

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

Rating-Agentur Expert RA 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:

- The economy in 2018 continued to grow at the rates of 2017 as real GDP hiked by 4,1% as compared to a year before, mainly due to high crude oil prices, as well as positive dynamics in all sectors of the economy. In 2019, we expect a slowdown in economic growth to around 3% amid declining oil production due to the planned repair work in the Kashagan, Karachaganak and Tengiz oil fields, as well as contagion from weak external conditions. Real GDP growth may be supported by the expansion of consumer lending; however, the dependence on the export of key commodities remains a significant drawback of the Kazakh economy;
- As of June 2019, the spread between the yields of the 5Y (remaining maturity) USD-denominated Kazakh Eurobonds and the U.S. 5Y Treasury is only 1,04p.p., which reflects an encouraging level of optimism and confidence from investors;
- The ratios of gross government debt to GDP and to budget revenues slightly increased in 2018 to 22% and 107% respectively. The discrepancy with our previous expectation is mainly due to KZT depreciation as external debt increased by 23,5% y-o-y in KZT terms. Furthermore, the share of the short-term external debt has grown more than 3x. Despite this, the current debt position remains a strength for Kazakhstan and does not represent a risk for the creditworthiness of the country;
- The National Bank of Kazakhstan (NBK) is expected to continue to implement a neutral monetary policy keeping a balance between price stability and support of economic growth. Nonetheless, policy effectiveness is still constrained by weaknesses in the financial markets as well as the NBK's exposure to political influence;
- In 2018, international reserves averaged USD 30,5 bn, which exceeded the IMF recommended reserve adequacy level for countries with a floating exchange rate. Also, international reserves are around 81% of gross government debt and a little more than 8 months of imports of goods and services;
- GDP per capita in PPP terms is expected to reach an all-time high of around USD 27,5 th in 2018 and remain one of the highest among its regional CIS peers¹;
- The unemployment rate has been stable at a level of 5% over the past years and it is expected to remain under control in the mid-term perspective.

¹ Estimated GDP per capita in PPP terms for 2018: Uzbekistan – USD 7 665; Tajikistan – USD 3 416; Turkmenistan – USD 19 527.

Restricting factors:

- Inflation continued to slow down, and by the end of 2018 it stood at 5,3%, lower than initially anticipated. As of March 2019, the annual inflation continued to slow down to 4,8%, already toward the lower boundary of the target. As a result of this and continued low inflation expectations, the NBK decided to trim the base rate by 25b.p. down to 9% back in April 2019. The expected inflation rate for 2019 is projected to be no more than 5,5%, which would be within the target range from 4% to 6% set by the NBK;
- Due to the favorable price conjuncture in the oil market and conservative expenditure policy, for the first time in the last four years, the consolidated budget presented a surplus of 0,54% to GDP at the end of 2018. Even though the non-oil budget deficit improved, the negative balance remained quite wide at -6,1% in 2018 reflecting the still high dependence of the economy on the hydrocarbon sector. In general, we anticipate the fiscal surplus in the 2019 at the level of 1,4% of GDP. Positive expectations regarding budget revenues are supported by a stable extracting industry, an increase in VAT revenues and a strengthening of non-oil revenue sources. In the expenditure side, the burden of supporting the banking sector will decrease, though an additional contribution of the government to support the economy and social spending is planned in order to maintain domestic demand;
- The continuing decline in the ratio of banking sector assets to GDP of 2,7p.p. y-o-y reflects both a downturn in lending volumes and a shrinking portfolios after the clearance of toxic loans. At the same time, corporate loans fell by 6,2%, but credit extended to individuals increased by 17,2%, so the retail sector, mainly mortgages, will remain a growth factor for banks. Moreover, the level of dollarization of funding sources remains a significant risk factor and accounted for almost 44% of all deposits as of end of 1Q 2019;
- Foreign investment dynamics did not recover since 2017, and the net inflow of FDI was even lower in 2018 at 2,24% of GDP. Although the inflows to the mining industry were higher, the outflows from the transport and logistics sectors and the lack of FDI in geological exploration, resulted in the low net figures;
- According the Global Competitiveness Index report from 2018, the overall score for Kazakhstan was 62 (59th place from 140). The level of competitiveness of the economy is supported by the improvement in macroeconomic stability connected with favorable oil prices. As an evidence, by the end of 2018, the external trade surplus was strengthened to almost 13% of GDP and the current account balance was slightly positive at 0,6%.

Negative factors:

- The lack of progress in the development of capital markets continues to be a factor negatively affecting the credit rating. The current weaknesses of the stock market are expressed in the low market capitalization of companies, which shrank in 2018 to 24,1% of GDP, as well as a high concentration of trading on top players. Nonetheless, we still anticipate that the development of Astana International Financial Centre (AIFC) could have a positive impact in the capital markets development in the mid-term perspective;
- Although the level of NPLs to total loans fell by 1,4p.p. y-o-y down to 8,61% as of 1Q 2019, it is suspected that in a real situation of poor payment culture and a weak rule of law, banks have a larger share of problem assets in their portfolios, weakening the credit rating assessment. The ongoing transformation processes in the banking sector have been accompanied by support for the liquidity of banks by the NBK, a further cleaning-up from distressed banks' assets and concentrations as a result of the merger of the two largest banks (Halyk Bank and Kazkommertsbank). As a consequence, the banking sector showed

an average ROA of 2,61% and strengthened the capital adequacy level to 16,6% in 2018. Moreover, liquidity metrics have also been improving as liquid assets to short-term liabilities increased by 20p.p. y-o-y as of 1Q 2019, though the excess liquidity has a non-depository nature and is the result of financial injections from the state. Going forward, we anticipate the system to continue its consolidation as we expect more M&A activity as single banks continue to feel pressures;

- The footprint of the state on business continues to be substantial, according to rough estimates, with a share of the public sector in the economy at the level of 40%. In general, the vector is aimed at gradually reducing state ownership to 15% of GDP through the implementation of a phased privatization program in 2016-2020; however, the hidden risks stem mostly from the possible materialization of implicit contingent liabilities associated with supporting the stagnant banking sector.

Stress factors:

- Concentration of tax revenues on one industry. Kazakhstan depends heavily on oil revenues, which made up around 37% of the state's budget that is 7,5% of GDP in 2018 (moderately weak stress-factor);
- Although the level of dollarization of the banking system slightly decreased during 2018, both, the share of loans and deposits in foreign currency remained quite high at the end of 1Q 2019: 19,6% and 43,7%, respectively (weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Long-term sustainability of high oil prices that will allow to accumulate sufficient budget revenues and decrease government debt;
- Continued industry diversification and building greener global economy resulting in higher non-oil GDP growth and improved non-oil fiscal balance;
- Continued improvement of the banking system performance.

The following developments could lead to a downgrade:

- A renewed decline in hydrocarbon prices combined with a negative development of the non-oil economy 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 current confirmation of Kazakhstan's rating at 'BBB-' with a stable outlook reflects the current positive trends in the national economy, improvement of the fiscal stance and sustainable macro indicators. The stable GDP growth, robust external position, positive fiscal balance, reasonable levels of inflation and adequate debt position are among the factors supporting the creditworthiness of the sovereign.

Despite the recovery processes and the current improvements in a number of indicators, the continuing stagnation of the banking sector has an inhibiting effect on the development of the economy. The presence of hidden problems with the quality of loan portfolios may lead to the possible materialization of contingent liabilities. The high dependence on the oil sector remains a significant risk as the volatility of prices and demand in the global commodity markets can lead to imbalances in the economy. Among the factors which put rating under pressure, is the dependence of monetary authorities on the political influence. In our view, the political power transition process so far does not pose significant credit risks, however the Agency will keep monitoring political developments in Kazakhstan within the next credit rating review cycle." – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Kazakhstan is available at:

https://raexpert.eu/reports/Research_report_Kazakhstan_14.06.2019.pdf

Next scheduled rating publication: 13 December 2019. The full sovereign rating calendar can be found at [Sovereign Rating Calendar 2019](#)

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
21.12.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
06.07.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
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 6 June 2019. 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 \(from April 2019\)](#). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for [Internal policies](#).

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.