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## Ratings

Sovereign Government Credit (LC)	<b>BBB-</b>
Sovereign Government Credit (FC)	<b>BBB-</b>
Country Credit Environment (LC)	<b>BB+</b>
Country Credit Environment (FC)	<b>BB+</b>

\* These ratings are unsolicited

## Main Economic Indicators of Kazakhstan

Macro indicators	2013	2014	2015f
Gross gov. debt, KZT bn	4537	5752	7947
Nominal GDP, KZT bn	35275	38712	37663
Real GDP growth, %	6,0	4,3	1,5
Gross gov. debt/GDP, %	12,9	14,9	21,1
Deficit (surplus)/GDP, %	5,0	1,8	-3,2
Inflation rate, %	4,8	7,4	13,6
Current Account Balance/GDP, %	0,4	2,1	-3,0
External debt, USD bn	-	-	155,6*

## Development indicators

	2014
Inequality adj. HDI	0,69
GDP per capita, USD th	24,1

## Default indicator

	29.01.2015
5-Year CDS spread, Bp	318
10Y Gov Bond Yield, %	7,1

Source: RAEX (Europe) calculations based on data from the IMF, CIA, Deutsche Bank, Trading Economics, Ministry of Finance of the Republic of Kazakhstan

\* - As of 3Q 2015

## Summary

Kazakhstan's 'BBB-' sovereign credit 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 and constraints over the flexibility of monetary policy also restrained the rating levels.

**Growth prospects expected to decline dramatically in 2016.** Real GDP is expected to post a growth of only 1,5% in 2015, the lowest since the aftermath of the global financial crisis in 2009, when the country grew at 1,2%. The Agency expects an even slower growth in 2016 following a contraction of domestic and external demand, as a result of an increase of interest rates by the National Bank of Kazakhstan (NBK), and a general slowdown of the world economy.

Unemployment has remained stable (averaging 5,3% from 2010 to 2015) and structural reforms are underway to, among other goals, diversify the economy and reduce the country's hydrocarbon dependence.

**New monetary policy framework has yet to show effectiveness.** In August 2015 the NBK decided to transit to an inflation-targeted monetary policy and a free-floating exchange rate regime. While the measures have cushioned external shocks and have alleviated the NBK's FX reserves, it spurred exchange rate volatility, fuelling further deposit dollarization and price inflation (CPI reached 13,6% in 2015). This has caused the NBK to intervene the FX market several times since it was officially liberalized.

Even though the NBK had been using FX and gold reserves to maintain the exchange rate along 2015, this has not been reflected in the official amount of FX reserves in the NBK's balance sheet (USD 28,1 bn as of end-2015). The balance shown in the NBK statistics is flat due to the use of currency swaps with commercial banks. In this sense, the Agency has been cautious in interpreting the stable and high level of reserves reflected in official statistics.

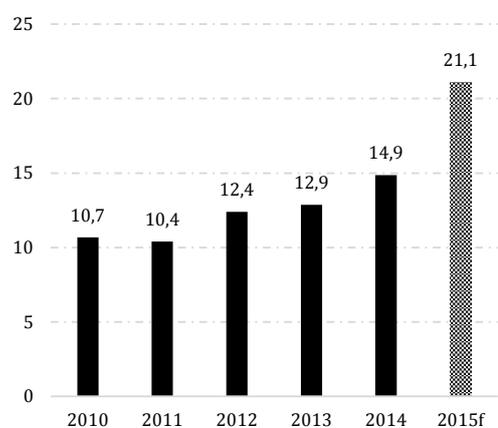
The NBK has introduced policies in order to de-dollarize the economy. One of the efforts by the NBK to achieve this is the increase on the KZT deposit rate ceiling from 10% to 14% and the reduction of the FX deposit rate from

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**Graph 1: General government debt, % of GDP**



Source: RAEX (Europe) calculations based on data from the IMF and the Ministry of Finance of the Republic of Kazakhstan

3% to 2% starting in February 2016. However, due to the exchange rate volatility, there is a latent risk that depositors will cash in their FX deposits instead of depositing KZT. Nonetheless, the result of these measures are yet to be seen.

**Government debt grew but remains at acceptable levels.** Kazakhstan's gross government debt preliminary estimations indicated that it will post a figure of 21,1% of GDP for 2015, a still acceptable level despite the 6 p.p. increase from 2014 (see graph 1). The steep hike was mainly due to an increase of the Eurobond issuance combined with a decline in budget revenues and nominal GDP.

The structure of the government's debt is solid. Short-term debt is fairly limited representing only 2,1% of the total debt and accounting for 0,4% of GDP and 2,2% of budget revenues in 2015.

Furthermore, according to data from the IMF, Kazakhstan is set to have a negative net debt position of 28,4% of GDP in 2015 due to its high amount of financial assets, mainly in the National Fund of the Republic of Kazakhstan (NFRK).

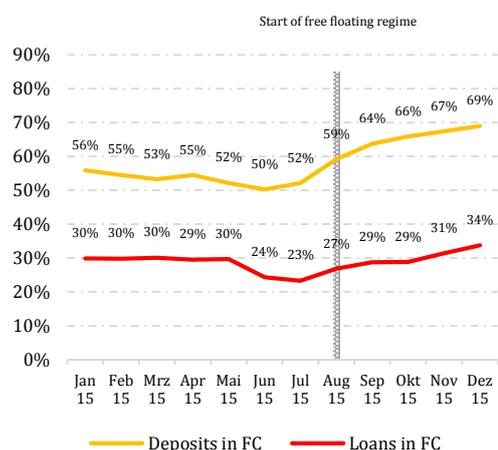
**Unstable perspective for the banking sector.** In 2015, the banking sector posted a ROA of 2% and bank assets to GDP are expected to increase by more than 12p.p. to 60% in the same time span. The amount of NPLs was reduced from 19,5% in 2013 to 12,4% in 2015 due to the transfer of assets from Kazkommerstbank to BTA Bank<sup>1</sup> and the dismissal of legal barriers to transfer these assets to SPVs. Additionally, the industry is also well capitalized with an average capital adequacy ratio of 14,1% for 2015.

Despite these positive metrics, the volatility of the USD/KZT exchange rate along with low oil prices and high dollarization levels present a delicate risk for the banking sector. Dollarization levels, in an already dollarized country, hiked substantially after the NBK declared a free floating currency regime. As of end-2015 the amount of FX deposits was 69% and FX loans were 34% (see graph 2). These factors could increase the level of NPLs as the debt servicing becomes more difficult.

Moreover, at year-end 2015, the NBK stopped servicing short-term liquidity to financial institutions as these used the funds to speculate against the local currency. This speculation contributed to further destabilization of the exchange rate and made money market rates more volatile.

The new regulatory capital rule, which prevents banks from having deposits representing more than 5,5x their equity, may be hard to comply

**Graph 2: Dollarization levels, % of total**



Source: RAEX (Europe) calculations based on data from the NBK

<sup>1</sup> 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.

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with given the high amount of FX deposits and continuous exchange rate depreciation (i.e. if depreciation continues, threshold levels can be reached even if banks stop taking deposits).

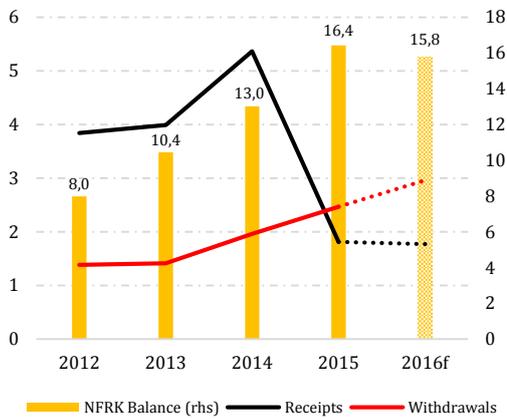
**Fiscal policy and finances threatened by oil and currency volatility.**

The fiscal policy and the NFRK balance have come under certain pressure.

The economic support package approved by the authorities<sup>2</sup> will be hard to implement given the projected decline in revenues. Nonetheless, contingent measures have already been taken such as, delaying several planned projects, using loans to finance the deficit, revising expenditures for 2016 and accelerating the privatization of assets from the Samruk-Kazyna wealth fund.

Additionally, receipts to the NFRK have started to decline and withdrawals have mounted in order to prop up the budget. Income to the fund in 2015 was KZT 1,8 tn, a reduction of 66% as compared to a year before. Withdrawals from the fund (between targeted and guaranteed transfers) were KZT 2,4 tn in 2015 and KZT 1,9 tn in 2014, a 22% increase (see graph 3). Both trends are expected to continue in the short-term and, if oil prices stay down, withdrawals continue at a higher pace and returns from the fund are not improved, the fund could be depleted in the near future.

**Graph 3: Dynamic of the NFRK, KZT tn**



Source: RAEX (Europe) calculations based on data from the Ministry of Finance of the Republic of Kazakhstan

**Important note for sovereign ratings**

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

<http://www.raexpert.eu/reports/Press release Kazakhstan 29.01.2016.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.

<sup>2</sup> The package includes withdrawals from the NFRK and loans from different institutions and is directed to support investment in infrastructure and further development of SMEs.

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