

Kazakhstan

Economic Assessment

Still fueled by the oil and gas sector, the rapid economic advance of recent years continued through the first half of 2004 with GDP up by 9.1% year on year. On the demand side, the expansion was driven by strong domestic consumption supported by public sector wage raises and investment, including buoyant housing activity. On the production side, a rapid expansion of oil and gas output (up 11.1% and 47.7%, respectively) boosted the industry sector, which benefited from high world prices of oil and metals, while strong gains in transportation and communications output led the services sector. Moreover, the agriculture sector grew by 5.2%, well above its historical average.

Economic growth was accompanied by rising demand for labor and higher incomes. According to official statistics, unemployment declined from an average of 8.7% in 2003 to 7.8% at end-June 2004. Employment gains were notable in construction and services. Notwithstanding sustained strong growth, the capital-intensive nature of the industry sector has produced only moderate employment gains (Figure 2.17). The average real wage rose by 13.1% during the first half of 2004 from a year earlier, reflecting both the Government's policy to carry through substantial increases in wages in the public sector to raise incomes and living standards as well as strong demand for qualified workers in certain activities.

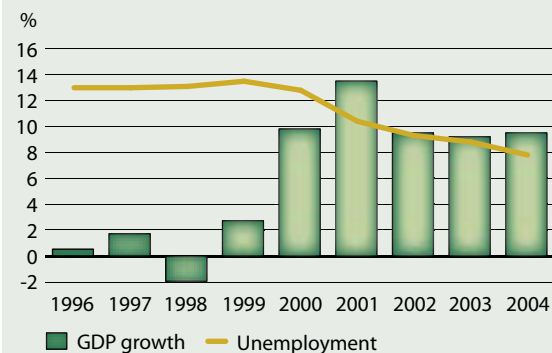
Fiscal policy remained expansionary in the first half of the year. Despite the tax cuts estimated at 1.2% of GDP (VAT was reduced by 1 percentage point to 15%, personal income tax was cut from 30% to 20%, and social payroll taxes were adjusted to a range of 7–20% from 21%), general budget revenues rose by 20.0% year on year. Both oil and non-oil revenues recorded strong gains. Total expenditures grew by 24.0%, mainly driven by higher expenditures for social

sectors, infrastructure, and development of the new capital, Astana. The general budget recorded a surplus of T35.3 billion, or 1.5% of GDP.

Inflation (annual average CPI) at 6.9% for the year ended June 2004 came in somewhat above the National Bank of Kazakhstan target of 5%, largely due to higher prices for food products. Rapid monetary expansion (M2 was up 22.6% in June from a year earlier), public sector wage increases, and imperfect competition in some products are among the factors creating price pressures. Strong export receipts and FDI cash inflows have generated pressures on the exchange rate, although the central bank continued its intervention policy to limit an undue appreciation of the currency. Accordingly, the tenge continued to strengthen against the dollar by 6.6% in real terms during the first half of 2004. In contrast to 2003, the local currency also appreciated against the Russian ruble by 1% and the euro by 8.7%, contributing to domestic producers' loss of price competitiveness.

Exports increased by 29.0% in the first quarter of 2004 from the year-earlier period, mainly as a result of high world prices of oil and metal exports. Although imports rose more rapidly

Figure 2.17 GDP Growth and Unemployment, Kazakhstan, 1996–2004



Source: National Statistical Agency.

Table 2.18 Selected Economic Indicators, Kazakhstan, 2004–2005, %

Item	2004		2005	
	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update
GDP growth	9.5	9.5	9.5	9.0
Inflation (CPI)	5.4	6.5	5.0	6.0
Current account/GDP	-1.1	-1.0	-0.6	-0.6

Source: Staff estimates.

in this period (up 44.0%), in response to high domestic demand, the trade surplus at \$1.5 billion was 15.0% higher than in the first quarter of 2003. However, the usual large net deficits on the services, income, and transfer accounts worsened due to a surge in payments for services for major investments in oil and gas sector projects and greater repatriation of FDI earnings and remittances of foreigners working in the country. As a result, the current account posted a deficit of \$349.0 million for the quarter, compared with a current account surplus (\$525.2 million) in the same period of 2003. As FDI and other capital flows remained significant, gross international reserves (including the assets of the National Fund) increased by \$1.9 billion in the first half of 2004 to \$10.5 billion at end-June.

Policy Developments

The Government continued with the implementation of its 12-year Innovative Industrial Development Strategy for 2003–2015 to foster economic diversification. It undertook several important steps toward structural reforms. In particular, it passed several new laws to restructure railways and energy and to liberalize telecommunications. The policy effort to “de-bureaucratize” the economy included overhauling the permits and licensing system. A total of 55 licenses were abolished with 24 more licenses to be cut by end-2004. In addition, the Government continued its policy effort to promote non-oil investment, with several new incentives: (i) 10-year corporate income tax holidays for new businesses, starting from 2005; (ii) a new amortization policy to reduce the amortization period from 30 years to 4–15 years, thus stimulating renewal of fixed

assets of enterprises; and (iii) a 30–50% reduction in profits subject to the corporate income tax for enterprises that undertake higher value-added production and adopt international quality standards.

Reflecting higher than expected world oil prices, the Government upgraded its estimate for central budget revenues by 7% in June 2004, though the budget deficit target of 1.9% of GDP for 2004 remains unchanged. The majority of the additional oil-related revenues will be used for financing social programs. A smaller part will be budgeted to start the Government’s new housing program for 2005–2007; the program will receive full funding in 2005.

The Government is undertaking comprehensive reforms in education and health. A switch from an 11- to 12-year compulsory education system, modernization of education management, and rationalization of the vocational and technical training systems are the priorities for education reform. Health services improvement and expansion of the number of primary health units are the main tasks in the health sector. The 2005 budget envisages an increase of expenditures for education and health of 49% and 83%, respectively, from 2004 levels.

A well-developed financial sector would significantly aid economic diversification and private sector development. Currently dominated by private commercial banks, the sector needs strengthening to efficiently channel the growing financial savings originating from extractive industries into funding for development of other parts of the real sector. Bank lending has grown rapidly; however, high lending rates hinder borrowing by some potentially fast-growing enterprises. Moreover, nonbank financial institutions (pension funds and insurance companies) are not yet active investors because the domestic securities market has yet to become a significant source of financial intermediation. To address these issues, the Government has taken steps toward financial sector deepening. In January 2004, it set up an independent Financial Supervision Agency to oversee financial institutions, and in June it established an Inter-Ministerial Commission to formulate a medium-term strategy for financial sector development.

Outlook for 2004–2005

The medium-term outlook is positive. The *ADO 2004* forecast for GDP growth of 9.5% in 2004 seems to be on track. Revised forecasts suggest that world oil prices may ease somewhat over the closing months of 2004 and moderate further in 2005. Given this outlook and a possible need to tighten financial policies to counter inflationary pressures, the projection for GDP growth in 2005 has been repegged at 9.0% from 9.5% in *ADO 2004*. Employment growth will continue, though it will stay below the output growth rate because of the capital intensity of ongoing industrial development.

The fiscal position is expected to remain strong, as growing oil revenues and strengthening tax administration will offset tax cuts. The revenue performance and the surplus recorded in the first half of 2004 suggest that the general budget deficit for 2004 will be less than the Government's forecast of 1.9% of GDP (as adopted

for *ADO 2004*) and it is now projected at 0.5% of GDP. The projected budget deficit of 1.0% of GDP in 2005 is maintained in view of the current medium-term fiscal plan.

The inflation forecast is now revised higher to 6.5% in 2004 and 6.0% in 2005 due to increases in public sector wages and expansion in the money supply. In view of projected high foreign exchange earnings, the tenge is likely to strengthen further.

Exports and imports are now expected to grow more rapidly than projected in *ADO 2004* due to higher than expected world prices for key export commodities in 2004–2005 and implementation of the large oil and gas investment projects. With this revised outlook, the trade surplus is expected to improve further, though net deficits on the services, income, and transfer accounts are likely to be largely offsetting. Accordingly, there has been no essential change made to the projection of the current account deficit, which remains at 1.0% of GDP in 2004 and 0.6% in the following year.