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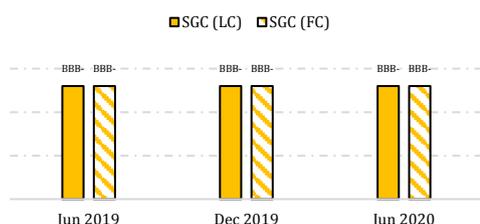
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Ratings

Sovereign Government Credit (LC)	BBB-
Sovereign Government Credit (FC)	BBB-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Kazakhstan

Macro indicators	2017	2018	2019
Gross gov. debt, KZT bn	10 805	12 524	13 867
Nominal GDP, KZT bn	54 379	61 820	68 956
Real GDP growth, %	4,1	4,1	4,5
Gross gov. debt/GDP, %	19,9	20,3	20,1
Deficit (surplus)/GDP, %	-4,3	2,6	-0,6
Inflation rate, %	7,1	5,3	5,4
Current Account Balance/GDP, %	-	-	-3,6
External debt, USD bn	-	-	156,8
Development indicators		2018	
Inequality adj. HDI		0,74	
GDP per capita, USD th		27,7	
Default indicator		12.06.2020	
5-Year CDS spread, Bp		125	
10Y Gov EuroBonds Yield,%		1,68*	

Source: RAEX-Europe calculations based on data from the IMF, WB, Cbonds, Ministry of Finance of the Republic of Kazakhstan and NBK.

* Maturity in 2028 (ISIN: XS1901718335)

Summary

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 from the COVID-19 crisis on the economy. 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, the external stance and GDP dynamics 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, which is gradually moving to adopt a free float regime.

The economy is expected to contract in 2020, but has potential for a strong recovery in 2021. After a significant real GDP growth of 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, while for the 1Q 2020 still showed a positive dynamic of 2,7% y-o-y.

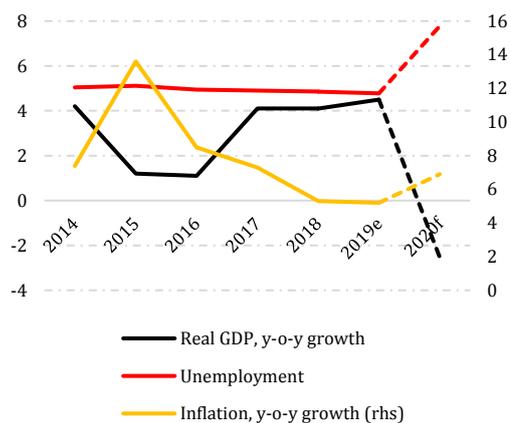
Due to the persistent price volatility in the oil market, uncertainty about the global economy recovery as well as prolongation of the quarantine measures in some regions of Kazakhstan, we expect a more pronounced contraction in 2Q and 3Q 2020, with a recovery in 4Q 2020. The government already announced various measures in order to support the economy, including direct financial support for citizens and new construction programs, with the total cost of around 8,5% of GDP. With the successful implementation of these measures together with the gradual recovery of the global economy, we can expect the overall contraction of the Kazakh economy to be around 0,5% by end-2020. However, if the quarantine measures in some regions of the country are prolonged or even strengthened, which we have already observed, and turbulence in the global economy persists in the following months, we can expect a contraction of up to 2,5% y-o-y in 2020 (see graph 1). The mentioned scenario contributed to restrain our rating assessment.

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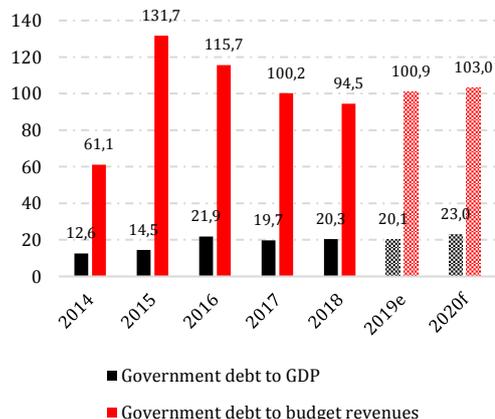
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Graph 1: Macroeconomic indicators, %



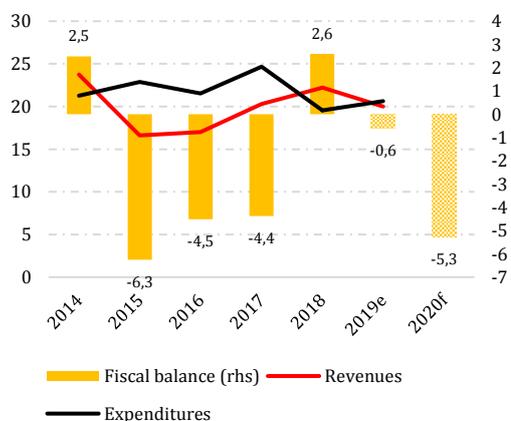
Source: RAEX-Europe calculations based on data from the IMF *The worst case scenario are reflected for the GDP dynamic and unemployment

Graph 2: Government debt dynamics, %



Source: RAEX-Europe calculations based on data from the IMF

Graph 3: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF

At the same time, the ratings remain supported by a moderately high level of GDP per capita in PPP terms, which is expected to reach around USD 28,5 th in 2019, as well as moderately low unemployment levels at 4,8% as of end of 1Q 2020. However, we expect a slight increase of the latter by the end of 2020. Also, as compared to other CIS peers, our view on the long-term post-crisis recovery is more encouraging due to current reforms in the country.

Debt load of the government is expected to increase, but to remain at bearable levels. The gross government debt to GDP and to budget revenues ratios remained almost unchanged over the last three years: the metrics stood at around 20% and 100% respectively in 2019. The structure of government debt also remained stable with low level of short-term debt of around 1% of GDP, which is well covered by international reserves – almost by 21x by May 2020. In addition, around 42% of the external debt had concessional terms.

However, due to the fact that around 30% of public debt is denominated in foreign currency, combined with our fiscal deficit forecast for 2020, we can expect a slight increase in the debt load by end-2020. Nevertheless, we do not anticipate this increase to pose substantial risks for the country’s creditworthiness (see graph 2). The international financial markets’ perception of the country’s debt risks appears to be acceptable since the yield spread between the 10Y German bund and the EUR-denominated Kazakh government bond with maturity in 2028 remains at a bearable level of 2 p.p.

We still observe substantial contingent liabilities risks for the Kazakhstan fiscal position, since the banking system stance remains fragile and even expected to deteriorate in the mid-run, while privatization plans were recently postponed by the government, including privatization of large SOEs, such as KazMunayGaz, Air Astana and Kazakhtelecom. Therefore, the number of state-owned companies will not change substantially until 2021.

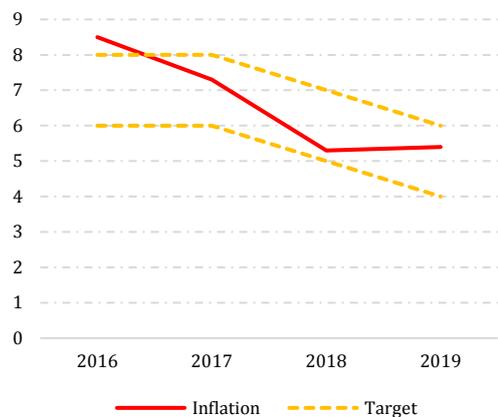
As a result of the oil price drop and the economy contraction together with the significant fiscal support, the deficit is expected to widen in 2020. After posting a substantial surplus of 2,6% of GDP in 2018, the fiscal balance turned to a deficit of around 0,6% in 2019 (see graph 3). Such dynamic was mainly driven by higher government expenses in education, social assistance and social security and public health care, while overall revenues increased at a slower pace.

In 1Q 2020, the stance of the public finances deteriorated substantially. The state budget revenues increased only by a modest 1,2% y-o-y, while

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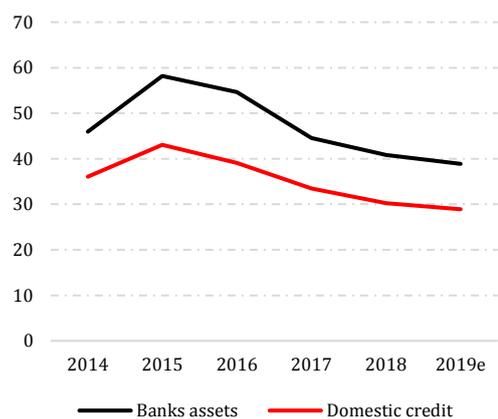
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Graph 4: Target vs inflation rate, %



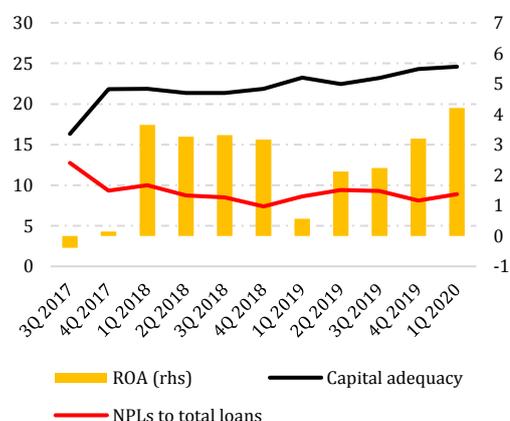
Source: RAEX-Europe calculations based on data from the IMF and NBK

Graph 5: Credit to the economy dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the WB and NBK

Graph 6: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the NBK

total transfers from the National Fund of the Republic of Kazakhstan (NFRK) to the budget increased by almost 50%. According to the preliminary data, the state budget deficit amounted to around 0,2% of GDP in 1Q 2020. However, excluding the transfers from the NFRK, the overall deficit amounted to 8,5% of GDP, as compared to 6,7% in 1Q 2019.

In April 2020, the government already changed its plans for 2020 with the reduction of budget revenues by KZT 1,7 tn and an additional transfer from the NFRK accounted for KZT 2,1 tn, while government spending is expected to increase from 20,6% to 23,9% of GDP. In our view, implementation of the announced anti-crisis fiscal support of the economy, as well as the lower oil prices can lead to a deficit in the range of 4%-6% of GDP by end 2020. At the same time, the fiscal position of the government in the mid-run will be supported by significant accumulated fiscal reserves in the NFRK.

The Central Bank keeps focusing on price stability. In order to support the national currency and hold back sharp price hikes, the National Bank of Kazakhstan (NBK) significantly tightened the monetary policy by increasing the base rate by 2,75b.p. up to 12% on 10 March 2020 from 9,25%. However, due to the fact that exchange rates stabilized after the sharp devaluation and inflation levels increased only from 6% in March 2020 to 6,4%, the NBK lowered the rate to 9,5% already on 6 April 2020. At the moment, due to the recovery of KZT exchange rate and stabilization of CPI index (6,7% y-o-y in May 2020), the NBK is keeping the key rate unchanged and revised its forecast for inflation from 9%-11% to 8%-8,5% by end 2020. However, even this level is substantially higher than the originally established NBK's inflation target of 4%-6% for 2020. We still expect the NBK to concentrate on price stability as well as move gradually to free float exchange regime. Nevertheless, we still consider that monetary policy effectiveness to be limited by the high level of dollarization, undeveloped financial markets and presence of subsidized lending.

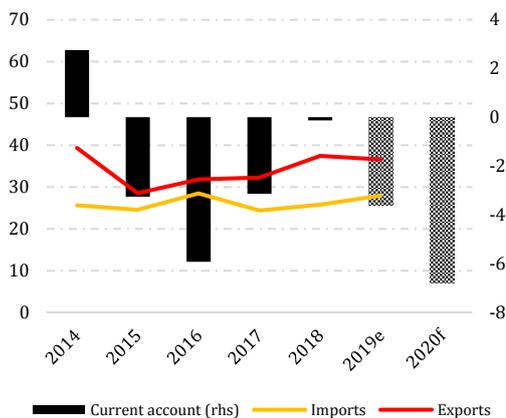
The banking sector position is expected to worsen in the mid run. In line with our forecast, the banking system assets to GDP ratio continued to decline in 2019 for the fourth year in a row. As of end 2019, the metric stood at 39% as compared to 40% by the end of 2018 (see graph 5). Moreover, the economic turbulence in the 1Q 2020 together with the lockdown in many industries, can accelerate the declining trend for banks' assets and credit. In April 2020, assets declined by 1,9% as compared to March 2020, while gross loans declined by 2,5% in absolute terms.

As we expected, after the finalization of the banks' asset quality review (AQR) by the NBK, the level of NPLs in the system reached 8,1% of total

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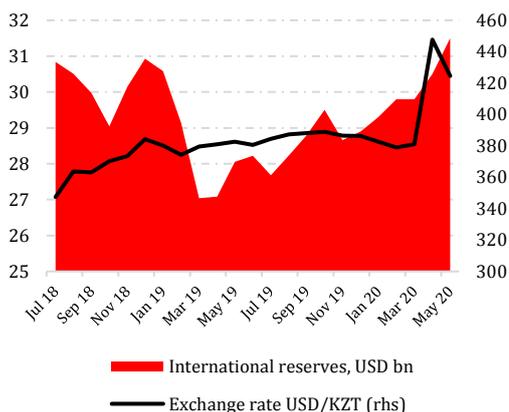
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Graph 7: External sector indicators, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and NBK

Graph 8: International reserves and exchange rate



Source: RAEX-Europe calculations based on data from the NBK

loans by end 2019, which is 1,5 p.p. higher than in 2018 (see graph 6). During 4M 2020 spurred by the anti-COVID-19 lockdown measures as well as oil price volatility, the metric reached 9,4% of total loans, with 9,5% for corporate loans and 5,5% for retail. We expect these levels to rise in the following months, but to stabilize by the end of 2020. In addition, still elevated levels of dollarization - 17,1% for loans and 43,4% for deposits - poses risks for the system resilience to external shocks.

On the other hand, the Kazakh banking system in 2020 is healthier as compared to the previous periods of turbulence in 2008-2009 and 2014-2015. As of the end of April 2020, the banks' level of capitalization and liquidity remained favorable as the capital adequacy ratio was 25% and the liquid assets in national definition formed around 47% of the banks' portfolio. In addition, the systematically important banks are under stricter control by the NBK after finalization of AQR. We also expect further decline of the profitability metrics, that already reached 2,9% and 23,2% for ROA and ROE as of April 2020, as compared to 3,1% and 24,3% as of the end 2019.

Finally, the underdevelopment of capital markets in Kazakhstan continues to drag the creditworthiness assessment as reflected by the low level of market capitalization, which stood at 26% of GDP by end-2019. Despite this figure, as mentioned in our previous review, the activation of the Astana International Financial Centre (AIFC) will have a positive effect for the local financial markets.

External stance still strong, but expected to deteriorate. As of end 2019, the current account deficit of Kazakhstan widened up to 3,6% of GDP as compared to 0,1% in 2018 according to IMF estimates (see graph 7). These dynamics have been the reflection of lower exports of goods, especially commodities due to lower prices, combined with solid domestic demand which caused imports to hike. According to an NBK's preliminary assessment, in 1Q 2020 the current account balance showed a surplus of USD 1,2 bn compared with a deficit of USD 124,6 m in 1Q 2019. This is mostly due to an increase in the trade surplus by 11,8% y-o-y up to USD 6,9 bn. In our view, the 1Q 2020 metrics are not fully reflecting the external position stance during the global turbulence and going forward, we anticipate the current account deficit to widen substantially as a result of lower oil prices. On the other hand, the level of international reserves stood at USD 31,5 bn by the end of May 2020, which, exceeds the IMF recommended reserve adequacy level for countries with a floating exchange rate (see graph 8). The reserves are equivalent to 87% of gross government debt and around 6 months of imports of goods and services, which supports our rating assessment.

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This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

https://raexpert.eu/reports/Press_release_Kazakhstan_12.06.2020.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.

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