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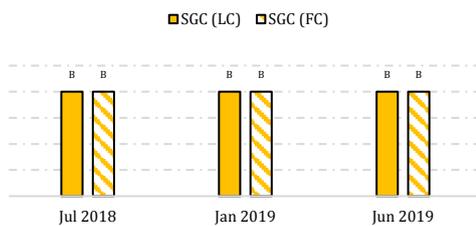
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Ratings

| | |
|----------------------------------|---------------|
| Sovereign Government Credit (LC) | B |
| Sovereign Government Credit (FC) | B |
| Outlook (LC) | Stable |
| Outlook (FC) | Stable |

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Kyrgyzstan

| Macro indicators | 2016 | 2017 | 2018 |
|--------------------------------|------|-------|------|
| Gross gov. debt, KGS bn | 281 | 312 | 312 |
| Nominal GDP, KGS bn | 476 | 530 | 557 |
| Real GDP growth, % | 4,3 | 4,7 | 3,5 |
| Gross gov. debt/GDP, % | 59,1 | 58,8 | 56,0 |
| Deficit (surplus)/GDP, % | -6,4 | -4,6 | -1,3 |
| Inflation rate, % | -0,5 | 3,7 | 0,5 |
| Current Account Balance/GDP, % | | | -9,8 |
| External debt, USD bn | - | - | 3,8 |
| Development indicators | 2018 | | |
| Inequality adj. HDI | | 0,61* | |
| GDP per capita, USD th | | 3,8 | |

Source: RAEX-Europe calculations based on data from the IMF, WB, Ministry of Finance of the Kyrgyz Republic and NBKR.
* 2017 data.

Summary

The SGC ratings of Kyrgyzstan were confirmed at 'B' level with a stable outlook supported by continuous economic recovery, high remittances inflow and reduction in financial dollarization. Subdued levels of inflation have allowed the Central Bank to loosen the monetary policy which has contributed to encourage credit growth. Moreover, strengthening of creditor's rights and improvements in the Civil Code, permitted Kyrgyzstan to climb some spots in the World Bank Doing Business ranking 2019.

However, significant public indebtedness, high level of poverty and the strong reliance on extracting industries as well as main trading partners, are factors restricting the country's creditworthiness and make the Kyrgyzstan's economy very sensitive to external shocks.

Government debt declined further, but remained significant. Total government debt to GDP decreased by 2p.p. y-o-y in 2018 down to 56% due to the write-offs of debt by the Russian Federation and higher principal amount payments during the year (see graph 1). There is a minor positive trend in external debt, which accounts 85% of the total debt, as it declined by 1% since the beginning of the year. The structure of the debt stays favorable with more than 94% obligations with long-term maturity and 98% issued on favorable concessional terms (see graph 2). The largest creditor continues to be the Export-Import Bank of China, mainly funding mineral resources exploration, energy supply development, transportation links, construction and other projects related to the "One Belt One Road" initiatives. Its share overcame 45% of the total external debt as of April 2019.

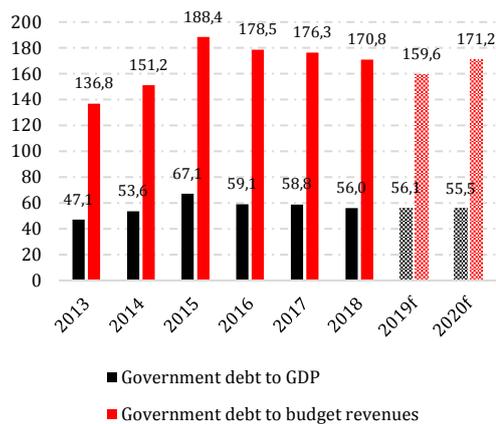
We expect government debt to remain at similar levels in the mid-term perspective and some unfinished projects will be covered by non-repayable grants provided by the Chinese government in 2019.

Fiscal policy improved as deficit decreased till the target level. The final result of the fiscal year of 2018 showed a budget deficit of 1,3% of GDP (see graph 3). It is a lower figure as compared to our previous forecast and it is a substantial improvement from the deficit of 4,6% in 2017. The positive change could be explained by higher than initially predicted revenues from the income tax from mining activity in Kumtor,

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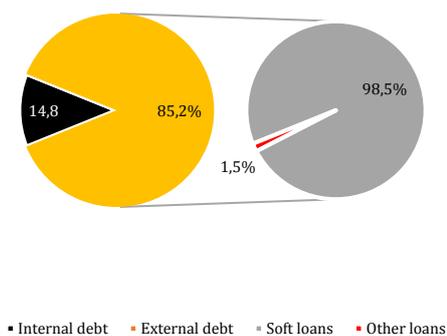
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Graph 1: Government debt dynamics, % of GDP



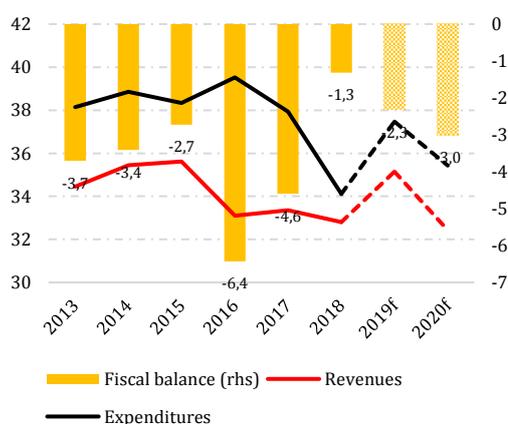
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Government debt structure as of 1Q 2019



Source: RAEX-Europe calculations based on data from the Ministry of Finance of Kyrgyz Republic

Graph 3: Fiscal budget dynamics, % of GDP



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

lower capital expenditures financed from the state budget and higher economic growth.

According to the main directions of the fiscal policy for 2019-2021, the state budget deficit is projected at 1,6% for 2019, 1,3% for 2020 and 1,5% for 2021. For 2019, the target is expected to be achieved mainly at a cost of lower budget expenditures on the health system (8x decrease in 1Q 2019 versus 1Q 2018). We anticipate the budget deficit to stand around 2% for 2019; however, cuts of social benefits raise concerns of an increase in poverty and a reduction in living standards.

Low inflation environment caused monetary policy to loosen further. Since the beginning of 2019, the National Bank of the Kyrgyz Republic (NBKR) cut its main policy rate back in February and once again in May down to 4,25% and its overnight credit rate by 0,25p.p. down to 5,75% also in May. As a result, broad money increased by 3,8% and total banking system loans and financial leasing to clients increased by 5% since the beginning of the year. At the same time, in order to control excessive liquidity in commercial banks, the NBKR raised the overnight deposit rate from 1,5% till 1,75% in May 2019. Such decision also had a positive impact on further de-dollarization of the banking system. Together with the increase of the average interest rate spread between deposits in local and foreign currency by 0,4p.p. y-o-y in April 2019, the share of foreign currency deposits in total deposits decreased by 5,2p.p. for the same period and stood at the level of 42,4%. The share of loans in foreign currency remained unchanged in 2019 at around 38% by end of April 2019.

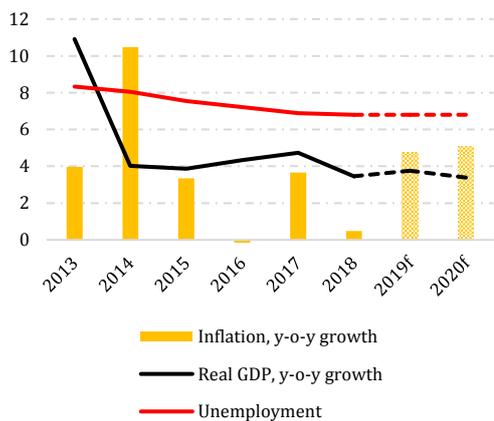
Such policy of the NBKR is implemented within the mid-term inflation target of 5-7%. Last year consumer price index (CPI) growth was insufficient to meet set objective, as annual inflation for 2018 was less than 0,5% (see graph 4). Nevertheless, the volatility on food prices remained during first months 2019. Therefore, the Agency will keep monitoring further NBKR decisions regarding policy adjustment and expect inflation rate for 2019 to be close to 4%.

Major banking soundness indicators deteriorated. Consolidated assets of commercial banks increased by 2% by April 2019 since the beginning of the year, but overall asset quality declined further. NPL ratio added 0,1p.p. reaching 7,8% as compared to a year ago. The real quality change could be even higher, as the effect was partially offset by total loan growth. Growing operational costs also negatively affected profitability, as ROA and ROE lost 0,7p.p. and 4,7p.p. y-o-y respectively by April 2019 (see graph 5). The net capital to asset ratio increased by 1,1p.p since our last review in January 2019 up to 17,8%, demonstrating satisfactory capitalization levels while liquidity conditions weakened

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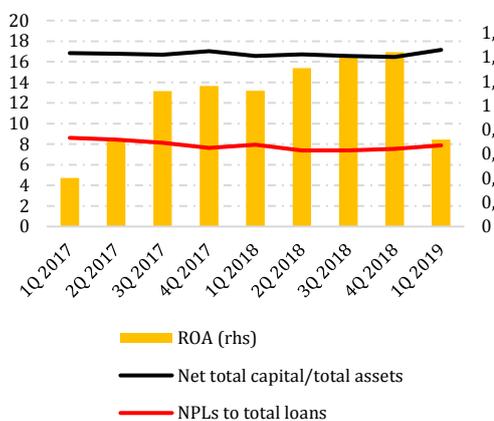
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Graph 4: Macroeconomic indicators, %



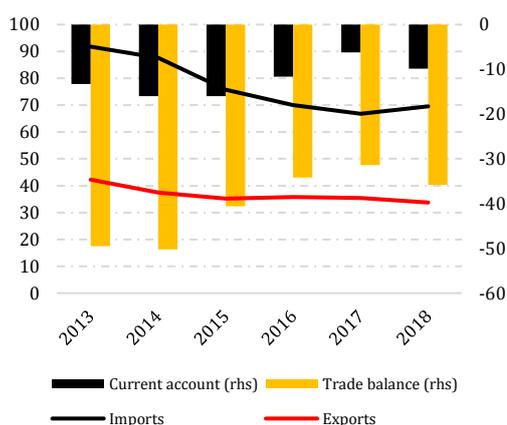
Source: RAEX-Europe calculations based on data from the IMF

Graph 5: Financial soundness indicators, %



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

Graph 6: External sector indicators, % of GDP



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

further. For 2019 we expect modest growth in credit to the economy, with total banking assets to GDP ratio at the level of 40% by the end of the year.

An acquisition of the troubled Rosinbank by NBKG occurred in 2018, despite the possible risks of the conflict of interest between banking supervision role and the ownership, should have positive impact on the overall banking stability indicators.

The Financial Action Task Force (FATF) welcomed new AML/CFTE (anti-money legalization/laundersing and counter-financing of terrorism or extremism) legislation that came into force in 2018. Although Kyrgyzstan is no longer on the FATF red list, large shadow economy, high remittances inflow and narcotics trafficking keeps financial crimes risk elevated.

The economy growth slowed down in 2018, but expected to accelerate by end of 2019, while external sector slightly deteriorated. The real economy expanded by 3,5% in 2018, that is 1,2p.p. less than in 2017, mostly due to decrease of production on Kumtor gold mine. Imports hiked widening the trade deficit up to 36% of GDP (see graph 6). Within the year, no significant geographical structure of import and export changes occurred, and the trade remained highly concentrated on major partners. The reliance on the main export product also continue to be high, precious metals accounts for 40,2% of total exports. The lack of necessary laboratory equipment in order to meet EU standards, as well as the existence of sufficient amount of trading intermediaries and excessive regulatory environment, does not allow Kyrgyzstan to fully enjoy the benefits of “GSP+¹” scheme.

International investors continue to be mistrustful of the country due to the continued obstacles to trade, as well as the high corruption perception. Recently announced further improvements of free economic zones tax regulations (still on discussion stage) should be a good sign for future foreign investment growth.

¹ “GSP+” - Generalised Scheme of Preferences Plus. The scheme allows eligible developing countries to pay fewer or no duties on exports to the European Union.

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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_Kyrgyzstan_28.06.2019.pdf

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

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