

Summer 2020

# NAVIGATING THE CRISIS



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# Foreword

The Kazakhstan Economic Update (KEU) is a semiannual report analyzing recent economic developments, prospects, and policy issues in Kazakhstan. The report draws on available data reported by the government, the National Bank of Kazakhstan (NBK), and additional information collected as part of the World Bank Group's regular economic monitoring.

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# I. Overview

**The COVID-19 pandemic has turned the world economy upside down.** As recently as January 2020, analysts and various institutions projected that, this year, the global economy would have recovered from the lowest growth since post-global financial crisis. But instead, developed and developing countries are fighting against the fallout from the pandemic. The global economy entered a serious recession in February, and global commodity prices tumbled. The earlier failure of OPEC and its allies to agree on a production cut amplified the impact of weakening global demand on oil exporters like Kazakhstan. Weaker activity, travel restrictions, and reduced mobility are projected to reduce global demand for oil by 9 percent in 2020<sup>1</sup>.

**The pandemic, the economic slump, and the stress on the corporate and financial sectors are mutually dependent, and the longer the crisis, the more destructive is the impact on human suffering<sup>2</sup>.** The Kazakh government acted early to contain the spread of COVID-19. Following the announcement of a state of emergency, a state commission was set up to coordinate the efforts to fight the pandemic, impose quarantine control, and provide support to those whose livelihood was affected by the coronavirus or by the emergency restrictions. The authorities implemented a fiscal package to provide support to firms

and households affected by the crisis. This effective approach to control the pandemic and improve access to health services should be continued and strengthened. But deployment of resources and reforms are also needed for Kazakhstan to navigate out of the crisis. The authorities may want to redeploy some resources from state programs toward improving access to and quality of education and healthcare, and for temporarily supporting workers and employers. Having a medium-term reform program can also help leverage resources from the private sector and better enable it to adjust and respond to new opportunities.

**The COVID-19 shock to Kazakhstan's economy is the largest in almost two decades and is already having a significant negative effect on growth.** The collapse in oil prices in 2009 and 2015 shrank aggregate demand and rocked the stability of the financial sector. This time, the supply side of the economy is also affected by a series of lockdowns, which was a necessary strategy to contain the epidemic. The measures are especially impacting businesses relying on physical presence and face-to-face transactions. The impact of fiscal and monetary stimuli on recovery will be tested by a protracted pandemic and prolonged slump in the global economy. The disruption in supply chains and unresolved tensions



in global trade can further complicate the sourcing of inputs. The stimulus package can restore economic growth only after the pandemic recedes.

Therefore, we project that GDP will contract by 3 percent in 2020 and will recover only modestly by 2.5 percent in 2021.

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<sup>1</sup> International Energy Agency, April 2020.

<sup>2</sup> See Izvorski, Mahajan, Moorthy, and Vincelette (2020): <https://www.brookings.edu/blog/future-development/2020/04/20/a-policy-framework-for-mitigating-the-economic-impact-of-covid-19/>.

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## II. The COVID-19 Pandemic: A Deteriorating External Environment and the Government's Response

The COVID-19 pandemic, a major global health crisis, has also pushed the global economy into an economic slump. Recognizing these challenges early, Kazakh authorities responded swiftly to contain the outbreak.

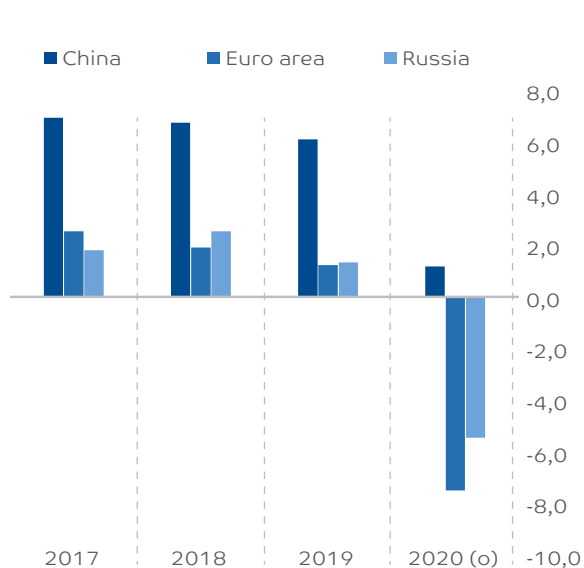
**COVID-19 has overstretched public resources and the capacity of health emergency response systems.** The pandemic spread quickly across the world, causing widespread illness, death, and disruption in economic activities. Authorities around the world are taking actions to prevent the pandemic from overrunning their health services and are introducing measures to support businesses and individuals against the shock. Developing countries are facing an even more challenging situation, as their health systems are less prepared to manage pandemics and they face more severe resources constraints in providing economic relief.

**Global economic activity has contracted as the coronavirus outbreak turned into a worldwide pandemic.** The economies of Kazakhstan's main export market trading partners have rapidly declined, reflecting

the impact of the COVID-19 pandemic **(Figure 1)**. At first, the outbreak led to a sharp slowdown in China, which then percolated through to major parts of East Asia and Europe. The outbreak's subsequent worldwide propagation, including to the United States and Latin America, has led to a massive worsening of the global economic outlook. Weakening demand from China, large-scale shutdowns, and quarantines have brought economies across the globe to a standstill, substantially reducing demand for commodities and other products.

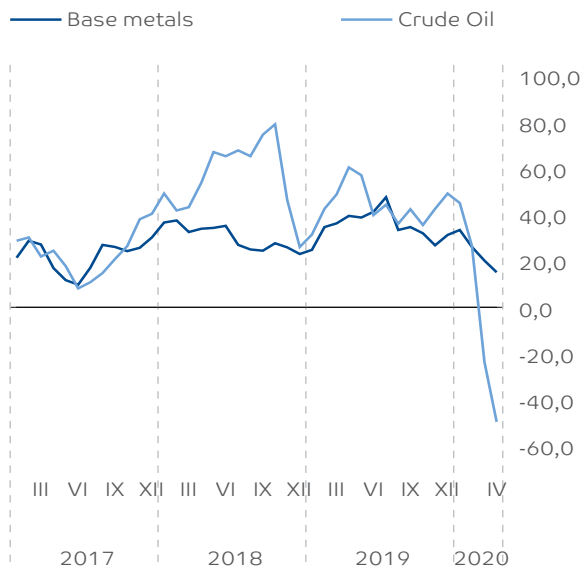
**Global energy and metal prices fell to multiyear lows before recovering partially.** Oil prices plunged in March to a 17-year low of roughly \$25 per barrel, reflecting disagreement over production cuts among OPEC+ partner countries and expectations of weak demand **(Figure 2)**. The economic impact of the coronavirus pandemic was a slashed demand for oil, resulting in a supply glut and overwhelmed storage capacity. Metals prices have also declined, reflecting a subdued industrial commodity demand, particularly from China. Tight trade and investment

**Figure 1. Contraction of growth in key foreign markets** (year-on-year, percent)



Source: IMF.

**Figure 2. Commodity prices are depressed** (index, 2016=1)



Source: IMF.

linkages to the Eurozone area, China, and Russia and high dependence on oil exports make Kazakhstan especially vulnerable to negative spillovers from the collapse in demand and in prices of commodities. Although oil prices remain well below the levels recorded last year, a recent rebound in demand pushed prices up to \$40 per barrel in early June, as countries began to lift containment measures and reopen economies.

**Kazakh authorities swiftly introduced decisive measures to contain the spread of COVID-19 and mitigate its impact.** The authorities closed borders, halted air travel, and imposed other travel restrictions to contain the spread of COVID-19. The government then declared a state of emergency, which lasted for two months. On March 19, the government rolled out quarantines to

control the pandemic, starting in Almaty and Nur-Sultan, and extended them to all regions, where officials intensified sanitary and epidemiologic procedures and expanded the capability of health services to handle COVID-19-related emergencies. The government allocated KZT 125.2 billion (USD 297 million) for a coordinated effort to suppress the pandemic. Besides the health measures, the government, the central bank, and the new financial regulatory agency also took action to support livelihoods and businesses and shelter them from the accompanying recession. The government introduced “anti-crisis” measures amounting to 5.7 percent of GDP (Box 1). Although Kazakhstan lifted its state of emergency on May 11, selected quarantine and social distancing policies remain in force, with restrictions being removed in stages across different regions.

## Box 1. The Fight against COVID-19 in Kazakhstan

The non-pharmaceutical intervention initiatives also included closing schools and switching to distance learning; closing public spaces and private businesses that attract crowds; closing international airports; banning passenger transport between major cities and intra-city public transport; and mandating 14 days of self-quarantine for international air passengers from certain countries.

The spending to suppress the pandemic includes purchases of additional health equipment, allowing citizens with deferred payment to the mandatory health insurance access to regular health services, and additional payment to medical personnel engaged in emergency response from March to August 2020.

The authorities also included the following key initiatives among the anti-crisis measures.

### **Maintain household economic welfare.**

- Give cash transfers to people who have lost their jobs owing to closure of businesses and lockdown during the emergency period: about 4 million people received the amount of KZT 42,500 per person per month.
- Index social benefit payments toward raising the cost of living standard.
- Fully cover all medical expenses irrespective of medical insurance contributions. The government extended the right to receive medical care in the compulsory social insurance scheme for all persons up to July 1, 2020.

### **Ease household expenses.**

- Provide food baskets and daily nonfood essentials for more than 1 million low-income and socially vulnerable people and people with disabilities.
- Request that banks not charge fines and penalties for delayed payments on consumer and business loans arising during the imposition of a state of emergency.
- Free costs of local internet for households, reduce utility bills, and provide subsidies for utility bills for vulnerable families.
- Introduce an employment program funded by KZT 300 billion for maintenance work on infrastructure facilities.

### **Protect businesses.**

- Extend the due date for all taxes paid by small and medium enterprises (SMEs) for three months and eliminate all fees related to the delay. The value-added tax (VAT) rate for SMEs operating in agro- and food processing industries will be reduced and the import of essential goods will be freed from customs duties for the duration of the state of emergency.
- Suspend property tax for one year for SMEs in the service industry. Small and microbusinesses will be relieved from taxes and obtain deferral on interest payments on existing loans.







- Suspend property tax for one year for businesses in the service industry. Small and microbusinesses will be relieved from taxes and will receive interest payment deferral on loans.
- Local governments and state-owned enterprises (SOEs) will stop charging rental fees to SMEs for three months.

#### **Improve firms' liquidity and cash flow.**

- Provide a package of liquidity provision measures by scaling up off-budget provision of subsidized credits to SMEs in the non-extractive industries and a credit line for working capital.
- Broaden the list of industries eligible to receive government support and raise the maximum amount for loans extended to businesses.
- Introduce forward purchases off-take contracts to support agricultural producers, and keep in force special expedited public procurement rules until August 2020.
- Introduce a new, affordable housing program and transform the Housing Savings and Construction Bank to an Otbasy (Family Bank).

#### **Take monetary policy action.**

- Ensure exchange rate stability. The NBK occasionally intervened by acting as a sole dealer for foreign currency sales via auction. The NBK also halved the amount of foreign currency that local companies can buy without supporting import documentation (from \$100,000 to \$50,000). The new regulations also require companies to sell their foreign currency on the market if it is not used for the stated goals within 10 days.
- SOEs to start selling part of their foreign currency revenue on the domestic market and converting their deposits into tenge.
- SOEs to direct their dividend payments (in full) to the state budget.

#### **Involve the financial sector.**

- Ask that banks not charge fines and penalties for consumer and business loan payments that are delayed during the state of emergency.
- Financial Regulatory Agency to lower the risk-weighting on loans to SMEs, public-private partnerships, and syndicated loans and expand the list of highly liquid assets to facilitate compliance with liquidity ratios. To help banks expand corporate lending, temporary macroprudential regulations will be introduced.
- Overturn a borrower's negative credit history if more than 50 percent of overdue debts have been repaid within 12 months and subsequent obligations have been fulfilled.
- Depending on the type of borrower and type of product, a new approach to the calculation of interest rates on loans will be introduced. Control over non-bank credit organizations will be strengthened, and licensing of microfinance activities will be established.

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## III. Economic Recession and Rising Inflation in Kazakhstan

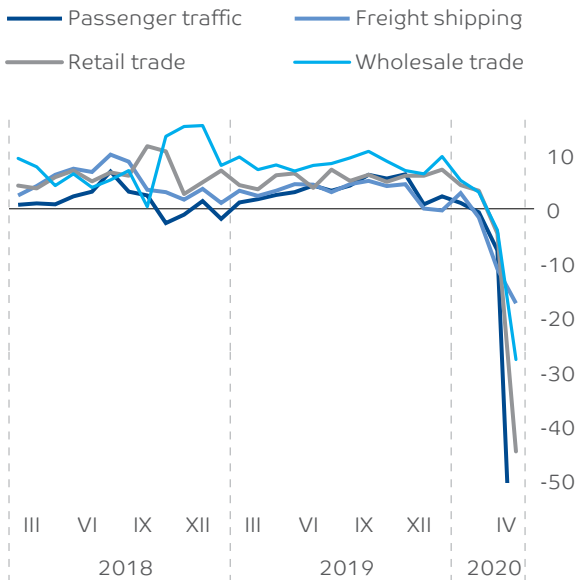
Although GDP showed mild growth in the first quarter, it dipped into recession in the following months as commodity prices dropped, trade declined, and containment measures to fight COVID-19 took a toll on economic activity. Supply disruptions and currency depreciation pushed up inflation.

**As only part of March was affected by the deteriorating terms of trade and nationwide mobility restrictions, first-quarter growth does not reflect the full scale of the pandemic.** Even though real GDP growth slowed to 2.3 percent year-on-year during January through March, the government's preliminary estimates show the economy shrinking 1.7 percent during January through May as the full effects of the crisis unfolded. Declining activity in the first quarter is attributable to a sharp contraction in the service sectors, which was subject to the lockdown in the capital city of Nur-Sultan and the business hub of Almaty, while the mining and manufacturing continued to exhibit resilience, at least in Q1-2020 (**Figure 3**). On the demand side, consumer spending and mining-related investment continued to support GDP. Consumer demand is estimated to have moderated to 1.2 percent growth, year-on-year, reflecting growing concerns over COVID-19 and the restriction measures, and despite steady growth in wages, social transfers to low-income households, and rising retail credit. Investment is expected to ease to 1.0 percent growth annually, supported mostly by foreign direct investments (FDIs) into

the oil and gas industry and residential construction (**Figure 4**) even as domestic private investment takes a major hit.

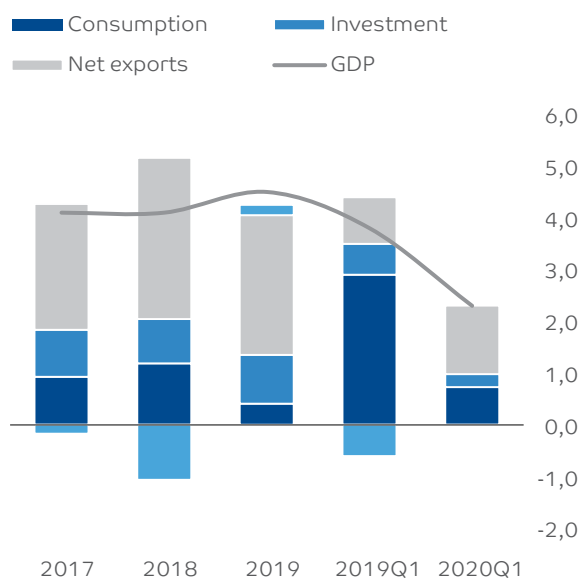
**Inflation has picked up recently to above the upper bound of the central bank target range.** Consumer prices are under renewed upward pressure due to currency depreciation and, to a lesser extent, supply disruptions. The collapse in oil prices pushed down the tenge by almost 15 percent in April relative to January, although the currency regained 5 percent in May amid recovering crude prices. Inflation had begun to increase even before the recent fall in the tenge, raising expectations of a further increase in prices. Food prices accelerated to 10.7 percent in May, above the previous year's record of 7.9 percent, while non-food inflation has moved lower in recent months. The currency depreciation and higher food prices more than offset weaker domestic demand, to push 12-month inflation to 6.7 percent by May from 5.4 percent in December (**Figure 5**). Lower utility tariffs, as part of government help to households, and weak consumer demand because of lockdowns appear to have had a limited offsetting effect on rising non-food product prices, which remain sensitive to currency depreciation. Import prices—reflecting exchange rate movements—remain an important source of pressure on essential consumer goods, having increased to 4.7 percent in March (**Figure 6**).

**Figure 3. Services sectors slow the most**  
(year-on-year, percent)



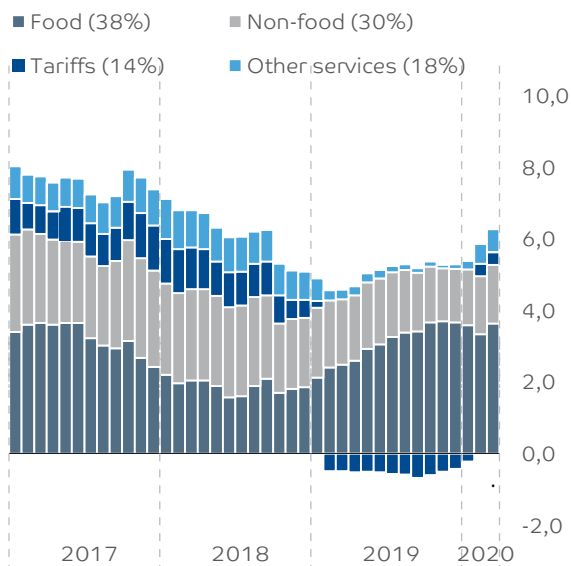
Source: World Bank staff calculations based on Committee on Statistics data

**Figure 4. Broad-based deceleration within demand components**  
(p.p. contribution, percent)



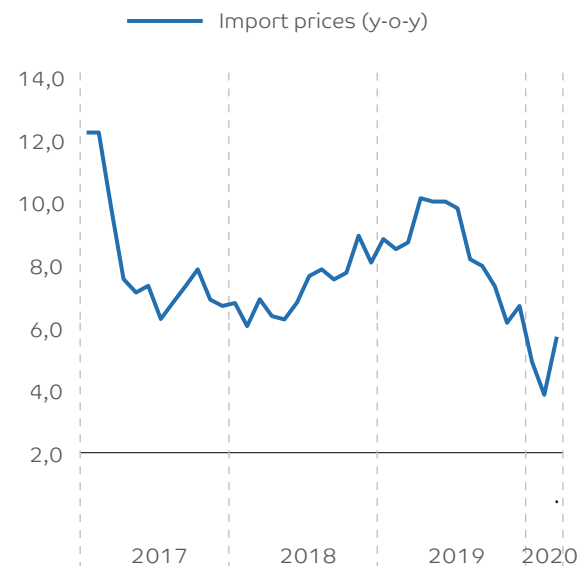
Source: World Bank staff calculations based on Committee on Statistics data

**Figure 5. Inflation picked up following the depreciation in exchange rate**  
(percentage point, percent)



Source: World Bank staff calculations based on Committee on Statistics data

**Figure 6. Downward pressure on exchange rate drives up import prices**  
(percent)



Source: World Bank staff calculations based on Committee on Statistics data

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## IV. Balance of Payments

Preliminary estimates of the balance of payments suggest a favorable external position in the first quarter of 2020. However, the deep global economic recession, weaker demand for oil, and disruption of activities around the world are likely to push the current account into deficit and reduce inflows of direct investments.

**The first-quarter current account shifted into a surplus of 3.8 percent of GDP from a position of near balance a year earlier.**

Despite the collapse in oil prices in March 2020, the volume of Kazakhstan's oil exports picked up by 14 percent year-on-year in Q1-2020, reflecting the shipment of amounts committed under existing contracts. Import values slightly dipped due to supply disruptions, the weaker exchange rate, and weaker domestic demand. The ongoing expansion project in the mining sector is likely to sustain, to a certain degree, demand for imported machinery and equipment for capital investment. The deficit of the service sector's balance decreased, reflecting lower demand for travel and transit services along with decline in oilfield and petroleum exploration services. Compared to first quarter last year, net outflow of primary and secondary income decreased as state enterprises repatriated investment earnings to pay dividends to the government as the sole shareholder (**Figure 7**). Nevertheless, the deteriorating external environment is significantly affecting the trade balance

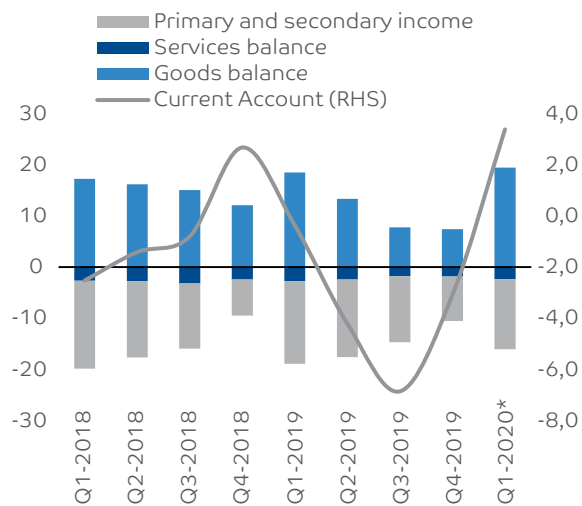
in Q2-2020 and, hence, likely to turn the current account into deficit.

**Kazakhstan continued to receive positive net inflows of capital during Q1-2020.** Net FDI inflows amounted to \$2.5 billion, or about 8 percent of GDP, throughout the first quarter of 2020 but at a slightly slower pace compared to the same quarter of last year. FDI in Q1-2020 was mainly driven by implementation of activities and reinvestment of earnings in the mining sector. As Kazakh firms and the government reduced their foreign assets, the financial account recorded a net inflow of portfolio capital of \$0.5 billion.

**The positive stance in the external position by the end of the first quarter, as well as the recent pickup in oil prices, has helped stabilize the tenge following its initial slide.** The collapse in global oil prices, deteriorating external demand, and plummeting confidence in domestic business led the tenge to depreciate by about 15 percent against the US dollar and 16 percent against the euro in mid-March (**Figure 8**). The NBK also sold USD 1.5 billion from its own reserves on the domestic market along with USD 0.9 billion from the National Oil Fund to help the budget and to prop up the tenge. The central bank also intervened in the foreign exchange market to minimize excess volatility in the tenge-US dollar rate. Following the first quarter surplus in the trade balance and the recent pickup in oil prices, the tenge has stabilized and regained some of its earlier losses.

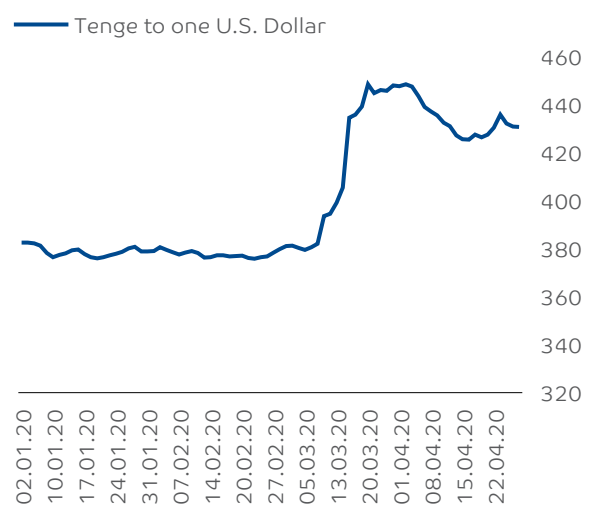


**Figure 7. Current account turned into surplus backed by steady volume of oil export and lower import (percent of GDP)**



Source: World Bank staff calculations based on Committee on Statistics data.

**Figure 8. The tenge depreciated following the collapse in oil prices (tenge to one US dollar)**



Source: The National Bank of Kazakhstan.

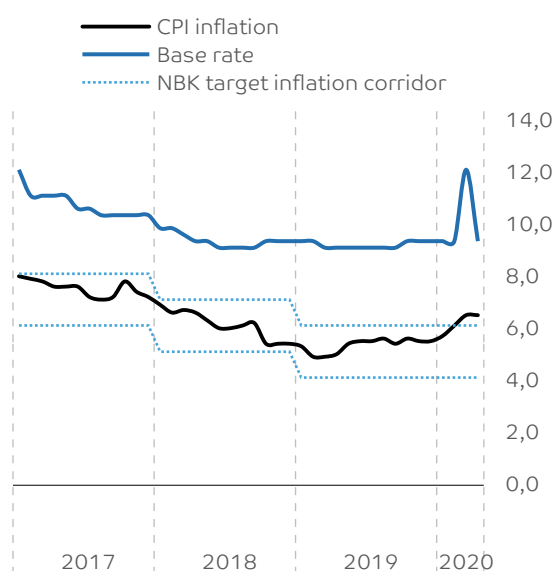
# V. Monetary Policy and the Financial Sector

The National Bank of Kazakhstan swiftly adjusted the monetary stance to accommodate liquidity support to firms and households. Amid concerns over the growing risk of nonperforming loans (NPLs), the new financial supervisory agency has taken steps to strengthen stability in the banking sector.

**The NBK has eased its policy stance by cutting the benchmark interest rate despite rising inflation.** Initially, in early

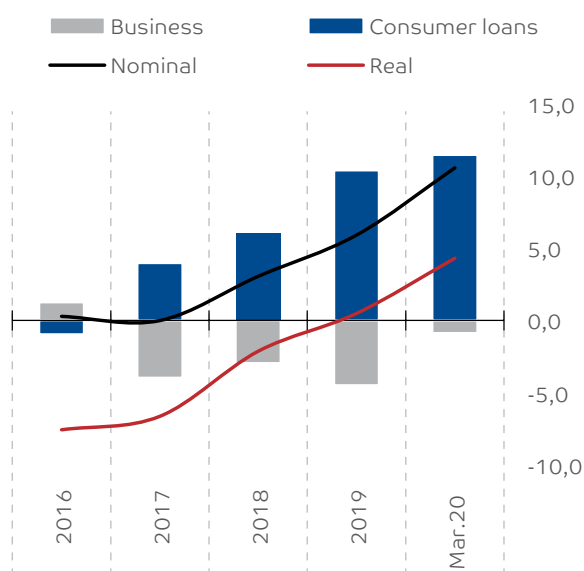
March, the NBK took an unscheduled action and hiked its policy rate by 275 basis points, from 9.25 percent to 12 percent, to combat the effect of a collapse in oil prices on the tenge. As the central bank came to assess that the crisis and the decline in oil prices was likely to be longer lasting than just a temporary shock, the NBK reversed its policy stance, brought the policy rate back to 9.5 percent, and widened the interest rate corridor to +/-200 bps. The policy rate has been left unchanged in an early June

**Figure 9. The policy rate has been adjusted to avoid raising cost of liquidity** (year-on-year, percent)



Source: World Bank staff calculations based on NBK data.

**Figure 10. Retail lending (consumer loans) has driven borrowing activity** (year-on-year, percent)



Source: World Bank staff calculations based on NBK data.



policy revision (**Figure 9**). The motivation for maintaining the existing policy rate has been to prop up a weakening economy, to allow the exchange rate to absorb shocks to terms of trade, and to not use interest rates to prevent the tenge from sliding at the expense of raising the cost of liquidity. The decision on the policy rate has also been in line with the central bank's new task to fund the stimulus package in response to falling activity. As part of the anti-crisis

package, the NBK has undertaken quasi-fiscal spending by channeling concessional loans for SMEs struggling with liquidity and by partly supporting cash-strapped households through direct transfers.

**Credit to corporates and SMEs contracted in real terms, while retail credit grew briskly.** Credit portfolios grew by 3.2 percent in Q1-2020 and 14.7 percent over the past year, in nominal terms. Consumer lending

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constitutes more than 60 percent of the retail individual lending portfolio and has been the main driver of the total credit growth, with 26 percent year-on-year growth in Q1-2020. Mortgage lending was the second important driver of the total credit growth, mostly fueled by state mortgage lending programs, with 36 percent year-on-year growth in Q1-2020. Meanwhile, lending to SMEs continued to contract in real terms, with a 2 percent decline in Q1-2020 and a 6 percent decline over the past year. Starting in September 2019, local currency lending to corporates started to pick up, but this increase in the total corporate lending portfolio still leaves it in negative territory, and its share continues to decrease in the total lending portfolio (from 63 percent at end-2017 to 59 percent at end-2018 and 52 percent in March 2020).

**Despite recent increases in bank loans and deposits in nominal terms, they continue to shrink relative to GDP.** Total lending and deposits of Kazakhstan’s banking sector at end-2019 accounted for 21.5 and 26.2 percent of GDP, respectively, down from 23.1 percent and 28.6 percent at end-2018. These ratios are well below the levels at the beginning of the decade (about 60 percent and 35 percent) and the levels observed for upper-middle-income countries (about 50 percent and 58 percent on average, respectively, in 2018). Dollarization of the banking system has also declined, as evidenced by the decline of the share of

foreign currency loans in the loan portfolio (from 27 percent at end-2017 to 20 percent in Q1-2020) and the share of foreign currency liabilities in total liabilities of banks (from 44 percent at end-2017 to 40 percent in Q1- 2020).

The COVID-19 outbreak and decelerating economic activities will have further negative effects on credit growth and banks’ financial condition. This environment will limit the risk appetite and ability of banks to lend to creditworthy borrowers and may lead to new problem loans not identified by the recently published Asset Quality Report (AQR). Under current uncertainties, however, it is premature to be precise about the size of the problem. After the “credit holidays” granted by banks in response to the virus outbreak, the quality of the lending portfolio is expected to deteriorate due to borrowers’ worsened financial condition. New loans on consumer and mortgage loans, which have been increasing over the past year, can be riskier, as the creditworthiness of these clients remains largely untested. According to rating agencies, the quality of retail lending is expected to suffer the most, mainly due to higher unemployment, forced unpaid leave, and lower real disposable incomes<sup>3</sup>. Rating agencies have already downgraded to negative the outlook for Kazakhstan’s banking sector, and for those of seven other countries in the region<sup>4</sup>. Nevertheless, the AQR process has confirmed that the banking system in Kazakhstan entered the crisis with relatively high capital buffers (Box 2.)

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<sup>3</sup> <https://www.fitchratings.com/research/structured-finance/fitch-revises-outlooks-on-4-kazakh-banks-to-negative-on-coronavirus-disruption-08-04-2020>.

<sup>4</sup> <http://www.kxan36news.com/fitch-changed-the-outlook-on-the-banking-sector-to-negative>.



## Box 2. The Banking Sector in Kazakhstan According to the AQR

**The recent Asset Quality Report results confirmed that the banking system entered the crisis with relatively high capital buffers.** The NBK has completed an independent AQR of 14 banks, which account for about 90 percent of the total loan activity of the banking sector. The AQR was aimed at revealing the true extent of banks' problem assets, most of which originated from the previous crises (legacy loans). The AQR results showed that International Financial Report Standards (IFRS) Stage 3 assets (that is, credit impaired assets—a wider category than NPL 90+) constitute 21 percent of the reviewed banks' total assets as of April 1, 2019. Total AQR-revealed potential losses were estimated at KZT 429 billion as of April 1, 2019, which leaves the actual capital of the reviewed banks (on a consolidated basis) well above the minimum level (the estimated Common Equity Tier 1 (CET1) capital adequacy ratio would decline from 15 percent to 12 percent). The new financial regulatory supervision agency prepared an action plan for a number of banks, which had estimated capital shortfalls per AQR results, to address those potential shortfalls. Shareholders of these banks will recapitalize the banks with an amount totaling KZT 40.5 billion, and an amount totaling KZT 116.7 billion will be covered by an asset protection scheme (guarantees) by the Problem Loan Fund.

**The AQR also revealed the need to enhance the regulatory and supervisory frameworks of the banking system.** The report identifies the need to: (1) improve the guidance on IFRS implementation for financial sector participants; (2) use supervisory stress testing to assess resiliency of the banks and improve the risk-based supervision framework; (3) move to the calculation of capital on a consolidated basis; (4) improve liquidity ratio requirements; (5) improve supervisory reporting; (6) establish more stringent requirements on frequency and quality of valuation of collateral and immovable property of the banks; and (7) establish requirements for recovery and resolution planning. Most of these actions, however, have been postponed due to the pandemic.

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## VI. Fiscal Policy: An Aggressive Response to Manage the Unprecedented Situation

To fight the COVID-19 pandemic and the looming economic recession, the authorities put in place a comprehensive support package from on-budget and off-budget sources. Tax revenues are expected to fall and fiscal policy will be expansionary, with a larger budget deficit to support the economy hit by the crises.

**Tax holidays and deferrals, larger spending on crisis management measures, and a decline in budget revenues are likely to lead to a sharp increase in the fiscal deficit in 2020.** The spread of COVID-19 has been a major shock to the economy and has required a countercyclical fiscal policy response. As the authorities launched a package of stimulus initiatives to mitigate economic damage from the pandemic, the fiscal policy stance is expected to be expansionary in 2020. With the stimulus package of at least USD 10 billion, or 5.7 percent of GDP, about half of which is coming through the budget and the rest from off-budget resources, the government budget deficit (state and local) is expected to rise sharply to 5.4 percent GDP in 2020 from 1.9 percent of GDP in 2019 (Tables 1 and 2). The deficit appears to be higher this year than in 2019 and requires additional withdrawals from the National Oil Fund and from borrowing in domestic and external capital markets in order to finance new anti-crisis measures and maintain the bulk of pre-crisis spending initiatives. On

the revenue side, the authorities plan to tap into reserves of the National Oil Fund, with additional transfers in the amount of KZT 2.1 trillion, to deploy financial resources accumulated in the country's Pension and Social Security Funds, as well as to borrow abroad. Liquidity provision programs to distressed SMEs in the form of cheap loans to cover operational and capital expenses are likely to be funded through central bank resources. Government estimates show that external borrowing needed to finance increased budget deficits will be about USD 3.0 billion for 2020.

**Given the unprecedented situation and need for fiscal support, the medium-term fiscal targets will temporarily be breached, delaying planned consolidation efforts.** The nonoil fiscal deficit—mid-term fiscal target projected to be cut to 6 percent GDP by 2025—is expected to rise to 13.2 percent of GDP from an estimated 8.0 percent last year, as higher expenditures outpace nonoil revenues, which are shrinking significantly as a result of collapsing commodity prices and slowing economic activity. The shortfall in tax revenues is estimated to be around KZT 2.0 trillion, attributable mainly to a sizeable decline in the collection of VAT, a decline in export duties on crude oil, and a decline in corporate income taxes. Spending reflects substantial increases in welfare programs for socially vulnerable

households and pensions, job creation initiatives, and financial support for SMEs. Due to an expansionary fiscal stance and developments related to the spread of the

coronavirus, the debt-to-GDP ratio in the projections is expected to move on a gradual upward path for the entire period, though it should remain manageable.

**Table 1. Anti-crisis stimulus package in response to COVID-19**

(US dollar, billions)

<b>Anti-crisis package (new spending)</b>	
Infection fighting	0.3
Value transfer to households	1.6
Employment safeguard	5.5
Liquidity provision to firms	2.7
<b>Total, US dollar, billions</b>	<b>10.1</b>
in percent of GDP	5.7
<b>Sources of financing</b>	
State budget	4.5
Off-budget (for example, Health Insurance Fund, SOEs)	5.6
<b>Total, US dollar, billions</b>	<b>10.1</b>

Source: World Bank staff calculations based on data shared by authorities.

**Table 2. General government fiscal accounts, 2017–20**

(percent of GDP)

	2017	2018	2019	2020 f
<b>Revenues</b>	21.3	17.5	18.5	19.8
Oil revenue	9.8	6.0	6.2	7.9
Nonoil revenue	11.5	11.5	12.3	11.9
<b>Expenditures</b>	23.0	18.4	19.6	24.7
Goods and services	7.2	5.2	5.7	7.3
Social transfers and wages	6.9	7.0	7.7	9.8
Capital spending and subsidies	4.0	3.4	3.6	4.5
Interest payments and other transfers	4.9	2.7	2.7	3.1
Net lending and financial transactions	1.0	0.5	0.7	0.4
<b>Overall balance</b>	-2.7	-1.3	-1.9	-5.2
<b>Nonoil balance</b>	-12.4	-7.3	-8.0	-13.2
Memorandum items:				
<b>National Oil Fund FX reserves</b>	35.0	32.3	34.4	35.9
<b>NBK FX reserves</b>	18.6	17.2	16.1	19.4
<b>Total government debt</b>	19.6	19.9	19.8	26.9
External	9.2	10.1	9.3	11.9

Source: World Bank staff calculations based on data published by authorities.

Note: The general government budget comprises the state and local budgets. The stock values of foreign exchange assets and government debt relative to GDP for semiannual periods are calculated by using annualized GDP data. FX = foreign exchange.

## VII. Economic Outlook and Risks

Kazakhstan's GDP is expected to contract significantly in 2020, reflecting weaker domestic spending and external demand, while weakened exchange rates and supply-chain disruptions sustain higher inflation. The absence of an effective vaccine or cure for COVID-19 and the threat of a protracted pandemic are overshadowing the prospects for economic recovery.

**We have marked down our growth expectations for 2020, taking into account a deteriorating external context and pandemic-induced suppression of activity.** GDP growth is expected to contract this year for the first time since the late 1990s. Simultaneous adverse effects of a deteriorating outlook of the global economy and domestic lockdown measures and

other mobility restrictions are likely to be significant. Although several countries have lifted lockdowns, demand for exports will likely remain depressed, which would continue to put a strain on tradable sectors of the economy. The baseline scenario assumes that the pandemic would peak by midyear and that the authorities will gradually lift most severe suppression measures across the country. Nevertheless, the depth and duration of the crisis depend on how timely and efficiently the pandemic will be contained and how global demand recovers following the end of restrictive policies.

**The GDP is likely to contract by nearly 3.0 percent in 2020, more than double the rate previously envisaged in early**

**Table 3. Baseline scenario: selected macro-fiscal indicators, 2017–21**  
(percent, unless otherwise indicated)

	2017	2018	2019	2020	2021
				Projections	
Real GDP growth	4.1	4.1	4.5	-3.0	2.5
Oil sector	7.4	8.6	0.7	-9.7	3.2
Nonoil economy	3.2	3.0	5.6	-1.3	2.3
Consumer price inflation, end of period	7.2	5.4	5.4	8.3	6.4
	(percent of GDP, unless otherwise indicated)				
Current account balance	-3.1	-0.1	-3.6	-5.2	-4.6
Foreign direct investment	2.3	3.0	3.2	2.3	2.7
Overall fiscal balance 1/	-4.4	2.6	-0.5	-9.9	-6.4
Nonoil fiscal balance	-12.6	-7.3	-8.1	-13.2	-9.7
Stock of FX assets in the National Oil Fund	35.6	36.0	34.3	35.9	32.9
Government debt	19.6	19.9	19.8	26.9	30.5

Source: World Bank staff calculations based on data published by authorities.

1/ The Consolidated Budget comprises the general government budget and the Oil Fund consumption.



**March, as external demand and prices for crude potentially collapse more sharply and the mitigation practices last longer and hit businesses harder than envisaged previously.** The country's commitment under the OPEC+ agreement requires reduction in oil production and exports by an estimated 20 percent in 2020. The significant number of cases of COVID-19 in one of the largest oil fields is expected to cause a ripple effect of declining activity in mining. Resulting domestic quarantine policies would cause substantial loss in other parts of the economy

as well. The spike in cases across regions has amplified negative impacts throughout the domestic economy. Containment measures are expected to have a significant impact on the propensity to consume and on investment, and pickup is also likely to take longer. Weak industrial production and elevated uncertainty would lead to diminished investments, including FDIs in the mining sector. Lockdowns are likely to moderate business activities to a greater extent in Nur-Sultan and Almaty, where around one-third of the country's GDP is concentrated (Table 3).

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**Inflation pressure is expected to remain through the end of 2020, but slow as the effect of exchange rate depreciation gradually dissipates.** Inflation this year will remain above the central bank target of 6 percent, following depreciation of the tenge. Although the exchange rate for the tenge has stabilized recently, the disruptions to the supply chains of goods and services are likely to sustain inflation pressure in the coming periods. The exchange rate remains under pressure from volatile oil prices set to remain at a lower range for a longer period, and from a looser fiscal stance that prop up demand for imported goods. As a significant portion of the consumer basket is met by imports, domestic prices remain responsive to exchange rate movements.

**Scaling up of budget expenditures as a result of announced fiscal stimulus measures in response to the crisis is expected to increase the deficit and public debt.** The crisis forced authorities to tap into a rainy-day reserve of the National Oil Fund, breaching key fiscal sustainability targets. Both the size of transfers from the National Oil Fund and a nonoil deficit of the budget are expected to be larger in 2020. Once countercyclical spending has phased out, the nonoil fiscal target is expected to return to a downward path. However, achieving midterm fiscal objectives might require more sizeable corrections in fiscal policy going forward.

**The National Oil Fund reserves will continue buffering the negative effects of external shocks on the fiscal position of the government.** Although foreign exchange reserves in the National Oil Fund are estimated to fall below the threshold level of 30 percent of GDP in coming years, they still provide a substantial cushion against commodity price shocks. Public debt

is forecast to move up to 30 percent of GDP but remain sustainable, despite government borrowing plans in international capital markets. Meanwhile, if tax revenues from economic fallout fall more sharply than expected, then the budget might require additional resources to close a financing gap. In that case, the country has the fiscal ability to raise revenue either through external borrowing or additional transfers from the National Oil Fund.

**External shocks are expected to widen the current account deficit.** The current account deficit is expected to widen to above 5 percent of GDP in 2020, in large part owing to deteriorated terms of trade and decline in volume of oil exports. At the same time, a weakening domestic demand and depreciation of the tenge would dampen demand for imports. However, a downward pace of adjustments for imports is anticipated to be less impactful than for exports. The current account deficit will improve gradually in following years as demand and price for oil will increase.

**The authorities have initiated several actions to support financial institutions and borrowers.** The regulator has temporarily lowered risk-weights on loans to SMEs, PPPs, and syndicated loans<sup>5</sup>, and expanded the list of liquid assets for prudential ratio purposes<sup>6</sup>. Banks and insurance companies were recommended not to distribute dividends or perform share buybacks. An SME working capital preferential lending program amounting to KZT 600 billion was developed and has commenced. Repayments on existing loans were deferred (credit holidays were provided, as mentioned above) by banks and other lenders until June 15 for individuals and for SMEs that were affected by the pandemic<sup>7</sup>. Moreover, banks were required

not to charge fines and penalties for delayed payments caused by the imposition of the state of emergency. As of April 28, 2020, more than 1.6 million individuals (31 percent) and 11,500 SMEs (44 percent) have received deferrals on outstanding loans amounting 376 billion tenge<sup>8</sup>.

**Risks to outlook are significantly skewed downside.** Our assessment shows that the risks to the economic growth have been firmly skewed downside relative to earlier estimates. A high level of uncertainty around the future course of the outbreak and the likelihood of re-imposing restrictive measures down the road would slow the recovery after lockdown. A downside scenario implies that restriction measures will in some form reappear this year with a second infection wave, but could be more targeted and with less strict containment measures. The rising incidence of debt overdue by consumers and corporations could put the financial sector under greater stress.

**While the authorities' decision to restart business activities will help to ease the economic crisis, it could be difficult for many businesses to resume production because of disruptions caused by a prolonged standstill.** The possibility of protracted containment measures going

forward should not be ruled out. This scenario is compounded by prospects of a deep global economic recession with far-reaching repercussions to Kazakhstan's already-fragile economic growth. If the pandemic continues to last longer and should the demand for and price of crude remain low, in this downside scenario GDP could contract by as much as 5–6 percent in 2020, which can significantly increase the poverty rate. A further drop in business activities will significantly deteriorate firms' balance sheets and undermine the ability of households to repay loans, which in turn would increase the risk of higher NPLs and widespread distress.

**A prolonged crisis is likely to increase poverty and can increase inequality in Kazakhstan.** Preliminary estimates suggest that the poverty rate may rise in 2020 from a projected 8.3 to 12.7 percent—equating to more than 800 thousand additional people living in poverty. The shock to the labor market in Kazakhstan due to both the pandemic and the mitigation measures has severe implications for employment, particularly sectors that employ low skilled workers. Unequal access to quality education, especially during lockdown, can negatively impact human capital development for the poor (see Section VII).

<sup>5</sup> Risk-weights for SME exposure in KZT lowered from 75 percent to 50 percent, FX loans with less than three-year maturity and greater than three-year maturity but hedged—from 200 percent to 100 percent).

<sup>6</sup> Included NBK deposits and nostro accounts, with foreign banks having favorable rating.

<sup>7</sup> For SMEs operating in economic sectors hit by the emergency situation (including trade, tourism, transport, restaurants, hotels, and so on) that could provide proof of financial deterioration.

<sup>8</sup> <https://finreg.kz/cont/%D0%A6%D0%B8%D1%84%D1%80%D0%B0%20%D0%94%D0%BD%D1%8F%20%D0%9F%D1%80%D0%B5%D1%81%D1%81-%D1%80%D0%B5%D0%BB%D0%B8%D0%B7%2028.04.%20%D0%A0%D0%A3%D0%A1%D0%A1.pdf>.

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## VII. Estimate of COVID-19 Impact on Learning Loss

**Before the outbreak of the global COVID-19 pandemic, the education system in Kazakhstan was struggling to provide high quality education to all students.** In PISA 2018, student performance dropped from its 2012 level and was 100 PISA points (roughly equivalent to two and a half years of schooling) below the OECD average. Around two-thirds of students tested by PISA performed below functional literacy. To mitigate the outbreak of COVID-19, Kazakhstan transitioned to emergency remote teaching using online platforms and TV-based broadcasts. However, due to the emergency nature of remote teaching initiatives, effectiveness is likely to be lower than face-to-face instruction.

**In Kazakhstan, the COVID-19 pandemic is resulting in substantial learning losses and is pushing many more students into functional illiteracy.** Assuming a student gains 40 PISA points of learning in a year, that schools are closed for around four months on average, and that remote teaching in the country is half as effective as face to face teaching, we estimate that learning in Kazakhstan will drop by the equivalent of 8 PISA points (see **Figure 11**), further aggravating the downward trend in learning outcomes in the country. Additionally, as most students in the country currently performs around the threshold for functional literacy and assuming some will lose more than others, the estimates

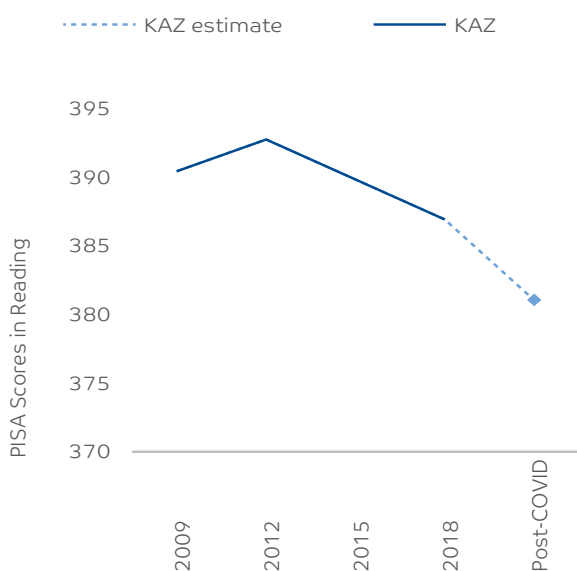
suggest that the percentage of students performing below functional literacy will increase by 3 percentage points (from 64 to 67 percent).

**The differential access and effectiveness of remote teaching is widening learning gaps across student populations.** While remote teaching is likely to be less effective for all students, it is even less effective for students from lower socio-economic quintiles. With parents working from home, parental work needs are prioritized, and it is likely that only students from families with good connectivity and multiple computers, electronic devices and televisions can fully utilize the remote teaching in place. Students with special needs may also face unique challenges accessing remote learning content. Using PISA 2018 data for access to learning modalities and assumptions on differentiated effectiveness (25% effective for the poorest, 50% effective for the average and 75% effective for the richest students), the reading achievement gap is expected to increase by 18 percent (from 45 to 53 PISA points) after only a short term school closure (**Figure 12**).

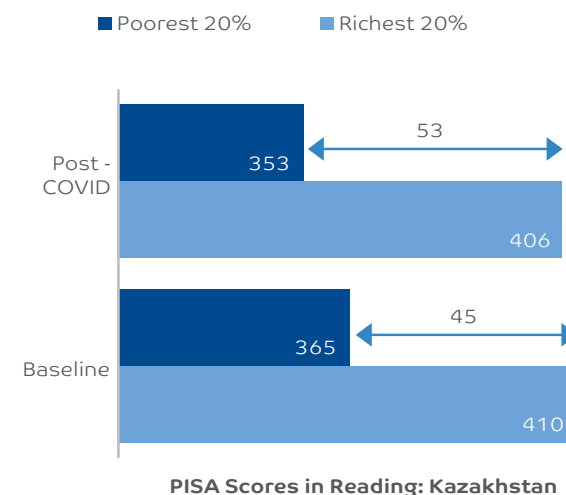
**The increased achievement gap and the income shock of the current pandemic can cause an increase in the rate of school dropout in the medium term, particularly for disadvantaged students.** Students who fall behind in education will be demotivated and at a higher risk to drop out of school. The



**Figure 11 Estimated impact on PISA scores due to COVID-19**



**Figure 12 Estimated impact of COVID-19 on socio-economic achievement gap**



40 points in PISA scale  $\approx$  1 year of schooling ESCS: Economic, Social, Cultural Status

loss in household incomes due to COVID-19 will also test households' ability to pay to keep students in school, increasing out-of-school youth and hindering transition to post-secondary education.

**The impact of COVID-19 on education and learning losses of the affected cohorts will have a decades-long impact on the economy.** Learning losses and reduced years of schooling for student cohorts affected by COVID-19 will reduce their expected earnings

by an estimated 2.9 percent, assuming a year of schooling increases earnings by 8 percent on average. This may amount to an overall economic loss of up to US\$1.9 billion (2011 PPP) every year. Kazakhstan needs to increase education spending and equity, ensure remediation to recover learning losses, prevent student dropouts and invest in building a resilient education system for other crises in the future.

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## VIII. Policy Watch

**Avoidance of a full-blown crisis will also depend to a large extent on controlling the COVID-19 pandemic.** Kazakh authorities have implemented strong health and social protection responses to minimize job loss, illness, and the loss of lives. However, it is difficult to predict the extent to which such anti-crisis action can shelter the economy from a deep and prolonged slump. A significant portion of the measures is directed at employment generation, which works better if the pandemic is brought under control and labor mobility is not impeded. The deferral of tax and social fund payments give firms breathing space, but the effect may not last long if businesses continue to sag. Similarly, the announced plan to increase public investments in residential constructions would perform best if household real income started to improve. In uncertain times like these, authorities must necessarily focus on initiatives that broaden access to health services, improve access and quality of distance education, and temporarily support firms and their workers.

**The authorities may want to ensure that measures to support financial institutions and borrowers are time bound, and that they preserve the financial health and transparency of the banking system.** Prudential relaxation, such as lowering risk-weights or expanding the list of liquid assets, might not be effective in stimulating

credit growth if banks' risk perceptions rather than the regulatory environment are the main constraint<sup>9</sup>. Conversely, such relaxation, if not well justified, may create transparency issues. Many countries around the world are allowing banks to fall below the regulatory buffers, built during "normal" times, while not necessarily changing the way risks are assessed. Undue weakening of the prudential rules could undermine trust in financial statements<sup>10</sup> and recent regulatory actions, including the AQR, thereby potentially aggravating rather than alleviating financial market pressures on banks.

**With the risk of a prolonged slump in the global oil market, Kazakhstan may want to consider a pathway for a resilient recovery.** Such a plan could include strengthening the effectiveness of public administration and services, including the use of e-platforms to deliver key public services, better tax administration, and a mechanism to review and redeploy fiscal resources toward better state programs. A focus on improving access to quality education, including distance learning, would be important to prevent a decline in the quality of human capital in Kazakhstan's low-income population. A renewed emphasis on reforms in the logistics, digital telecommunications, and financial sectors could help the overall private sector explore new opportunities.



<sup>9</sup> <https://www.bis.org/publ/bisbull09.pdf>.

<sup>10</sup> <https://www.bis.org/fsi/fsibriefs1.pdf>.

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