

ECONOMIC RECOVERY DURING CHALLENGING TIMES



Kazakhstan Economic Update
Winter 2021/2022

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Foreword and Acknowledgement

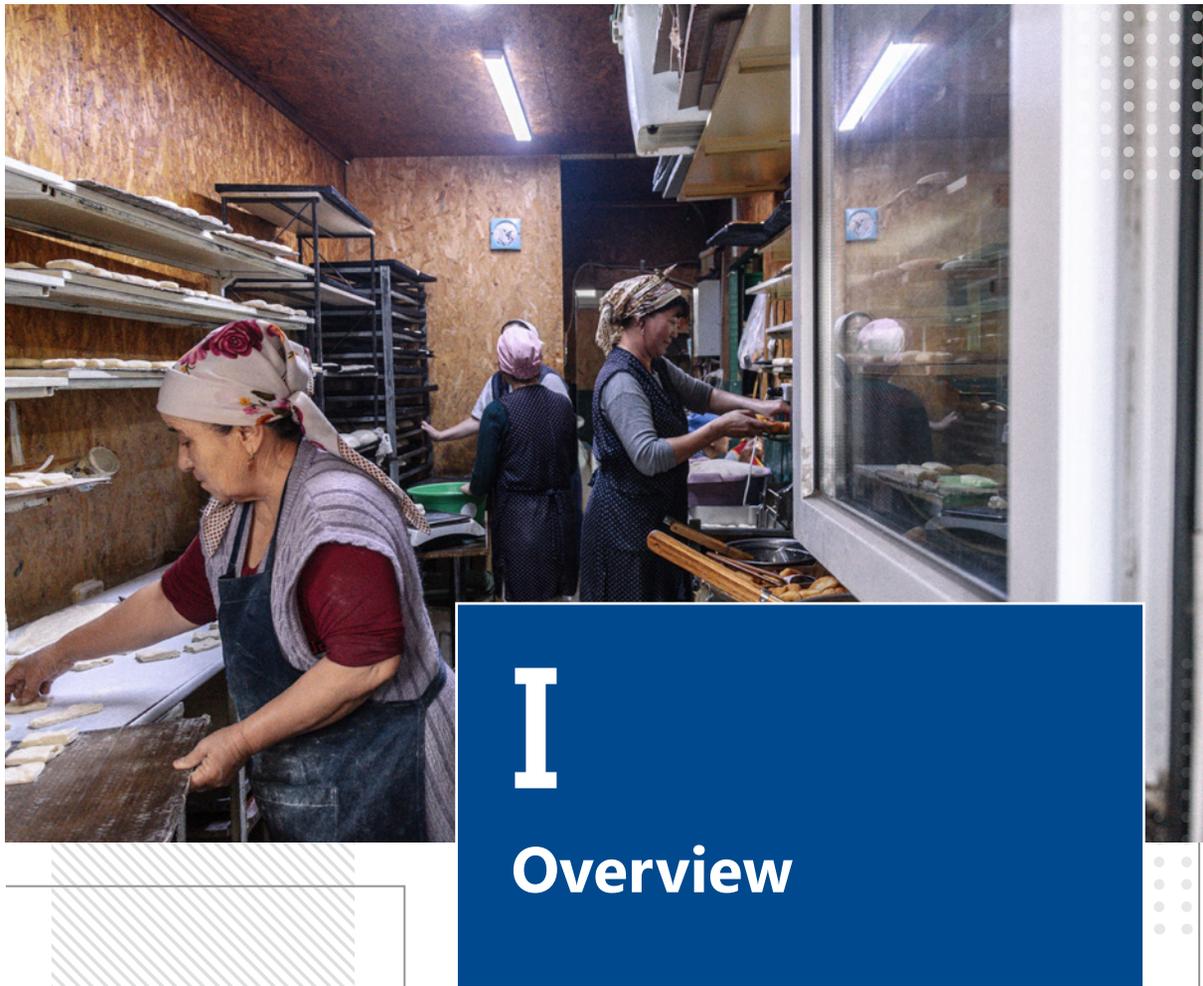
The *Kazakhstan Economic Update* (KEU) is a semiannual report analyzing recent economic developments, prospects, and policy issues in Kazakhstan. The report draws on available data reported by the government, the National Bank of Kazakhstan (NBK), and additional information collected as part of the World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

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The views and opinions herein are expressed using the information obtained from official sources. Any errors and omissions are solely those of the authors.



A favorable change in the course of the pandemic helped the resumption of critical activities in Kazakhstan. After a rapidly rising number of COVID-19 cases over the summer months, in November 2021, the average daily confirmed cases declined by 33 percent relative to a month earlier to 1,900, reaching 1270 in November. By end of November, 42 percent of population was fully vaccinated, compared to 20 percent in early August. Improvement in the epidemiological situation prompted the authorities to gradually relax restrictions on mobility, allowing for the reopening of public facilities and the introduction of a nationwide health contact tracing system.¹ The stringency index, which reflects mobility restrictions, in November declined by 10 percent from August.² About 86 percent of students at secondary schools have now resumed face-to-face class instructions, while international travel has resumed with at least sixteen countries.

Economic recovery has gradually gained momentum since the third quarter of 2020 but accompanied by higher inflation. After suffering a pandemic-driven slump of -2.6 percent in 2020, we project real GDP growth of 3.5 percent in 2021. Household consumption, driven by pent-up demand, fiscal policy support, and reduced COVID-19 restrictions, has been a major driver of GDP

¹ The "Ashyq" system is linked to the e-government system and allows the authorities to track the COVID-19 status of individuals.

² Based on Our world in Data, <https://ourworldindata.org/>

dynamics on the demand side. The reopening of the economy at the end of last year and the easing of mobility restrictions have boosted the services sector, including retail trade and transportation. Annual inflation surged to 8.9 percent y-o-y in September, the highest recorded level since 2016, driven mostly by food price inflation and large-scale disruptions in global supply chains. The inflation surge is exceeding the central bank's target range and resulting in a tighter monetary policy stance.

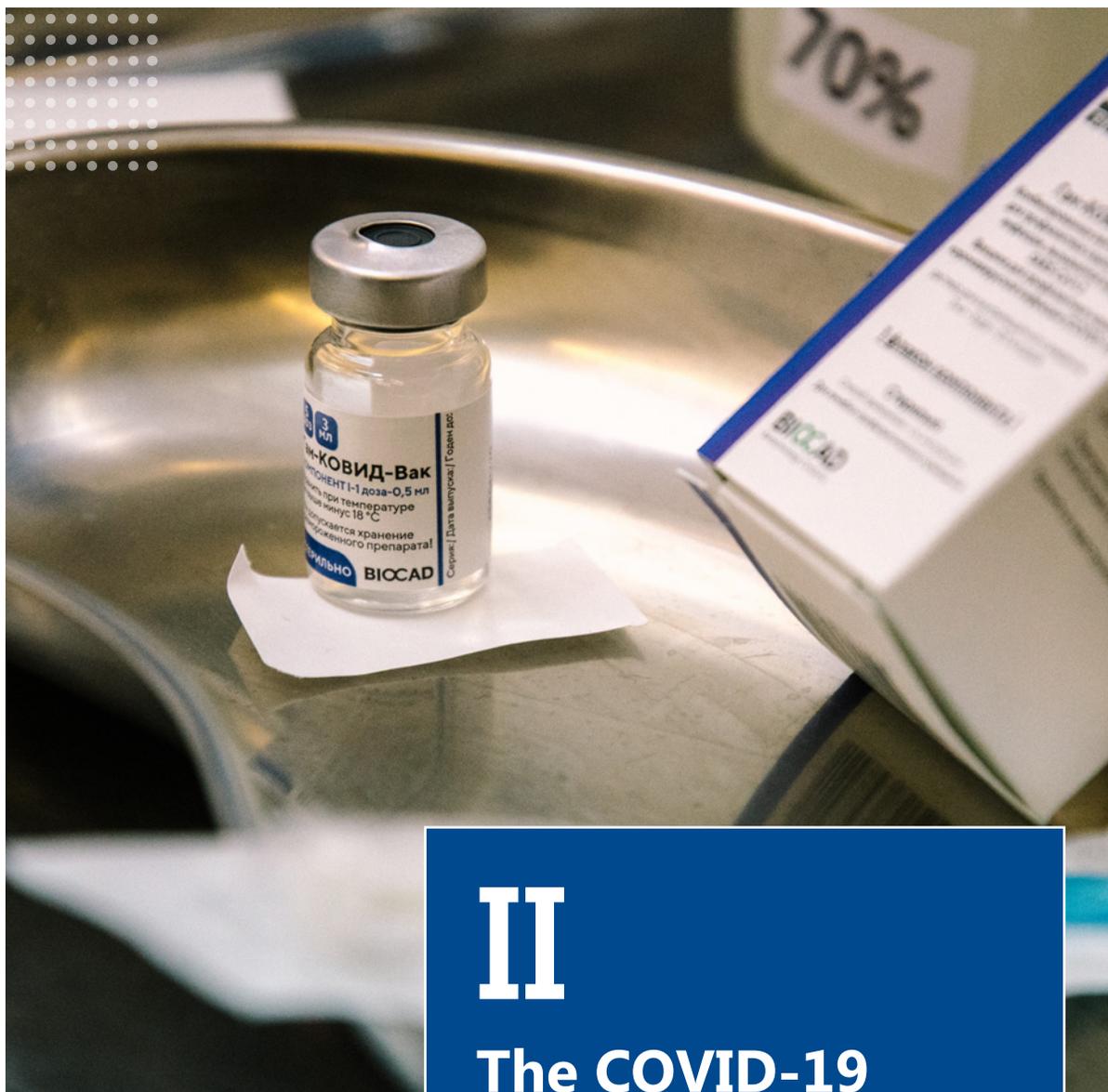
Kazakhstan's external balance has improved and the deficit in fiscal balance has narrowed slightly. Kazakhstan's exports gained from the gradual recovery of trading partners' economies and improving global demand and commodity prices. The resumption of domestic and external economic activities also increased services exports. These improvements led the current account deficit to improve to 2.5 percent of GDP in Q2 this year, compared to a deficit of 4.5 percent in Q2 last year. The government's countercyclical fiscal stance to support economic recovery this year is opportune. Early this year, the government introduced a supplementary budget which included additional spending of 1.8 percent of GDP on healthcare, support to SMEs, and infrastructure projects. Despite this fiscal support, improved oil-revenue and strong economic rebound narrowed the budget deficit for the first 9 months in 2021 to 3.1 percent of GDP, compared to 4.2 percent same period last year.

The pick-up in growth is projected to be sustained through next year. We project real GDP growth in the 3.5-4.0 percent range in 2022, although the economy will remain below the pre-pandemic baseline path for the entire forecast horizon. Growth will be supported by robust domestic activity, a supportive fiscal stance, and further progress in vaccination. Improving growth prospects in foreign markets will buoy external demand for commodities. Investment activities are expected to pick up further along with improvement in business confidence and the implementation of infrastructure projects. Higher oil prices can also provide an opportunity to replenish fiscal buffers and improve the current account balance.

Despite the improving economic outlook, downside risks remain. The risk of another potential COVID-19 outbreak cannot be ruled out despite the decline in the number of cases. A more effective vaccination campaign and improvements in controlling the spread of the virus have become key short-term priorities. Without higher coverage, the reintroduction of containment measures would be needed, which could hamper growth and delay recovery. Rising inflation is another concern that erodes purchasing power, particularly among vulnerable households, and would require a tighter monetary stance, potentially affecting domestic borrowing conditions. This possibility also applies to Kazakhstan's external borrowing cost once other central banks hike interest rates to tame inflation expectations. Volatile prices and uncertainty over the scale of demand growth for oil are other risks that could weaken the current account and pressure the exchange rate.

Kazakhstan's development path is vulnerable to climate change. This year, extreme temperatures in May and June caused a drought, which negatively affected the production of wheat, Kazakhstan's key agricultural export. Kazakhstan is vulnerable to climate change that exacerbates natural hazards such as floods, mudslides, and droughts. The country ranks 46th out of 181 countries in the 2020 ND-GAIN vulnerability Index.³ At the 26th United Nations (UN) Climate Change Conference of Parties (COP) in Glasgow, Kazakhstan reaffirmed its commitment to achieving carbon neutrality by 2060 as part of the global effort to curb rising temperatures. Kazakhstan's fossil fuel-dependent economy will face pressure from the international and domestic green transition agenda. Therefore, a broad set of policies is needed to help Kazakhstan adapt, mitigate climate shocks, and support the transition to a low carbon economy, including minimizing the social impact and supporting economic diversification.

³ University of Notre Dame (2019). The Notre Dame Global Adaptation Initiative. URL: <https://gain.nd.edu/our-work/country-index/> *The ND-GAIN Index ranks 181 countries using a score which calculates a country's vulnerability to climate change and other global challenges, as well as their readiness to improve resilience. The more vulnerable a country is the higher their score, while the readier a country is to improve its resilience the lower it is.*



II

The COVID-19 Situation

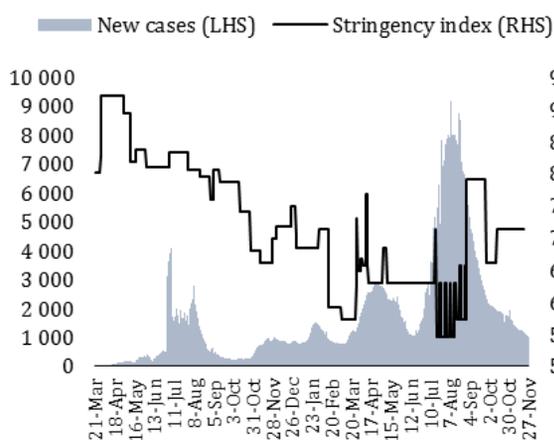
There has been significant improvement in the COVID-19 environment, with a declining number of cases observed following the surge in August this year. Stepping up the pace of vaccination and continued implementation of the tracing mechanism are critical in reducing the risk of another outbreak.

The number of confirmed cases has declined after a third-wave outbreak of COVID-19 mid-year. The average of newly confirmed cases reached about 7,466 per day in August 2021 compared to 2,296 earlier in May, mainly due to the spread of a more transmissible ‘Delta’ variant. During the same period, the average number of confirmed deaths per day also jumped to 117 from about 21. Yet, the number of confirmed cases started to decline sharply in September. The authorities also introduced a nationwide system for health tracing to manage the risk of infection in commercial and public spaces.

While the share of the vaccinated population has increased, the pace of vaccination remains slow. The authorities inoculated about 54,000 people per day in October, down from 71,800 people in September. Demand for shots and the rate of immunization remain low. According to Our World in Data, the share of Kazakhstan’s fully vaccinated population is lower when compared with developed OECD countries; this despite its smaller population, domestic production, and distribution of the national QazVac vaccine, as well as the availability of several other vaccines for inoculation (Figure 2).

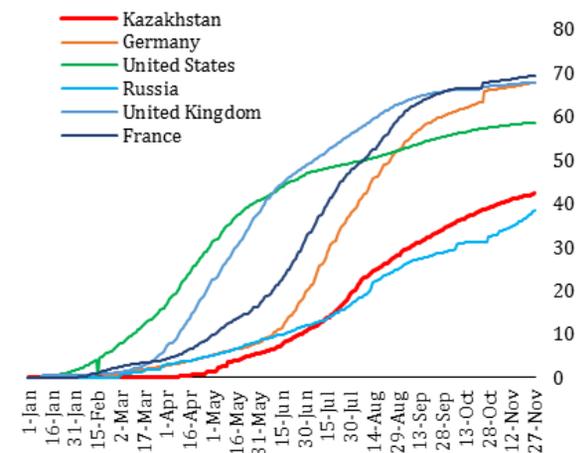
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Figure 1. The number of COVID-19 cases and government response⁴



Source: Our World in Data database. Data for November 27, 2021.

Figure 2. The vaccination rate still lags behind advanced economies (percent of the population fully vaccinated)



Source: World Bank staff calculations based on Our World in Data database. Data for November 27, 2021.

⁴ The Stringency Index is a composite measure from the Oxford COVID-19 Government Response Tracker based on nine response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest)



III

The External Environment

While global economic recovery continues, it has recently displayed reduced momentum amid a sharp rise in new COVID-19 outbreaks and continued global supply bottlenecks. The strong recovery is accompanied by a surge in commodity prices that are critical for Kazakhstan's exports.

The economies of Kazakhstan's major trading partners continue to rebound, but the resurgence of COVID-19 is overshadowing the momentum. Thanks to fiscal and central bank liquidity support and a rapid loosening of mobility restrictions, a strong rebound in consumer demand has boosted growth in the US economy in 2021. The Chinese economy, too, has continued to recover from the crisis, although its growth momentum moderated in Q3 2021. A property slowdown, energy shortages, and a resurgence of COVID-19 curbed growth of the Chinese economy to 4.9 percent y-o-y in Q3, after a sharp 7.9 percent pick-up in Q2. The imposition of COVID-related travel restrictions has weakened growth momentum in manufacturing and retail sales.⁵ Unlike China's economy, which exceeded its pre-pandemic output level in 2020, in Q3, the eurozone was on track to regain its 2019Q4 output level only by end-2021 (**Figure 3**). Having expanded by 14.2 percent y-o-y in Q2, growth in the eurozone slowed to 3.7 percent in Q3, as companies continue to face challenges from supply chain disruptions and rising energy prices.⁶ The Russian economy is estimated to have reached its pre-crisis level in the first half of 2021. However, its rebound has also moderated in the second half of the year because of reduced fiscal support and a tighter monetary policy stance as inflation accelerates. The low vaccination rate and rising new cases have weighed on economic activity and are expected to moderate growth in 2022.

Global economic recovery, following the easing of restrictions on mobility, has contributed to higher inflation rates in advanced and developing economies alike. While inflation in advanced economies accelerated against the backdrop of continued fiscal and monetary stimulus and the release of pent-up demand, in some developing countries, exchange rate depreciation has lifted the prices of imported goods since the beginning of 2021. Logistics bottlenecks and widespread shortages of intermediate products were among drivers of price increases among Kazakhstan's key trading partner economies. The more recent rise in energy bills for consumers due to soaring oil and gas prices and higher food prices also piled pressure on inflation in the eurozone countries.

A strong recovery in commodity demand since the beginning of 2021 has pushed up the prices of Kazakhstan's key exporting products. The rebound in global demand for oil as mobility steadily returns to pre-pandemic levels, amplified by supply disruptions in the U.S., as well as the OPEC+ group's intention to keep a significant production capacity off the market, have been key factors behind the rise in energy prices. Oil prices spiked to a seven-year high of almost US\$ 85 per barrel in mid-October, more than twice as high as a year earlier⁷ (**Figure 4,5**). Surging gas prices have also had a spillover effect on oil prices. Oil is becoming more economically competitive considering rising gas prices, which increases its potential use as a substitute for electricity and heating generation⁸. This could partly support a short-term upward trajectory for oil prices. The World Bank's base metals index saw a sharp rise of 36.6 percent between April 2020 and May 2021 before plateauing in the second half of 2021. Robust demand from China, the world's largest consumer, lower stocks of certain metals, and supply disruptions and bottlenecks in shipping have buoyed metal prices. However, rising new COVID-19 infections in China, which has led to renewed lockdowns, and the decline in the real estate sector, could dent demand and halt the rally in metal prices. Agricultural prices also rose substantially by 37.2 percent y-o-y in September 2021. The prices of certain foods have been pushed up by increasing input costs owing to spiraling prices for gas and fertilizers, production shortfall, and strong demand (**Figure 6**).

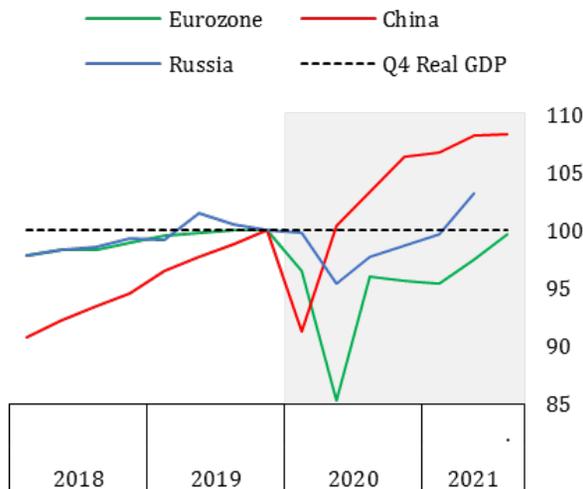
⁵ World Bank ECA Economic Update, Fall 2021.

⁶ <https://ec.europa.eu/eurostat/documents/2995521/11563347/2-29102021-BP-EN.pdf/e8d47562-a783-9b7c-c1f6-0241602abbd9?t=1635490030844>

⁷ World Bank, "Pink Sheet," October 2021.

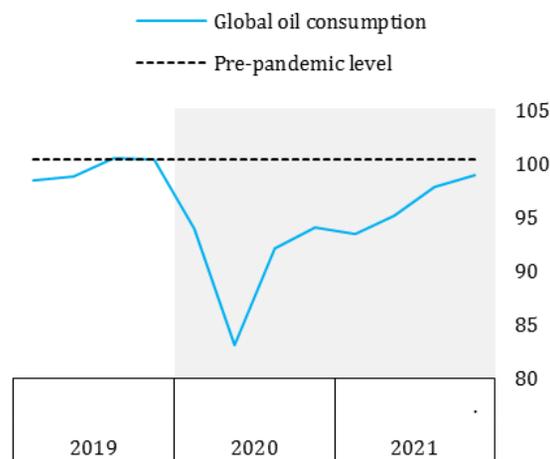
⁸ World Bank, "Commodity Market Outlook", October 2021.

Figure 3. Growth momentum in key foreign markets (index Q42019=100)



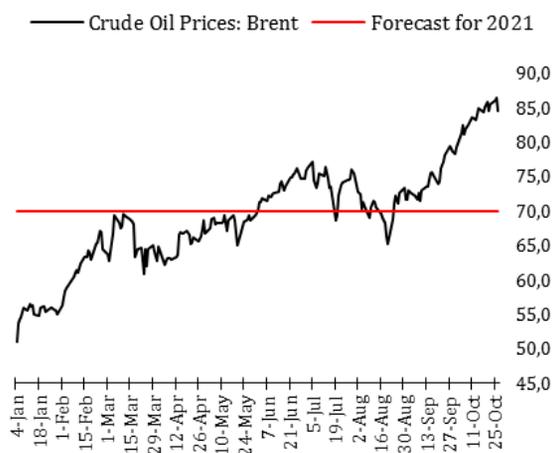
Source: OECD database, staff calculations

Figure 4. Oil demand continues to recover but remains below its pre-pandemic level (Million barrels per day)



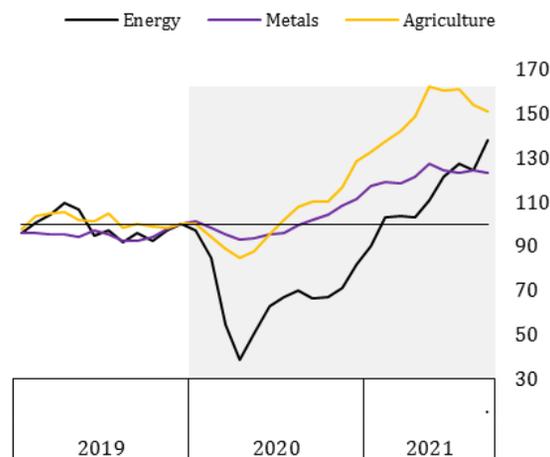
Source: U.S. Energy Information Administration, World Bank Group.

Figure 5. Oil prices soared in the second half of 2021 (US\$ per Barrel)



Source: International Energy Agency, World Bank Group.

Figure 6. Global commodity prices are on the rise (price index, 12M2019 = 100)



Source: World Bank Group.



IV

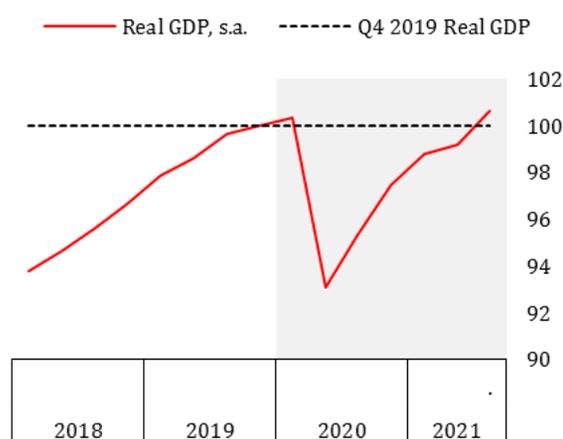
Economic Growth and Inflation

Kazakhstan's economic recovery is on track, having sustained quarterly growth throughout Q3. Reduced COVID-19 cases and the loosening of mobility restrictions support business activities and maintain the rebound in consumer demand. However, sustained inflation can dampen the growth momentum and erode purchasing power, particularly for lower income households.

The Kazakh economy has rebounded to its pre-pandemic level as the impact of COVID-19 continues to dissipate, and vaccination is progressing. Since the start of 2021, GDP has continued to recover and head towards its pre-pandemic level. Following 1.3 percent q-o-q (seasonally-adjusted) growth in Q1, the growth momentum weakened slightly in Q2 because of a sudden rise in COVID-19 cases and certain containment measures. However, economic activity gained momentum in Q3. Real GDP expanded by an estimated 0.4 and 1.4 percent q-o-q in Q2 and Q3, respectively bringing the economy to its pre-crisis size (**Figure 7**).

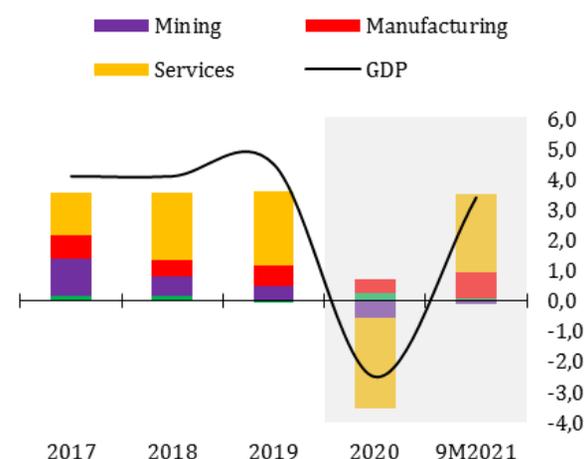
The key drivers of demand-side GDP growth are consumer spending, supported by reduced COVID-19 restrictions, and continued fiscal and credit support to households and enterprises. Solid growth in retail trade and automobile registrations indicate a strong rebound in household consumption and unleashed pent-up demand. The volume of retail trade rose by 6.1 percent y-o-y in January-September, while spending on passenger cars picked up by 21.6 percent in the first eight months of 2021 from a year earlier. Real household incomes, mainly supported by real wages, increased by 5.9 percent y-o-y in September, as the reopening of the economy enabled greater normalization of activities.

Figure 7. GDP has exceeded its pre-pandemic level *Index, 2019Q4=100*



Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 8. Economic activity is driven by buoyant services and manufacturing *(contribution, percent)*



Source: World Bank staff estimates based on Bureau of National Statistics data.

Solid growth in housing construction and investments in non-extractive sectors have boosted overall investment. After contracting by 3.4 percent in 2020, capital investment rose modestly by 2.0 percent in real terms in January-September. Solid growth in housing investment and manufacturing and services industries drove overall growth despite still weak FDI inflows into mining.⁹ High uncertainty over the evolution of the pandemic and weak production and exports of oil, which languished below pre-pandemic volumes, are likely factors holding back FDI. Housing investment increased by 25.4 percent y-o-y in January-September, with demand for housing

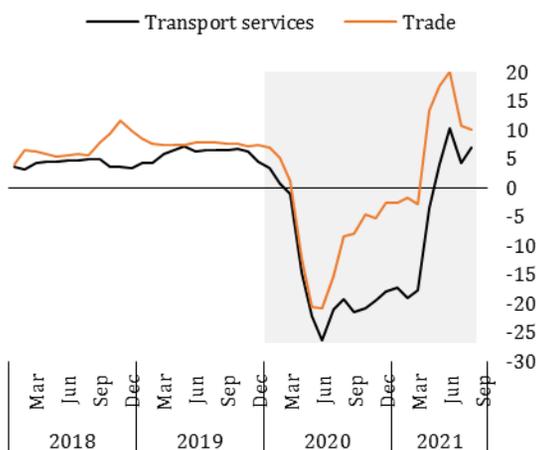
⁹ Although according to the NBK data the gross inflow of FDIs into the mining industry has grown by 27.1 percent y-o-y in the first half of 2021, it remains still below the pre-pandemic volume.

remaining robust, supported by exceptional withdrawals of pension savings for home purchases and solid growth in mortgage lending.¹⁰

On the production side, reopening the economy has increased activity in the face-to-face services sectors. These sectors, such as wholesale and retail trade, transportation, hospitality, and other personal services, were heavily affected by containment measures. High demand from housing and government infrastructure projects boosts construction and manufacturing industries mainly aimed at the domestic market. In contrast, output in mining has been restrained by sluggish oil exports (**Figure 8.9.10**). Oil production was still down by 3.4 percent in the first nine months of the year compared to a year earlier owing to compliance with restrictions imposed by OPEC+ and maintenance work at the Tengiz oil field.^{11 12}

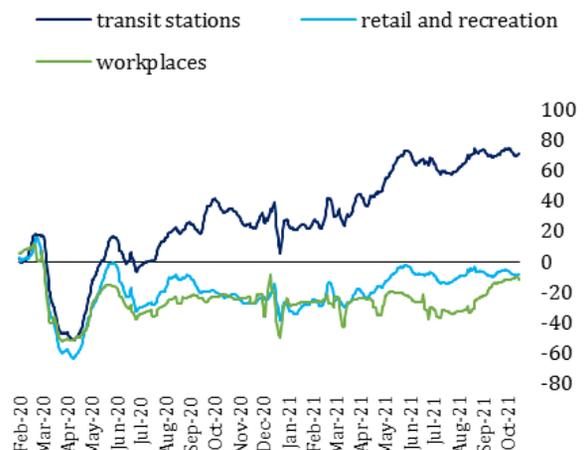
Inflationary pressures have intensified as the economy recovers from the crisis. The 12-month inflation rate in September picked up to 8.9 percent from the 7.5 percent recorded in December 2020 (**Figure 11**). The surge in inflation since the beginning of 2021 points to increased upward pressure from the release of pent-up demand as the COVID-19 pandemic eases and supply-side factors linked to rising input costs. A sharp rise in real wages and the prices of utilities, energy, and delivery services signal rising input costs for producers and, in part, explain the across-the-board price rises observed so far this year. Real wages picked up after the resumption of activity, especially in the service sectors. Global logistical disruptions and soaring shipping costs have started to become apparent in import prices, which rose from 5.4 percent in December to 9.4 percent y-o-y in September, despite a broadly stable tenge exchange rate. As the share of imported goods in consumption baskets is high, rising prices for imported final and intermediate goods are likely to add to costs and ultimately be passed on to consumers (**Figure 12**).

Figure 9. Easing of the lockdown lifts the service sector (year-on-year three-month MA, percent)



Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 10. Mobility indicators have returned to pre-pandemic levels



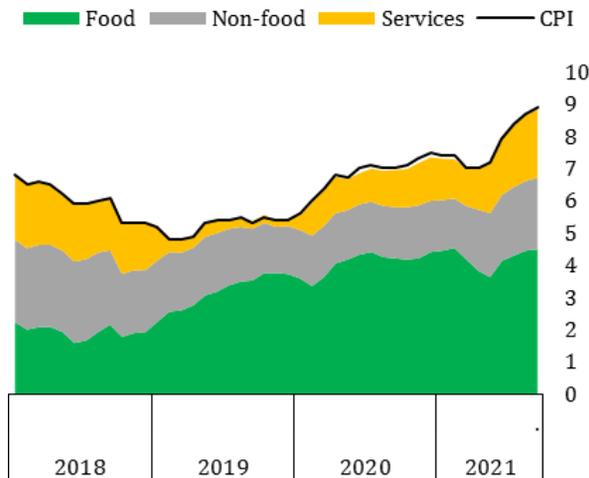
Source: Google COVID-19 Community Mobility Trends. Data for November 4, 2021

¹⁰ https://www.enpf.kz/ru/about/press-center/news/index.php?ELEMENT_ID=11733.

¹¹ <https://www.reuters.com/business/energy/opec-compliance-with-oil-cuts-rises-116-august-sources-say-2021-09-21/>

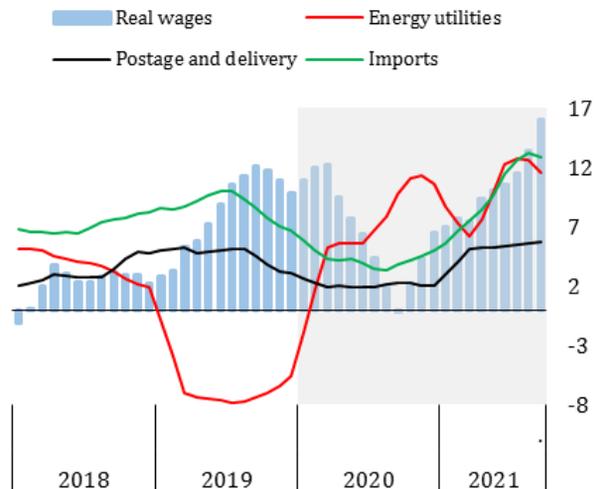
¹² [From the quota of 1,508 million barrels per day in September oil production will increase by 16,000 barrels per day from that point onward. https://astanatimes.com/2021/09/kazakhstan-to-continue-steadily-increasing-oil-production-under-opec-deal/](https://astanatimes.com/2021/09/kazakhstan-to-continue-steadily-increasing-oil-production-under-opec-deal/)

Figure 11. Inflation has picked up
(year-on-year, percentage point)



Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 12. Producers face rising cost pressure
(year-on-year, percent)



Source: World Bank staff calculations based on Bureau of National Statistics data.

A substantial rise in food and gasoline prices has been another concern arising from the pandemic. In September, food and gasoline prices respectively rose by 11.5 percent and 14.5 percent y-o-y. The prices of certain essential food products such as potatoes, carrots, and eggs have soared in recent months on lower seasonal production and increased exports that have depressed domestic market supply. Service sectors notably impacted by the lockdown, such as out-of-home-dining, education, and personal care services, have also become more expensive lately (**Figure 13**). House resell and rental prices have continued to climb since mid-2020, rising respectively by 26.9 percent and 17 percent y-o-y. However, construction costs, including building materials, rose by a mere 2.6 percent y-o-y in September¹³. The government policy of incentivizing the use of pension savings to purchase housing, plus subsidized mortgage programs, has contributed significantly to solid demand and the appreciation of home prices, with the number of residential property transactions soaring by a record high of 97.4 percent y-o-y in January-September 2021 (**Figure 14**)¹⁴. In response to rising food prices, the authorities have set price caps on certain staple food products to protect the income of socially vulnerable citizens, introducing export quotas on grain¹⁵. As part of import substitution programs, the measures also include larger subsidized loans to stimulate domestic food production and a freezing of the cost of utilities for producers¹⁷.

¹³ A faster rise in prices for newly-built dwellings than input costs for construction firms since the start of the pandemic points to the limited competition in the industry, which enables developers to hike prices and increase profitability.

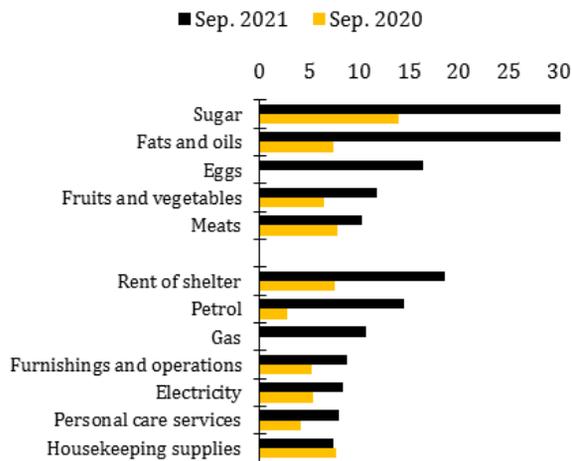
¹⁴ The authorities continue giving priority to improving housing affordability for low-income households through subsidizing mortgage rates, lowering down payments, and loosening credit requirements for first-time home buyers.

¹⁵ The government program is likely accelerating second-home purchases by wealthier households with higher savings with Pension Fund, further pushing up house prices and making ownership less affordable for many first-time buyers.

¹⁶ <https://www.apk-inform.com/ru/news/1520983>

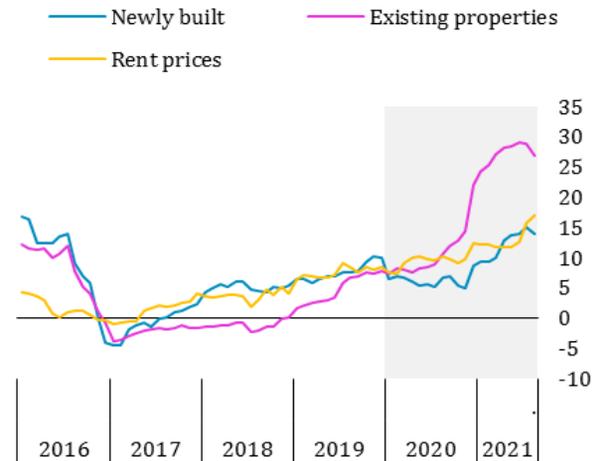
¹⁷ <https://primeminister.kz/ru/news/antiinfljacionnoe-regulirovanie-pravitelstvo-predlagaet-mery-po-snizheniyu-cen-na-produkty-benzin-i-zhile-781611>

Figure 13. Prices for staple food have risen sharply (year-on-year, percent)



Source: World Bank staff calculations based on Bureau of National Statistics data.

Figure 14. Housing prices have continued to soar (year-on-year, percent)



Source: World Bank staff calculations based on Bureau of National Statistics data.

The effects of rising food prices are greater for low-income and vulnerable people. A considerable body of literature attests to the poverty-increasing impacts of rising food prices.¹⁸ Low-income households spend a higher proportion of their total budget on food. The poorest twenty percent of the population in Kazakhstan spends around 57 percent of their budget on food purchases (Table 1). In comparison, the wealthiest ten percent has a lower share of food consumption, at around 46 percent (both excluding housing). As food prices increase, some households can be pushed into poverty if their incomes are not rising at the same rate. Moreover, rising prices can deepen the extent of deprivation among low-income families and force some to spend less on food or other essential services. Therefore, increasing food prices should be monitored given their potentially significant welfare and distributional impacts, and programs that support low-income families should account for these rising food costs.

Table 1. Food and non-food expenditure shares in Kazakhstan, by decile

	Share of food consumption	Share of non-food consumption
1st decile	57.5%	42.4%
2nd decile	57.1%	42.8%
3rd decile	55.3%	44.6%
4th decile	53.5%	46.4%
5th decile	52.6%	47.4%
6th decile	51.0%	49.0%
7th decile	49.9%	50.1%
8th decile	48.8%	51.2%
9th decile	48.0%	52.1%
10th decile	46.4%	53.7%

Source: WB's calculations by using the Kazakhstan Household Budget Survey 2018.

¹⁸ Laborde, D., Martin, W., & Vos, R. (2020). Poverty and food insecurity could grow dramatically as COVID-19 spreads. International Food Policy Research Institute (IFPRI), Washington, DC.



IV

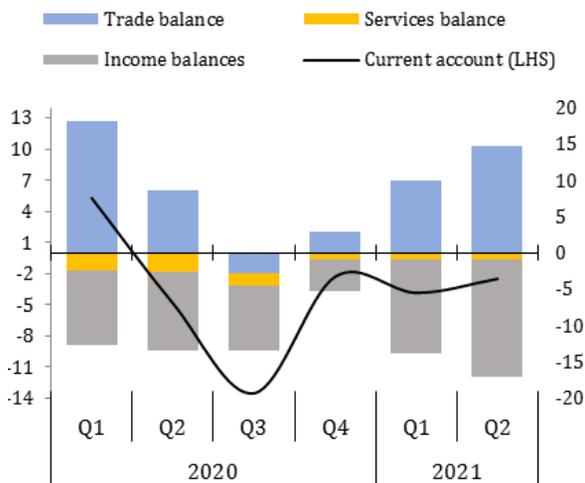
The External Balance

Recovery in global demand and commodity prices has narrowed Kazakhstan's current account deficit supported by improvement in the goods and services trade balance. However, higher global commodity prices can influence domestic prices through imports. Efforts to attract foreign investments need to continue as net direct investment flow remains below the pre-pandemic level.

Buoyed by a strong rebound in exports, Kazakhstan’s current account deficit narrowed to 2.5 percent of GDP in Q2-2021, compared to 4.9 percent of GDP in Q2-2020. The trade balance improved to 14.7 percent of GDP in Q2 this year compared to 8.5 percent last year, supported by a strong rebound in demand and prices of exports (**Figure 15,16**), particularly of crude oil, metal products, and agriculture and animal products. On the other hand, goods imports also picked up in Q2 2021, growing by 9.5 percent compared to last year. However, monthly data suggests that goods imports dipped in July and August, along with the substantial increase in international shipping costs. The deficit on services trade in Q2 2021 stood at 1.0 percent of GDP compared to 2.4 percent last year, as the pace of export volume in transport services picked up, including transit cargo services. Notwithstanding, the deficit in the income balance widened, driven by a significant outflow of profit repatriation of foreign companies.

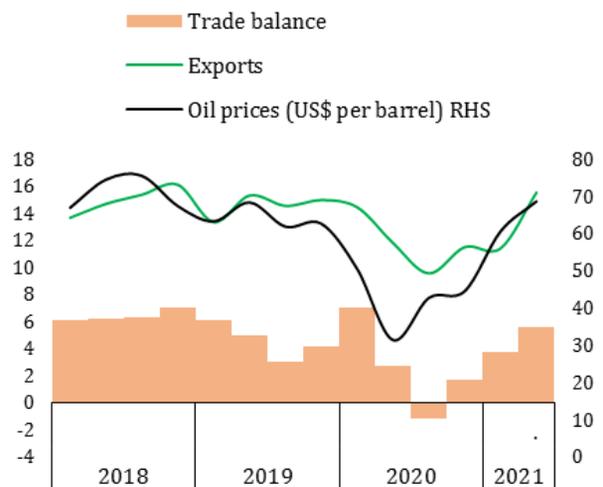
Higher global demand and commodity prices are likely to support exports, but with problems in international supply chains, these trends seem set to influence domestic prices through imports. OPEC+ continues to stick to an existing pact for a gradual increase in oil output, sending crude prices to three-year highs of above US\$81 a barrel. The supply crunch and higher demand for heating and industrial use also send the global price of natural gas soaring. Meanwhile, bottlenecks faced by international container shipping have increased costs and times for transporting goods across continents. These factors have stoked fear of protracted inflationary pressure, including among Kazakhstan’s major trading partners such as the EU and Russia. The effect for Kazakhstan is a higher import price index which grew by 11.5 percent in Q2 2021, compared to 3.9 percent last year, and is likely to raise the domestic price of goods.

Figure 15. Components of the current account (Percent of GDP)



Source: World Bank staff calculations based on NBK data.

Figure 16. Higher oil prices increased exports and improved the trade balance (US\$ billion)



Source: World Bank, NBK.

Net direct investment remains below the pre-pandemic level, underlining the urgency of policies to attract and diversify investments.¹⁹ After recording a low figure in Q1 2021, net direct investment in the first half this year picked up to about 2.3 percent of GDP, but below the 5.9 percent of GDP recorded in the same period last year. While the bulk of the gross FDI inflows are destined for the mining sector, the authorities stated that the manufacturing industry has experienced a sharp rise in gross FDI inflow of 57 percent. Notwithstanding, the government will now need to focus on creating an environment attractive to foreign investment inflows to support green growth and raise investment in fixed assets to achieve the 30 percent of GDP target by 2025 in the National Investment Strategy for 2018-2022.

The gross international reserves of the NBK remain at a comfortable level, and the pace of nominal tenge depreciation has slowed. Gross international reserves reached US\$35.5 billion in September, more than adequate to cover three months of imports. After receiving an IMF SDR allocation in August, the reserves declined by US\$1.3 billion in September due to government debt repayment. The tenge exchange rate depreciated against the US dollar through September, although the pace was reduced to 0.39 percent y-o-y compared to 6.15 percent in June, thanks to rising oil prices and a broadly weakening US dollar.

¹⁹ Data on FDIs here are used from Balance of Payment statistics



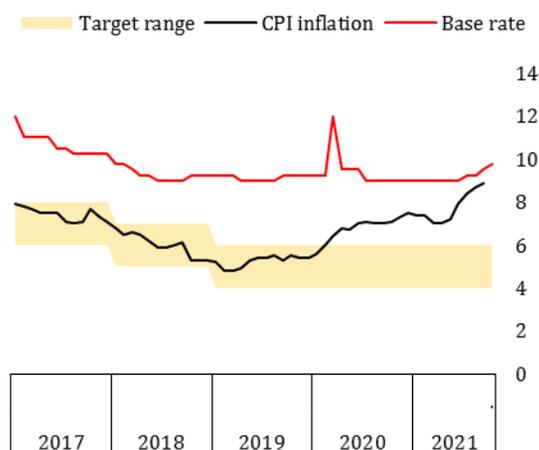
V

Monetary Policy and the Financial Sector

The monetary authority has started tightening the monetary policy to respond to a sharp surge in inflation accompanying the strong economic rebound. Changes in prudential requirement measures and credit support to firms have helped the banking sector perform relatively well during the Covid-19 crisis. However, the risk of higher NPLs from the rapid growth of consumer loans and a possible withdrawal of credit support to firms remains a concern. The ongoing efforts to strengthen the banking sector regulation and supervision are timely

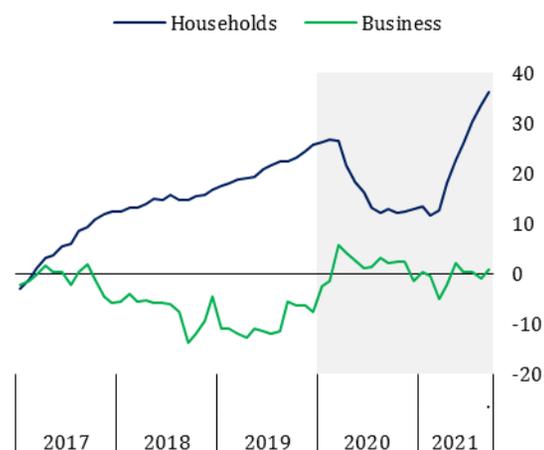
Monetary policy has turned to a tightening cycle to bring inflation back on target. The National Bank (NBK) lifted its benchmark policy rate by 0.25 p.p. to 9.75 percent in October, marking the third increase in interest rates in 2021 so far, as annual inflation in September had hit the highest monthly record for five years. Inflation has exceeded the NBK’s 4-6 percent target for 15 consecutive months, raising serious concerns over a possible de-anchoring of inflation expectations (**Figure 17**). In 2020, in response to the pandemic and to ward off a deep contraction, the benchmark interest rate was cut twice by a cumulative 3.0 p.p. to 9.0 percent. The tightening monetary policy followed rate hikes across major trading partner economies, including eurozone countries and Russia. Even though some of the factors causing higher inflation in 2021 could be temporary and mostly beyond the control of domestic monetary policy, the recent move can strengthen confidence in the inflation targeting framework and help keep inflation expectations anchored.²⁰ Monetary tightening can also help contain excess lending, especially in the consumer segment, and prevent higher NPLs, after the crisis. In that respect, firm commitment to further inflation targeting and effective communication are essential in maintaining central bank credibility. Yet supporting the economic recovery through various direct lending provisions will remain another NBK priority imposed by the authorities.

Figure 17. The policy rate has risen in response to rising inflation (year-on-year, percent)



Source: World Bank staff calculations based on NBK data.

Figure 18. Increased borrowing by households is driving up bank loans (year-on-year, percent)



Source: World Bank staff calculations based on NBK data.

The banking sector has remained resilient throughout the economic crisis brought about by COVID-19. At the outset of the pandemic, as part of anti-crisis measures, the authorities eased specific prudential requirements for banks—this included reduced credit risk weights for loans and guarantees, a lowered capital conservation buffer, and loosened asset classification rules for restructured loans.²¹ Thanks to these measures, despite the pandemic-driven decline in 2020, banks’ capital positions and profitability have been strong. The aggregate capital adequacy ratio was 25.0 percent in September – almost twice as large as during the economic

²⁰ <https://www.nationalbank.kz/en/news/novosti/12240>

²¹ Most of these relaxation measures are expected to be phased out by end-2021.

crisis of 2015-16. Among commercial banks' profitability measures, the aggregate return on equity (ROE) was at 3.2 percent in September 2021 (3.4 percent in September 2020). The share of officially reported NPLs in the loan portfolio decreased from 6.9 percent in December 2020 to 4.3 percent in September 2021, as banks wrote off a substantial share of legacy NPLs and a wave of business insolvencies were averted by dint of loan guarantees, subsidized loans, and regulatory forbearance during the lockdowns. However, once the government's anti-crisis support measures are fully withdrawn, it is unclear if those firms – which had received support during the early months of the pandemic – will manage to survive the pandemic shock and stay afloat.²² This has implications for the banking sector, potentially leading to higher NPLs, and deteriorating the commercial banks' profitability and balance sheet.

Consumer and mortgage credits have been the main drivers of overall loan growth. Banks have continued to lend with support largely from government-funded subsidized lending programs mainly for mortgages and more significant normalization of activity. Increasing demand for high-margin retail loans and mortgages is driving overall credit growth. Retail loans picked up by 32.8 percent, and the government housing programs boosted mortgages by 37.8 percent y-o-y, respectively, in September, thereby supporting bank profitability²³. The authorities need to carefully monitor the credit dynamics and debt burden ratios of households. They may shortly need to intervene with appropriate macroprudential measures to avoid surges in problem loans. Meanwhile, lending to businesses continued to decline in January-September 2021 – a trend that had persisted since the crisis of 2015-16, registering annual contraction. Demand for loans from firms is not growing despite continued incentives through concessional lending programs for SMEs (Figure 18).

The authorities have been strengthening regulation and supervision in the banking and microfinance sectors. Following the Asset Quality Review conducted in 2019, the Agency for Financial Regulation and Supervision (AFR) initiated a series of reforms to ensure banks' compliance with AFR actions and strengthen the bank resolution framework. In early 2020, Kazakhstan's bank resolution framework was amended largely in line with good international standards. In parallel, the Agency has been working on the implementation of a risk-based supervisory framework (SREP). The new supervisory risk-based model is built on three major pillars: supervisory reporting and evaluation process (SREP), AQR, and supervisory stress testing. In early 2021, the AFR conducted remotely a pilot AQR with selected participating banks. Regular AQR will be conducted on an expanded list of banks from 2022. In October 2021, the AFR initiated pilot stress-testing of credit and market risk for individual banks (to be finalized by March 2022). The AFR plans to move to a full-scale stress-testing of majority of banks in 2022, with the stress-test results leading to capital add-ons where needed in 2023. In 2020, the AFR also finalized the registration of all operating microfinance organizations (MFOs) to define the regulatory perimeter and strengthen financial consumer protection. As of end-2020, out of about 5,500 MFO organizations, 1,064 were registered with the AFR. The rest were in the process of mandatory liquidation. As of 2021, microfinance activities are subject to AFR licensing, with proportional regulation to be introduced in the future.

²² *Turning the Tide on the COVID-19 Crisis (English)*. Kazakhstan Economic Update Washington, D.C.: World Bank Group.

²³ Mortgages include loans extended for home construction



VI

Fiscal Policy

The government's expansionary fiscal stance has helped sustain economic recovery from a sharp recession last year. The budget deficit is projected to narrow slightly but remain elevated to provide continued support to the economy. Once economic recovery is set on a firmer footing, the authorities should consider calibrating fiscal policy to gradually rebuild buffers, improving revenue mobilization, improving quality, and reprioritizing spending.

Fiscal policy has been expansionary in 2021, supporting economic recovery. The budget deficit narrowed to an estimated 3.1 percent of GDP in the first nine months of 2021, from 4.2 percent of GDP during the same period in 2020 (Table 2). But the deficit for 2021 overall is expected to remain elevated compared to pre-crisis levels amid a slow recovery in non-oil tax revenue and continued fiscal stimulus measures. In early 2021, the government rolled out a new spending package in response to the pandemic. The supplementary budget for 2021 assumes US\$3.1 billion (1.8 percent of GDP) of additional spending on the healthcare system, concessional loans to SMEs, and infrastructure projects.²⁴ While the package is lower than that implemented in 2020 (US\$15 billion, or 8.5 percent of GDP), the authorities have continued extending support measures to the economy. Transfers from the National Fund of the Republic of Kazakhstan (NFRK) have been the primary funding source at the cost of new fiscal measures. The government plans to withdraw an extra US\$2.0 billion (equivalent to 1.2 percent of GDP) from NFRK on top of the US\$8.7 billion (5.1 percent of GDP) planned for 2021.

Government debt is projected to increase to finance the expansionary fiscal stance. On the revenue side of the budget, in January–September 2021, higher commodity prices lifted corporate income taxes by 44.4 percent y-o-y, mainly from the mining and manufacturing industries. Meanwhile, higher oil prices and a production hike of 1.1 million tons at the Tengiz oilfield increased customs duty on oil exports nearly twofold. However, the primary deficit remained elevated at 1.6 percent of GDP in January–September, although lower than the 2.8 percent seen during the same period of 2020.²⁵ The government debt is projected to increase to 26.2 percent of GDP by end-2021, up by almost 6.6 percentage points from 2019.²⁶ To help finance the deficit the authorities secured loans from IFIs in 2020, which were fully disbursed in 2021, along with domestic placements of government bonds.

The government should remain committed to fiscal sustainability and calibrate its fiscal policy according to medium-term macroeconomic objectives. Fiscal support was urgently needed to mitigate the fallout of the crisis but has led the government to breach the numerical objectives of the fiscal rule set before the COVID-19. To ensure fiscal sustainability and reduce the budget's reliance on oil-related revenues, the authorities have begun the work on redesigning the fiscal framework and recalibrating their pre-COVID-19 rules.²⁷ Although the government budget deficit is falling by about 0.2 percentage points of GDP in 2021, deficits are still well above pre-pandemic levels.

Looking forward, the authorities may need to start thinking about reducing high budget deficits once economic recovery has secured a firm footing. Restoring fiscal buffers and ramping up non-oil revenue mobilization efforts, plus broader structural reforms that raise economic growth would help foster fiscal sustainability. Budget revenues can be supported by improved tax collection efforts and contemplating the introduction of progressive tax rates. At the same time, expenditure policies can benefit considerably from the enhanced effectiveness of existing programs with a more targeted approach to recipients. While strengthening transparency and accountability, the authorities may also wish to prioritize efficiency gains, particularly on public investments required for economic diversification, and facilitate the

²⁴ <https://primeminister.kz/ru/news/utochnenie-prognoznih-parametrov-obespechit-realizaciyu-vaznyh-meropriyatiy-po-uluchsheni-yu-zhizni-grazhdan-i-razvitiyu-ekonomiki-a-smailov-2031834>

²⁵ Revenue minus spending, excluding interest payment.

²⁶ <https://adilet.zan.kz/rus/docs/Z2000000387>

²⁷ <https://24.kz/ru/news/poslanie-2021/item/495856-prezident-poruchil-podgotovit-kontseptsiyu-upravleniya-gosfinansami>

transition to a low carbon economy. Better targeted social assistance programs can help deliver higher outcomes with the same budgetary resources.

Table 2. Government fiscal accounts, 2019–21
(Percent of GDP)

	2019	2020	2021 (e)	9M2020	9M2021(e)
Revenues	18.3	20.5	20.4	22.9	21.5
Oil revenue	6.1	7.6	7.5	10.0	7.9
Nonoil revenue	12.2	13.0	12.9	12.8	13.6
Expenditures	19.5	23.7	23.3	25.8	23.7
Wage bill	2.9	3.7	3.5	4.1	4.3
Goods and services	5.6	6.2	6.0	6.7	5.6
Interest payments	1.0	1.1	1.6	1.5	1.7
Social transfers	4.8	5.3	5.1	6.2	5.7
Producer subsidies	0.9	1.1	1.1	1.2	1.2
Capital spending	2.7	4.0	3.9	3.6	2.6
Others	1.7	2.3	2.1	2.5	2.6
<i>Net lending and financial transactions</i>	0.7	0.9	0.8	1.2	1.0
Overall balance	-1.8	-4.0	-3.7	-4.2	-3.1
Non-oil balance	-8.0	-11.5	-11.2	-14.2	-11.2
Financing of deficit/use of surplus	1.8	4.0	3.7	4.2	3.1
External borrowing (net)	0.3	-0.1	1.9	-0.2	1.8
Domestic borrowing (net)	1.5	4.1	1.8	4.4	1.3
<i>Memoranda</i>					
Stock of FX assets in the Oil Fund	34.0	34.3	31.8	33.0	30.2
Total government debt	19.6	24.8	26.2	23.4	24.6
External	9.2	10.7	11.8	10.1	10.6

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

Note: The government budget comprises the state and local budgets. FX: foreign exchange.



VII

Economic Outlook and Risks

Growth is projected to accelerate due to gradual improvement in the external sector and sustain the rebound in domestic demand. However, the risk to the outlook is significant. Growth has come at the price of accelerated inflation which can erode purchasing power and cause further increases in prices and wages. The authorities may wish to maintain flexibility in calibrating the fiscal position to support economic recovery and take the opportunity to rebuild buffers. Stepped-up efforts to increase vaccinations and continue the tracing initiative are also needed to minimize the risk of another COVID-19 outbreak

Economic growth will accelerate in 2022 as global conditions continue to improve and the pandemic subsides. With economic activity having returned to pre-pandemic levels in Q3, the outlook for 2021 overall has been revised upwards due, in large part, to a stronger-than-expected recovery. Yet, the outlook remains broadly unchanged for the coming years. Overall, we expect the economy to expand by 3.5-4.0 percent in 2022 with the gradually waning impact of COVID-19. An income rebound and further release of pent-up household demand, plus continued fiscal measures and a more conducive external environment, are expected to support growth. Following a sharp fall since the beginning of the COVID-19 crisis, investment is likely to pick up on the back of further activity in the mining sector and the strong demand for residential property²⁸. Moderate growth in the Euro Zone and China will also restore exports, although demand for imports will grow, limiting the contribution to growth of the external sector.

On the supply side, services and domestic market-oriented manufacturing will continue to grow as the economy recovers and the COVID-19 vaccination gathers pace. The government housing program and planned infrastructure projects are likely to spur construction²⁹. The mining sector will benefit from increased production and rising oil prices. However, the industry may face challenges from the low FDI flows of the past two years amid pandemic-related uncertainty. Oil production is projected to increase modestly in 2022, helped by easing OPEC+ quotas and in line with a recovery in global demand. Overall, while the economy is expected to recover, the crisis is likely to cause a permanent loss of output. By the end of 2022, the level of real GDP could be permanently 7.0 percent lower than in the pre-COVID-19 outlook, which may cost the economy a loss in output of about US\$14 bln (**Figure 19**).

Upside risks to growth are a swifter domestic vaccine campaign and a strong pickup in demand in export market economies that could enable higher growth performance in 2022 and thereafter. Sustained high energy commodity prices due to lower global production capacity and further limits on output by OPEC+ could improve fiscal balances and help rebuild fiscal buffers.

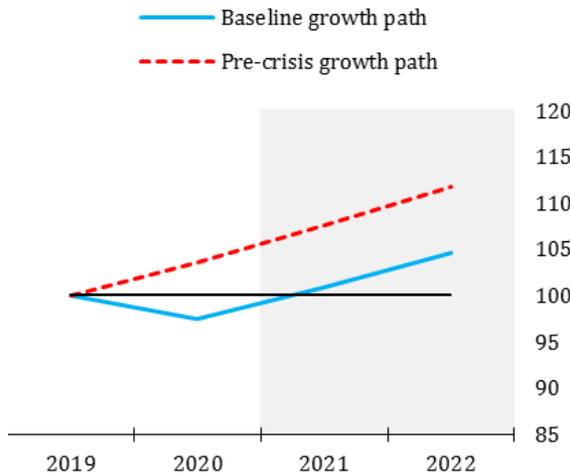
Increased inflation pressure will persist, and inflation is projected to remain beyond the target range in 2022. As the economic recovery progresses, we expect inflationary pressure to last in 2022 due to rising global food and energy prices. Continued fiscal support measures and the planned increase in the minimum wage would sustain price pressures and keep inflation above the central bank's target range.³⁰ We forecast inflation subsiding only gradually toward the end of 2022 if the effect of pandemic-linked and domestic factors wanes and the NBK successfully implements measures to anchor inflation expectations, which have drifted upwards dramatically in 2021. Other factors that could also lead inflation to remain elevated in the short term include expensive housing and more persistent supply disruptions that could further raise import prices.

²⁸ <https://kursiv.kz/news/pensionnaya-sistema/2021-09/kazakhstancy-smogut-perechislyat-pensionnye-nakopleniya-na>

²⁹ <https://primeminister.kz/en/news/perspektivy-razvitiya-ekonomiki-rk-napravleny-na-ukreplenie-nacekonomiki-konkurencii-i-sohranenie-social-noy-stabilnosti-a-smailov-247835>

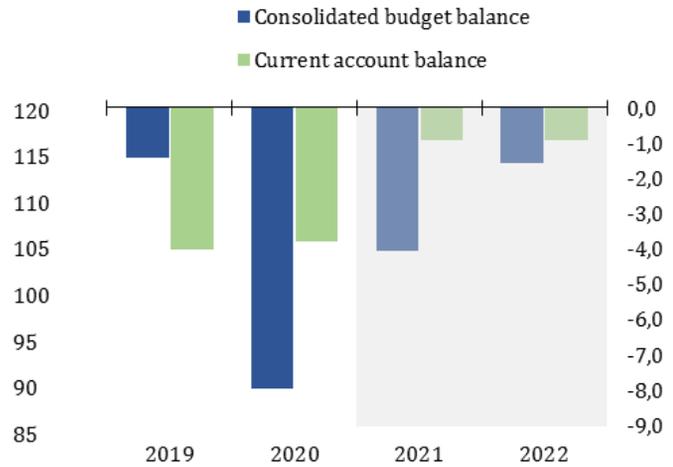
³⁰ <https://primeminister.kz/en/news/etzh-artuynyn-zhalpy-aserin-keminde-35-mln-kyzmetker-baykaydy-a-smayylov-238259>

Figure 19. GDP will pick up but remain below its pre-pandemic growth path (index 2019=100)



Source: World Bank staff calculations based on NBK data.
 Note: Dotted line refers to pre-crisis growth projection in January 2020 before the start of the COVID-19 pandemic.

Figure 20. External and Fiscal balances are set to improve (percent of GDP)



Source: World Bank staff calculations based on NBK data.
 Note: The consolidated budget comprises state and local governments and the National Fund.

In the three-year rolling budget, the government outlines its consolidation plans to curb spending and the deficit but will maintain specific fiscal support measures in 2022. We project budget expenditure decreasing steadily as a share of GDP to 21.7 percent in 2022, down by 2.3 percentage points from the 2020 level. While some of the crisis-linked discretionary spending will be scaled down, the draft budget for 2022-2024 continues prioritizing expenditures on social assistance programs. These include higher wages for teachers and medical personnel, social transfers to low-income families, and pensions. The authorities plan to continue spending on several infrastructure programs, including Nurly-Zhol, Nurly-Zher, and industrial development. And yet, the scope for budget investments is narrowing, as the share of social spending has been steadily rising. On the revenue side, higher oil prices and exports plus a broader economic recovery are expected partially to reverse the deterioration in the fiscal position. Oil and non-oil revenues are expected to recover, whereby aggregate revenue will rise to 20.1 percent of GDP in 2022 from an estimated 19.6 percent in 2021. Echoing the budget revenue, the fiscal deficit of the consolidated budget will narrow to 1.6 percent of GDP in 2022 compared to an estimated 4.0 percent in 2021 and 8.0 percent of GDP in 2020. Nevertheless, given the shock of the pandemic, the budget will remain in deficit throughout the forecast period. The government debt-to-GDP ratio is projected to increase slightly to 27.4 percent of GDP in 2022 but remains manageable (**Figure 20**).

Consolidation measures, reprioritizing spending, and mobilizing non-oil revenue can improve fiscal sustainability. The commitment to fiscal discipline and spending consolidation in the medium term is commendable and would help the government rebuild fiscal buffers and broaden the fiscal space. However, as the pandemic is not yet under control, maintaining flexible and targeted fiscal support to ensure sustainable recovery should be a short-term priority. In addition, in the medium term, a reprioritizing of noncritical spending and improved efficiency of existing budget programs would also help promote healthy fiscal policy. As the economy will be smaller in size in the medium-term than the level projected before the crisis, the risk of the budget receiving lower non-oil tax revenues is elevated. In that respect, the authorities urgently need to

step up their non-oil revenue mobilization efforts. However, the government's fiscal plans for 2022-2024 have no concrete actions in that direction.

Table 3. Kazakhstan: selected macro-fiscal indicators, 2018–2023

	2018	2019	2020	2021f	2022f	2023f
National income and prices	(In percent of GDP unless otherwise indicated)					
Real GDP growth	4.1	4.5	-2.5	3.5	3.7	4.8
Oil sector growth	8.6	5.0	-5.8	-0.4	2.3	11.7
Non-oil sector growth	3.0	4.4	-1.5	4.5	4.1	3.5
CPI inflation (end of period)	5.3	5.4	7.5	8.7	6.6	5.5
External accounts	(In percent of GDP unless otherwise indicated)					
Current account balance	-0.1	-4.0	-3.8	-0.9	-0.9	-0.7
Exports of goods and services	37.4	36.3	30.6	39.2	38.5	35.5
Oil exports	21.1	18.5	13.8	21.5	21.6	19.7
Imports of goods and services	-25.8	-28.3	-26.4	-26.3	-26.4	-26.8
Foreign direct investment, net	2.6	3.2	3.5	3.1	3.1	3.0
Monetary accounts	(In percent, y-o-y growth rate)					
Reserve money growth	20.1	3.6	41.8	9.6	9.2	8.3
Policy rate, year-end (in %)	9.25	9.25	9
Consolidated fiscal accounts */	(In percent of GDP unless otherwise indicated)					
Revenues	18.9	18.4	16.1	19.6	20.1	19.6
Expenditures	18.6	19.8	24.0	23.6	21.7	20.4
Consolidated budget balance	0.2	-1.4	-8.0	-4.0	-1.6	-0.9
Public Debt **/	(In percent of GDP unless otherwise indicated)					
Government debt	19.9	19.6	24.8	26.2	27.4	27.7
External	10.1	9.2	10.7	11.8	11.6	11.3
Domestic	9.8	10.4	14.1	14.5	15.8	16.4
Government debt service (% of state revenues)	10.3	11.4	10.8	12.1	12.5	11.6
<i>Memoranda</i>						
Nominal GDP (bln. of US dollars)	179	182	171	181	194	211
Nominal GDP per capita (thousands of US dollars)	9.8	9.1	9.6	10.1	10.9	11.5
Oil price - Brent (US\$ per barrel)	68.3	61.4	41.3	70.0	74.0	65.0

Sources: Government and NBK data and WBK staff estimates and projections. f=forecast.

Note: */ The consolidated budget comprises the state and local governments and the National Fund.

**/ Includes only the debt of the state and local government and government guarantees. Does not include SOE debt.

We forecast the current-account deficit narrowing substantially in 2022, supported by a more conducive external environment. Exports in nominal terms are expected to accelerate and outpace the growth of imports, despite a pick-up in domestic demand for imported goods, widening the merchandise trade surplus. The upward trajectory of exports will be underpinned by rapidly rising oil prices and the planned increase in oil production after the further tapering of OPEC+ induced limits. The domestic fiscal stimulus measures and several subsidized credit provision programs will continue to sustain strong demand for imports. Export-related transport costs, travel with resumed tourism activity, and oil-linked imported services bills will keep the balance of services in deficit. The primary income balance is projected to post a deficit, reflecting profit repatriation from FDI-linked projects in the mining sector and the repayment of external debt obligations.

While we expect the economy to recover and register a steady advancement, several risks could constrain the growth trajectory in the short term. *First*, the vaccine rollout remains a prime concern, as does the possible emergence of new contagious virus variants before herd immunity is reached. In addition to strengthening enforcement for contact tracing, the authorities still need to advance the vaccine rollout. Without widespread vaccination, the economy remains vulnerable to sporadic restrictions in some particularly affected areas, jeopardizing sustained recovery. *Second*, the recent rise in food prices is eroding purchasing power, particularly for vulnerable low-income households. At the same time, expensive housing makes homeownership and renting costs less affordable for many first-time buyers and tenants. Higher prices for consumer essentials could amplify the burden of actual joblessness among self-employed and part-time workers, sustaining a high level of poverty and denting growth after the COVID-19-crisis. *Third*, volatile prices and uncertainty over the scale of demand growth for oil present additional risk. Growth could underperform if the ongoing global supply-side disruptions last longer than expected and dampen demand for oil in Kazakhstan's main exporting markets. Further outbreaks of COVID-19 in major trading partners also present a downside risk impacting mobility and demand. In such an eventuality, demand for Kazakhstan's exports could weaken, slowing projected growth, and deteriorating the external account.



Kazakhstan’s strong commitment to achieving carbon neutrality is commendable, and strengthening coordination becomes critical in finalizing the preparation and implementation. In 2020, Kazakhstan announced its carbon neutrality goal by 2060 and completed a new Doctrine to achieve the goal. To progress towards its climate targets, Kazakhstan would need to institutionalize the climate change agenda domestically. Current institutional architecture is spread across Government agencies and subnational levels (akimats). In addition, several other entities are involved, such as non-commercial entities, state-owned enterprises, and associations. The authorities may wish to consider

strengthening the legal and policy framework for climate change, with a clear division of responsibilities among the various agencies at central and sub-national levels and specific roles assigned to the Accounts Committee, Parliament, and the civil society. The government may also consider embedding decarbonization policy measures in the strategic and budget planning framework, public investment management and procurement, and facilitate broad public access to all climate-related public expenditures.

The development of law on agglomerations and plans to deepen regional decentralization are important initiatives for sustainable development. President Tokayev, in an annual address to the nation in September 2021, instructed the formulation of a new law on agglomerations. The new law is expected to address the disparities between urban and rural economic development, set clear administrative boundaries and responsibilities for levels of public administration, and facilitate better economic integration nationwide. The President also called for greater powers and accountability of local executive and representative bodies, as well as continued fiscal decentralization and improved inter-budgetary relations.³¹ Meanwhile, the transfer of functions, powers, and accountability will require the capacity building of the state bodies and stakeholders across the regions. Therefore, this reform needs to be implemented by considering potential capacity gaps and adequate resource provision. These measures and an effective monitoring and evaluation system at the central government level should help foster the continuity of the reforms and mitigate the risk of failure.

Full compliance with International Public Sector Accounting Standards (IPSAS) is critical to ensure accountability and transparency of public spending. Kazakhstan has already invested considerable resources in adopting IPSAS. However, the recent analysis of consolidated public financial statements (CPSFS), and the audit opinion issued by the Accounts Committee for Control of Execution of the Republican Budget for 2020, note that gaps remain, including cases of non-compliance with IPSAS revealed during the practical preparation of CPSFS. The government should continue to improve the quality of financial statements, which will also require large capacity building for public accounting practitioners.

The planned increase in the minimum wage will likely boost the earnings and household income of Kazakhstan's low-wage workers. However, going forward, improved methodologies for setting the minimum wage are needed that consider labor market dynamics. The ratio of the minimum wage to the average salary – a widely used indicator in evaluating minimum wage levels – was 0.20 in 2020, lower than that of OECD countries. A rise in the minimum wage of around 40 percent in 2022 is expected to raise the ratio to 24 percent of the average nominal wage, which in October 2021 was 33 percent higher than in 2019. Among the poorest 10 percent of the population, about a quarter of formal workers earn close to the minimum wage. Raising the minimum wage benefits formally-employed low-income workers, who often have difficulty advocating for wage increases on their own. However, more accurate methodologies that consider labor market dynamics could be implemented to update the minimum wage regularly. The minimum wage should be reviewed annually to account for productivity growth to ensure that future changes to the minimum wage increase would be less disruptive and more effective in increasing earnings among the low-income group. A significant rise in the minimum wage, especially during an economic recession, can burden small businesses. Those enterprises often employ low-skilled workers and pay salaries of around the minimum wage. Therefore, the authorities may consider wage subsidies to mitigate the risk of layoffs when minimum wage increases take effect.

³¹ Reform actions were listed under the Local Self-Government Development Concept until 2025 as approved by Presidential decree № 639 on August 18, 2021; and in the President's Address to the Nation delivered in Parliament on September 1, 2021.



IX

The challenges of climate change for Kazakhstan

What makes Kazakhstan vulnerable to climate change?

1.1 Climate vulnerabilities and impact from climate-related natural disasters

Kazakhstan is facing higher average temperatures and rainfall volatility resulting in heat stress and health related concerns. Kazakhstan saw average temperatures rise by 0.28°C per decade between 1941 and 2011. Annual temperatures were 0.3°C to 1.4°C warmer during the period of 1997–2010 than during the baseline period of 1971–2000. These trends apply across Kazakhstan, but particularly in the north, west and south of the country. Temperature rises have been highest during autumn and winter, while warming has been less severe during summer, with an increase of 0.18°C per decade.

Kazakhstan is expected to experience faster warming than the global average, leading to health issues from heat stress. Projections predict potential warming of 5.3°C by the 2090s, compared with the 1986–2005 baseline, under the highest emissions pathway (RCP8.5). This is 3.7°C greater than the rise projected by the lowest emissions pathway (RCP2.6), indicating the wide difference in outcomes that Kazakhstan could experience by controlling global emissions. For Kazakhstan, the extreme heat hazard is classified as ‘medium’. This means at least a 25 percent chance that at least one period of prolonged exposure to extreme heat, resulting in heat stress, will occur within the next five years.

More frequent droughts, floods, mudflows, and reduced water security will damage Kazakhstan’s agricultural productivity in both crop and livestock farming. Kazakhstan is expected to face average warming faster than the global average, and faster than most Asian nations, bringing more frequent natural disasters and higher rainfall volatility. As a result, vulnerability assessments reveal that wheat yields will suffer. And although wheat yields may increase slightly until 2030, in the longer term, yields during the spring are forecast to decrease by 27 to 50 percent (mainly due to reduced soil moisture and higher temperatures).³² Grain yield losses may have implications for food security. Kazakhstan’s water-holding capacity for agricultural products (primarily used for cotton and rice) means that agricultural production is extremely water-intensive. The level of adaptation will be a key determinant of loss in agricultural yields over the coming years.

1.2 Kazakhstan’s growth model is vulnerable given its reliance on hydrocarbons

Rapid growth has been supported mainly by dependence on hydrocarbons, while diversification remains limited. Kazakhstan has achieved an impressive economic performance since its independence, driven by abundant hydrocarbon resources. It has transitioned from lower to upper-middle-income status in less than two decades, moving to the latter group in 2006, and maintains an ambition to move to high-income country status. Since 2002, GDP per capita has risen sixfold and poverty has fallen sharply. Rapid growth resulting from the harnessing of abundant hydrocarbon resources—mainly oil, gas, and coal—has led to dependence on fossil fuels, amounting to about 66 percent of Kazakhstan’s export value in 2019. The oil and gas sector represented 21 percent of GDP in 2019 and contributed one-third of the general government budget in that year.

This non-diversified economic approach poses risks to achieving the country’s development goals going forward. The vulnerability of this model was exposed in three recent economic downturns, namely the global financial crisis of 2008 and the Russian economic crisis of 2014, combined with the fall of global oil prices and, most recently, the COVID-19 crisis.

Sustainable and inclusive growth will require a significant shift in Kazakhstan’s growth model. At this juncture, Kazakhstan’s growth model is far too dependent on hydrocarbons. It will need to undergo an economic transformation to achieve high-income status inclusively and

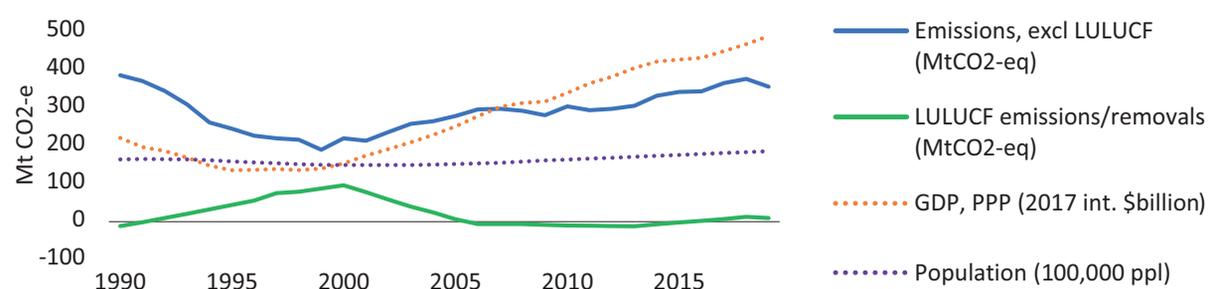
³² 27%: World Bank (2021) - Climate Change Knowledge Portal: Kazakhstan, 50%: ADB & World Bank (2021) - Climate Risk Country Profile - Kazakhstan

sustainably.³³ Internationally, Kazakhstan will also come under increasing pressure to decarbonize its economy and exports as the world transitions to a lower-emissions future. This will take the form of political pressure to deliver on climate change targets and economic pressure as demand for hydrocarbon exports wanes.

Kazakhstan's contribution to growing emissions and the sources of those emissions

Although the emissions intensity of GDP and emissions per capita had fallen until recently, Kazakhstan's emissions were growing. Emissions, excluding land use, land-use change, and forestry (LULUCF), roughly doubled between 2001 and 2018, returning to 1990 levels (before Kazakhstan's independence) (Figure 21). In 2019, pre-COVID-19 pandemic, Kazakhstan achieved a reduction in emissions while maintaining GDP and population growth. Nonetheless, Kazakhstan's emissions (excl. LULUCF) of 355 Mt CO₂-eq in 2019 make it one of the highest emitters regionally and estimated 20th globally.³⁴

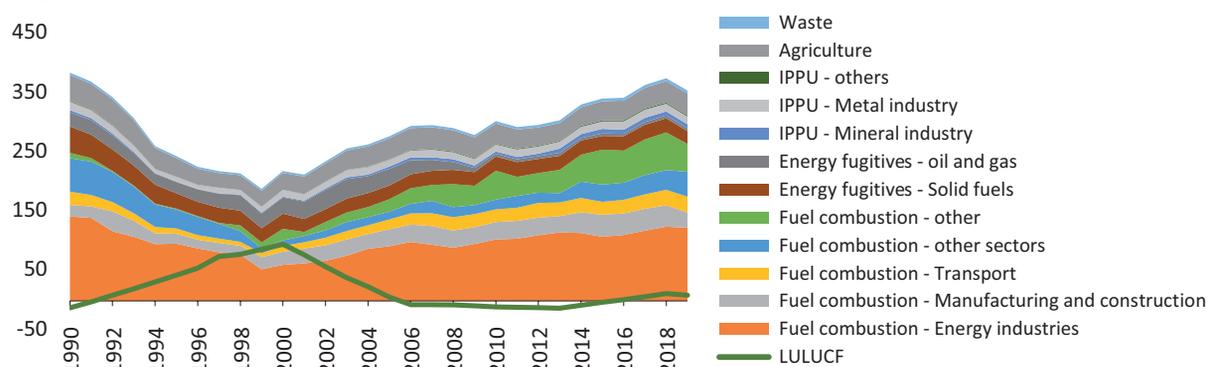
Figure 21. Historical emissions, GDP, and population



Sources: Kazakhstan 2021 CRF tables (emissions); World Bank (GDP, population)

Most of the increase in emissions since 2001 is attributable to energy use in energy industries, transport, and manufacturing, and construction (Figure 22). Energy industries are the most significant contributor to Kazakhstan's GHG emissions, and these emissions more than doubled in 2000–2019. Emissions from transport nearly tripled between 2000 and 2019, comprised mostly of emissions from road transport.

Figure 22. Historical emissions by sector

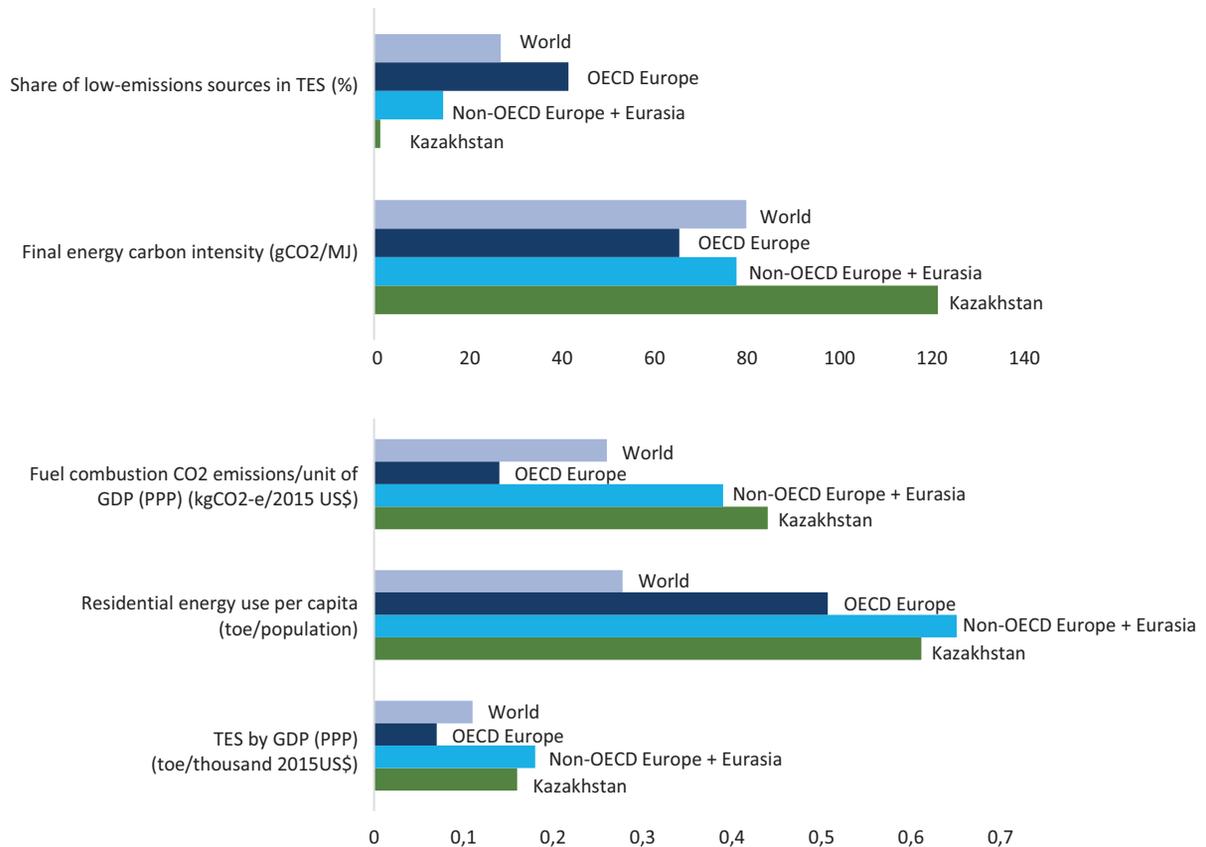


Source: Kazakhstan 2021 CRF tables

³³ World Bank, 2018. "Systematic Country Diagnostic of Kazakhstan: A New Growth Model for Building a Secure Middle Class."

³⁴ [CO2 Emissions | Global Carbon Atlas](#)

Figure 23. Energy and emissions intensity comparisons



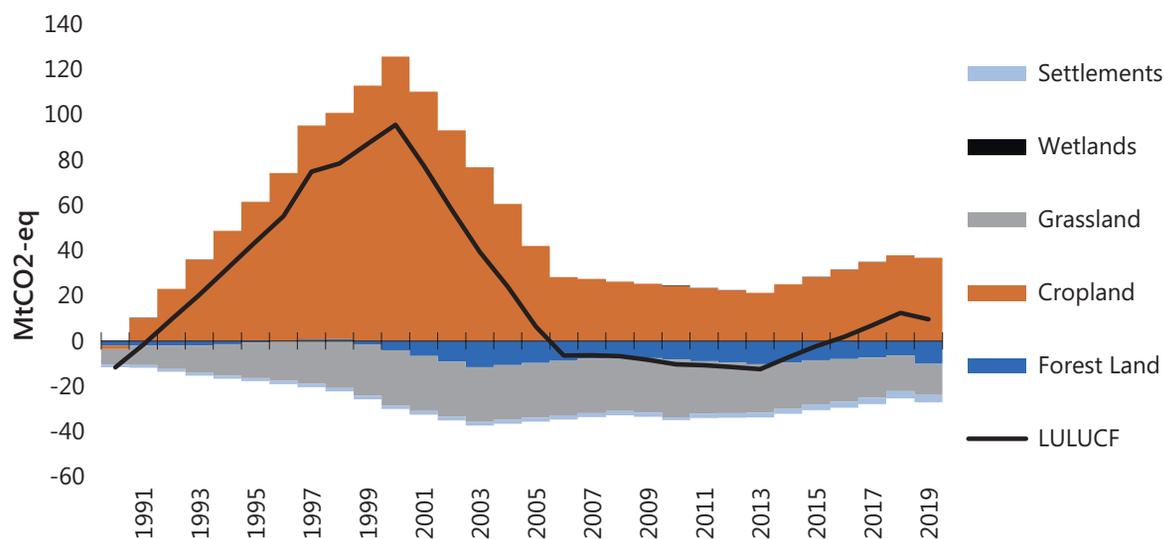
Source: International Energy Agency (IEA).

Residential energy use and associated emissions are also growing rapidly. Residential energy use has grown more than fivefold since 2000, currently representing 27 percent of total energy consumption. This means that residential energy use today accounts for over 13 percent of Kazakhstan’s energy emissions.³⁵

Kazakhstan’s energy supply is far more carbon-intensive than other ECA countries (Figure 23), due to the country’s high reliance on coal and oil, with natural gas a smaller, albeit growing, contributor. Kazakhstan’s grid energy intensity of around 900 gCO₂/kWh³⁶ and final energy carbon intensity of approximately 120 gCO₂/MJ are higher than most countries in the region and nearly double the average for OECD Europe. The proportion of energy supply from low-emission sources is deficient, even with no nuclear energy, at less than 2 percent of the total energy supply. Kazakhstan performs somewhat better on energy intensity metrics: residential energy use per capita and energy intensity of GDP (measured as TES by GDP) are lower than the regional average but higher than OECD European countries and the world average.

Land-sector emissions fluctuate and can serve as a meaningful offset (Figure 24). Net LULUCF emissions fluctuated from a high of around 95 Mt CO₂-eq in 2000 to a low of -12 Mt CO₂-eq in 2013. This 109 Mt CO₂-eq change—equivalent to nearly a third of 2019 emissions excluding LULUCF—over 13 years makes the land sector the most volatile component of Kazakhstan’s emissions. Net LULUCF emissions are increasing again, and climate change is putting potential land-sector emission offsets at risk.

Figure 24 Components of LULUCF emissions



Source: Kazakhstan 2021 CRF tables

Kazakhstan's pledge for carbon neutrality

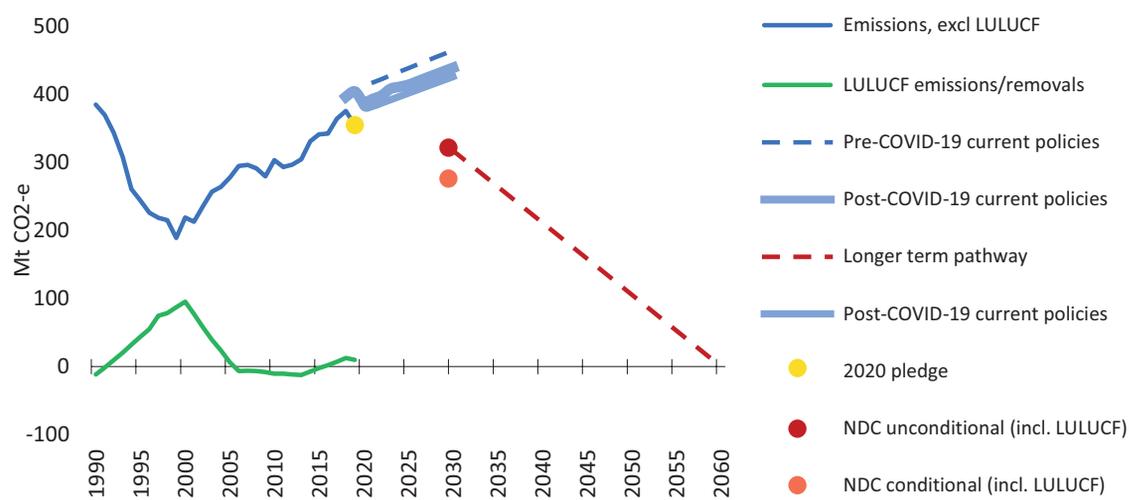
Kazakhstan's intended Nationally Determined Contribution (NDC), announced in 2015, commits to an economy-wide unconditional emissions reduction of 15 percent below 1990 levels by 2030. Kazakhstan submitted its NDC under the December 2015 Paris Agreement, which aims to limit global warming to well below 2°C compared with 1990 levels.

Kazakhstan is now targeting carbon neutrality by 2060. The first NDC was followed in December 2020 with an announcement by President Kassym-Jomart Tokayev that Kazakhstan would target carbon neutrality by 2060 as part of Kazakhstan's strengthened national climate plan. The Government is also finalizing a low-carbon strategy to help guide policy implementation. It will also make climate change adaptation a legal requirement in its new environmental code for sectoral and regional policy planning. Kazakhstan has already launched a national emission trading scheme (ETS)—the only one in Central Asia.

However, based on current projections, emissions are expected to increase further. Kazakhstan's 2030 targets set under the Paris Agreement—an unconditional 15 percent reduction from 1990 levels or a 25 percent reduction conditional on international support—require a reversal in the increasing emissions trend. Even faster reductions will be needed to reach the longer-term net-zero by 2060 target. However, based on current policies and measures, emissions are projected to continue growing (Figure 25). Decarbonizing the energy supply and reducing the energy intensity of the economy will be vital to meeting targets.

The Government recognizes that further reforms are needed to meaningfully reduce GHG emissions and meet medium- and long-term targets. Kazakhstan has formulated a draft update to the NDC Roadmap and a National Allocation Plan (NAP) report on the ETS, proposing substantial reforms.

Figure 25. Emissions targets and projections



Sources: Kazakhstan 2021 CRF tables (Historical emissions); Kazakhstan's Intended Nationally Determined Contribution (2020, 2030 targets); Astana Times <https://astanatimes.com/2020/12/tokayev-announces-kazakhstans-pledge-to-reach-carbon-neutrality-by-2060/> (2060 target), Climate Action Tracker, Country Assessments November 2020 - <http://climateactiontracker.org> (emissions projections)

Identifying the challenges and opportunities of the low-carbon transition is needed

Kazakhstan's fossil-fuel-dependent economy faces real transition risks in both domestic and international spheres. Kazakhstan faces the dual challenge of being both vulnerable to climate impacts and exposed to global action toward a low-carbon transition. As the rest of the world transitions to a lower-emissions future, demand for Kazakhstan's oil exports and the share of oil revenue in government revenue are expected to decline. Kazakhstan is highly dependent on aging coal-fired electricity plants, which supply about 70 percent of the country's electricity compared to 37 percent globally, according to the IEA.³⁷ Therefore, moving to low-carbon emission will require Kazakhstan to ramp up the share of renewables in electricity generation and reduce the use of coal as the main source for heating. With its carbon-intensive domestic energy supply, even demand for other products manufactured in Kazakhstan could be affected by carbon border adjustments.

A well-designed long-term national transition plan for all aspects of climate action is vital if Kazakhstan is to achieve its targets. The importance for Kazakhstan of addressing climate change cannot be overstated, given its high vulnerability and the enormous challenges of shifting its growth model away from one reliant on fossil fuels. Kazakhstan will need to invest low-carbon technologies over the next 40 years in the electricity and heat, transportation, mining and manufacturing, housing and utility sectors, as well as agriculture to achieve its ambitious goal of carbon neutrality by 2060.³⁸ Such a major transition will require far-reaching policy reforms and measures to facilitate a shift in energy generation sources, increase energy efficiency and conservation, and promote new sources of growth beyond fossil fuels. Continuous reforms in the financial sector, revenue mobilization and management of public finances, and the pricing of domestic fossil fuels are needed to support investment in climate adaptation and mitigation. The transition will also require measures to support a just transition for affected workers and communities, to minimize the impact on jobs and income of low-income households. All of these will need a carefully designed long-term national transition plan covering all aspects of climate action.

³⁷ Based on International Energy Agency (IEA) 2019 data.

³⁸ As stated by Kazakh Minister of Ecology, Geology and Natural Resources Serikali Brekeshev in October 2021.



Greater resistance to shocks and increased private sector participation will only be forthcoming if Kazakhstan widens its economic base and energy sources. Widening Kazakhstan's economic base and energy sources will improve resilience to shocks and attract more private investments in sectors beyond the extractive industries. Economic diversification and modernization are recognized in Kazakhstan's development plans—the National Development Plan to 2025 and the longer-term Kazakhstan 2050 strategy. Underpinning both of the above goals is the need to implement policies that attract investment, incorporating a push away from fossil-fuel dependence. They also require Kazakhstan to establish a level playing field for the private sector to support growth of new markets, such as transport and logistics, engineering, and ICT, support innovation and digitalization, develop green infrastructure, and modernize agriculture and water management.

Kazakhstan has the potential to take advantage of many opportunities for economic transition. These include the potential to produce and export minerals essential for the global low-carbon transition, improving agricultural productivity, and developing renewable energy resources to fuel local industry and new energy exports. Kazakhstan has reserves of minerals critical for low-carbon development globally, including bauxite, cadmium, iron ore, manganese, and zinc, and a substantial share of global chromium reserves.³⁹ While Kazakhstan produces some of these minerals, there is room to expand processing to capitalize on its vast resources. In addition, processed aluminum, iron, and steel are expected to be in high demand for the manufacturing of vehicles and wind turbines. Combined with Kazakhstan's vast potential for renewable energy generation, the country is well-placed to capitalize on its bauxite and iron ore reserves to develop green steel and aluminum industries.⁴⁰ By adapting to changing climatic conditions and improving the sustainability of its agriculture, Kazakhstan can continue to be an important agricultural producer globally.

There is urgency in finalizing climate policies, as Kazakhstan's targets require a sharp reversal in GHG emission trends and substantial decarbonization. The rapid pace of economic development in Kazakhstan increases the risk of locking in investments inconsistent with reducing GHG emissions, such as plans for new investments in the production and domestic use of fossil fuels.⁴¹ This risks wasting substantial funds on what could become stranded assets or locking in high levels of GHG emissions-intensity in the energy sector. Therefore, the opportunity for public sector investment and reform during the post-pandemic economic recovery provides an opportunity to drive the transition, while also bearing the risk of locking in bad investments.

There is more work to be done, which is where the World Bank can help

Far more work needs to be done to identify options and scenarios for implementing climate actions for Kazakhstan. Some of this work is already underway via the World Bank's Country Climate and Development Report (CCDR)—a new core diagnostic tool to help countries align climate action and development efforts. Kazakhstan's CCDR, targeted for 2022, will outline and prioritize key short and medium-term measures that can be taken to address priority climate change issues and help it to achieve its long-term development goals. In doing so, the CCDR will consider ways to mitigate physical and transition risks, capitalize on opportunities, support Kazakhstan to improve the resilience of its economy, maintain a robust economic growth trajectory, and encourage growth that translates to improved wellbeing for vulnerable populations and poverty reduction.

³⁹ World Bank. 2017. *The Growing Role of Minerals and Metals for a Low Carbon Future* (English). Washington, DC: World Bank Group.

⁴⁰ UNDP estimates that Kazakhstan has the potential to generate several times its own electricity demand with renewables. (UNDP [2014] *Renewable Energy Snapshots, Kazakhstan*).

⁴¹ UNFCCC Fourth Biennial Reports <https://unfccc.int/BRs>.



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