

Rating-Agentur Expert RA confirmed at 'B' the ratings of Kyrgyzstan. The rating outlook is stable.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Kyrgyzstan at 'B' (Moderately low level of creditworthiness of the government) in national currency and at 'B' (Moderately low level of creditworthiness of the government) in foreign currency. The rating outlook is 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:

- Short-term debt remained rather low and well covered by the FX reserves and is estimated to have been 0,6% of GDP and 1,6% of budget revenues in 2017;
- The economy is gradually recovering from the last external shock, caused mainly by declining remittances and lower trade turnover, indicated by the real GDP expected growth at 4,5% and 3,3% in 2017 and 2018 respectively.

Restricting factors:

- Headline inflation dynamics were considered to be acceptable, as the inflation rate was contained at around 3,7% in 2017 on the backdrop of rising food prices, and in May 2018 constituted just 1,4% confirming the still high volatility of prices. However, both were well outside the National Bank of Kyrgyzstan (NBKR) target band (between 5% and 7%). Oil and food price volatility remains one of the main sources of overall price uncertainty in the economy. Additionally, even though financial dollarization levels continue to ease, they remain high and continue to hurt the effectiveness of the policy transmission mechanism;
- As a result of the ongoing credit boom, the NPLs to total loans decreased down to 7,7% in May 2018. Capitalization levels remained satisfactory indicated by capital to assets ratio at 16,7% in May 2018, with ROA picking up to the level of 1,4% as of the same date. As a response to the NBKR's expansionary monetary policy, the banking sector indeed showed some signs of recovery, but the embedded vulnerabilities remain, as banks are exposed to currency and policy risks;
- Net foreign direct investment inflows to GDP were on a negative trend since 2015, decreasing by around 16p.p. down to 1,2% in 2017, indicating a slowdown in inward direct investment by non-residents in the country;
- The amount of government debt relative to GDP declined down to about 56,7% in May 2018, driven by favorable KGS dynamic, investment projects rephasing and write-off of Russia's debt. However, the debt level remained a concern as Kyrgyzstan's debt to GDP ratio remains the highest amongst the regional peers¹ in that period. The country was significantly exposed to exchange rate dynamics given the fact that around 87% of its debt was FX-denominated as of May 2018. Nevertheless, the concessional nature of more than 98% of the external debt increases probability of debt restructuring if needed, hence reduces the credit risk of the sovereign;
- We still consider the quality of the fiscal policy to be moderate since the government missed the initial fiscal deficit target of 3% in 2017, which was subsequently relaxed down

¹ Here Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan.

to 3,5% of GDP. This allowed the government to accommodate additional funds for social needs prior to the elections and disaster relief measures, which, unless canceled, may negatively affect mid-term fiscal plans. Additionally, the absence of a credible, effective and enforceable fiscal rule, which would be able to act as an anchor and safeguard against further fiscal slippages, limits certainty over the government's mid and long-term fiscal plans further restricting the credit rating;

- Albeit recent favorable dynamic, the unemployment rate in the past six years stayed rather high and was estimated at 7,1% in 2017;
- Low institutional development of the country was reflected in the high corruption perception, low government effectiveness and political stability index, inadequate rule of law, as well as low position in Doing Business Ranking (77th out of 180) in 2017. At the same time, the country has a long history of cooperation with international organizations, which helps to maintain transparency of the government reporting at acceptable levels.

Negative factors:

- Real GDP growth dynamics remained favorable, however GDP per capita in PPP terms was still low, estimated at USD 3 668 in 2017, ranking the country behind most of its peers¹;
- The banking sector remains underdeveloped with bank's assets and volume of private credit standing at around 40% and 20% of GDP in 2017 respectively; however, dynamics of these indicators have been positive;
- Competitiveness of the Kyrgyz economy remained very narrow. The country imports most of its products (trade deficit of 31,4% of GDP in 2017) and has a competitiveness index of 3,9 from the WEF in 2017 which ranks 102nd out of 138 countries, one of the lowest among its regional peers²;
- The stock and bond exchange markets remained underdeveloped with a very low total market capitalization of listed companies (3,9% of GDP in 2017), low turnover, high concentration of trades on the biggest issuers (ten largest equity issuers account for about 88% of the amount of annual trading in 2017) and a narrow variety of products.

Stress factors:

- High dependence on third countries, as well as on international organizations to finance operations and receive financial aid and remittances (moderately weak stress factor);
- Despite positive dynamics, financial dollarization continued to be a problem representing 47,6% of total deposits and 38,2% of total loans in May 2018 (very weak stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Gradual reduction of dollarization levels combined with the maintenance and stability of price levels and the exchange rate.

The following developments could lead to a downgrade:

- Continued widening of the fiscal deficit exceeding the target levels coupled with subsequent government debt accumulation above sustainable levels;
- Resumed risk accumulation in the banking sector.

"The SGC rating of Kyrgyzstan confirmed at 'B' with a stable outlook reflects declining dollarization levels, favorable banking sector dynamics and moderate inflation postings. The continued recovery of the main CIS trading partners, through growing remittances and trading

² Here Kazakhstan and Tajikistan, as Turkmenistan and Uzbekistan are not included in the competitiveness report by WEF.

activity, expansionary monetary and fiscal policies supported the output growth. However, it remains heavily dependent on the amount of gold production in the country.

At the same time, the rating level was constrained by the still high government debt levels vulnerable towards exchange rate volatility and absence of a credible fiscal rule. Moreover, continuously missed fiscal and monetary targets, low institutional and economic development, as well as still low levels of credit to the economy restrained the rating further.” – Clarified Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH.

Responsible expert: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

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

Research report on Kyrgyzstan is available at:

https://raexpert.eu/reports/Research_report_Kyrgyzstan_13.07.2018.pdf

Next scheduled rating publication: TBD in December 2018.

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
19.01.2018	Scheduled revision of both types of ratings for the country	B	B	NA	NA
21.07.2017	Scheduled revision of both types of ratings for the country	B	B	NA	NA
27.01.2017	Scheduled revision of both types of ratings for the country	B	B	NA	NA
29.07.2016	Scheduled revision of both types of ratings for the country	B	B	NA	NA
19.02.2016	First assignment of both types of ratings for the country	B	B	NA	NA

Minute's summary

The rating committee for Kyrgyzstan was held on 11 July 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 – Full Public Version (from May 2018) can be found under the following link: https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.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: International Monetary Fund, World Bank, World Economic Forum, Doing Business, United Nations, Kyrgyz Stock Exchange (KSE), National Bank of Kyrgyzstan (NBKR), Ministry of Finance of the Kyrgyz Republic, Ministry of Economy of the Kyrgyz Republic, National Statistical Committee of the Kyrgyz Republic, Transparency International, Human Development Report.

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.

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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.

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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.