



Kazakhstan: COVID-19 Active Response and Expenditure Support Program

Project Name	COVID-19 Active Response and Expenditure Support Program	
Project Number	54188-001	
Country	Kazakhstan	
Project Status	Proposed	
Project Type / Modality of Assistance	Loan	
Source of Funding / Amount	Loan: COVID-19 Active Response and Expenditure Support Program	
	Ordinary capital resources	US\$ 1,000.00 million
	Asian Infrastructure Investment Bank	US\$ 750.00 million
Strategic Agendas	Inclusive economic growth Regional integration	
Drivers of Change	Governance and capacity development Partnerships	
Sector / Subsector	Health - Disease control of communicable disease Public sector management - Economic affairs management - Social protection initiatives	
Gender Equity and Mainstreaming	Effective gender mainstreaming	
Description	<p>Kazakhstan's economic growth was relatively strong in early 2020 above 4% and the macroeconomic outlook for 2020 2022 of 4% growth on average and continuous fiscal consolidation was in line with the good performance of recent years. But the recessionary effects of the global coronavirus disease (COVID-19) pandemic have now significantly worsened Kazakhstan's macroeconomic outlook. The country's non-oil fiscal deficit as a percentage of its gross domestic product (GDP) for 2020 is now set to widen to 11%, from 8% in 2019 and an originally expected 7% for 2020, which is also a result of the current discretionary countercyclical efforts. This situation will interrupt the downward trajectory from 10% in 2017.</p> <p>Early health and epidemic-control responses. The pre-COVID-19 efforts in early January to build health system response capacity were effective, as were the strict social containment measures implemented since March (i.e., right after the first confirmed cases in the country). But the medical emergency remains a challenge.</p> <p>Economic and social costs of COVID-19 response. The non-pharmaceutical interventions (NPIs) to slow down the spread of the virus imposed significant restrictions on Kazakhstan's non-oil economy and seriously hurt the country's macroeconomic outlook. Several enterprise surveys undertaken in early April indicate that (i) by the end of March, 48% of employees had been put on leave without pay and 13% had been terminated; and (ii) for the second quarter of 2020, an estimated 40% of employees could be put on leave without pay and 12% could be terminated. Tourism, hospitality, education, food services, retail trade, and manufacturing were among the areas hit hardest. Also, women tend to be particularly affected by restrictions on economic activity they account for more than 65% of the labor force in areas such as hospitality, education, and wholesale and retail trade; own or manage most of the microenterprises; and also represent a significant share of the informal labor market. Various estimates point to a loss of 1% of GDP per week of social lockdown.</p> <p>Pandemic-caused global recession reaching Kazakhstan. The economic difficulties that Kazakhstan began experiencing in March are now being compounded by (i) a new oil price shock (and the collapse in the prices of other commodities), and (ii) the sudden stop of global capital flows into emerging markets. These direct consequences of the global pandemic halved the prices of 85% of Kazakhstan's export goods. Exchange rate pressures were eased by allowing a 20% depreciation of the tenge and by raising the policy rate, which increased the debt-servicing costs across the economy. Pressures on the asset quality of banks are already constraining the provision of new liquidity to microenterprises and small and medium-sized enterprises (SMEs). This added to the ongoing disruptions outlined in para 4. Without a fiscal response, the economy will contract by 5% or more. The poor and vulnerable, including women, can be disproportionately affected. Poverty rates may reach 11% 13% (from 6.6% now). Robust and comprehensive government response. To counter this sequence of shocks, the government decided on a comprehensive package of medical, public health, and countercyclical fiscal measures totaling T5.9 trillion (8% 9% of GDP, or about \$13 billion). The government will self-fund more than 81% of this, including with additional transfers of \$4.7 billion \$5 billion from the National Fund of the Republic of Kazakhstan (NFRK). The remaining \$2 billion of net new financing needs require foreign and domestic debt issuance. The sound pre-shock macroeconomic management record of the government is instrumental in giving credibility to its recent monetary and macroprudential policy decisions in banking and exchange-rate markets. The proposed assistance from the Asian Development Bank (ADB) will help the government mitigate the medical and economic impacts of the COVID-19 pandemic on Kazakhstan, and support its (i) immediate COVID-19 health policy response, (ii) social protection and employment recovery measures, and (iii) overall stimulus measures. Kazakhstan's CPRO eligibility is summarized in Table 1 and detailed in Appendix 4. The proposed program is aligned with ADB's Strategy 2030, including its operational priorities of addressing remaining poverty risks, accelerating progress in gender equality, and fostering regional cooperation and integration.</p>	

Project Rationale and Linkage to Country/Regional Strategy

First pandemic-related shock. As of 25 May 2020, Kazakhstan confirmed 8,322 COVID-19 cases (the first ones were recorded on 13 March) and registered 35 related deaths. The national health system was rapidly upgraded to cope with the epidemic, thanks to the readiness implementation measures initiated in early January 2020, i.e., before the epidemic arrived in the country. But the strict NPIs mandated in March to slow the spread of the virus imposed significant restrictions with serious implications for businesses and employment. Microenterprises and SMEs suffered in particular their turnover fell by 75%. The business areas hit directly and hardest are tourism, hospitality, education, food services, and manufacturing. Restrictions on economic activity can particularly affect women. While the health emergency remains a serious challenge and its fiscal costs are likely to be sizable, it is the recessionary macroeconomic outlook for Kazakhstan that is troubling: estimates point to a loss of 1% of GDP per week.

Second pandemic-related shock. While the COVID-19 pandemic rapidly overwhelmed health systems and shut down large segments of economies across the world, from the People's Republic of China (PRC) to Europe to the United States, it is becoming particularly lethal in developing and emerging economies that are highly dependent on commodity exports or tourism revenues. Kazakhstan's experience is of particular significance. The collapse of the international prices of oil and other commodities (which determine more than 80% of Kazakhstan's export revenue) is reinforced by the global recessionary outlook for 2020. Also, a sudden stop in capital flows hit emerging markets, and the cumulative outflows from these markets since the onset of the COVID-19 crisis are extraordinary in magnitude, even by the standards of the global financial crisis. This will directly affect banks with foreign-currency refinancing needs, and all firms and individuals with debt denominated in foreign currency. Without a fiscal response, the economy could contract in real terms by 5.5% in 2020 (instead of the 4% average growth that had been projected for 2020-2023 as late as February 2020). The collapse in export revenues brought about exchange rate pressures, which the monetary authorities allowed to take hold while raising the policy rate to 12% (from 9.25%) to smooth the currency depreciation process. As a consequence, debt-servicing costs in the economy have risen for both local currency credit and foreign currency credit contracts, even if the policy rate was subsequently lowered to 9.75% in the face of weakening aggregate demand. This is now affecting the asset quality of banks, and will further constrain access to finance for microenterprises and SMEs.

Social vulnerabilities, poverty, and gender risks. Unless countered, the shocks that hit Kazakhstan can exacerbate the levels of poverty and social vulnerability. Gender risks are also recognizable. The dimensions and risks can be disaggregated by shock.

(i) The COVID-19 crisis could increase hospitalization and medication costs to a level that would overwhelm the budgets of the poor and most vulnerable, if infected. It also puts health workers, of whom 70% are women, at risk.

(ii) The strict social lockdown measures and other NPIs of the government are crucial in containing the medical emergency. But these measures pose significant risks to livelihoods and income generation in business activities where women's participation is high. Women account for more than 65% of the labor force in some of the industries most affected by the current lockdowns. Women also represent a large share of the equally hard-hit informal workforce.

(iii) Without a sizable but well-targeted fiscal response, the economy could contract by 5.5% or more in 2020, and poverty rates could reach 11% to 13%. Women could be disproportionately affected by a deep recession, given existing gender disparities in wage levels and unemployment rates, and already disadvantaged access to finance in normal times.

Fiscal and implementation challenges. The health budget is expected to swell, as are other expenditure items. Tax revenue related to the extractive industries is expected to plummet in 2020. But other tax revenue will also be affected by the foreseeable business and employment distress. The formula-determined, guaranteed transfers from the NFRK for 2020 will receive an additional and sizable top-up. But given the sharp drop in oil revenues and a marked reduction in the market value of its external financial assets, the NFRK will be substantially depleted. This is significant in view of the NFRK's crucial role in ensuring financial stability and intergenerational equity. Kazakhstan's access to international capital markets to finance public expenditures is now very limited, as indicated by the recent rise in the risk spreads of regional sovereign eurobonds. Key role in Central Asia's trade and remittance flows. Kazakhstan's economy plays a key role in Central Asia's trade and remittance flows, and represents 50% of Central Asia's GDP. To support its developing member countries in countering the severe fiscal and macroeconomic impacts of the COVID-19 pandemic, ADB established the CPRO under its Countercyclical Support Facility (CSF). The CPRO ensures that all developing member countries have the necessary resources to act quickly and sizably. It was also meant to generate a regional public good and allow an internationally coordinated response that would lower the transmission of infections and mitigate negative cross-border social and economic spillovers. The number of nationals from the Kyrgyz Republic, Tajikistan, and Uzbekistan that work in Kazakhstan and send home remittances has increased substantially. Kazakhstan is a significant importer of food and other products from the Kyrgyz Republic and other Central Asia countries. It is a major wheat exporter to regional countries, and a serious crisis with prolonged border closures could threaten the food security in Central Asia because of re-exports from the PRC. Kazakhstan's efforts to mitigate the pandemic and a recession have aspects of a regional public good.

Impact	Adverse impacts of COVID-19 on the population's health, incomes, and economic opportunities mitigated.
Outcome	Spread of the disease managed and of poverty contained.
Outputs	
Geographical Location	Nation-wide

Safeguard Categories	
Environment	C
Involuntary Resettlement	C
Indigenous Peoples	C

Summary of Environmental and Social Aspects	
Environmental Aspects	
Involuntary Resettlement	
Indigenous Peoples	
Stakeholder Communication, Participation, and Consultation	
During Project Design	
During Project Implementation	

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Timetable	
Concept Clearance	20 Feb 2022
Fact Finding	02 Apr 2020 to 02 Apr 2020
MRM	15 May 2020
Approval	-
Last Review Mission	-

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