

Rating-Agentur Expert RA confirmed at 'BBB-' the ratings of Kazakhstan. The rating outlook changed from positive to stable.

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. The rating outlook changed from positive to stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Gross government debt to GDP and to budget revenues remained stable and at bearable levels in 2019 at around 20% and 100%¹ respectively, showing a solid debt position of the government, while the structure of debt remains mixed. On the one hand, external debt remains high accounting for 46% of total debt. But on the other hand, the level of short-term debt remains low and covered 21x by international reserves, while 42% of the external debt is in concessional terms. However, due to the fact that around 30% of debt is denominated in foreign currency, we can expect a slight increase of the debt load by end-2020 due to KZT depreciation;
- As of June 2020, the yield spread between the 10Y German bund and the EUR-denominated Kazakh government bond with maturity in 2028, despite widening up to 2 p.p., stood at a bearable level reflecting a good perception of the country's risk by the market;
- In response to the KZT devaluation in 1Q 2020 and increasing inflationary pressures, the National Bank of Kazakhstan (NBK) significantly tightened the monetary policy by increasing the base rate by 2,75b.p. up to 12% in March 2020; however, it then lowered the rate to 9,5% less than one month later. We anticipate the NBK's to continue managing monetary policy pursuing price stability, as well as moving gradually to a free float exchange regime. However, as shown by such abrupt changes, the effectiveness and transmission mechanism remain limited, especially taking into account the weak financial system and still high dollarization;
- As of May 2020, international reserves stood at USD 31,5 bn, which exceeds the IMF recommended reserve adequacy level for countries with a floating exchange rate. Also, international reserves are around 87% of gross government debt and 6 months of imports of goods and services;
- GDP per capita in PPP terms is expected to reach an all-time high of around USD 28,5 th in 2019 and remains one of the highest among its regional CIS peers²;
- The unemployment rate remained stable at a level of 4,8% as of end 1Q 2020. However, we can expect slight increase of this metric by the end of 2020 due current economic crisis.

Restricting factors:

- Inflation in Kazakhstan remains elevated and volatile due to the high exposure to external shocks. After reaching 5,4% by end 2019, the CPI index hiked up to 6,7% y-o-y by the end

¹ These figures do not include debt of the National Bank of Kazakhstan.

² Estimated GDP per capita in PPP for 2019: Uzbekistan – USD 8 999; Tajikistan – USD 3 589; Turkmenistan – USD 20 410.

of May 2020, mostly due to KZT depreciation and expected to be in the range of 8-8,5% by end 2020³, which is above the original NBK's target of 4-6%;

- The banking system shrunk in 2019 and has continued along this trend in 1H 2020. The sector's assets to GDP stood at 39% in 2019 as compared to 40% by the end of 2018 and we can expect further decline of assets, as shown by recent figures: in April 2020 assets declined by 1,9% as compared to March 2020, while gross loans declined by 2,5%;
- Foreign investment dynamics have declined since 2016, and we anticipate a net inflow of FDI close to 2% of GDP in 2019;
- According the Global Competitiveness Index report from 2019, the overall score for Kazakhstan was 63 (55th place from 140), a slight improvement as compared to 2018. However, due to the volatility on the oil market and forecast recession in the Kazakh economy, we can expect a negative trend in this metric's dynamic. Moreover, the external trade balance remained positive in 2019 at 8,6% of GDP, albeit narrower, and the current account deficit widened up to 3,6% of GDP;
- After posting a substantial surplus of 2,6% of GDP in 2018, the fiscal balance turned to a deficit of around 0,6% in 2019. Such dynamic was mainly driven by higher government expenses in education, social assistance, social security and public health care, while overall revenues increased at a slower pace. In 1Q 2020, the fiscal deficit widened up to 8,5% of GDP without transfers from the National Fund of the Republic of Kazakhstan (NFRK) and reached 0,2% of GDP if taking into account such flows. This dynamic was mainly a result of the sharp oil price decline the, strict quarantine measures in most of the regions of Kazakhstan, as well as the overall turbulence in the economy. In our view, implementation of the announced anti-crisis fiscal support of the economy (with overall approximate costs of KZT 5,9 tn equivalent to around 8,5% of GDP), as well as lower oil prices will lead to an overall deficit in the range of 4%-6% of GDP by end-2020. At the same time, the fiscal position of the government will be supported by significant accumulated fiscal reserves in the NFRK;
- After a significant growth of real GDP at 4,5% y-o-y in 2019 (which was the highest since 2013), the economy of Kazakhstan has contracted by 0,2% y-o-y in 4M 2020, and we expect the overall 2020 contraction to be around 0,5% taking into account implementation of significant fiscal stimulus as well as gradual recovery of oil markets by the end of the year. However, continuous turbulence in the global economy as well as potential prolongation of quarantine measures in some regions of the country can lead to a deeper contraction of up to 2,5% y-o-y.

Negative factors:

- Capital markets in Kazakhstan remain undeveloped, volatile and non-liquid as shown by the low level of market capitalization, which was as low as 26% of GDP by end-2019. Despite the volatility observed during 1H 2020 the stock index of the national stock exchange – KAZE – almost fully recovered by mid-June 2020, and returned to its pre-crisis levels of around 2 300. In addition, as mentioned in our previous review, the development of the capital markets is underway as the Astana International Financial Centre (AIFC) continues to contribute in the evolution of the Kazakh financial market, including the development of Islamic and green finance;
- After the finalization of the banks' asset quality review (AQR) by the NBK, the level of NPLs in the system reached 8,1% by end-2019 and continued to grow in 1Q 2020 spurred by the COVID-19 lockdown measures as well as oil price volatility. By the end of April 2020 the NPLs levels reached 9,4% of total loans, with 9,5% for corporate loans and only 5,5% for retail. We expect these levels to rise in the following months, but to stabilize by the end of 2020. We also expect a further decline in the profitability metrics, which already

³ Official forecast of the National Bank of Kazakhstan (NBK).

reached 2,9% and 23,2% for ROA and ROE as of April 2020⁴, as compared to 3,1% and 24,3% by the end of 2019. However, the banks' level of capitalization and liquidity remained favourable as the capital adequacy ratio was 25% and the liquid assets in national definition formed around 47% of the banks' portfolio as of the end of April 2020;

- Despite the performed AQR, as well as further decline of the banks' assets, we still consider the banking sector stability as weak, taking into account high level of related party lending, dollarization and historically observed high level of hidden NPLs. This keeps posing a high risk of contingent liabilities' materialization. Nonetheless, the number of state-owned companies has been gradually declining as the privatization process has continued in 2019 despite hitting some bumps in the road in terms of delayed IPOs. At the same time, the current economic situation already forced the government to postpone the privatization.

Stress factors:

- Concentration of tax revenues on one industry remains high. Kazakhstan depends heavily on oil revenues, which make up around 44% of the state's budget that is more than 8% of GDP (weak stress-factor);
- After slight decrease of dollarization of the banking system during 2019, both, the share of loans and deposits in foreign currency slightly increased during 1Q 2020 and stayed at quite high levels at the end of April 2020: 17,1% and 43,4%, respectively (very weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Increase in oil prices higher than our base scenario to support GDP growth and the external trade position;
- Faster and stronger than originally anticipated recovery from the current economic crisis with higher non-oil GDP growth and improvement of non-oil fiscal balance;
- Improvement of the general stance of the banking system, especially asset quality.

The following developments could lead to a downgrade:

- Further deterioration of economic activity which will have a direct impact on public finances and external buffers;
- Unexpected devaluation of local currency as a result of pressures from lingering low oil prices;
- Further weakening of the banking system, which would materialize contingent liabilities of the government.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None.

⁴ Here refers to ROAA and ROAE for 4M 2020.

“The Agency has confirmed Kazakhstan’s ratings at ‘BBB-’ and changed the outlook from positive to stable. Our decision to change the outlook mostly reflects the impact on the economy from the COVID-19 crisis. The effects of the pandemic in Kazakhstan have mainly been observed through over supply and lower demand on oil, which has caused the oil price to sink. This affects directly the country’s public finances, already elevated dollarization levels, external stance and GDP dynamic for 2020. In addition, the banking system is expected to weaken ever further.

On the other hand, the ratings of Kazakhstan were supported by significant volume of international reserves, which partly mitigates the current shocks for the economy and local currency, bearable levels of the debt load, as well as improved quality of the monetary policy of the National Bank of Kazakhstan, that gradually moving to free float regime.” – Clarified Vladimir Gorchakov, Associate Director of Rating Agentur Expert RA.

Research report on Kazakhstan is available at:

https://raexpert.eu/reports/Research_report_Kazakhstan_12.06.2020.pdf

Next scheduled rating publication: 11 December 2020. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2020](#)

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
13.12.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Positive	Positive
14.06.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
21.12.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
06.07.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
12.01.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
14.07.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
22.07.2016	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
29.01.2016	First assignment of both types of ratings for the country	BBB-	BBB-	NA	NA

Minute's summary

The rating committee for Kazakhstan was held on the 12 June 2020. 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 – Full Public Version](#) (from April 2019). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: [ESG factors in RAEX-Europe's Credit Ratings](#)

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

SGC ratings can be used for regulatory purposes according to the ESMA definition.

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

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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.