

Rating-Agentur Expert RA GmbH assigned 'BBB-' sovereign government and 'BB+' credit climate ratings to Kazakhstan

Rating-Agentur Expert RA GmbH assigned 'BBB-' sovereign government credit rating (SGC) to Kazakhstan in national currency (Moderately high level of creditworthiness of the government) and 'BBB-' in foreign currency (Moderately high level of creditworthiness of the government).

Rating-Agentur Expert RA GmbH assigned 'BB+' country credit environment rating (CCE) to Kazakhstan in national currency (Sufficient quality of credit environment of the country) and 'BB+' in foreign currency (Sufficient quality of credit environment of the country).

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Low projected gross government debt to GDP (21,1%) and to budget revenues (103%) in 2015;
- Solid amount of FX reserves covering gross government debt by 1,2x and external debt by 2,7x by year-end 2015;
- Short-term debt is fairly limited, it represents merely 2,1% of the total debt and it accounts for 0,4% of GDP and 2,2% of budget revenues in 2015;
- GDP per capita (projected to be USD 24 300 in 2015) is one of the highest among its regional CIS peers and has been steadily increasing in recent years;
- The unemployment rate has been stable over the past years and it is projected to remain at satisfactory levels in 2015 (5,0%);
- Adequate capitalization of the banking system posting a capital adequacy ratio of 14,1% in 2015, a stable indicator over the past six years;
- The government has presented ambitious privatization plans which involve selling valuable assets from the sovereign wealth fund (Samruk-Kazyna) including the hydrocarbon, energy and telecommunications sectors.

Restricting factors:

- Despite the consistent decline in revenues since 2011 and the first projected deficit since 2009 (3,2% of GDP for 2015), the fiscal position remains acceptable;
- The banking system is still sluggish. Bank assets and private credit to GDP were 60,1% and 39% respectively. The amount of NPLs was reduced to 12,4% in 2015 mainly due to the transfer of assets from Kazkommerstbank to BTA Bank¹ and dismissal of legal barriers to transfer these assets to SPVs. Even though profitability was positive (ROA=2%), dollarization levels still pose a risk to the banking system;
- The new inflation-targeting monetary policy regime has been partly ineffective. While, the free floating currency has helped to cushion external shocks and declining oil prices, it has caused exchange rate volatility and the necessity for the National Bank of Kazakhstan (NBK) to intervene the market several times since it was fully liberalized. Furthermore,

¹ BTA Bank's license was voluntarily surrendered to the NBK which means that the Bank is not officially part of the banking sector and, thus, its assets (and NPLs) are not accounted for.

dollarization levels in the country impede the successful transmission of monetary policy to the financial system;

- Acceptable level of competitiveness of the economy as measured by the index of economic competitiveness from the World Economic Forum (the country scored 4,48 out of 5,7 in 2015);
- Fiscal policy in the short-term has been designed to spur economic growth. Nonetheless, most of the revenues are hydrocarbon-dependent and current and expected oil prices have already taken a toll on the budget balance and the assets of the National Fund of the Republic of Kazakhstan (NFRK).

Negative factors:

- Steep increase in gross government debt from 14,9% of GDP and 61% of budget revenues in 2014 to 21,1% and 103% respectively in 2015. This was attributed to a projected decline in revenues and nominal GDP and, mostly, to an increase in external debt (Eurobond issuance), domestic debt remained almost unchanged;
- The fiscal balance has been narrowing since 2011 and it is projected to present a deficit in 2015 due to declining revenues caused by dampened oil prices;
- Real GDP growth has been declining since 2011 and this trend is expected to continue in 2015 where growth is projected to be 1,5% as compared to 4,3% in 2014;
- The inflation rate spiked to 13,6% at the end of 2015 driven by KZT devaluation. A year back it was 7,43%, within the NBK target range between 6% and 8%;
- The national stock exchange is underdeveloped with only 85 listed companies, a market capitalization of 31,5% of GDP and 95% of the trades corresponding to the ten largest issuers.

Stress factors:

- Concentration of tax revenues on one industry. Kazakhstan depends heavily on oil revenues, which make up around 60% of the state's budget and 33% of GDP (weak stress factor);
- Financial dollarization in Kazakhstan has sharply increased in 2015. As of end-2015, around 33,7% of total loans and 69,0% of total deposits were denominated in foreign currency (moderate stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Poor performance of the national stock exchange (KASE) as evidenced by the 50% decline of the KASE index over the last six years;
- Default of Kazakh financial institutions during 2015 (BTA Bank, Alliance Bank, AO Astana Finance).

Restricting factors:

- Volatile real interest rate over the past six years. Nonetheless, it lowered in 2015 to 2,1%, an attractive level for investors.

Positive factors:

- Narrow spread between average lending and deposit rates (0,5%).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Substantial de-dollarization in the country which would cause an improvement of the monetary policy transmission mechanism and ease the banking sector risks;

The following developments could lead to a downgrade:

- Materialization of banking sector risks as reflected by higher NPLs, lower profitability and lower capitalization caused by further deterioration of oil prices and continued exchange rate volatility.

“Kazakhstan’s ratings are supported by low government debt, solid amount of assets, including FX reserves, and still acceptable fiscal buffers. Nevertheless, the ratings also reflect the harsh impact on macroeconomic and fiscal indicators due to the steep decline in oil prices and exchange rate volatility. The grim prospect for the banking sector, due to high levels of financial dollarization, and constraints over the flexibility of monetary policy also restrained the rating levels. If oil prices remain low and the exchange rate continues to be volatile, we expect further deterioration of growth prospects and public finances for 2016.” – Clarified Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH.

Responsible expert: Hector Alvarez, Expert of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

Research report on Kazakhstan is available at:

http://raexpert.eu/reports/Research_report_Kazakhstan_29.01.2016.pdf

Next scheduled rating publication: 22 July 2016. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign.php#conf-tab-5>.

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Minute's summary

The rating committee for Kazakhstan was held on 27 January 2016. The quorum for the rating committee was present. After the responsible expert presented the factors, which influenced the rating assessment, the members of the committee expressed their opinions and suggestions within the framework of the Sovereign methodology. The chairman of the rating committee ensured that every member of the committee expressed his/her opinion before proceeding to the voting.

The following methodology was used for the rating assessment: Methodology for Assigning Sovereign Government Credit Ratings and Country Credit Environment Ratings. Short Public Version (from April 2015) can be found under the following link: (http://raexpert.eu/files/methodology/MethodologyShort_Credit_Ratings_Sovereign_2015.pdf). Descriptions and definitions of all rating categories can be found within the aforementioned methodology. The user of the rating shall read the methodology in order to have a full understanding of the rating procedure.

These ratings are unsolicited. The rated entity did not participate in the rating process.

Main sources of information: National Bank of Kazakhstan, Ministry of Finance of the Republic of Kazakhstan, World Federation of Exchanges, International Monetary Fund, World Bank, Trading Economics, World Economic Forum, Doing Business, United Nations, Kazakhstan Stock Exchange (KASE), publications in the media.

Limits of the Credit Rating

During the rating assignment process, Rating-Agentur Expert RA GmbH (the Agency) used publicly available information that was considered to be reliable, complete and non-biased. The responsible expert performed the rating assessment of the country with information considered as the most reliable and up to date in accordance to the overall position of the country and the Agency's internal criteria for selecting data providers. The information and data used for this specific assessment can be considered as of sufficient quality.

Despite similar methodologies, credit ratings of Kazakhstan from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:

- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

Conflict of interest

The responsible expert was neither influenced nor biased by third parties during the rating assessment. All employees involved in the rating assessment and revision of the rated entity have reported absence of conflicts of interests before initiation of the rating process.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

Risk warning

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's Research Reports.

This Report represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

Office responsible for preparing the rating

The office responsible for the preparation and issuance of this credit rating is the office of Rating-Agentur Expert RA GmbH in Frankfurt am Main, Germany.

Rating-Agentur Expert RA GmbH is a credit rating agency established in Germany and therefore shall comply with all applicable regulations currently in force in the European Union.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

Rating-Agentur Expert RA GmbH applies the Code of Conduct Fundamentals for credit rating agencies issued by the International Organization of Securities Commissions (IOSCO Code) and includes the basic principles of IOSCO Code in its Code of Conduct.