



KAZAKHSTAN

Highlights

- **The economy continues to grow steadily.** GDP growth was 4.1 per cent in 2017 and a similar rate in the first three quarters of 2018, driven by oil output expansion and favourable commodity prices.
- **A new development plan was unveiled.** The 2025 Strategic Development Plan envisages reforms in the following key areas: human capital, technological innovation, promoting competitiveness, strengthening the rule of law, regional development and urbanisation, and increased efficiency of the public administration.
- **The Astana International Financial Centre (AIFC) has been launched.** The new centre will serve the needs of the financial services of neighbouring countries and beyond by providing regulatory and judicial standards that are typically available in developed markets.

Key priorities for 2019

- **Efforts to privatise state-owned enterprises (SOEs) need to step up.** Pre-privatisation activities including the improvement of management and governance structures of SOEs and aligning procurement practices with international standards need to continue. Privatisation of strategic enterprises should advance.
- **The authorities should accelerate the implementation of regulatory reform.** The short-term focus should be on key areas such as utilities tariff-setting and renewable energy.
- **The asset quality in the banking sector should be further improved.** Improvements in governance and risk management practices as well as further strengthening of the central bank's regulatory and supervisory capacities are needed.

Main macroeconomic indicators %

	2014	2015	2016	2017	2018 proj.
GDP growth	4.2	1.2	1.1	4.1	4.0
Inflation (average)	6.7	6.7	14.6	7.4	6.4
Government balance/GDP	1.7	-2.2	-1.6	-2.7	-2.0
Current account balance/GDP	2.8	-2.8	-6.5	-3.4	-1.5
Net FDI/GDP [neg. sign = inflows]	-2.1	-1.7	-9.7	-2.4	-3.0
External debt/GDP	71.2	83.2	119.2	105.1	n.a.
Gross reserves/GDP	13.2	15.1	21.6	19.3	n.a.
Credit to private sector/GDP	33.5	37.7	33.0	30.5	n.a.

Macroeconomic performance

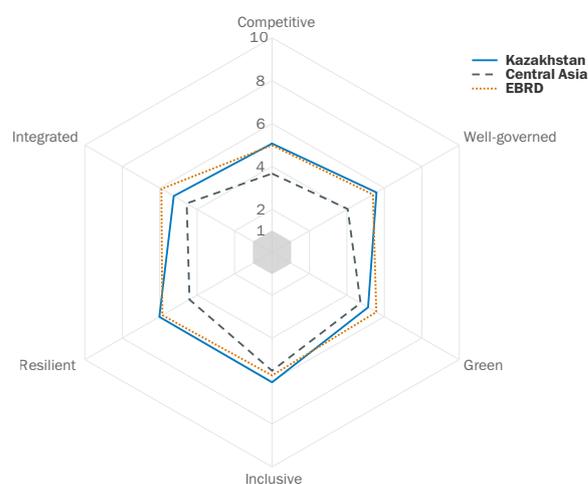
The economy continues to grow at a rate above 4 per cent. After a significant slow-down to 1.1 per cent in 2016, real GDP growth rebounded to 4.1 per cent in 2017 and remained at that level (year-on-year) in the first three quarters of 2018. Growth was supported by an acceleration of gross fixed capital formation (5.3 per cent year-on-year in the first half of 2018), growth of exports (8.9 per cent year-on-year in the first half of 2018) and a recovery in private consumption (4.5 per cent growth year-on-year in the first half of 2018), enabled by rising real wages. Oil output growth was 10.5 per cent in 2017 and reached 6.6 per cent year-on-year in the first three quarters of 2018. Credit expansion remains sluggish notwithstanding the decline in the non-performing loan (NPL) ratio from 12.8 per cent in July 2017 to 8.2 per cent in August 2018.

Despite increasing oil prices, the exchange rate came under pressure in 2018. While the exchange rate appreciated in late 2017 and early 2018, depreciation pressures returned in April 2018 following the depreciation of the Russian rouble. The tenge weakened against the US dollar by 8.5 per cent during the first nine months of 2018. Although annual inflation moderated from 7.9 per cent in January 2017 to 6.1 per cent by September 2018 (within the central bank's target of 5.0 to 7.0 per cent), inflationary pressures are on the rise as a result. This prompted the central bank to increase the base rate from 9.0 per cent to 9.25 per cent in October 2018, reversing a series of rate cuts since May 2016.

Fiscal adjustment is proceeding and the current account deficit has narrowed. As a result of sizeable government spending in 2017, which increased to 25.0 per cent of GDP in 2017 from 22.1 per cent in 2016 due to measures in support of the banking sector, the fiscal balance deteriorated from 5.5 per cent of GDP in 2016 to 6.3 per cent in 2017. From 2018 the authorities have embarked on a fiscal consolidation path. The government budget plan foresees the narrowing of the consolidated budget deficit to 1.5 per cent of GDP in 2018 as the guaranteed transfers from the oil fund will be cut. The current account deficit narrowed from 6.7 per cent of GDP in 2016 to 2.9 per cent in 2017 and continued shrinking in the first half of 2018, helped by rising exports.

Growth is expected to moderate slightly in the short term. GDP is currently forecast to grow by 4.0 per cent in 2018 and 3.5 per cent in 2019, due to slower oil output expansion. Large investment projects in oilfield development and gasification of the country will continue supporting growth. Domestic consumption will also likely recover somewhat after growing by a meagre 1.5 per cent in 2017, boosted by increases in real wages and an expansion of lending to households. Risks to the growth outlook stem mainly from banking sector difficulties and a possible slow-down in external demand for commodity exports.

Assessment of transition qualities (1-10)



Major structural reform developments

The government has announced a new strategic plan. The “2025 Strategic Development Plan” was approved in February 2018. The plan rests on seven pillars: human capital, technological innovation, promoting competitiveness, strengthening rule of law, regional development and urbanisation, changing people’s mindset, and improvements in the public sector. The 2025 plan is supported by several specific programmes, such as the “Digital Kazakhstan 2018-22” state programme. In addition, five social initiatives were announced in March 2018 and are designed to promote sustainable and broad-based growth through the provision of affordable housing, lower tax rates for low-income groups, improved access to finance for small and medium-sized enterprises (SMEs), and the gasification of Astana and other regions. Furthermore, the State of the Nation Address by the President delivered in October 2018 envisages an increase in the minimum wage and the prolongation of state programmes supporting SMEs and developing infrastructure.

Several legislative changes were implemented to improve the business environment and the investment climate. A new tax code was adopted in December 2017 which aims to reduce the tax burden and simplify tax administration procedures. A new subsoil use code implementing international standards for minerals and hydrocarbons extraction came into force in June 2018. The Customs Code of Kazakhstan has been brought into compliance with the Customs Code of the Eurasian Economic Union. It focuses on the automation of customs processes, e-declaration and optimisation of customs procedures. The introduction of an electronic customs declaration system and reduction of customs administrative fees resulted in Kazakhstan’s advancement in the trading across borders score in the World Bank’s Doing Business 2019 report. Overall, Kazakhstan ranks 28th out of 190 countries in terms of ease of doing business, improving its position substantially from 2017, when it ranked 36th. The country comes first in protecting minority investors and performs relatively well in areas such as starting a business and enforcing contracts, but significant gaps remain in trading across borders, getting credit and getting electricity.

Financial sector development is advancing. An important development for regional financial sector development was the launch of the Astana International Financial Centre (AIFC) in July 2018. The new centre has already attracted over 80 financial and non-financial firms. Within the AIFC, the Astana International Exchange (AIX) started operating in January 2018 with Shanghai Stock Exchange and NASDAQ as its key strategic partners. To stimulate the development of the new stock exchange, various government decrees provide for conducting initial public offerings (IPOs)/ secondary public offerings of several large state-owned companies on the AIX. Another important development includes the eligibility of government bonds and central bank short-term notes for the Clearstream system, which improves foreign investor access to Kazakh securities and helps build a yield curve. All of these measures represent important steps towards creating a more resilient financial system by promoting alternative and complementary sources of funding to the traditional banking sector.

Efforts to address banking sector weaknesses continue. The merger of two large banks – Halyk Savings Bank and Kazkommertsbank – was completed in July 2018. In 2017 the authorities provided financial support to five other banks through the purchase of their subordinated debt for 15 years, conditional on additional capital injections from shareholders and implementation of their specific plans to increase asset quality and reduce NPLs. The central bank revoked the licences of three smaller banks and extended a stabilisation loan to the second largest bank in August 2018. The banking sector as a whole continues to be hampered by insufficiently strong risk management and corporate governance practices. The still-high level of NPLs constrains banks from fully performing their roles as financial intermediaries. In order to stimulate credit growth, the National Bank of Kazakhstan started in August 2018 a programme to invest Tenge 200 billion (US\$ 600 million) from assets of the Pension Fund into buying bonds of banks.

Further steps have been taken towards the development of the green economy. In January 2018, the government re-launched the emissions trading system (ETS), which had been suspended since 2016. The system now includes new allocation methods, following the introduction of amendments to the Environmental Code in 2017. As part of the ETS, in February 2018 Kazakhstan started an online platform allowing greenhouse gas emitters to trade quotas and verify data on emissions. Another major initiative includes holding the first renewable energy auction in May 2018, which replaces the fixed tariff system with market-based pricing. This provides the basis for cost reduction in renewable energy projects and promotes further progress in tapping into Kazakhstan's large renewable energy potential. Additional legislative changes include the adoption of amendments to the Law on Natural Monopolies in December 2017, which envisages commercial tariff-setting in water and district heating from 2020.

SOE reform and privatisation are proceeding. The government reported that 502 of 887 state-owned enterprises had been offered for sale and 421 had been sold for Tenge 216 billion (US\$ 584 million) as of the end of June 2018. The sale of assets of Samruk-Kazyna (SK), the national state holding company, made up more than 60 per cent of the proceeds. It is planned to sell another 87 assets by the end of 2018. Kazatomprom, the world's largest uranium producer, plans to sell a 25 per cent stake on the London Stock Exchange and on the AIX in late 2018 as part of an IPO. IPOs of Air Astana and Kazakhtelecom are also expected to take place on the AIX in the fourth quarter of 2018. Other blue chip assets under SK are in the process of transformation with a view to improving corporate governance practices and increasing operational efficiency. For instance, Kazakhstan Temir Zholy, a vertically integrated national railway transportation operator, and Samruk-Energy, a strategic energy holding company, adopted a new organisation structure and eliminated duplicated processes.
