund	0.01	0.0

III. SDR Department

	SDR Million	Percent of Allocation
Holdings	0.79	n.a.

IV. Outstanding Purchases and Loans **None**

V. Financial Arrangements

Type	Approval Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
EFF	12/13/99	3/19/02	329.10	0.00
EFF	7/17/96	7/16/99	309.40	154.70
Stand-by	6/05/95	6/04/96	185.60	185.60

VI. Projected Obligations to the Fund

None

VII. Safeguards Assessments

The safeguards assessment procedures are not applicable to the National Bank of Kazakhstan (NBK) at this time.

VIII. Exchange Rate Arrangements

The currency of Kazakhstan is the tenge, which was introduced in November 1993. The official exchange rate is determined on the basis of foreign exchange auctions that are held daily. Auctions are held for U.S. dollars, euros, and Russian rubles, and official rates are quoted for over 30 other currencies on the basis of cross-rates. Since late 1999, the exchange rate regime has been a managed float with no pre-announced path, although the tenge has appreciated significantly against the U.S. dollar since 2002. On April 29, 2005, the rate was T 131.61 per U.S. dollar. The exchange rates at numerous exchange bureaus are very close to the auction rate, and the spread between buying and selling rates is very small. The exchange system is free from restrictions on payments and transfers for current international transactions.

IX. Article IV Consultation

Kazakhstan is on the standard 12-month consultation cycle. The last consultation was concluded on April 30, 2004 (see IMF Country Report No. 04/339).

X. FSAP Participation and ROSCS

Kazakhstan participated in the Financial Sector Assessment Program (FSAP) in 2000. The staff report on the Financial Sector Stability Assessment (FSSA) was issued on November 27, 2000. The FSSA included the following ROSC modules: Basel Core Principles for Effective Banking Supervision, Core Principles for Systemically Important Payment Systems, Code of Good Practices on Transparency in Monetary and Financial Policies, IOSCO Objectives and Principles of Securities Regulation, and IAIS Insurance Core Principles. An FSAP update mission took place in February 2004. The fiscal transparency module was completed in October 2002 and the final report published in April 2003. A data module mission took place in April/May 2002, and its final report was published in March 2003.

XI. Technical Assistance

Kazakhstan has received considerable technical assistance and training by the Fund in virtually every area of economic policy, including through about 75 technical assistance missions provided during 1993–2003 by FAD, LEG, MFD, STA, and the IMF Institute. In addition to short-term missions, the Fund has provided resident advisors to the National Bank of Kazakhstan, to the Agency of Statistics of the Republic of Kazakhstan, and to the ministry of finance. Other international agencies and governments, including the World Bank, EU TACIS, EBRD, UNDP, and OECD, also are providing a wide variety of technical assistance.

The following list summarizes the technical assistance provided by the Fund to Kazakhstan since 1995.

Monetary and Financial Systems

Technical assistance has enabled steady progress to be made in a number of arrears related to monetary and exchange affairs, including banking legislation, central bank accounting, payments system reform, central bank organization and management, foreign operations and reserve management, banking supervision, monetary statistics, currency issuance, monetary operations, and money-market development. Since 1996, missions to Kazakhstan by the Monetary and Financial Systems Department of the Fund have included:

1. January 1995: NBK Accounting
2. April 1995: Accounting Workshop
3. April–May 1995: Modernization of the NBK: Payments System; Monetary Operations; Banking Supervision
4. September 1995: Advisory Mission to the NBK: Monetary Operations, Monetary Analysis and Research, T-Bills Market, Payment System, Foreign Exchange Operations and Markets
5. November 1995: Article VIII compliance
6. June 1996: Advisory Mission to the NBK: Monetary Operations, T-Bill Development, Payments System, and Banking Supervision
7. April 1997: Staff Visit on Payments System
8. April 1997: Expert Visit on Payments System
9. Fall 2001: Multi-topic Mission—Financial Sector Consolidated Supervision and Capital Account Liberalization
10. December 2002: Sequencing of Capital Account Liberalization and Financial Sector Supervision
11. January 2003: Assessment of the CPSS Core Principles for Systematically Important Payment Systems and Transparency of Payment System Oversight
12. September 2004: Bringing Banking Prudential Regulation up to EU Standards
13. September 2004: Implementing Inflation Targeting: Next Steps

Fiscal Affairs

The Fiscal Affairs Department of the IMF has given comprehensive advice to Kazakhstan in the areas of tax and expenditure administration, the establishment of a treasury system, and the introduction of a social safety net. Technical assistance missions to Kazakhstan since 1999 have included:

1. September 1995: Treasury System
2. June 1996: Seminar on Public Expenditure and Treasury Management
3. September 1996: Executive Workshop on Treasury Systems in Economies in Transition
4. October 1996: Energy Taxation
5. April 1997: Tax Administration
6. June 1997: Seminar on Public Expenditure and Treasury Management
7. July 1997: Expenditure Policy
8. January 2000: Tax Code
9. February 2000: Customs Administration Reform
10. August 2000: Tax Code
11. April 2003: Customs Administration
12. 1997–2004 Treasury Modernization
13. September 2004: Treasury Reform Process

Statistics

The Fund's technical assistance program in statistics has focused on the development of the institutional framework appropriate to the needs of a market economy. The assistance has concentrated on establishing procedures for collecting and compiling monetary, government finance, balance of payments (including external trade), national accounts, producer price statistics, and consumer price statistics in accordance with international standards. Since 1999, missions by the IMF's Statistics Department to Kazakhstan have included the following:

1. January 1995: Government Finance Statistics
2. January–February 1995: External Trade Statistics
3. February 1995: Money and Banking Statistics
4. April-May 1995: Producer Price Index
5. August 1995: Inspection Mission
6. October 1995: Balance of Payments Statistics
7. December 1995: National Income Coordination
8. June 1996: Money and Banking Statistics
9. September–October 1996: External Trade Statistics
10. April 1997: Money and Banking Statistics
11. August 1997: Balance of Payments Statistics
12. September 1997: Price Statistics
13. September 1997: National Accounts Statistics
14. November–December 1997: Monetary and Financial Statistics
15. February 1998: Monetary and Financial Statistics
16. May-June 1998: Balance of Payments Statistics
17. September–October 1998: Monetary and Financial Statistics
18. March 1999: National Accounts Statistics
19. July 1999: GDDS Pilot Country Study
20. February 2000: National Accounts Statistics
21. February 2000: Balance of Payments Statistics
22.. March-April 2000: Monetary and Financial Statistics
23. September–October 2000: National Accounts Statistics
24. November 2002: International Reserves Template

Legal Department

1. March 1995: Commercial Banking Legislation
2. March 1995: Tax Code
3. November 1995: Article VIII Compliance
4. December 2003: Draft Law on Mandatory Reporting on Certain Financial Transactions

IMF Institute

Kazakh officials have participated in courses in Washington and at the Vienna Institute in the areas of macroeconomic management, expenditure control, financial programming, taxation, statistics, and other areas. In addition, the Fund's Institute has conducted courses in the region. Seminars and training sessions have also been conducted by MAE and STA technical assistance missions.

XII. Resident Representative

Position terminated in August 2003.

Kazakhstan—Relations with the World Bank Group

(As of May 2, 2005)

Kazakhstan became a member of the World Bank and International Development Association in July 1992, and of the International Finance Corporation (IFC) in September 1993. The Bank's lending program has been curtailed in recent years as a result of the country's reduced borrowing needs. At present, there are nine active projects with a total commitment of $598 million (eight IBRD loans and one grant), of which $365 million have been disbursed. The Bank is preparing five new operations in support of the agricultural sector, the environment, ecology, innovation and technology transfer, and possibly customs administration, with an expected financing envelope of about $180 million.

A Country Partnership Strategy, agreed in September 2004, focusing on knowledge transfer (some of which embedded in lending operations) and a strategic partnership. It will build on the $3 million three-year Joint Economic Research Program, which is cofinanced by the Government of Kazakhstan.

The IFC maintains 20 active operations, equivalent to total financing of $330 million, including syndications in the financial sector, manufacturing, agribusiness, oil and gas, and extending IFC's Reach Program; to date, $137.7 million have been disbursed.

The Bank is assisting the government in attracting grants from the Global Environmental Facility, the International Fund for Agricultural Development, and, together with UNAIDS, the Global Fund to Fight AIDS, Malaria, and TB.

Kazakhstan—Relations with the EBRD

(As of April 30, 2005)

As of end-April, 2005, the EBRD's gross cumulative disbursements amounted to €750 million. The current portfolio is composed of 71 projects with a total value of €2.3 billion, of which €1.1 billion are financed by the EBRD. The Bank expects to sign new project agreements in Kazakhstan on the order of €200–250 million per year.
EBRD's strategic priorities include: (a) the advancement of commercial principles in public sector infrastructure, including through nonsovereign lending; (b) the promotion of economic diversification through support for domestic and foreign investment, SMEs, and trade liberalization; and (c) the development of the financial sector in order to increase its capital base, enhance its stability, encourage prudent credit expansion, and facilitate the diversification of domestic financial assets.

Assistance to Kazakhstan focuses on infrastructure operations, the financial sector and general industry. The infrastructure projects target the development of roads, railroads, ports, airports, and telecommunications. In 2004, EBRD credited MunaiTas, a company jointly run by Kazakhstan's oil pipeline operator and China's largest oil and gas group, $81.6 million for a project linking the landlocked country's oilfields to its main export routes. The 10-year loan will finance construction a part of its 448 km oil pipeline connecting oilfields in the Aktobe region of central Kazakhstan to the Caspian Pipeline Consortium and the Atyrau-Samara export pipelines. Also in 2004, EBRD agreed to provide without sovereign guarantee $60 million to the state-owned Kazakhstan Electricity Grid Operating Company for the construction of a new electricity line facilitating the transmission of surplus power from north to south Kazakhstan (cofinanced with Raiffeisen Bank Österreich, Bayerische Landesbank, and Kazakhstan Development Bank). In September 2003, EBRD provided a loan amounting to €48 million to Kazakhtelecom as part of a larger support package involving international banks and the donor community. EBRD also provided $119 million for the rehabilitation of the 900 km road between Kazakhstan's main port of Aktau on the Caspian Sea and the regional center of Atyrau. The Bank also provides targeted technical assistance in the areas of tariff reform and infrastructure.

In the financial sector, the Kazakhstan Small Business Program has disbursed since 1998 in excess of 130,000 microcredits totaling over $800 million. EBRD increases its efforts to support nonbank financial sector such as insurance, leasing, and mortgages. In February 2005, it signed a $10 million loan to BTA Ipoteka to finance residential mortgages.

Kazakhstan—Relations with the Asian Development Bank

(As of April 30, 2005)

Kazakhstan became a member of the Asian Development Bank (ADB) in 1994. As of 31 December 2004, total loan commitments amounted to $501.6 million, covering nine projects in agriculture and natural resources, education, finance, transport and communication, and water supply, sanitation and waste management.

At end-April 2005, total loan disbursements amounted to $424 million. In 2003, ADB approved a $34.6 million loan for a rural area water supply and sanitation sector project, the first loan since 2001. The current country strategy and program was prepared in 2003 and is being updated annually. ADB emphasizes knowledge transfer as one of the main pillar of collaboration. ADB's focus in Kazakhstan in 2005–07 will be rural poverty reduction and activities with a regional impact. The former will be supported by activities in rural water supply, rural development, natural resources management, small and medium enterprise support, and rural education. The latter could include work in the transport, trade and finance, and energy sectors. Kazakhstan is no longer eligible for concessional resources from the Asian Development Fund.

The ADB has provided Kazakhstan with technical assistance (TA) grants in several sectors, including agriculture, education, finance, pension reform, transportation, energy, water supply and sanitation, aid coordination and management, public investment programming, and poverty reduction planning and implementation. As of April 30 2005, total TA commitments amounted to $28.05 million, covering 57 projects.

Kazakhstan—Statistical Issues

The quality and coverage of Kazakhstan's economic statistics are generally adequate for macroeconomic surveillance. The April 2002 data ROSC mission found that international standards for methodological soundness, accuracy and reliability of data are either fully observed or largely observed by Kazakhstan. Nevertheless, there were shortcomings in some statistical practices that could detract from accurate and timely analysis of economic and financial developments and the formulation of appropriate policies.

Kazakhstan has made considerable progress since the 2002 data ROSC mission. On March 24, 2003 Kazakhstan became the 53rd subscriber to the Special Data Dissemination Standard (SDDS), marking a major step forward in the development of the country's statistical system. It is the first country to graduate from the General Data Dissemination System to the SDDS, and the second country of the Commonwealth of Independent States to subscribe to the SDDS.

Notwithstanding the progress achieved since 2002, a more analytically rigorous disaggregation of national accounts into the oil and non-oil sectors of the economy would aid in assessing macroeconomic developments and formulating the policy stance.

Sector specific issues

In the area of **national accounts,** several weaknesses remain in both the quality of GDP estimates by sector produced by the National Statistical Agency and the quality and timeliness of GDP estimates by expenditures. First, the quality of **GDP estimates by industry** is affected by the poor coverage of production and financial statistics, particularly concerning small enterprises and informal activities. Second, while some progress has been made in making **GDP estimates by final expenditure** consistent with output-based measures, there remain substantial shortcomings, particularly in the estimation of fixed capital formation.

As a result of extensive technical assistance, the quality of **fiscal data has improved**, in particular following the **consolidation, in 1999, of most extrabudgetary and social security funds** into the fiscal accounts and the provision of more **detailed expenditure data** on a quarterly basis. However, the coverage of oil revenues, particularly royalties, is not transparent and may be significantly undervalued. Progress has also been made in the establishment of a **classification of the fiscal accounts** consistent with the Fund's *Government Finance Statistics Manual 2001* (*GFSM 2001*) methodology. However, as a result of the reorganization of the public sector, including the redefinition of budgetary units, difficulties have arisen with regard to the **recording and reporting of expenditure arrears**. Since 1997, the authorities have reported detailed data for publication in the *GFS Yearbook.* The latest data reported for publication cover consolidated general government and are presented using the new template consistent with the *GFSM 2001*. The ministry of finance also provides monthly indicators (general government) for publication in *International Financial Statistics (IFS).*

The existing framework for compiling **monetary statistics** generally conforms to recommended Fund methodology, and data are compiled on a timely basis. Steps are being taken by the NBK to further improve the quality and coverage of data. In particular, **the chart of accounts for commercial banks** has been revised to enable the NBK to distinguish sectors and financial instruments in accordance with the *Monetary and Financial Statistics Manual*. The NBK has extended **institutional coverage** to compile a financial sector survey that includes the Development Bank and credit companies. The authorities have started implementing the recommendations of past money and banking statistics missions regarding the use of residency criteria as defined in the *Balance of Payments Manual*, fifth edition (*BPM5*), including changing the data base where foreign branches and foreign companies' representatives should be classified as resident. However, there are inconsistencies among banks in recording **syndicated lending** which can distort the measure of net foreign assets and credit to the domestic economy. Also, **data revisions** in the monetary statistics are not synchronized with those for the International Investment Position and balance of payments statistics. MCD and STA staff are working with the authorities to harmonize the presentation of monetary statistics.

In the area of balance of payments, the overall quality and timeliness of data are satisfactory. Considerable progress has been made in implementing the Fund technical assistance recommendations to address two major deficiencies.

First, the coverage of **trade data** has been improved through a survey to determine the volume of shuttle trade and travel expenses. The NBK has also worked closely with relevant agencies, including the STA staff, to update the ratios used for adjusting c.i.f. imports to an f.o.b. basis, which was implemented in March 2005 and resulted in revision of import data from 2000 to 2004. Compilation of export and import price indices has been initiated, and historical data are also now available. Nevertheless, the timeliness of trade data remains an issue; improvements can be expected with the continuing computerization of customs administration. In addition, separation of import data into those related to the oil sector would aid in macroeconomic analysis and assessment of the policy stance.

Second, the NBK has initiated changes and additions to the Law of the Republic of Kazakhstan "*On State Statistics*" to improve the coverage of international operations of branch offices of foreign companies and, thus, bring **foreign direct investment statistics** in line with the standards set forth in *BPM5*. In particular, work is continuing to ensure the correct treatment of construction services provided by foreign companies that operate local branch offices. The Data ROSC mission in 2002 also noted some other shortcomings in the compilation of balance of payments statistics. These shortcomings include (a) commercial banks defining nonresidents on a legal basis rather than on the *BPM5* principle, affecting data reporting by these banks for balance of payments purposes; and (b) discrepancies between balance of payments and other macroeconomic statistics.

Kazakhstan: Table of Common Indicators Required for Surveillance

(As of May 17, 2005)

	Date of latest observation	Date received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of publication[6]	Memo Items: Data Quality-Methodological soundness[7]	Memo Items: Data Quality-Accuracy and reliability[8]
Exchange Rates	05/12/05	05/12/05	D	M	M		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	05/01/05	05/04/05	M	M	M		
Reserve/Base Money	05/01/05	05/04/05	M	M	M	O, O, LO, LO	LO, O, O, O, O
Broad Money	05/01/04	05/04/05	M	M	M		
Central Bank Balance Sheet	04/30/05	05/03/05	M	M	M		
Consolidated Balance Sheet of the Banking System	03/31/05	04/29/05	M	M	M		
Interest Rates[2]	04/30/05	05/07/05	W	W	M		
Consumer Price Index	04/30/05	05/07/05	M	M	M	O, LO, O, O	O, O, O, O, O
Revenue, Expenditure, Balance, and Composition of Financing[3]—General Government[4]	Q1/2005	05/06/05	M	M	M	O, LNO, LO, O	O, O, O, LO, LO
Revenue, Expenditure, Balance, and Composition of Financing[3]—Central Government	Q1/2005	05/06/05	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	12/31/04	03/30/05	M	M	M		
External Current Account Balance	Q4/2004	03/31/05	Q	Q	Q	O, LO, O, O	LO, O, O, O ,O
Exports and Imports of Goods and Services	Q4/2004	03/31/05	Q	Q	Q		
GDP/GNP	Q1/2005	04/16/05	Q	Q	Q	O, LO, O, LO	LO, LO, LO, LO, O
Gross External Debt	Q4/2004	03/30/05	Q	Q	Q		

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Including currency and maturity composition.
[6] Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A); NA: Not Available.
[7] Reflects the assessment provided in the data ROSC published on March 18, 2003, and based on the findings of the mission that took place during April 16–May 3, 2002 for the dataset corresponding to the variable in each row. The assessment indicates whether international standards concerning concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).
[8] Same as footnote 7, except referring to international standards concerning source data, statistical techniques, assessment and validation of source data, assessment and validation of intermediate data and statistical outputs, and revision studies.

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IMF Executive Board Concludes 2005 Article IV Consultation with the Republic of Kazakhstan

On July 1, 2005, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Republic of Kazakhstan.[1]

Background

Kazakhstan's economy continued to grow rapidly and real GDP growth remained robust at an estimated 9.4 percent in 2004. Increased hydrocarbon production continued to underpin growth, although the output of nonhydrocarbon sectors also expanded at a rapid pace. Consumer price inflation picked up to 6.9 percent, near the upper end of the National Bank of Kazakhstan's (NBK) band of 5–7 percent. Labor market conditions tightened, with real wages increasing by 14 percent, the unemployment rate declining to 8.4 percent, and a marked pickup in immigration. Activity remained strong in early 2005 with an estimated 9.3 percent real GDP growth in the first quarter, and inflation picked up to an average of 7.1 percent during January–April. Sustained rapid growth has led to a significant reduction in poverty, but some other social indicators remain weak.

Fiscal policy imparted stimulus to the economy as the non-oil deficit widened by about 1½ percentage points to 4.7 percent of GDP in 2004, while the overall budget surplus remained

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

broadly unchanged at 2.7 percent of GDP. The impact of tax cuts was partly offset by higher nontax revenue and one-off receipts. As a result, non-oil revenues increased broadly in line with estimated non-oil GDP, but declined in relation to overall GDP. On the expenditure side, public spending increased by 0.8 percent of GDP, reflecting a rise in social expenditures by 0.4 percentage point as well as sizable increases in the housing, agriculture, and energy areas. Assets of the National Fund of the Republic of Kazakhstan (NFRK) rose by US$1.4 billion (3.4 percent of GDP) to over US$5 billion.

The external position strengthened further in 2004, supported by high oil prices and large-scale external borrowing by banks. The current account swung into surplus, with the rise in hydrocarbon export receipts more than offsetting a very rapid expansion of imports and higher profit remittances abroad. Non-oil exports also expanded rapidly, aided by buoyant nonfuel commodity prices. The capital account surplus widened, reflecting continued large foreign direct investment inflows and an increase in private sector external borrowing, as banks took advantage of low international interest rates and favorable investor perception of Kazakhstan to mobilize funds abroad through syndicated loans and eurobond issuance. As a result, official reserves (excluding NFRK assets) rose to US$9.3 billion at end-2004, equivalent to six months of imports, with a marked pickup in the pace of accumulation during the last quarter of the year.

The conduct of monetary policy has been complicated by the large inflows of private capital, surging oil earnings, and buoyant demand conditions. In an effort to stem upward pressure on the tenge while containing money growth, the NBK supplemented its exchange market intervention with continued large-scale sterilization operations. In the event, with sterilization costs mounting, the increase in the NBK's reserves was not fully sterilized. Reserve and broad money growth accelerated, the tenge appreciated by 9 percent against the U.S. dollar and 4 percent against the ruble, and the NBK incurred a net loss for 2004.

With the deposit base expanding and external funding readily available at attractive terms, bank lending has boomed. Credit surged by over 50 percent in 2004, while deposits increased by about 70 percent, with the share of tenge deposits rising markedly to almost two thirds. Property-related lending expanded especially rapidly and, by end-2004, accounted for 18 percent of bank credit. Banks have also become increasingly active internationally on the assets side, through branch operations, acquisitions of financial entities in neighboring countries, and a pickup in cross border lending operations. The banking system's ratios of classified loans and loan losses have edged up.

Although considerable progress in the structural area has been achieved since the early 1990s, the pace of reform implementation has slowed in recent years. Privatization of small- and medium-sized enterprises is basically complete, prices have been liberalized, and a framework for prudential regulation and supervision of the financial sector is in place, including with the establishment of the Financial Supervision Agency in 2004. In addition, steps have been taken to bring foreign trade policy legislation and enforcement practices into compliance with the World Trade Organization. However, transition indicators compiled and reported by the European Bank for Reconstruction and Development show little improvement since the late 1990s in the areas of competition policy and enterprise restructuring.

Executive Board Assessment

Executive Directors commended the Kazakhstani authorities' prudent macroeconomic policies in the past several years, which have been critical in achieving rapid economic growth, declining unemployment, and sustained reduction in poverty. Looking forward, Kazakhstan's economic outlook remains highly favorable, providing a good opportunity to continue addressing the country's pressing social needs and regional disparities, and improving living standards on a lasting basis. Kazakhstan's sizable petroleum wealth offers tremendous opportunities but also presents significant challenges. Directors agreed that meeting these needs and challenges will require continued efficient and sustainable management of petroleum wealth, keeping inflationary pressures in check, and implementing structural reforms to promote economic diversification.

Directors noted that the fiscal stance remains consistent with fiscal sustainability, given the outlook for oil prices and production. While welcoming the increase in social spending, Directors cautioned that the large across-the-board increases in civil service salaries could exacerbate inflationary pressures and have longer-term fiscal implications. Accordingly, they encouraged the authorities to consider reforms aimed at restructuring the civil service and improving its pay structure. Directors also emphasized the importance of intensifying scrutiny over spending efficiency.

Directors welcomed the authorities' commitment to maintaining low inflation. Given the choice of a looser fiscal stance, they considered that sufficient upward exchange rate flexibility should be allowed to dampen inflationary pressures and bring inflation down within the NBK's band. Achievement of the inflation objective would clearly demonstrate the commitment of the authorities to price stability as the primary goal of monetary policy. Directors also discussed the impact that appreciation of the tenge could have on competitiveness. They recognized that the overall policy mix, particularly the quality of fiscal and structural policies, would be crucial for generating the productivity gains needed to preserve the competitiveness of the non-oil sector over the longer term.

Directors noted that the conduct of monetary policy in the present context characterized by large capital inflows, and given the authorities' plan to remove the remaining capital account restrictions by 2007, would benefit from increased exchange rate flexibility. Looking ahead, Directors welcomed the authorities' intention to move to a full-fledged inflation-targeting regime over the medium term. While the related supporting infrastructure is being developed, some exchange market intervention and accompanying sterilization may still be warranted in the near term to avoid excessively rapid appreciation. Directors welcomed plans to broaden reserve

requirements, and agreed that coverage of all foreign and domestic liabilities would aid the conduct of monetary policy. They also looked forward to the planned recapitalization of the NBK.

Directors saw the ongoing process of remonetization and dedollarization as a welcome sign of increased confidence in the banking system. While the banking system remains well capitalized, the recent surge in bank lending warrants close monitoring of the quality of loan portfolios. Directors urged the authorities to implement promptly the measures under consideration to stem risks related to banks' foreign borrowing and property-related lending. They welcomed efforts to close gaps in prudential regulations over related-party lending as well as the plans to mitigate risks associated with cross-border lending.

Directors urged the authorities to ensure that banking supervision, including supervisory resources, keeps pace with the growth and development of the financial system, particularly in light of the ongoing efforts to promote Almaty as a regional financial center. To facilitate effective consolidated supervision of financial institutions, Directors encouraged the authorities to enhance procedures for the exchange of information with central banks and supervisory agencies in neighboring countries. They also called for approval and implementation of enhanced legislation to meet international standards in combating money laundering and the financing of terrorism.

Directors welcomed the authorities' initiative to redesign the longer-term oil wealth management strategy and the rules governing the NFRK. Directors welcomed the authorities' interest in a fiscal ROSC reassessment, which would help in the design of the new NFRK rules. They noted that full integration of the NFRK with the budget will improve the transparency of oil revenue and better inform fiscal policy decisions. To safeguard oil wealth and protect the economy from fluctuations in world oil prices, Directors recommended that the release of funds from the NFRK to the budget be guided by a medium-term fiscal sustainability framework that targets the non-oil deficit—grounded by prudent assumptions regarding longer-term oil prices and production. Directors welcomed the authorities' plan to join the Extractive Industries Transparency Initiative, which would further enhance transparency.

Directors stressed that decisions on further sizable tax cuts should be aligned with the new oil wealth management strategy, and be based on the availability of sufficient budgetary resources, once priority spending needs have been met. They urged the authorities to resist proposals to differentiate tax rates across sectors, particularly VAT rates, given their highly distortive nature.

Directors called for reinvigorating structural reforms to enhance economic governance and improve the investment climate. Institutional development should be stepped up, especially in relation to procurement systems and public investment monitoring. Reforms in the areas of competition policy and enterprise restructuring should improve the provision of basic services and lower the cost of doing business in Kazakhstan. Directors observed that early WTO accession and further trade liberalization, particularly through a reduction in tariff dispersion and steps to facilitate regional trade, would help boost the non-oil sector's growth prospects.

Regarding development institutions and industrial promotion, Directors stressed the need to ensure that the clusters initiative remains focused on labor training and infrastructure provision, and that development institutions' lending is well-targeted and restricted to addressing genuine market failures in the availability of long-term financing. They urged the authorities to refrain from offering tax incentives and providing credit on subsidized terms or to projects of uncertain commercial viability.

Directors commended the improvements in the quality and provision of economic statistics. They encouraged the authorities to work toward a more rigorous separation of national accounts data (including imports) into the oil and non-oil sectors of the economy, and to seek technical assistance to this end.

Kazakhstan: Selected Economic Indicators

	1999	2000	2001	2002	2003	Prel. 2004
			(Changes in percent)			
Real economy						
Real GDP	2.7	9.8	13.5	9.8	9.3	9.4
CPI (end-of-period)	17.8	9.8	6.4	6.6	6.8	6.7
			(In percent of GDP)			
Public finance						
Government revenue and grants	17.5	21.7	25.7	22.5	25.4	26.0
Government expenditures	22.7	22.5	23.0	21.0	22.5	23.3
General government balance 1/	-5.0	-0.8	2.7	1.4	2.9	2.7
General government non-oil balance	...	-4.1	-3.9	-3.0	-3.1	-4.7
General government debt (end-of-period) 2/	30.6	27.2	20.5	17.6	15.5	12.6
			(Changes in percent)			
Money and credit						
Base money	56.9	5.3	30.9	18.2	52.2	117.7
Broad money	84.4	45.9	42.8	34.1	27.0	68.2
Banking sector credit to the economy	51.1	81.0	78.9	34.9	45.6	51.8
Interest rate on NBK notes (end-of-period)	14.3	7.9	5.8	5.9	5.2	4.0
			(In percent of GDP)			
Balance of payments						
Trade balance 3/	2.8	12.8	5.3	8.1	11.9	16.7
Current account balance 3/	-0.1	3.1	-5.3	-4.1	-0.9	1.3
External public debt	23.9	21.5	17.2	14.2	11.8	8.3
Gross international reserves						
In billions of U.S. dollars, end of period	2.0	2.1	2.5	3.1	5.0	9.3
In months of imports of goods and nonfactor services	3.6	2.8	2.8	3.3	4.5	5.9
			(Changes in percent)			
Exchange rate						
End-of-period level (tenge/U.S. dollar)	138.3	145.4	150.9	155.9	143.3	130.0
Real exchange rate vis-à-vis U.S. dollar 4/	-29.8	1.5	0.3	0.4	12.3	15.2
Real exchange rate vis-à-vis Russian ruble 4/	-29.3	-8.7	-7.9	-5.1	-5.5	1.3

Sources: Kazakhstani authorities; and IMF Staff estimates.

1/ Under this definition of the general government balance, privatization revenue is treated as a financing item and measured from below-the-line financing, which includes the statistical discrepancy.

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

3/ Reported figures for the 1999–2001 current account have been adjusted for staff estimates of the underinvoicing of exports. Imports have been revised starting in 2000.

4/ End-of-period from end of previous year. A negative sign indicates a depreciation.