

Rating-Agentur Expert RA confirmed at 'BBB-' the sovereign government rating and at 'BB+' the credit climate rating of Kazakhstan

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

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

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Real GDP is expected to have grown to around 3,3% in 2017 mainly as a result of higher industrial production, especially oil production, which translated into robust exports growth. Furthermore, private consumption growth has declined as compared to 2016;
- Government debt is expected to have been around 21,8% of GDP in 2017, in line with the figures posted in 2016 and 2015. However, debt to budget revenues is anticipated to have decreased by 4p.p. to 112,7% in 2017. Short-term debt remains low at 0,3% of GDP;
- Monetary policy remains loose as inflation continued to decelerate in 2017. As a result, the National Bank of Kazakhstan (NBK) trimmed the base rate by 25 b.p. to 10,25% in August 2017. As mentioned in our previous review, the inflation targeting policy and free-float exchange regime implemented by the NBK has stabilized inflation and the exchange rate;
- The level of international reserves has slightly declined toward end-2017 after the spike in July due to conversion operations from transfers of the National Fund of the Republic of Kazakhstan (NFRK). However, they remain quite high at USD 31 bn as of November 2017 covering external debt by 2x and gross government debt by 1x;
- We expect GDP per capita in PPP terms to be around USD 26 071 in 2017 and remain one of the highest among its regional CIS peers;
- The unemployment rate has been stable over the past years and is projected to remain at satisfactory levels in 2017 (5,0%);
- Despite the adverse condition in the banking system, the officially reported capital adequacy ratio stood at around 16,3% in 3Q 2017;
- The privatization program remains in place and the authorities plan to sell major assets by 2021;
- FDI was high in 2016 but it dropped significantly in 2017. Direct investment inflows were about USD 4,8 bn by 3Q 2017 as compared to USD 14,9 bn a year before.

Restricting factors:

- We expect the fiscal deficit to have posted a figure of around 6,5% of GDP in 2017, as previously anticipated. This is due to the substantial increase in expenditures (11,2% y-o-y as of 3Q 2017) as compared to revenues (8,2% y-o-y as of 3Q 2017). Even though the government has made strides to reduce the budget dependence on oil, the non-oil deficit

is also expected to have widened in 2017. We expect the authorities to continue to reduce the use of funds from the NFRK going forward;

- Credit to the economy remains stagnant. We expect the volume of private credit to GDP to have declined in 2017 to around 44% from 45% in 2016. Moreover, we also anticipate a decline in the overall banks' assets to GDP ratio by around 10p.p. from 2016. The still high amount of troubled loans in the system has caused limited credit growth, especially for the corporate sector. Furthermore, deposit dollarization levels remained stable at 48% as of 11M 2017; while FX loans slightly declined down to 27% as of the same date;
- The level of competitiveness of the economy remains satisfactory. The index of economic competitiveness from the World Economic Forum was 4,4 out of 5,7 in the 2016-2017 report.

Negative factors:

- The level of consumer prices grew by 7,1% y-o-y by end-2017 showing steadiness as a result of a more stable exchange rate. Despite posting a lower figure than a year before, the inflation rate remains high;
- The market capitalization of the Kazakh Stock Exchange declined to around 28% of GDP as of September 2017 and remains highly concentrated on a few issuers. Thus, we still consider the underdevelopment of the capital markets as a negative factor;
- The banking sector remains fragile. Despite persisting adequate official capitalization metrics, NPLs resumed an upward trend toward the second half of 2017 when they stood at 12,7% of total loans as of 3Q 2017 (this, without considering restructured loans and NPLs from SPVs). Moreover, in the same period, bank's ROA was negative (-0,4%) for the first time since the aftermath of the 2008 financial crisis. The KKB and Halyk Bank have recently agreed to merge operations and the new institution is expected to account for 40% of the market. On the one hand, this may stabilize the system, however, it increases concentration and may hurt competition;
- Given the increasing risk in the banking system, we still consider a potential materialization of contingent liabilities as a key threat to the stability of the government finances.

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, despite declining further in 2017, remains a risk for the economy and the banking system. As of November 2017, around 27% of total loans and 48% of total deposits were denominated in foreign currency (very weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Relatively narrow and stable spread between average lending and deposit rates as of October 2017 (5%);
- The KASE index continues to increase consistently as it jumped by more than 50% in 2017.

Restricting factors:

- The real interest rate has been volatile over the past six years and it increased up to around 6,4% as of October 2017.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Sustained increase in oil prices along with further diversification of the economy and fiscal consolidation;
- Improvement in the banking system metrics alongside a sustainable reduction in the level of FX deposits.

The following developments could lead to a downgrade:

- Deterioration of fiscal metrics as a result of either a renewed depression of oil prices or further weakening of the banking system.

“Kazakhstan’s SGC ratings at BBB- and CCE ratings at BB+ are underpinned, on the one hand, by the low level of government debt, sufficient fiscal buffers and the continued stabilization of the consumer price level as well as the exchange rate, which caused a steady decline in the amount of deposit dollarization. Additionally, the external sector has recovered as the trade and current account balances posted improved figures in 2017.

On the other hand, the ratings also reflect the persistent banking system risk which heightens the probability of contingent liability materialization for the Kazakh government. Furthermore, we continue to observe a stalled credit market, especially for corporations, as a result of the still high NPLs and restructured loans.” – Clarified Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

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

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

Research report on Kazakhstan is available at:

https://raexpert.eu/reports/Research_report_Kazakhstan_12.01.2018.pdf

Next scheduled rating publication: 6 July 2018. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
14.07.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BB+	BB+
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BB+	BB+
22.07.2016	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BB+	BB+
29.01.2016	First assignment of both types of ratings for the country	BBB-	BBB-	BB+	BB+

Minute's summary

The rating committee for Kazakhstan was held on 11 January 2018. 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 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.pdf. Descriptions and definitions of all rating categories can be found under the following link: <http://raexpert.eu/sovereign.php> under the "Rating scale" section. 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), Cbonds, 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.

Regulatory use

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

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 press-release and research report.

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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.