At a Glance

- Over the past decade, Kazakhstan has made strong policy strides and responsibly absorbed large natural resource-based earnings by implementing a rules-driven fiscal framework. However, diversification remains a challenge for a country with the ninth-largest oil reserves in the world, as hydrocarbon output constituted 21% of GDP and about 62% of exports in 2017.

- As oil output growth stabilizes in 2018, real GDP growth is expected to moderate to an average annual rate of 3% through 2020. Growth in the non-tradable services sector will be supported by stronger domestic demand, as real household income is expected to start to recover. Moreover, the planned additional investment in oil output expansion projects will lead to an increase in construction activity.

- Risks to the outlook include a potentially weakening external environment, worsening problems in the banking sector, and a missed opportunity to deepen structural reforms. To mitigate risks and facilitate a sizable expansion of the tradable non-oil sector’s role in the economy, the Government must demonstrate significant improvements in the rule of law, the investment climate, and the quality of human capital.

Country Context

Kazakhstan has a land area equal to that of Western Europe, but one of the lowest population densities globally. Strategically, it links the large and fast-growing markets of China and South Asia and those of Russia and Western Europe by road, rail, and a port on the Caspian Sea.

Kazakhstan has transitioned from lower-middle-income to upper-middle-income status in less than two decades. The country moved to the upper-middle-income group in 2006. Since 2002, GDP per capita has risen sixfold and poverty incidence has fallen sharply, showing a significant progress in country performance in the World Bank’s indicator of shared prosperity.

Kazakhstan’s challenging external environment caused a broad-based economic slowdown in 2014 and put upward pressure on inflation. Progress on poverty reduction was largely stagnant in 2014 and 2015, reflecting slow growth and anemic labor market outcomes. In 2017, more favorable terms of trade and increased oil production supported an economic recovery and an improvement in poverty indicators in Kazakhstan.

Ongoing structural and institutional reforms aim to reduce the role of the state in the economy and facilitate the development of a vibrant, modern, and innovative tradable non-oil sector.

The economy’s vulnerability to external shocks remains the main challenge to achieving stable and sustainable development. External demand from China and the Russian Federation, Kazakhstan’s main trading partners, as well as global oil demand and prices, will continue to be the key external factors impacting Kazakhstan’s economic performance. Domestic factors include the pace of implementation of structural and institutional reforms.
The World Bank and Kazakhstan

This year marks the 25th anniversary of the partnership between the Government of Kazakhstan and the World Bank Group (WBG). Since 1992, the Bank has provided 46 loans to the country for a total amount of more than US$8 billion.

The Country Partnership Strategy (CPS) for 2012–17 was designed to ensure continued strong government ownership of Bank-supported programs. It concentrated on the Government’s key priorities of competitiveness and jobs; strengthened governance in public administration and service delivery; and safeguarding of the environment.

The World Bank has recently developed a Systematic Country Diagnostic (SCD), an evidence-based analysis that selectively addresses a set of binding constraints in order to support Kazakhstan’s aspiration to achieve equitable growth and integration into the top 30 economies.

Building on the outcomes of the SCD and the results and impact of the Bank’s operations, a new Country Partnership Framework is being developed in consultation with counterparts and civil society to shape a new investment program and quality technical assistance to the Government for 2019–2023.

Key Engagement

Since 2003, the World Bank has significantly extended its Advisory Services and Analytics (ASA) provided under the Joint Economic Reform Program (JERP). Over the years, the program has proved to be an innovative solution, with a client-driven knowledge agenda and Bank-selected work, bringing in and building up international experience.

The JERP is structured around the CPS pillars focusing on development gaps in growth, governance, and the public service delivery agenda. The program is designed to ensure strong government ownership while enhancing the Bank’s contribution to the country’s development in a way that goes beyond funding.

The Subnational Doing Business in Kazakhstan 2018 report is the continuation of a subnational study in the Doing Business series that focuses on business regulations affecting small to medium-sized domestic firms in Kazakhstan.

Subnational Doing Business studies go beyond the largest business cities to examine conditions across a number of locations in a single economy or region in order to capture local differences in business regulations or in the implementation of national laws.

The study creates quantitative indicators on four regulatory areas—starting a business, dealing with construction permits, getting electricity, and registering property—governed by local jurisdiction and/or local implementation of national regulations.

This year, the study will compare all Kazakhstan’s regions and recommend reforms based on examples within the country and from the 188 other economies measured by the global Doing Business project. The results will be shared with local- and national-level stakeholders to support all levels of government in their reform initiatives to improve the ease of doing business across Kazakhstan.

The study is being conducted at the request of the Government of Kazakhstan, with the support of the World Bank Group.

WORLD BANK PORTFOLIO

Number of Projects: 13
Lending: $3.8 Billion
IBRD: 10 Loans
GEF: 3 Grants
**Recent Economic Developments**

Following two years of weak growth, Kazakhstan’s economy recovered in 2017. Real GDP growth accelerated to 4% in 2017, up from 1.1% in 2016. Oil production, which rose by 10.5% year-on-year (y-o-y) in 2017, was the primary driver of this improvement. An increase in oil output was observed in the oil fields that were not covered by the OPEC-led cuts in 2017. Together with more favorable terms of trade, it generated positive spillover effects to the manufacturing and services sectors.

On the demand side, growth was driven by an improvement in net exports, highlighting oil sector expansion and the recovery of global oil prices. The current account deficit narrowed substantially in 2017 to 3% of GDP (from 6.5% in 2016), buoyed by more favorable terms of trade. The improvement in the current account balance helped the tenge to strengthen by about 10% in real terms against the U.S. dollar in 2017. On the financing side, foreign direct investment (FDI) inflows and foreign borrowing by state-owned enterprises were offset by short-term capital outflows. The central bank reported an increase in assets held by residents abroad. As a result, gross international reserves of the central bank and the Government (in the oil fund) declined by nearly US$5 billion (3% of GDP).

Because of the banking sector bailout, the overall fiscal deficit widened to 7% of GDP in 2017. The Government recapitalized the Problem Loans Fund with an injection of US$6.5 billion (about 4% of GDP) in 2017 to support the recovery of banks’ balance sheets, and the central bank provided another US$2 billion to support the ailing banks. The central bank continued to implement its inflation-targeting policy. As the impact of the 2015 currency depreciation eased, consumer price inflation halved from an average of 14.6% in 2016 to 7.4% in 2017. With inflation easing, the central bank cut its policy interest rate three times in 2017 and two times in early 2018. The latest rate cut, in March 2018, lowered the policy rate to 9.5%.

The poverty rate (using the US$5.5/day international poverty line) rose from 5.6% in 2013 to a peak of 7.9% in 2016; it is estimated to have fallen to 6.9% in 2017. The incidence of poverty increased in all regions of Kazakhstan between 2014 and 2015, the last year for which data is available. Poverty rates in the most vulnerable southern regions more than doubled during this period. Despite the economic recovery and improved consumer confidence, household income remained under pressure in 2017, as the labor market struggled to recover. Real wages and salaries declined by 2.1% y-o-y. The official unemployment rate remained unchanged in 2017 at 4.9%.

**Economic Outlook**

As oil output growth stabilizes from 2018 onward, real GDP growth is expected to moderate to an average annual rate of 3% through 2020. Growth in the non-tradable services sector will be supported by stronger domestic demand as real incomes of households are expected to start recovering. Moreover, the planned additional investment in oil output expansion projects will drive an increase in construction activity.

Assuming that there are no external shocks and that the authorities continue their inflation-targeting regime, consumer price inflation will stabilize at between 4.3 and 5.3% in the medium term.

As oil prices are projected to stabilize at around US$60 per barrel in 2018–20, the current account balance and fiscal oil revenue are also expected to level off. The fiscal position will improve gradually in the wake of fiscal consolidation efforts. The Government is planning to cut the non-oil fiscal deficit from over 13% of GDP in 2017 to 7% by 2020.

As the economy continues to grow, labor income—the primary driver of poverty reduction in Kazakhstan—is forecast to return to positive real growth. As a result, the poverty rate is projected to decline to 5% by 2020.
Project Spotlight

Fostering Productive Innovation Project

Following the successful completion of the Technology Commercialization Project (TCP) in 2015, the World Bank and the Ministry of Education and Science of Kazakhstan launched the Fostering Productive Innovation Project (FPIP).

The new project promotes high-quality, nationally relevant research and the commercialization of technologies using a holistic approach needed to create a sustainable innovation ecosystem in the country. The project supports a grant program and finances innovative consortia, innovation brokerage, and technology transfer offices.

The project’s main components are introducing bottom-up competitive selection procedures that are open to all sectors of the economy with the intention of fostering a dynamic productive sector in the country, particularly a segment of private de novo firms. The first round generated strong interest from the private sector and scientific community, and out of 17 applications, three projects received funding of US$4 million and an additional US$2 million from private co-investors.

To date, 43 scientific groups have received grants to pursue the commercialization of research and development (R&D) ideas ranging from an IT system to help the vision-impaired to the bioremediation of soil contaminated by oil. The total amount of funding today exceeds US$21.2 million, with co-financing from private companies at 10% on average.

The project also complements existing financial instruments and solutions suitable to different stages of start-up company development. Currently, the World Bank team and the main stakeholders at the National Innovation System are working together to establish an early-stage Venture Capital Fund to demonstrate the commercial viability of the investments.

Finally, the project is focusing on the launch of an Innovation Observatory to monitor innovation performance in both the private and public sectors of Kazakhstan.