

27<sup>th</sup> of February, 2015

**Author:**

**Gustavo Angel**

Expert of Rating-Agentur Expert RA GmbH

**For further information contact:**

**Rating-Agentur Expert RA GmbH**

Office 601a, Mainzer Landstrasse 49,  
 60329 Frankfurt am Main, Germany  
 +49 (69) 3085-54-85

E-mail: [info@raexpert.eu](mailto:info@raexpert.eu)  
[www.raexpert.eu](http://www.raexpert.eu)

## Introduction

Due to the significant decrease of oil and gas prices during the second half of 2014, fiscal revenues of Kazakhstan declined in such a manner that the budget of the government showed a negative balance by the end of last year. In addition, Kazakhstan geographical and economic proximity to Russia posed additional risks to its creditworthiness as the Russian economy got into a recession in 2014. While debt load of the Kazakh government still remains at bearable levels, future repayment and roll-over of debt can be problematic if current levels of fiscal revenues are not expected to rebound. Contrary to expectations, the pension fund of Kazakhstan showed a good performance under the management of the government and the National bank of Kazakhstan. In view of the current situation of the country, which includes depressed oil prices, high levels of NPL in the banking sector, dollarization of loans and deposits as well as expectations of devaluation in the near future, the president of Kazakhstan outlined a number of anti-crisis measures. The recent call for early presidential elections this year is expected to pave the way for preserving political stability during the time these measures are enforced.

**Lower fiscal revenues triggered the current budget deficit figure.** The downfall in oil and gas prices which took place during the second half of 2014 had a negative impact on government fiscal revenues which declined 18% to 7 287 billions of Tenge in 2014 from 8 911 billions of Tenge a year before. The impact on the overall budget was such that the fiscal balance showed a deficit of 2,9% of GDP after 4 years of continued profits. This sharp decline in budget balance shows the strong dependence of Kazakhstan on oil and gas taxation.

**Debt load of the Kazakh government remains at tolerable levels.** The current figure of gross government debt (5 199 billions of Tenge in 2014) poses no significant risk to the Kazakh economy as it represents 13% of GDP. Even though the ratio of government debt to budget revenues showed an increment of around 20 p.p. in 2014 from 51 p.p. in 2013, most of this increase can be explained by the fall in fiscal revenues due to lower oil and gas taxation. While a drop of such a magnitude is unlikely to

## Main Economic Indicators of Kazakhstan

Macro indicators	2012	2013	2014*
Gross pub. debt, bill Tenge	3761	4537	5199
Nominal GDP, bill Tenge	30347	35275	40314
Real GDP growth, %	5,0	6,0	4,6
Gross gov. debt/GDP,%	12,4	12,9	12,9
Deficit (surplus)/GDP,%	4,5	5,0	-2,9
Inflation rate,%	6,0	4,8	6,7
Curr. Account balance/GDP,%	0,5	-0,1	0,3

### Development indicators

	2013
Inequality adj. HDI	0,67
GDP per capita (Thou. of USD)	24,1

### Default indicator

	As of 27.02.2015
5-Year CDS spread (Bp)	303
10Y Gov Bond Yield, %	7,1

Sources: RAEX (Europe) calculations based on data from World Bank, IMF, Bloomberg, Ministry of Finance of Kazakhstan.

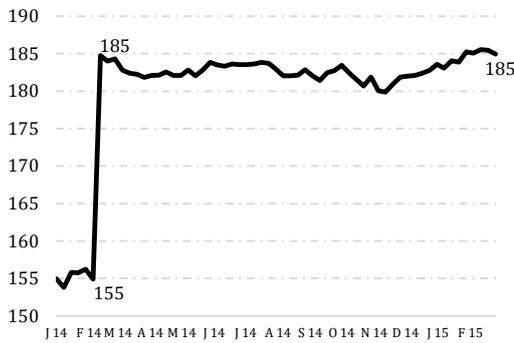
\* Assessment of RAEX (Europe) based on current data provided by IMF and the Ministry of Finance of Kazakhstan.

## Disclaimer

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 Report 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.

**Graph 1: Tenge/USD exchange rate**

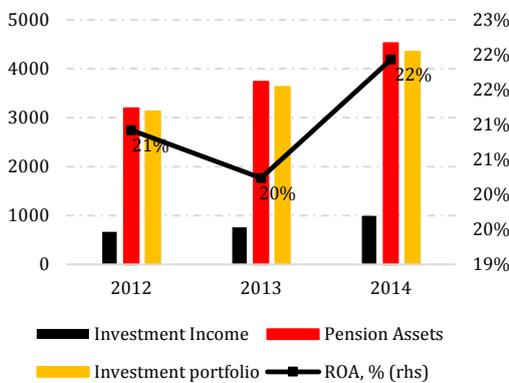


Source: RAEX (Europe) calculations based on data from National Bank of Kazakhstan

be observed in following years, revenues are not expected to recover in the near future.

**Drop in oil prices and current devaluation of the Russian Ruble pose additional risks to Tenge devaluation.** Every time there was an external shock connected to international prices of oil and gas, the National Bank of Kazakhstan was forced to make adjustments to the exchange rate of Tenge against USD. An example of this is depicted by the sharp devaluation of Tenge against USD following the decline in oil prices in late 2008. While oil and gas prices declined in a pronounced manner and the Ruble depreciated tremendously during 2014, the Tenge did not react to such a context. After the Tenge devalued by more than 19% in February 2014 following the announcement of the FED's quantitative easing tapering, its exchange rate against the USD remained almost flat during the whole year (see graph 1). With today's oil price, Kazakhstan is likely to have difficulties balancing its fiscal budget and at some point a new devaluation of the Tenge will be needed. Individuals and corporate savers, while trying to hedge by converting their Tenge savings into USD, introduce additional risks of making the Tenge devaluation a self-fulfilling prophecy<sup>1</sup>.

**Graph 2: Performance of the Kazakh pension system**



Source: RAEX (Europe) calculations based on data from The Financial Supervision of the National Bank of Kazakhstan

**After nationalization and unification, Kazakh pension system showed a sound performance.** When the president of Kazakhstan announced the unification of the pension system under the Integrated Accumulative Pension Fund (IAPF) in early 2013, the general public was concerned about the skills of the government and the National Bank of Kazakhstan to manage the funds. The 2014 transfers of Kazakhstan to the IAPF, which totaled 632 billion of Tenge and represented 12% more than in 2013, were financed by higher contributions from the working population and increased the discontent and concern of people in the performance of the fund. Against many forecasts, the pension fund of Kazakhstan showed a slight improvement in its first full year since the government took control over its funds. In 2014, the IAPF showed a ROA of 22% which represents an increase of 2% compared with 2013 (see graph 2). Additionally, the investment portfolio of the fund increased by 20% in 2014, reaching a total amount of 4 346 billions of Tenge by the end of the year. It is important to mention that more than 50% of the loan portfolio is comprised by government debt securities which suggest that the pension scheme is used by the government as a financing vehicle. Besides this, the pension system has shown a good performance so far which, apart from the aforementioned indicators, is reflected in the

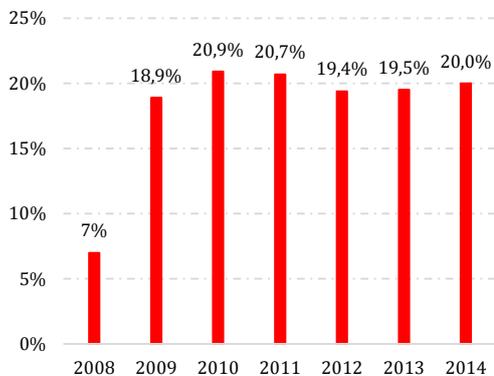
<sup>1</sup> Self-fulfilling crisis refers to a situation that a financial crisis is not directly caused by the unhealthy economic fundamental conditions or improper government policies, but a consequence of pessimistic expectations of investors. In other words, investors' fear of the crisis makes the crisis inevitable, which justified their initial expectations.

**Disclaimer**

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.

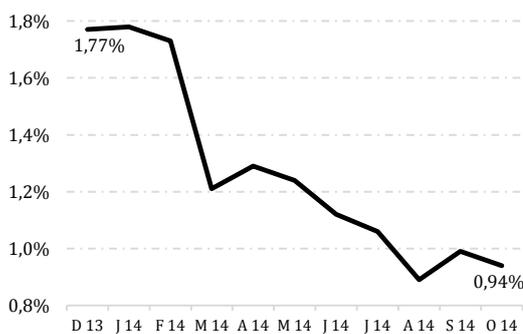
This Report represents the opinion of Rating-Agentur Expert RA GmbH and is not a recommendation to buy, hold or sell any securities or assets, or to make investment decisions.

**Graph 3: NPL (% of total loans)**



Source: RAEX (Europe) calculations based on data from World Bank

**Graph 4: ROA of Kazakh Banking Sector**



Source: RAEX (Europe) calculations based on data from The Financial Supervision of the National Bank of Kazakhstan

positive net investment income which increased by 50% during the period 2012-2014.

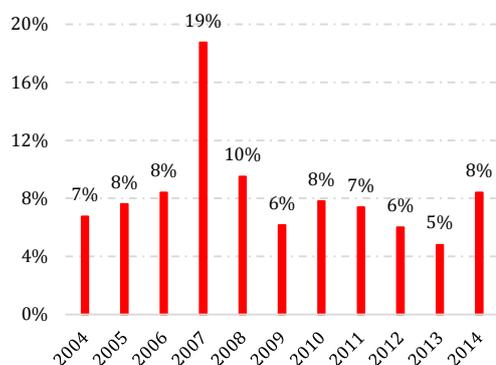
**Nursultan Nazarbayev called for early election to ensure political stability while anti-crisis measures are enforced.** Kazakhstan's president, Nursultan Nazarbayev, announced that early presidential elections will take place on April 26, 2015. The announcement follows a February 14 request by the Assembly of the People of Kazakhstan, to hold elections two years before Nazarbayev's current term finishes. The idea behind this early elections is to ensure political stability during the period of execution of the anti-crisis programme announced by the Nursultan Nazarbayev. Among other measures, the anti-crisis programme considers expenses reduction of Samruk Kazyna (Kazakhstan National Wealth Fund) including a drop in administrative costs by 20% and investment costs by 18%. These measures were considered after latest statistics about the industrial activity were released earlier this year. Kazakhstan has been hit by plummeted world oil prices and by the current economic crisis in Russia, a close and major trade partner. Kazakhstan's oil output fell by 1,2% in 2014 and is forecasted to decline even further this year, while the offshore Kashang oilfield (one of the country's largest) is not expected to restart production before the end of 2016. Additionally, the country's industrial output is expected to fall by 0,3% while the growth rate of gross domestic product is forecasted to slow to 1,5% this year.

**Banking sector of Kazakhstan showed a poor performance during 2014 as share of NPL remains high.** From an economic perspective, high levels of bank loans dollarization pose a significant risk to loan holders in terms of currency devaluation. The fact that the Kazakh economy has shown sharp devaluations in the past, proves that it is a harsh place to hold a loan denominated in foreign currency. After the sharp devaluation of 25% that Tenge suffered in February 2009, the level of NPL jumped to 19% (from 7% a year before) and remained around that figure over the last 6 years (see graph 3). As a result, ROA of Kazakh Banking Sector has been declining, reflecting both low earnings and higher loan-loss charges (see graph 4). In order to tackle the problem, on February 2015 the governor of the National Bank of Kazakhstan (NBK), Kairat Kelimbetov, announced a number of NPL measures which have to be fulfilled by banks until 2016. In that sense, Banks will be required to reduce NPL ratios in two stages to 15% by the end of 2015 and to 10% by the end of 2016. Licenses from Banks which are not able to comply with such requirements until 2016 will be potentially withdrew.

**Disclaimer**

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 Report 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.

**Graph 5: Annual inflation rate in Kazakhstan**



Source: RAEX (Europe) calculations based on data from World Bank

**High levels of dollarization are fueled by volatility of inflation rate and sharp devaluations of Tenge.** As of December 2014, banking deposits denominated in foreign currency represented around 55% of total banking deposits. In general terms, currency dollarization occurs when the inhabitants of a country do not trust the local currency and make transactions in a currency of another country. In the case of Kazakhstan high levels of dollarization is in part the result of mistrust in Tenge due to high volatility of inflation rate (see graph 5). An additional factor which has driven dollarization in Kazakhstan is the sharp devaluation that Tenge suffered after periods of exchange rate tranquility as evidenced at the beginning of 2009 and 2014. Given the high probability of a potential strong devaluation of Tenge in the next months, levels of dollarization are expected to remain high in the near future. Recent measures announced by the NBK to encourage de-dollarization of the economy, which include enforcement of contracts in Tenge by law, are unlikely to have the desired effects unless policies towards reduction of inflation volatility and sudden devaluation of Tenge are implemented.

### Conclusion

High dependence on oil and gas prices as well as close links to the Russian economy had a significant negative impact on the whole economic position of Kazakhstan. High volatility of inflation rate alongside sharp depreciations of Tenge after times of exchange rate tranquility and expectations of Tenge devaluation in the near future are still driving the current sizable levels of dollarization in the country. Even though government debt load remains low and stable around 13% of GDP, recent decline in government revenues poses a negative risk for future repayments and issuance of debt. While a number of anti-crisis measures were already put in place in order to face the current weaknesses of the country, some of them seem to sound too ambitious for the scheduled time of their enforcement and may not have the desired effects unless they are accompanied by long-lasting policies.

### Disclaimer

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 Report 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.