DEBT SUSTAINABILITY ANALYSIS

1. **Kazakhstan's public sector debt will remain comfortably sustainable for the foreseeable future.** The current fiscal effort is making a very appropriate and much-needed use of the available fiscal space of the country. Kazakhstan public sector remains a net creditor at this stage, and the projected Gross Financing Needs of the Government till 2025 (updated post-COVID and already factoring in the revised fiscal outlook for 2020), to be increasingly satisfied by market-based debt issuance from 2021 onwards, imply projected debt levels that will remain sustainable for the foreseeable future (30% by 2025). Two key conclusions of this DSA exercise are:

   i. Borrowing from ADB (or from any other source of concessional finance) will have a negligible but still positive impact on the debt-to-GDP ratio going forward. This is implicit in the comparison with a counterfactual scenario (on which a Debt Sustainability Analysis [DSA] is normally and conservatively based on) in which the projected new deficit-financing (and borrowing) is on market-based terms.

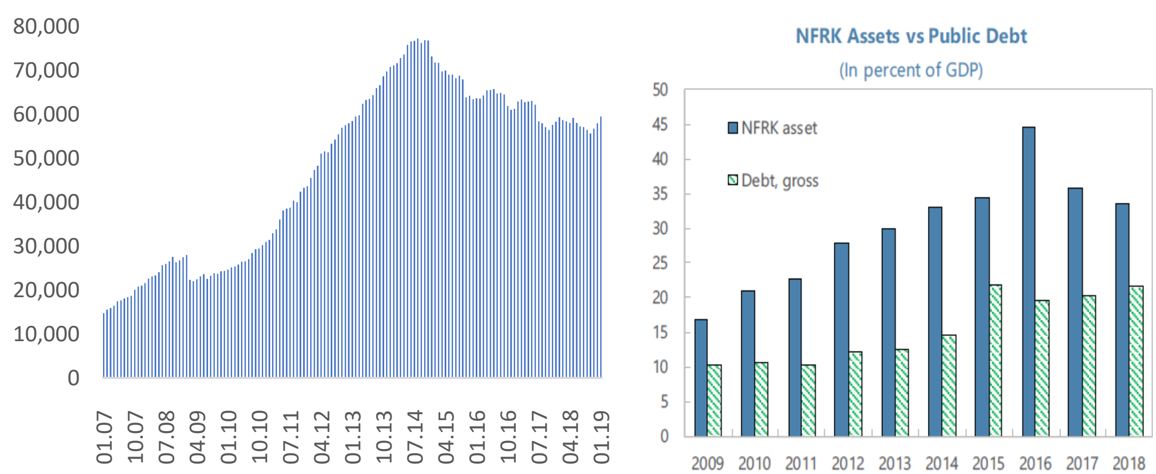
   ii. Large tapping of the National Fund of Republic of Kazakhstan (NFRK) to finance the crisis response is not expected to affect the target of 30% GDP by 2025, a threshold in Kazakhstan's fiscal rules and still a significant buffer. Thus, the Kazakhstan Government is expected to remain an external new creditor till 2024 at least.

2. Paras. 3–4 below provide background for the pre-COVID situation. Paras. 5–7 summarize the main conclusions of an updated DSA, as of May 2020. Para. 8 summarizes the DSA update that IMF staff shared with the ADB team on March 2020, as a reference.

A. Pre-COVID-19 Background

3. **The NFRK and the Pre-COVID-19 Public Debt Situation**. To ensure sustainable use of NFRK resources, a presidential decree had established fiscal rules to provide for maximum transfers to the budget to support the economy, and a minimum total asset size to perform the mandated savings guaranteed functions of the NFRK (i.e. 30%). This was to ensure intergenerational transfer of oil revenues (given the finite supply of natural resources) and NFRK resources are not drawn down extensively, which signals prudent fiscal management.

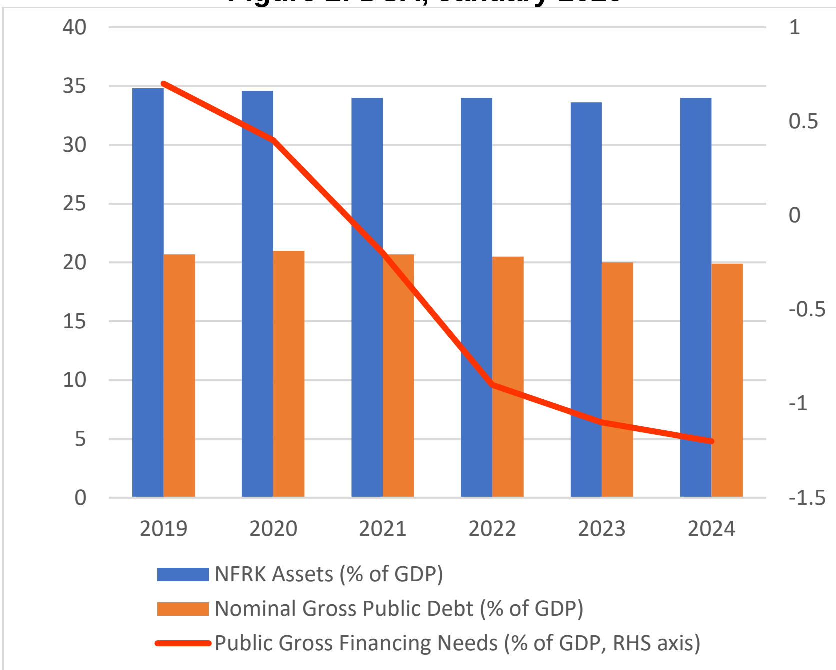
Figure 1: Assets of the NFRK ($ billion)



Source: National Bank of Kazakhstan and IMF.

4. **Pre-COVID-19 Public Debt Projections**. Gross public debt amounted to 20.2% of GDP at the end of 2019. 37% of this public debt was external debt.[1] In January 2020, a debt sustainability analysis (DSA) by the International Monetary Fund's Article IV Report projected public debt to stabilize at around 20.3% of GDP for the medium term in the baseline scenario.[2]

Figure 2: DSA, January 2020



Source: IMF Article IV, January 2020.

B. Updated Debt Sustainability Analysis as of May 2020

5. **COVID19-related Macro-Fiscal shock and Countercyclical fiscal policy Response.** The COVID-19 outbreak and has worsened Kazakhstan's economic outlook by imposing health and economic difficulties in, compounded by the effects of the (i) new oil shock, and (ii) the sudden-stop in capital inflows to its economy. Overall growth is expected to turn negative in 2020 without a countercyclical response. The state budget for the fiscal year 2020 was approved in September 2019, based on an average of $55 per barrel global oil prices. The government is experiencing a substantial revenue shortfall due to plunging oil prices in March 2020 to below $30/bbl and economic shock from the COVID-19 pandemic. President Tokayev announced a significant anti-crisis package in two rounds of action in late March totaling KZT 5.9 trillion or 9% of GDP. Measures include increased health expenditure, cash transfers to households, targeted support to the agriculture sector and to small and medium-sized enterprises (SMEs), housing construction, and infrastructure investment as part of the Employment Roadmap program. The general government balance (including the NFRK) is expected to deteriorate from -1.9% of GDP in 2019 to -5.3% of GDP in 2020.[3]

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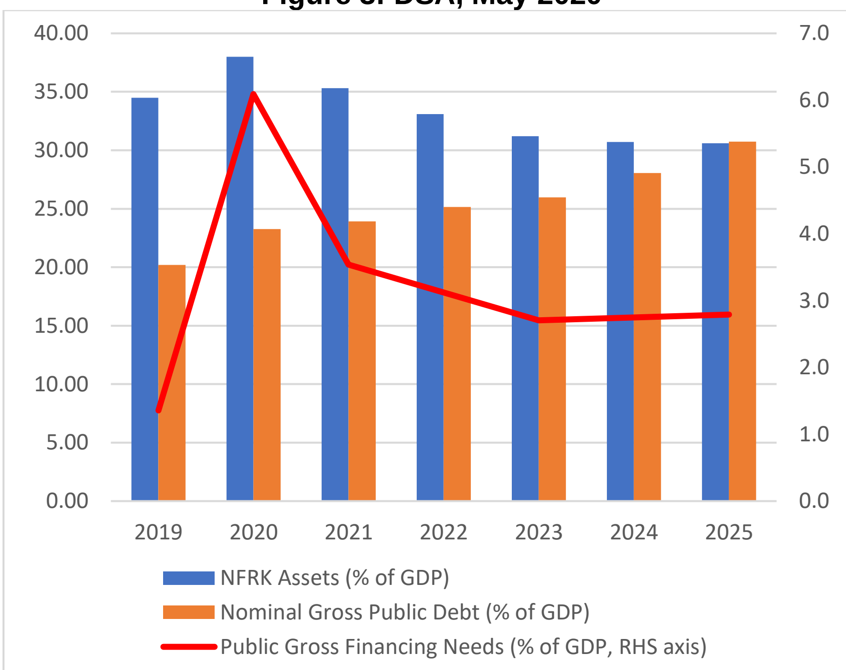
[1] Total public sector debt, when added by the state-owned enterprises' debt, was 44.7% of GDP in 2019. But there is significant interagency debt included in this number, and lack of inclusion of assets under the balance-sheets of these SOEs deems it irrelevant for a DSA.

[2] IMF. 2020. Republic of Kazakhstan: Selected Issues, *IMF Country Report.* No, 20/38. Washington, DC.

[3] The non-oil fiscal deficit as a percentage of GDP for 2020 is now set to widen from -7% to -11%. Expenditure is projected to increase by 2% of GDP (KZT 1.4 trillion) relative to the original 2020 budget given the additional

6. **Additional financing needs and NFRK Transfers to the Budget**. Total New Net Fiscal Financing Needs are estimated at $7 billion in 2020. Financing needed for the higher deficit in 2020 is expected to come from higher transfers from the National Fund Republic of Kazakhstan (NFRK) and increased borrowing from IFIs (like ADB and AIIB), which implies concessional terms. Despite the government's earlier plans to reduce NFRK transfers to the budget, the government will have to draw down on the NFRK to some extent to partly finance the deficit, given the rapidly widening of the non-oil fiscal deficit. The overall NFRK transfers to the state budget are expected to reach $5 billion by the end of 2020. This, in turn, will deplete more than 8% of the accumulated funds of NFRK. Despite renewed accumulation from 2021, NFRK assets are projected at slightly above 30% of GDP by 2025, which still represents a significant buffer and above the 30% of GDP threshold targeted by the authorities' fiscal rules. Taking into account NFRK assets, Kazakhstan is projected to remain in a surplus position till at least 2024. The resulting projections for gross Public Debt in Figure 3 below include an assumption that, to ring-fence the level of the NFRK in 2024–2025, the Government issues additional debt in 2024–2025.

Figure 3: DSA, May 2020



Source: ADB staff.

7. **IFI borrowing positive—albeit negligible—effect on debt sustainability.** A DSA is normally and conservatively based on the forward-looking assumption that deficit-financing is on market-based terms. This allows for much of the inquiry to focus on checking if projected primary deficits going forward[4] imply a stable, rising or decreasing ratio of debt/GDP over the medium term. Key to this exercise are the assumptions regarding the future path of the primary deficit.[5]

measures planned as part of the stimulus package. Oil revenue is projected to decrease by 1.6% of GDP (or 27 percent year-on-year) relative to 2019, given the drop of oil prices and the projected reduction in oil production. VAT revenue collections are projected to decline by 0.4% of GDP (or 15 percent) relative to 2019, given the impact of the state of emergency on domestic economic activities. Given the expected short-term measures, the general government deficit is expected to recover to around -2% of GDP over the medium term.

[4] Plus a dynamic factor that is driven by comparing financial terms already locked-in to the existing stock of debt and the growth rate of GDP

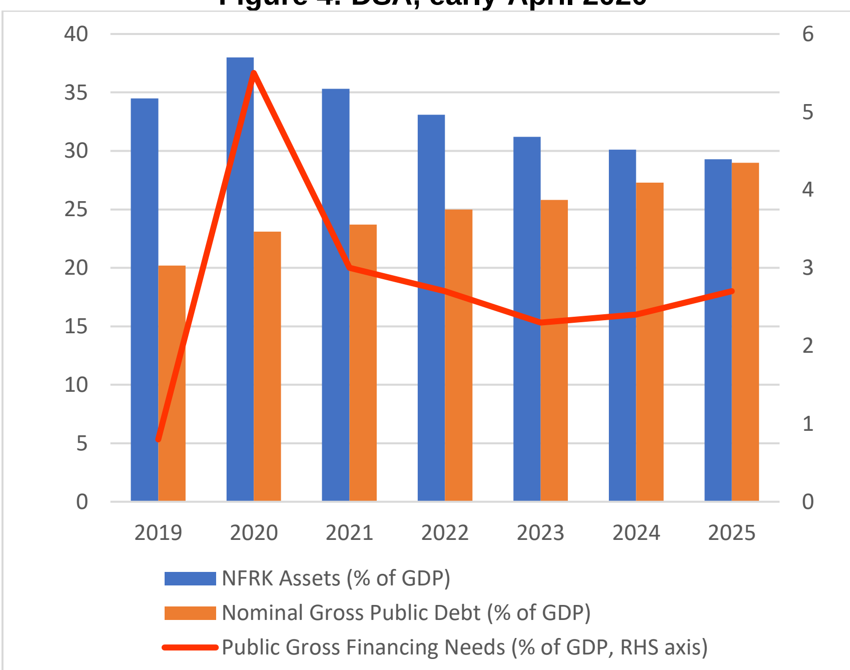
[5] As the dynamic factor highlighted in Footnote 4 above is largely endogenous.

IFI concessional lending, because it is concessional, is bound to improve the picture of whatever this core exercise concludes, as it would imply relatively softer financial terms (and reduce the effective interest rate service costs of the exercise). Naturally, financial assistance from ADB will not add to Kazakhstan's debt vulnerability risks in the medium term. The proposed ADB loan financing, in the amount of $1 billion and on broadly concessional terms, would represent only 2.4% of the country's outstanding public debt stock. While providing critical support to the projected fiscal deficit in 2020, it will still lower the projected debt ratio path slightly, as it represents a reduction to the annual debt service obligations of the Government going forward than what would otherwise be the case of market-based financing (the actual assumption of the DSA).

C. Updated Debt Sustainability Analysis by the IMF as of Early April 2020

8. **IMF Update on the DSA.** An updated DSA had already been conducted, post COVID-19 shock, by IMF staff, and discussed with the ADB staff and the Government. In this IMF updated DSA, gross public debt is projected to rise to 29% of GDP in 2025 and to remain sustainable, particularly given the assumptions on consolidation of the non-oil fiscal balance going forward. Figure 4 shows its main conclusions, which are very similar to what is presented in Figure 3. The differences in the exchange-rate scenario and post 2024 ring-fencing of the NFRK determine the differential.

Figure 4: DSA, early-April 2020



Source: IMF staff, confidential.

9. Table 1 and Figure 5 below refer to the updated IMF DSA, in a more familiar presentational form. The underlying document will, however, likely remain unpublished.

Table 1: Updated IMF debt sustainability analysis – baseline scenario

Debt, Economic and Market Indicators [1]

	Actual			Projections					
	2009-2017 [2]	2018	2019	2020	2021	2022	2023	2024	2025
Nominal gross public debt	14.6	20.3	20.2	23.1	23.7	25.0	25.8	27.3	29.0
Of which: guarantees	0.5	1.1	1.2	0.0	0.0	0.0	0.0	0.0	0.0
Public gross financing needs	0.2	-2.3	0.8	5.5	3.0	2.7	2.3	2.4	2.7
Public debt (in percent of potential GDP)	14.6	20.5	20.8	22.6	23.5	24.9	26.2	27.5	29.0
Real GDP growth (in percent)	4.1	4.1	4.5	-2.5	4.1	3.7	5.0	3.1	3.1
Inflation (GDP deflator, in percent)	10.2	9.2	6.3	-1.7	7.5	7.1	6.4	5.9	5.6
Nominal GDP growth (in percent)	14.8	13.7	11.0	-4.2	12.0	11.1	11.7	9.3	9.0
Effective interest rate (in percent) [4]	5.5	5.7	5.7	5.4	4.9	4.7	4.8	4.8	4.6

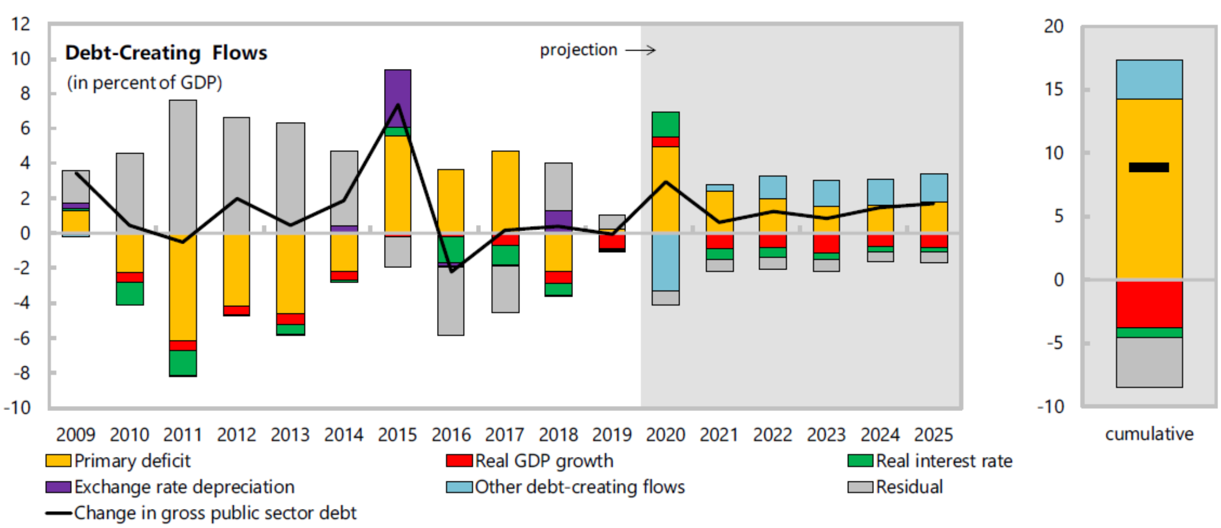
As of April 08, 2020		
Sovereign Spreads		
EMBIG (bp) 3/		453
5Y CDS (bp)		128
Ratings	Foreign	Local
Moody's	Baa3	Baa3
S&Ps	BBB-	BBB-
Fitch	BBB	BBB

Contribution to Changes in Public Debt

	Actual			Projections							
	2009-2017	2018	2019	2020	2021	2022	2023	2024	2025	cumulative	debt-stabilizing primary balance [10]
Change in gross public sector debt	1.5	0.4	-0.1	2.9	0.6	1.3	0.9	1.5	1.7	8.8	
Identified debt-creating flows	-1.1	-2.3	-0.8	3.7	1.3	1.9	1.5	2.1	2.3	12.8	
Primary deficit	-0.5	-2.2	0.2	5.0	2.4	2.0	1.5	1.6	1.8	14.3	0.5
Primary (noninterest) revenue and grant	21.6	19.7	18.7	16.7	16.9	16.9	17.0	16.8	16.5	100.7	
Primary (noninterest) expenditure	21.1	17.5	19.0	21.7	19.3	18.9	18.5	18.3	18.3	114.9	
Automatic debt dynamics [5]	-0.6	-0.1	-1.0	2.0	-1.5	-1.4	-1.6	-1.1	-1.1	-4.5	
Interest rate/growth differential [6]	-1.0	-1.4	-1.0	2.0	-1.5	-1.4	-1.6	-1.1	-1.1	-4.5	
Of which: real interest rate	-0.6	-0.7	-0.1	1.5	-0.6	-0.6	-0.4	-0.3	-0.3	-0.7	
Of which: real GDP growth	-0.4	-0.7	-0.8	0.5	-0.9	-0.8	-1.1	-0.7	-0.8	-3.8	
Exchange rate depreciation [7]	0.4	1.3	-0.1	...	...	...	...	...	...	...	
Other identified debt-creating flows	0.0	0.0	0.0	-3.3	0.4	1.3	1.5	1.6	1.6	3.1	
GG: Privatization Proceeds (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.2	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
The NFRK asset accumulation [8]	0.0	0.0	0.0	-3.2	0.4	1.3	1.6	1.6	1.6	3.2	
Residual, including asset changes [9]	2.5	2.7	0.8	-0.8	-0.7	-0.7	-0.6	-0.6	-0.6	-4.0	

Source: IMF staff, confidential.

Figure 5: Change in public debt and its drivers (% of GDP) in the IMF Updated DSA



Source: IMF staff, confidential.