Rating-Agentur Expert RA GmbH confirmed at 'B' the sovereign government rating and at 'B-' the credit climate rating of Kyrgyzstan

Rating-Agentur Expert RA GmbH 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.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Kyrgyzstan at 'B-' (Moderately low quality of credit environment of the country) in national currency and at 'B-' (Moderately low quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Short-term debt remained considerably low and very well covered by the FX reserves and is estimated to be 1,02% of GDP and 2,7% of budget revenues in 2016;

- Despite a recent slowdown caused by decreasing remittances and lower trade turnover, real GDP growth is expected to remain favorable at 2,6% and 2,3% in 2016 and 2017 respectively;

- The government has a privatization program for 2015-2017 listing the companies to be privatized as well as those where the government will sell a part of interest. This is expected to compensate increased public expenditures, as well as significantly improve budget flexibility.

Restricting factors:

- Quality of the fiscal policy remained unfavorable evidenced by a lack of fiscal discipline leading to a steep decline in revenues – actual tax and non-tax income is less than budgeted by 7,6% and 23,6% by November 2016 – while the fiscal deficit has expanded by an estimated 6,3p.p. in the last three years up to 4,4% of GDP in 2016;

- Kyrgyzstan still heavily relies on external debt to finance big infrastructure projects (mainly maintenance). Therefore, a legislation allowing the government to determine the amount of government debt on an annual basis has come into force in January 2017. In our view, this will reduce certainty around government's mid- and long-term fiscal plans;

- Relatively high unemployment rate estimated at 7,4% in 2016;

- Investment potential has been growing, though it remained moderately low as evidenced by the national savings to GDP ratio estimated at 18,5% in 2016.

Negative factors:

- The government debt level is still considered to be substantial as Kyrgyzstan's debt to GDP ratio is the highest amongst its regional peers. Even though the government debt load (mainly long-term international concessional loans) decreased by 3,9p.p. and 10p.p. down to 62,1% of GDP and 163,4% of budget revenues respectively in 2016, it was mainly driven by the appreciation of KGS along 2016. This coupled with the fact that the gross government debt in USD terms has increased by 10% y-o-y by November 2016, motivated us to assess the factor as negative;

- The yield on the 5Y government bond remained substantially high at 18,1% as of November 2016 still reflecting high open market financing costs for the government and a negative investors' perception of the long-term risks in the economy;

- Despite still overall favorable dynamics of real GDP, GDP per capita in PPP estimated at USD 3 500 in 2016 remained low and puts Kyrgyzstan behind its peers;

- Consumer prices contracted by 0,5% y-o-y in 2016, hence the price stability objective of the monetary policy was missed again (inflation between 5-7%). The inflation rate has been highly volatile for the past three years and was mostly determined by the exchange rate pass through (this effect has eased in the 2H 2016) due to decreasing but still high imports (estimated at 55,9% of GDP in 2016) and dollarization levels, which, alongside an underdeveloped interbank market, also had a negative impact on the effectiveness of the policy transmission mechanism;

- The banking sector remains underdeveloped with banks' assets and volume of private credit estimated at 39,4% and 20,7% of GDP in 2016 respectively. Meanwhile the amount of risk accumulated by the sector continues to be substantial. As of November 2016 ROA was expected to decrease by 1.1p.p down to 0,3% as compared to December 2015. Additionally, NPLs were 9,3% of total loans in the same period; this represents a 2,2p.p. growth since the last year. However, the sector remained well capitalized with a capital to assets ratio of 16,5% by November 2016;

- Competitiveness of Kyrgyz economy is very narrow. The country imports most of its products (trade deficit was estimated at 32% of GDP in 2016) and had a competitiveness index of 3,83 from the WEF in 2015 which ranks 102nd out of 140 countries, one of the worst amongst its regional peers.

Stress factors:

- High dependence on Russia, China and on International Organizations to finance operations and receive financial aid and remittances (weak stress-factor);

- Dollarization continued to be a problem representing 56,2% of total deposits and 44,1% of total loans in 2016 (weak stress-factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Very high and volatile levels of real interest rate;

- Stock and bond exchange market remained underdeveloped with a small amount of listed companies (26 as of January 2017), low turnover, high concentration of trade on the biggest issuers (ten largest issuers account for about 85,4% of the amount of annual trading in 2016) and a narrow variety of products.

Restricting factors:

- Interest rate spread was expected to stay moderately high at around 6,3% in 2016;

- Average institutional development of the country was reflected by a low position in Doing Business Ranking (75th out of 180), shallow level of trust in the government with only 37% of population trusting the government according to Human Development Report and substantial level of corruption (Transparency International reports CPI index stood at 28 in 2015).

Positive factors:

- Very good performance of the stock market index (KSE) showing an accumulated return of 86,5% during 2014-2016.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Smooth recovery of the biggest regional partners which would reduce external pressures and help push real GDP growth;
- Further reduction of dollarization levels, price stability and exchange rate maintenance.

The following developments could lead to a downgrade:

- Further fiscal deficit expansion coupled with subsequent government debt accumulation above sustainable levels;
- Continuing risk accumulation in the banking sector.

"The sovereign rating of Kyrgyzstan is curbed by the excessive reliance on external financial aid, further widening of the fiscal deficit as well as the inability to sustain price stability. The banking sector remains vulnerable, as banks' profitability continues to sink. Fiscal deficit is expected to expand as Kyrgyzstan has missed tax and non-tax revenue targets. Government debt levels have decreased mainly due to a steep appreciation of the KGS along 2016. However, these levels remain a negative factor due to uncertainty regarding potential shocks on the exchange rate – given the high share of FX denominated debt – and future debt accumulation plans.

Sharp decline of dollarization levels caused by the implementation of new de-dollarization policies and cuts in the policy rate have caused lending rates to decrease. Furthermore, high external exposure have limited output growth; however, provided further smooth recovery of the biggest CIS partners, would propel economic growth." - 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:

http://raexpert.eu/reports/Research_report_Kyrgyzstan_27.01.2017.pdf

Next scheduled rating publication: 21 July 2017. The full sovereign rating calendar can be found at http://raexpert.eu/sovereign/#conf-tab-5

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	**Foreign currency**	**National currency**	**Foreign currency**
29.07.2016	Scheduled revision of both types of ratings for the country	B	B	B-	B-
19.02.2016	First assignment of both types of ratings for the country	B	B	B	B

Minute's summary

The rating committee for Kyrgyzstan was held on 24 January 2017. 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 and Country Credit Environment Ratings. Short Public Version (from April 2015) can be found under the following link: http://raexpert.eu/files/methodology/Methodology-Short-Sovereign.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.

Despite similar methodologies, credit ratings of Kyrgyzstan from RAEX (Moscow) (both SGC and CCE) may be different from those assigned by Rating-Agentur Expert RA GmbH due to:
- Possible differences in expert assessments of individual factors;
- Some differences in methodologies (methodologies are similar but not identical);
- Differences in the date/period of assessment for individual factors.

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

The Agency disclaims all liability in connection with any consequences, interpretations, conclusions, recommendations and other actions directly or indirectly related to the conclusions and opinions contained in the Agency's Research Reports.

This press-release represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

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.