

## Rating-Agentur Expert RA GmbH confirmed at 'BBB-' the ratings of Kazakhstan. The rating outlook is stable.

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Kazakhstan at 'BBB-' (Moderately high level of creditworthiness of the government) in national currency and at 'BBB-' (Moderately high level of creditworthiness of the government) in foreign currency. The rating outlook is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

### MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

#### Positive factors:

- Real output in the economy was higher than we previously expected as it grew by 4% as a result of higher industrial production, especially oil production, which translated in robust exports growth. We anticipate growth to remain robust going forward; however, still highly dependent on the oil market;
- Government debt stood at 21,2% in 2017 maintaining a stable pace for the last three years. Moreover, debt to budget revenues decreased by around 13p.p. down to 114% in 2017. Short-term external debt, despite having increased, remained low at 0,5% of GDP in 2017;
- Given lower inflation expectations and actual prices growing at a constantly slower pace, the National Bank of Kazakhstan (NBK) cut the base rate by 0,25p.p. once again in June down to 9%. As mentioned previously, the inflation targeting policy implemented by the NBK has stabilized inflation and the exchange rate;
- Since the beginning of the year, international reserves have increased consistently up to USD 31,2 m as of May 2018 due to an increase in assets from the National Fund. These reserves cover external debt by 2x and gross government debt by 1x;
- We expect GDP per capita in PPP terms to have been around USD 26 300 in 2017 and remain one of the highest among its regional CIS peers;
- The unemployment rate has been stable over the past years and remained at satisfactory levels in 2015 (5,0%);
- The privatization plan remains in place and is expected to be already completed at around 80%. The authorities plan to sell all major assets by 2021;
- FDI net inflows were high in 2016 when they stood at 12,2% of GDP; but they dropped significantly in 2017 down to 2,8%, the lowest figure in more than 20 years. However, this number is still positive as compared to other emerging economies.

#### Restricting factors:

- The fiscal deficit widened further to 6,3% of GDP in 2017 as expenses grew at a higher pace than revenues. This trend continued in 1Q 2018 when revenues increased by only 1,4% while expenses hiked by 13,5% y-o-y as spending on education, public health care and social security continued to increase substantially. As mentioned in previous reviews, the government continues to make efforts to reduce the budget dependence on oil, however, the non-oil deficit is also expected to have widened in 2017;
- Credit to the economy has remained stagnant. Banks assets to GDP declined by 10p.p. in 2017 down to 46% of GDP and private claims of financial institutions also declined by

3p.p. down to 41,5%. The absolute level of bank's assets and loans remained practically unchanged from the beginning of the year until April 2018. Furthermore, deposit dollarization levels continued to decline slightly down to 44% of total deposits as of May 2018; while FX loans have slightly declined down to 25% of total loans as of the same date;

- The level of competitiveness of the economy remains satisfactory. The index of economic competitiveness from the World Economic Forum was 4,4 out of 5,7 in the 2016-2017 report.

#### Negative factors:

- Inflation continues on a downward trend, albeit remaining high, as it posted a y-o-y increase of 6,2% as of May 2018. This has been a continued result mainly from the stabilization of the exchange rate; however, we still consider that inflationary pressures remain latent in the economy given the exposure toward external factors;
- As of March 2018, the market capitalization of the Kazak Stock Exchange increased slightly as compared to 2017 up to around 31% of GDP; however, it is still highly concentrated in a few issuers. Therefore, the underdevelopment of the capital markets remains a negative factor;
- The main factor restraining Kazakhstan's rating is the weakness of the banking sector. Despite having sound balance sheet indicators, restructured loans and lack of credit growth remain a concern. Moreover, Qazaq Bank, Bank of Astana and Eximbank suffered extensive deposit withdrawals after Nazarbayev criticized their operations. However, financial soundness indicators remain encouraging; as of April 2018, capital adequacy remained high at 16,9%, NPLs have declined consistently down to around 9% (this, without considering restructured loans and NPLs from SPVs) and ROA was positive at 0,4%. Finally, due to the restructuring efforts of the banking system, it remains concentrated;
- The potential materialization of contingent liabilities remains a threat to the stability of public finances given the fragile banking system. However, the amount of SOEs has reduced slightly as a result of the government's privatization plan which has advanced substantially.

#### Stress factors:

- Concentration of tax revenues in one industry. Kazakhstan depends heavily on oil revenues, which make up around 60% of the state's budget and 33% of GDP (weak stress factor);
- Financial dollarization in Kazakhstan, despite declining further as of 5M 2018, remains a risk for the economy and the banking system. As of May 2018, around 25% of total loans and 44% of total deposits were denominated in foreign currency (very weak stress factor).

#### SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Long-term sustainability of high oil prices which would cause fiscal buffers to improve further and would contribute to the fiscal consolidation efforts;
- Continued diversification of the economy which would make Kazakhstan less exposed to oil price shocks;
- Continued reduction in financial dollarization levels as well as a notable improvement in the banking system metrics.

The following developments could lead to a downgrade:

- A renewed decline in hydrocarbon prices which would cause a deterioration of the country's fiscal stance;
- Further weakening of the banking system which would materialize contingent liabilities of the government.

“The rating of Kazakhstan confirmed at ‘BBB-’ with a stable outlook reflects the acceptable amount of government debt, stabilizing inflation levels and declining financial dollarization. Moreover, fiscal buffers remain vast and the external position is solid and we expect it to continue in the same trend going forward.

However, the rating is negatively affected by the risk stemming from the banking system which increases the probability of contingent liabilities’ materialization. In addition, the highly dependent and concentrated economy in the oil sector augments the volatility of economic growth and reduces stability. Finally, resulting from still high NPLs and restructured loans, the growth in credit to the economy continues to be subdued.”

Responsible expert: Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH

Reviewer: Gustavo Angel, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Kazakhstan is available at:

[https://raexpert.eu/reports/Research\\_report\\_Kazakhstan\\_06.07.2018.pdf](https://raexpert.eu/reports/Research_report_Kazakhstan_06.07.2018.pdf)

Next scheduled rating publication: TBD in December 2018.

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**RATING HISTORY:**

| Date       | Review reason   | SGC               |                  | Outlook           |                  |
|------------|---|-------------------|------------------|-------------------|------------------|
|            |   | National currency | Foreign currency | National currency | Foreign currency |
| 12.01.2018 | Scheduled revision of both types of ratings for the country | BBB-              | BBB-             | NA                | NA               |
| 14.07.2017 | Scheduled revision of both types of ratings for the country | BBB-              | BBB-             | NA                | NA               |
| 20.01.2017 | Scheduled revision of both types of ratings for the country | BBB-              | BBB-             | NA                | NA               |
| 22.07.2016 | Scheduled revision of both types of ratings for the country | BBB-              | BBB-             | NA                | NA               |
| 29.01.2016 | First assignment of both types of ratings for the country   | BBB-              | BBB-             | NA                | NA               |

## Minute's summary

The rating committee for Kazakhstan was held on 4 July 2018. 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 – Full Public Version (from May 2018) can be found under the following link: [https://raexpert.eu/files/methodology/Methodology\\_Full\\_Sovereign\\_V3.pdf](https://raexpert.eu/files/methodology/Methodology_Full_Sovereign_V3.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: National Bank of Kazakhstan, Ministry of Finance of the Republic of Kazakhstan, World Federation of Exchanges, International Monetary Fund, World Bank, Trading Economics, World Economic Forum, Doing Business, United Nations, Kazakhstan Stock Exchange (KASE), Cbonds, publications in the media.

## 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.

## Regulatory use

SGC ratings can be used for regulatory purposes according to the ESMA definition.

## 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 press-release and research report.

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.