KAZAKHSTAN

Growth returned in 2021 with quarantine loosening. Drought and higher global energy prices boosted inflation, while the current account deficit narrowed. Growth will slow in 2022 because of monetary tightening and adverse consequences from the Russian invasion of Ukraine but reaccelerate in 2023 as reform takes effect. Inflation will ease with tight monetary policy, currency interventions, price controls, and higher oil production and prices yield a 2023 current account surplus. Achieving carbon neutrality requires bold action, including better targeted fuel subsidies and lower emission caps.

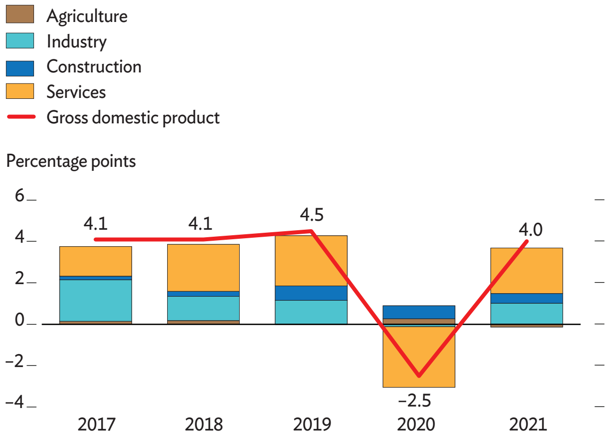
Economic performance

The economy reversed 2.5% contraction in 2020 to grow by 4.0% in 2021 as measures to control COVID-19 were gradually lifted and vaccination rollout accelerated (Figure 3.4.1). On the supply side, industry expanded by 3.8%, reflecting a 5.5% rise in manufacturing spurred by continued government support for light industry and machine building. Mining increased by 1.7%, with gains of 2.1% in metal ore and 4.6% in nonmetallic mineral production, while oil and gas production remained flat. Services rebounded by 3.9%, reflecting increases of 12.9% in communications, 9.2% in trade, and 3.6% in transport and warehousing. Growth in construction remained strong at 7.6% as some pension funds were used to finance housing. Agriculture contracted by 2.4% as a 6.7% decline in crop production under severe drought outweighed 3.6% expansion in livestock.

Data on the demand side, available for the first 9 months of 2021, show economic activity reviving and raising private consumption by 5.0% from the comparable period of 2020. Public consumption grew by only 1.2% as economic support measures were phased out. Growth in investment stagnated as a 3.4% decline in inventories offset a 2.0% rise in gross fixed capital formation. Net exports rose notably as import volume fell by 5.1%, outpacing 1.6% decline in export volume.

Figure 3.4.1 Supply-side contributions to growth

Growth returned in 2021, led by a rebound in services.



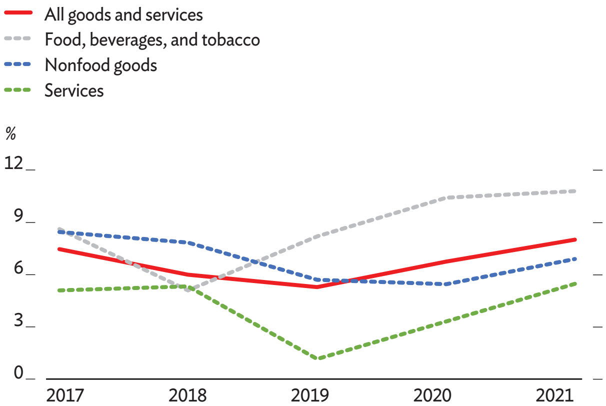
Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics (accessed 14 March 2022).

Average annual inflation accelerated from 6.8% in 2020 to 8.0%, reflecting double-digit food price increases and higher production and transportation costs from rising fuel prices (Figure 3.4.2). Severe drought increased food price inflation from 10.4% in 2020 to 10.8%, with many staple food prices rising by double digits. Higher fuel costs and utility tariffs raised inflation for other goods from 5.5% in 2020 to 6.9% and for services from 3.3% to 5.5%.

This chapter was written by Genadiy Rau of the Kazakhstan Resident Mission, ADB, Nur-Sultan. Adil Sultangazy, intern and Nazarbayev University student, assisted with data collection and analysis for the policy challenge section.

Figure 3.4.2 Average inflation

Inflation accelerated, reflecting higher prices for all components.

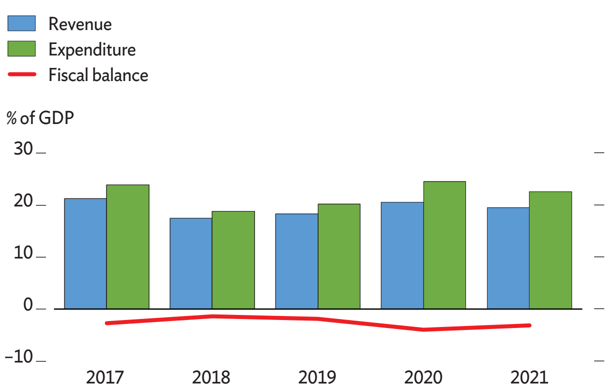


Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics (accessed 14 March 2022).

In April 2021, the government revised the state budget with additional allocations equal to 1.6% of GDP for pandemic relief and economic support. Total 2021 outlays nevertheless subsided from the equivalent of 24.7% of GDP in 2020 to 22.6%, despite rising by 6.1% in nominal terms on increases of 17.2% for education and 15.5% for health care (Figure 3.4.3). State budget revenue declined from 20.7% of GDP to 19.5%, despite a 9.1% nominal increase reflecting gains of 38.4% in corporate income tax and 22.0% in personal income tax. Transfers from the National Fund of the Republic of Kazakhstan, the sovereign wealth fund, declined to 5.5% of GDP. Borrowing declined as the state budget deficit shrank from the equivalent of 4.0% of GDP in 2020 to 3.1%, and the non-oil deficit shrank from 11.5% to 9.9%. Government and government-guaranteed debt declined from 30.5% of GDP at the end of 2020 to 28.5% a year later despite a 7.5% increase in nominal terms.

Figure 3.4.3 Fiscal indicators

The fiscal deficit narrowed as expenditure slowed more than revenue in percent of GDP.



GDP = gross domestic product.

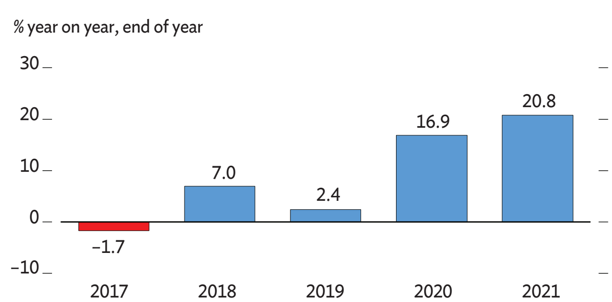
Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics (accessed 14 March 2022).

With inflation above the 4%–6% target range, the central bank raised the key policy rate by 25 basis points in July 2021 and twice again in September and October to 9.75% to contain inflationary expectations. Growth in broad money (M3) accelerated from 16.9% in 2020 to 20.8% as deposits grew by 22.7% and credit to the economy by 26.5% (Figure 3.4.4). However, the volume of central bank short-term securities fell by 28.2%, in part to offset a 16.2% rise in government securities issued to help finance the budget deficit. Credit growth accelerated, with growth in mortgage lending rising from 34.3% in 2020 to 40.0%—the same growth rate to which consumer lending soared from only 4.0% in 2020. Subsidized state lending programs and use of pension funds boosted homebuying. Lending to firms rebounded by 9.3% in 2021 after years of contraction, with loans to small and medium-sized enterprises rising by 29.2%. High loan volume halved the share of nonperforming loans from 6.9% at the end of 2020 to 3.3% a year later. Foreign currency deposits declined from 37.3% of all deposits at the end of 2020 to 36.0%, and foreign currency loans decreased from 13.0% of all loans to 10.3%.

Preliminary estimates show the current account deficit narrowing from 3.8% of GDP in 2020 to 3.0% as the merchandise trade surplus doubled, with higher oil and gas prices raising merchandise exports by more than a quarter while merchandise imports grew by only 6.6%.

Figure 3.4.4 Broad money growth

Money growth accelerated in 2021, contributing to inflation.



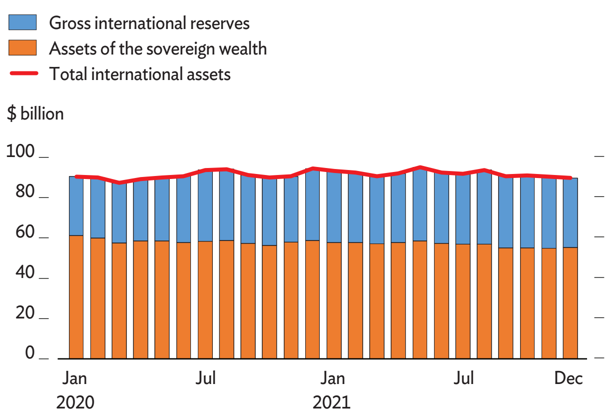
Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics (accessed 14 March 2022).

The deficit in services fell by 43.1% as global pandemic restrictions constrained outbound travel, while income from cargo transit services expanded. Profit repatriation rose by 56.4%, widening the deficit in primary income, while higher outward money transfers pushed the secondary income account into deficit. Net inflow of foreign direct and portfolio investment declined.

With the central bank selling $491 million in reserves to support the currency, gross international reserves declined by 3.5% to $34.4 billion at the end of 2021, cover for 8.8 months of imports, with more than two-thirds of reserves held in gold. Sovereign wealth fund assets declined by 5.8% to $55.3 billion as transfers to the state budget exceeded earnings by 72.2% (Figure 3.4.5). External debt, 58.8% of which is private intercompany debt, declined gradually to equal an estimated 90.8% of GDP, reflecting debt repayment by foreign subsidiaries. In June, the government issued for the second time 40 billion rubles worth of ruble-denominated bonds in Russia, Kazakhstan's largest trade partner, to finance the budget deficit.

Figure 3.4.5 Foreign currency reserves and sovereign wealth fund

Reserves and assets of the sovereign wealth fund remained high.



Source: Republic of Kazakhstan. Agency for Strategic Planning and Reforms. Bureau of National Statistics (accessed 14 March 2022).

Economic prospects

The Russian invasion of Ukraine undermined business confidence, which was already strained after domestic protests in January 2022. Spillover from economic sanctions imposed on Russia will, on top of tight monetary policy, slow growth in 2022. However, an economic reform program that aims to raise household incomes and support economic activity will limit spillover impact and reaccelerate growth in 2023. On these assumptions, growth is projected slowing to 3.2% in 2022 before accelerating again in 2023 to 3.9% (Table 3.4.1).

Table 3.4.1 Selected economic indicators, %

Macroeconomic indicators are gradually improving.

	2020	2021	2022	2023
GDP growth	–2.5	4.0	3.2	3.9
Inflation	6.8	8.0	7.8	6.4
CAB/GDP	–3.8	–3.0	–0.1	0.5

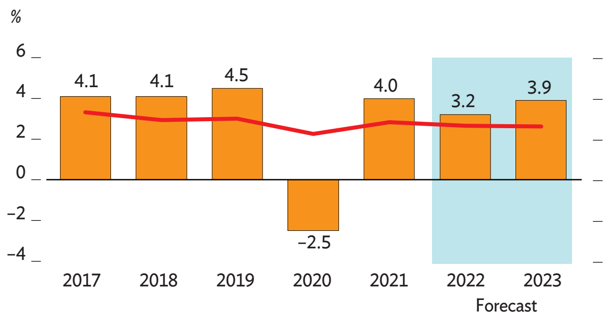
CAB = current account balance, GDP = gross domestic product.
Sources: Bureau of National Statistics; National Bank of Kazakhstan; Asian Development Bank estimates.

On the supply side, growth in services is forecast to slow to 3.5% in 2022 and then reaccelerate to 4.9% in 2023 as transport, trade, and catering benefit from the removal of COVID-19 restrictions with more than half of the population already fully vaccinated (Figure 3.4.6). Growth in industry is similarly forecast to slow to 3.0% in 2022 and reaccelerate to 3.7% in 2023 as rising external demand for commodities boosts mining by 1.9% in 2022 and 2.7% in 2023. Continued government support for import substitution will expand manufacturing by a somewhat slower 4.4% in 2022 and then 4.8% in 2023. As pension fund withdrawal to pay for homebuilding declines, growth in construction is forecast to moderate to 4.3% in 2022 and 3.8% in 2023, buoyed by ongoing state housing and infrastructure programs. Agriculture will rebound by 3.4% in 2022 from a low base and grow by 3.6% in 2023 as reform benefits crop and livestock production.

On the demand side, growth in consumption is projected to decelerate to 3.3% in 2022 as currency depreciation and tight monetary policy limit expansion in household incomes and consumer credit, stabilizing in 2023 at 3.5%. Investment is forecast to stagnate in 2022 as business confidence recedes and then rise by 4.9% in 2023, with gross fixed capital formation benefiting from reform and government-supported housing and infrastructure programs. Net exports will increase gradually in both years as rising commodity export volume outpaces consumption-driven imports.

Figure 3.4.6 GDP growth

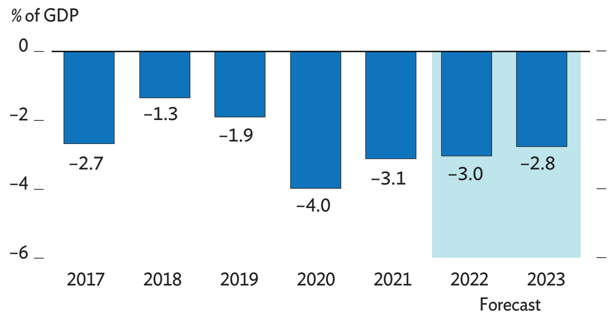
Economic growth will slow in 2022 before recovering in 2023.



GDP = gross domestic product.
Source: *Asian Development Outlook* database.

Figure 3.4.8 Fiscal balance

The fiscal deficit will continue narrowing in 2022 and 2023.



GDP = gross domestic product.
Source: *Asian Development Outlook* database.

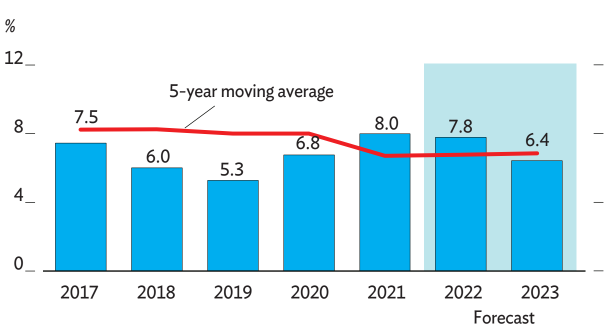
Inflation is projected to slow to 7.8% in 2022 and 6.4% in 2023, reflecting joint central bank and government efforts to contain price increases (Figure 3.4.7). Following protests in January 2022, the government introduced a half-year moratorium on increases in gasoline, staple food, and utility prices. Together, price controls and export restrictions are projected to slow food price increases to 10.2% in 2022 and 8.4% in 2023. Tight monetary policy and central bank interventions supporting exchange rate stability will hold inflation for other goods to 6.8% in 2022 and 5.8% in 2023. Utility price regulation and intensifying competition in the service sector are expected to limit inflation in services to 5.4% in 2022 and 4.4% in 2023.

The budget deficit is projected to continue to subside, but more gradually, to the equivalent of 3.0% of GDP in 2022 and 2.8% in 2023, with the non-oil deficit declining to 8.6% and then 8.0% (Figure 3.4.8). Despite a gradual rise in tax revenue, total revenue is projected to slide to 18.7% of GDP in 2022 and 17.8% in 2023 as transfers from the sovereign wealth fund are curtailed. Expenditure is forecast to drop further to 21.7% of GDP in 2022 and 20.6% in 2023 as extensive economic support programs are phased out, though partly offset by higher social outlays. Government and government-guaranteed debt are projected to remain at 28.5% of GDP at the end of 2022 and slip to 28.0% a year later.

Monetary policy over the next 2 years is expected to focus on bringing inflation toward the target range. As the Russian invasion of Ukraine escalated, the central bank raised its key policy rate by 325 basis points to 13.5% on 24 February 2022 and pledged a 10% premium for local currency deposits not converted or withdrawn for a year (Figure 3.4.9). Containing inflation will require further tightening of liquidity and phasing out subsidized lending programs, with broad money growth forecast to slow to 9.1% in 2022 and 6.4% in 2023.

Figure 3.4.7 Inflation

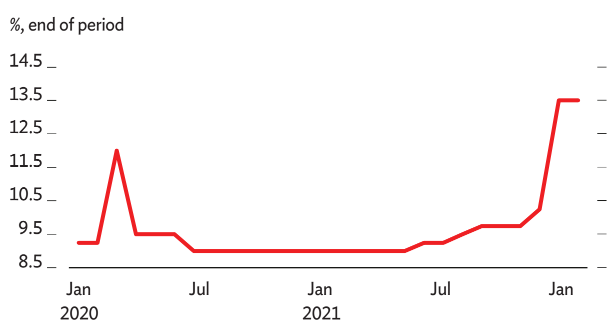
Inflation will slow in 2022 and 2023 but remain above the target range.



Source: *Asian Development Outlook* database.

Figure 3.4.9 Central bank policy rate

The key policy rate was raised sharply in early 2022 in response to external shocks.

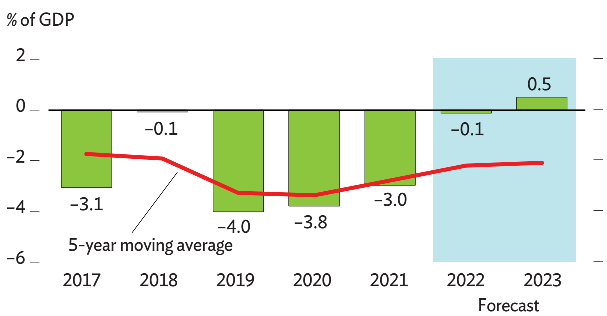


Source: Haver Analytics (accessed 14 March 2022).

The current account deficit will shrink to marginal in 2022 and turn to 0.5% surplus in 2023 (Figure 3.4.10). Record-setting commodity prices will generate merchandise export earnings last seen a decade ago expanding by 38.2% in 2022 and, as the situation stabilizes, 0.7% in 2023. Imports are projected to grow by 8.4% in 2022, driven by higher prices and volumes for consumer goods, and by 2.4% in 2023. With the resumption of international travel, the prepandemic service deficit is forecast restored by 2023. As commodity investors enjoy windfall profits, the primary income account deficit will surge by 57.6% in 2022, then narrow by 9.4% in 2023 as profits fall along with projected oil prices. Outward transfers are expected to grow by a further 26.5% in 2022, widening the secondary income deficit, but pause notably in 2023, turning that balance positive.

Figure 3.4.10 Current account balance

Sharp increases in exports will move the current account into surplus by 2023.

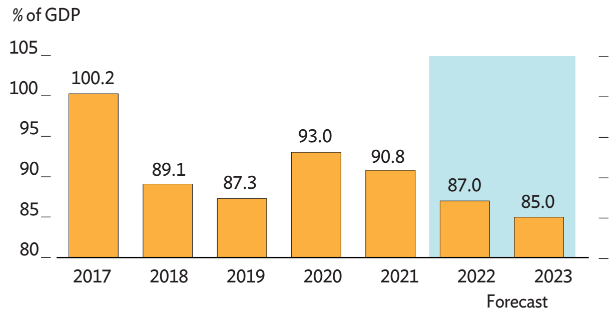


GDP = gross domestic product.
Source: *Asian Development Outlook* database.

Gross international reserves are projected to fall by the end of 2022 to $31.5 billion, or cover for 7.4 months of imports, as the central bank sells reserves to smooth exchange rate fluctuations. They should recover to $33.8 billion at the end of 2023. Sovereign wealth fund assets are forecast to expand to $58 billion in 2022 and to more than $60 billion in 2023 as budget transfers fall below inflows. External debt is expected to decline further to equal about 87% of GDP at the end of 2022 and 85% a year later as state-owned enterprises continue repaying foreign debt and foreign-owned subsidiaries repay intercompany debt (Figure 3.4.11).

Figure 3.4.11 External debt

Debt repayment will reduce the ratio of external debt to GDP.



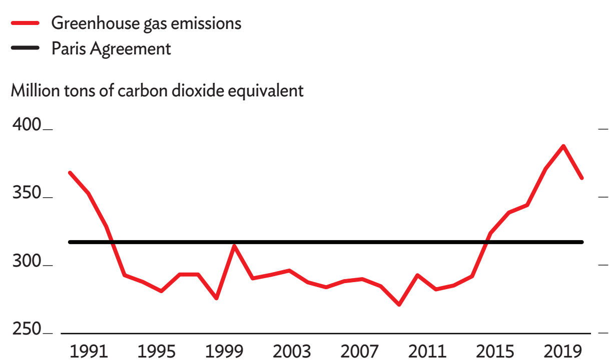
GDP = gross domestic product.
Source: *Asian Development Outlook* database.

Policy challenge—achieving carbon neutrality

Kazakhstan's economy remains carbon intensive, running on fossil fuels that leave a substantial carbon footprint. Over the past decade, greenhouse gas emissions increased by a third, exceeding 360 million tons of carbon dioxide in 2019 (Figure 3.4.12). Kazakhstan has the 12th highest global energy intensity relative to GDP, according to Enerdata's 2021 World Climate and Energy Data Yearbook. This stems primarily from its dependence on coal to generate electricity, 69.7% of which comes from coal-fired power plants (Figure 3.4.13). Households pay among the lowest electricity prices in the world. At only

Figure 3.4.12 Greenhouse gas emissions

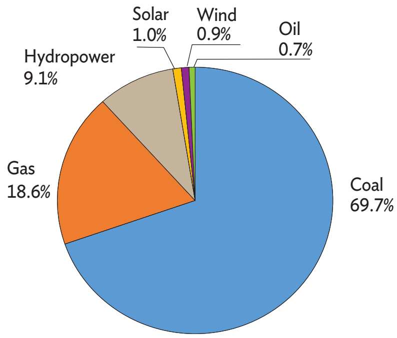
Greenhouse gas emissions increased by a third over the past decade.



Source: Ministry of Ecology, Geology and Natural Resources. 2021. *National Report of the Republic of Kazakhstan on the Inventory of Anthropogenic Emissions from Sources and Removals by Sinks of Greenhouse Gases Not Regulated by the Montreal Protocol for 1990–2019.*

Figure 3.4.13 Electricity production by source, 2020

Coal supplies over two-thirds of electricity.



Source: Our World in Data (accessed 14 March 2022).

$0.042 per kilowatt-hour, they are less than a third of the global average of $0.138. Low gasoline prices at $0.47 per liter—again about a third of the world average—add to the problem, discouraging conversion to fuel-efficient cars as the average age of domestic automobiles approaches 20 years.

In 2021, oil production reached 85.7 million tons, 78.9% of which is exported. The European Union, which imports over half of Kazakhstan's oil production, is phasing in a carbon tax on imports and restricting the sale of cars with internal combustion engines, posing a major challenge to Kazakhstan and other economies dependent on crude oil exports.

In 2016, Kazakhstan signed the Paris Agreement, pledging to reduce greenhouse gas emissions in 2030 by 15% from 1990 levels. Recent government data acknowledged that emissions in 2019 were down by just 2.4% from 1990, and the Climate Action Tracker website has rated Kazakhstan's climate targets and policies highly insufficient, raising emissions, not reducing them. A case in point is the country's emissions trading system, which has since 2013 increased emission allowances. Heavy fossil fuel use also affects the quality of life, as residents, especially in the country's western and central regions, consistently voice dissatisfaction with high pollution and poor air quality.

In 2020, Kazakhstan pledged at the World Climate Ambition Summit to achieve carbon neutrality by 2060. The government is developing plans to attain this goal, including changes in legislation. Achieving carbon neutrality is a challenge because eliminating carbon subsidies requires careful planning, a clear communication strategy, thorough implementation, and support for the vulnerable groups least able to bear the immediate costs. This may require reform in several areas.

The government's antimonopoly agency sets prices for electricity and district heating to cover only current operating expenses, without room for investment or modernization. Moreover, exports of gasoline are banned, and energy prices have been frozen to contain inflation following local protests. Indirect subsidies by which oil is supplied to domestic refineries at artificially low prices are estimated to have cost $2 billion in 2021. Tight state control of energy and fuel prices distorts the market, hampers competition, and is economically unsustainable. Yet removing controls raises energy and fuel prices and is thus politically unpopular. The government can mitigate the damage from higher prices through targeted support to low-income and vulnerable groups by subsidizing part of their utility and fuel bills. This need not raise budget outlays if the fiscal space is generated by removing more general fuel subsidies.

Careful management of inflation expectations must be included because higher energy and fuel prices may raise production and transportation costs. Thus, the government should encourage greater energy efficiency. This can involve offering firms and households matching funds, tax credits, and other incentives to undertake energy-efficient modernization of production, transport, and homes. In addition, stringent emission allowances and a robust carbon price would encourage large emitters to introduce carbon-capture technology.

Finally, global and private green investment is needed to cover some of the estimated $650 billion cost of achieving carbon neutrality by 2060. Kazakhstan has successfully stimulated renewable energy sources through auctions since 2017. In a relatively short time, $1.8 billion has been invested in 124 renewable energy projects that now generate 3.6% of electricity in Kazakhstan. However, planned new auctions are being postponed, sowing uncertainty. A multiyear auction timetable would help promote climate-related investment. Moreover, approving the earlier announced plan for achieving carbon neutrality and other legislative initiatives would improve the business climate by providing greater legal certainty, lowering costs and risks for investors.