KAZAKHSTAN

Highlights

- **Growth is accelerating.** GDP growth accelerated to 4.3 per cent year-on-year in the first nine months of 2017, from 1.1 per cent in 2016, primarily supported by the recovery in oil exports and stronger activity in the construction, agriculture and transport sectors.
- **Banking sector consolidation is advancing.** In July 2017, Halyk Savings Bank, Kazakhstan's largest bank, finalised the purchase of Kazkommertsbank (KKB), the second largest, after the state allocated US$ 6.4 billion to clean the balance sheets of banks with large shares of non-performing loans (NPLs). The merger of two other large banks, Tsesnabank and Bank CenterCredit is expected.
- **The Kashagan oilfield restarted in September 2016.** Production reached 180,000 barrels per day as of June 2017, about 10 per cent of Kazakhstan's total production. This is a marked development for the field, which had suffered from long delays and cost overruns owing to logistical and technical challenges.

Key priorities for 2018

- **Implementation of the government's structural reform agenda is a key priority.** Priorities include continuing efforts for a successful privatisation of state-owned entities, tariff reform in regulated sectors, development of the Astana International Financial Center (AIFC), banking sector reforms and the establishment of the framework for a green economy transition.
- **The role of the state in the economy should be further reduced.** Work needs to continue towards a better balance between the respective roles of the public and the private sectors, by supporting the growth of private enterprises, including small and medium-sized enterprises (SMEs), in agribusiness and other non-extractive sectors, as well as public sector reform and the commercialisation and privatisation of state-owned enterprises (SoEs).
- **The banking sector should be further strengthened.** The National Bank of the Republic of Kazakhstan (NBK) should continue its work on the reduction of legacy problem loans, as well as to further strengthen banking sector regulation and supervision, by taking more robust action regarding banks that fail to adjust their activities.

Main macroeconomic indicators %

	2013	2014	2015	2016	2017 proj.
GDP growth	6.0	4.3	1.2	1.1	3.8
Inflation (average)	5.8	6.7	6.7	14.6	7.3
Government balance/GDP	4.8	1.7	-2.2	-0.3	-2.9
Current account balance/GDP	0.5	2.8	-2.8	-6.5	-5.3
Net FDI/GDP [neg. sign = inflows]	-3.4	-2.1	-1.5	-9.8	-5.8
External debt/GDP	63.4	71.2	83.2	119.3	110.1
Gross reserves/GDP	10.4	13.2	15.1	21.5	n.a.
Credit to private sector/GDP	31.4	30.5	31.0	27.1	n.a.

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Macroeconomic performance

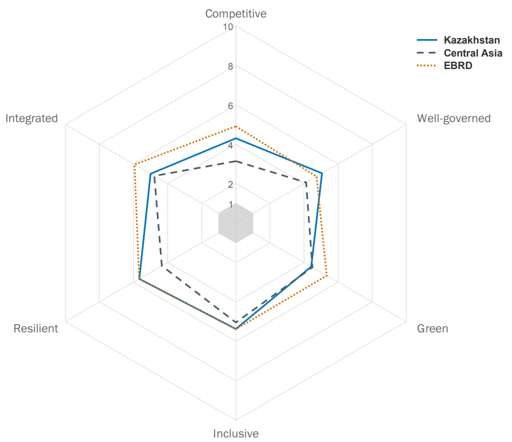
The economy is recovering. Real GDP growth accelerated to 4.3 per cent year-on-year in the first nine months of 2017, primarily driven by the rebound in oil exports and strong performance in the agriculture, construction and transport sectors. This follows a significant slow-down during 2014-16, due to the plunge in oil prices, weaker domestic demand and the recession in Russia. Exports rose by 32.2 per cent in the first eight months of 2017 in US dollar terms, mainly due to higher metal and stable oil prices, after falling 20 per cent in 2016 and 42 per cent in 2015. Imports increased by 17.9 per cent in the same period of 2017 after a drop of 17 per cent in 2016 and 26 per cent in 2015. Foreign exchange buffers have remained strong at combined net international reserves of the NBK and National Oil Fund foreign assets of about US$ 90 billion in September 2017, or 27 months of imports of goods and services.

Monetary conditions have normalised. Monetary policy has been effective at anchoring inflation expectations despite inflation spikes following the abrupt change in the exchange rate regime back in 2015. Inflation has returned to the 6.0 to 8.0 per cent NBK target corridor, reaching 7.1 per cent in September 2017 year-on-year. Following 46 per cent depreciation in 2015, the tenge has stabilised since March 2016. The NBK has gradually lowered its monetary policy rate from a high of 17.00 per cent at the beginning of 2016 to 10.25 per cent in August 2017. After lack of liquidity in the period of exchange rate pressure, there is excess short-term liquidity in tenge now, which is being sterilised by the central bank. However, sources of long-term tenge remain concentrated in a few institutions such as the Unified Pension Accumulation Fund that is managed by the central bank.

NPLs continue to weigh on the banking sector, but there is a new momentum towards resolution. The NPL ratio increased to 10.7 per cent in June 2017, from 6.7 per cent at the end of 2016, partly as a result of growth in overdue accrued interest. While this is around the 30 per cent level that persisted over 2008-13, the underlying asset quality remains a concern given the presence of not fully transparent off-balance sheet structures. However, steps have been taken to strengthen the NBK's supervisory mandate, dollarisation is declining, and banking sector consolidation is taking place with the injection of state funds.

Growth is expected to reach 3.8 per cent in 2017 and remain strong at 3.5 per cent in 2018, driven by increasing crude production, including from the restarted Kashagan oilfield, favourable oil prices and a recovery in real incomes growth, which turned negative in the second quarter of 2017. Inflation is expected to remain within the 6.0 to 8.0 per cent range set by the NBK currently, but might be shifted to 5.0 to 7.0 per cent in 2018.

Assessment of transition qualities (1-10)



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Major structural reform developments

Key structural reforms are moving forward gradually. The country's policy response to the oil price drop and the difficult economic environment in 2014-16, which focused mainly on counter-cyclical government spending and the move to a flexible exchange rate and inflation targeting regime, has created a more conducive environment for economic growth and further structural reforms. Key reforms include the development of the AIFC, which is taking shape. The Astana International Exchange is to be launched in early 2018. In June 2017, the Shanghai Exchange and the AIFC signed an agreement under which the Shanghai Exchange became a strategic cooperation partner of the AIFC and owns 25.1 per cent of the Astana Exchange. In other developments, the government amended the regulatory framework governing renewable energy development in 2017 in order to reduce the foreign exchange risk for investors. A framework for tariff reform in regulated sectors has been developed, although social issues make the immediate application challenging. Legislation concerning subsoil use is being amended with the objective to implement international standards for minerals and hydrocarbons extraction.

Kazakhstan ranks 36th of 190 countries in terms of ease of doing business according to the World Bank *Doing Business 2018* report. The country made progress in three components of ease of doing business: the transfer of a property was streamlined by improving registration transparency and the land administration system's dispute resolution mechanisms; investor protection was improved by strengthening minority shareholder rights and their role in major corporate decision making, by requiring greater corporate transparency and allowing better access to corporate information during trial; enforcing contracts was made easier by introducing tighter time standards for key court events – they are respected in the majority of cases.

A new development strategy has been unveiled. In January 2017 the President announced the new development strategy, "Third Modernization: Global Competitiveness". It aims to accelerate the modernisation and digitalisation of key sectors of the economy, increase productivity, diversify the economy away from hydrocarbons (in particular by boosting manufacturing), address banking sector weaknesses, reduce impediments to the private sector, increase the effectiveness of the civil service and reduce the role of the state in the economy by accelerating privatisation efforts.

Banking system consolidation and recapitalisation is taking place. In July 2017, Halyk Savings Bank, Kazakhstan's largest bank, finalised the purchase of Kazkommertsbank (KKB), the second largest, after the state allocated US$ 6.4 billion to clean the balance sheet of banks with the largest shares of the sector's NPLs. It is assumed that large banks will be the major recipient of the government fund injection, while the smaller banks will be expected to rely mostly on capital injections from their shareholders. In February 2017 the NBK also supported KKB via its liquidity line to repay its sizeable €400 million Eurobond in a timely manner. The merger of two other large banks, Tsesnabank and Bank CenterCredit is expected.

Steps are being taken to strengthen NBK's supervisory mandate. More robust actions against banks that fail to adjust their activities have been taken. The banking licence of Kazinvestbank was suspended due to the systematic failures to fulfil payment obligations. On 22 May 2017 NBK repeatedly suspended Delta bank's licences for accepting deposits from individuals and legal entities until November 2017. There are upcoming stress tests and an Asset Quality Review (AQR) of large banks planned for late 2017. In August 2017, the NBK adopted a programme to improve the financial stability of the banking sector and introduce a risk-oriented approach to the financial supervision process. The NBK will spend around tenge 500 billion (US$ 1.5 billion) on the implementation of the programme.

Fiscal policy is being stepwise adjusted to the continued lower level of oil prices. The draft 2018 budget envisages further adjustment through reduction of stimulus spending and higher non-oil revenues from growth and improved administration. A new draft tax code has been prepared, which focuses on changes in natural resources taxation and VAT improvements and making the tax system more progressive. An expansion of public-private partnerships (PPPs) is also being considered.

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The government is making progress with its ambitious privatisation programme. Between mid-2016 and mid-2017, 53 small companies owned by the state-holding-company Samruk-Kazyna (SK) were sold. SK has been actively working on the pre-privatisation preparation of blue-chip companies, and it mobilised international advisers with the objective to attract strategic investors that can bring know-how and improve governance. SK also held a privatisation workshop at the London Stock Exchange in April 2017, showcasing initial public offering candidates, particularly Air Astana. Under the privatisation programme 2016-20, adopted in December 2015, assets singled out for privatisation include 782 entities in total, with 216 assets under the SK umbrella representing the most important strategic part. The SK assets have been divided into two parts, with 44 core assets and 172 smaller assets. The plan is to privatise the small non-core assets during 2016-17 and the large blue-chip companies during 2018-20. Air Astana and KazAtomProm are expected to be privatised in 2018-19.

The Kashagan oilfield restarted in September 2016. In November 2016 the field achieved a commercially viable level of production with sustained output at 75,000 barrels per day (b/d). In June 2017, production reached 180,000 b/d. The government expects that Kashagan will reach its first-stage full output capacity of 370,000 b/d before the end of 2017, with overall annual oil output at around 8.9 million tonnes. This will mark a milestone in the development of the field, which has suffered from long delays and cost overruns owing to logistical and technical challenges, and will help it meet its growth targets.