

Rating-Agentur Expert RA GmbH confirmed at 'BBB-' the sovereign government rating and at 'BB+' the credit climate rating of Kazakhstan

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.

Rating-Agentur Expert RA GmbH confirmed the country credit environment rating (CCE) of Kazakhstan at 'BB+' (Sufficient quality of credit environment of the country) in national currency and at 'BB+' (Sufficient quality of credit environment of the country) in foreign currency.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Government debt was 21,1% of GDP and 117,1% of budget revenues at the end of 2016. Given the fiscal consolidation efforts, we expect these figures to follow a stable but still upward trend in the mid-term perspective. Moreover, short-term debt is still low at only 0,2% of GDP and accounting for 1% of total debt;
- Monetary policy remains accommodative since inflation expectations have eased. The NBK has cut rates twice since our last revision and as of June 2017 it stands at 10,5%. As mentioned in our previous review, the inflation-targeting policy has stabilized inflation and the exchange rate;
- The level of international reserves remains solid at USD 30,4 bn as of May 2017 covering external debt by 2,2x, gross government debt by 1x and represents around 9 months of imports;
- GDP per capita in PPP terms increased to USD 25 154 in 2016 and is still one of the highest among its regional oil-producing CIS peers¹;
- The unemployment rate has been stable over the past years and remained at satisfactory levels in 2016 (5,0%);
- Despite the adverse condition in the banking system, officially reported capital to assets ratio stood around 10,8% in 2016;
- The privatization plan remains in place and the authorities plan to sell major assets by 2021;
- FDI net inflows were high in 2016 related to the hydrocarbons sector. However, it has slowed down in the beginning of 2017 and we expect it to continue in the same direction moving forward.

Restricting factors:

- As previously expected, real GDP grew by 1,1% in 2016 driven by fiscal support, higher oil production and a pickup in mining output. In the current year, real output growth has been solid and we expect it to continue in this trend moving forward;
- Given the government's loose fiscal policy, spending increased through the Nurlı Zhol initiative and was as high as 3% of GDP in 2016. Thus, the budget posted another deficit

¹ Oil-producing CIS peers include Azerbaijan, Russia and Uzbekistan.

of 4% of GDP in 2016. We expect this figure to widen in 2017 given the government's injection of funds in the Problem Loans Fund (PLF); however, after this one-off effect, we anticipate the metric to continue in a downward trend from 2018. Moreover, the new fiscal rules will aim at maintaining strong buffers and reducing dependence on oil, ultimately stabilizing transfers from the National wealth fund;

- Credit to the economy stalled in 2016 when private credit was around 45% of GDP, the same figure as in 2015. Bank assets to GDP, on the other hand, stood at 56%, a decline of 2p.p. from a year ago. The slowdown in credit caused an excess of liquidity in the market which was sterilized by the NBK. In 2017, credit has picked up modestly in nominal terms, as of May 2017, total loans increased by 1,4% y-o-y. Additionally, deposit dollarization levels continue to decrease (48% as of May 2017) while FX loans have remained stable;
- 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 2016.

Negative factors:

- Inflation remains high according to our internal thresholds. Nonetheless, still driven by the base effect, it continues to gradually decline as expected. As of June 2017 it posted a 7,5% y-o-y increase and we expect it to end 2017 with a similar figure given lower inflation expectations as a result of a stable currency;
- The underdevelopment of the Kazak stock exchange remains a negative factor. Its market capitalization is around 30% of GDP and it is highly concentrated in a few issuers;
- The banking system has shown signs of fragility and underdevelopment for the past years despite its stable capitalization and officially reported loan quality metrics. However, the amount of off-balance sheet bad loans along with official NPLs has increased up to about 40% of total loans according to IMF figures, restructured loans have also hiked and KKB, one of Kazakhstan's biggest banks, continues to struggle. As a result, a merger between KKB and Halyk Bank was completed and the government is planning to inject KZT 2 tn to the PLF to continue cleaning up the system of bad debt;
- Given the increasing risk in the banking system, we consider a potential materialization of contingent liabilities a key risk to the stability of the government finances.

Stress factors:

- Concentration of tax revenues on 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 in 2017, remains a risk for the economy and the banking system. As of May 2017, around 29% of total loans and 48% of total deposits were denominated in foreign currency (very weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Relatively narrow and stable spread between average lending and deposit rates as of May 2017 (4,6%);
- The KASE index continues to increase consistently. It has hiked by around 24% since the beginning of 2017.

Restricting factors:

- The real interest rate has been volatile over the past six years. As of end-2016, it increased by 2p.p. from 2015 to stay at 5,9%. However, we expect it to remain steady given more stable inflation and interest rates.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Sustained and stable increase in oil prices which would support the government's fiscal consolidation efforts and would reduce external pressures and propel real GDP growth;
- Prolonged period of stability of the exchange rate combined with stable inflation and a reduction in dollarization levels.

The following developments could lead to a downgrade:

- Further deterioration in the banking system which would materialize contingent liabilities of the government;
- A renewed decline in oil prices which would propel an increase in government debt and exert pressure on the fiscal budget and monetary targets.

"The confirmation of Kazakhstan's SGC ratings at BBB- and CCE ratings at BB+ is supported by prevailing low levels of government debt as well as by the continuous improvement in the effectiveness of the monetary policy which has been translated in increasingly stable inflation and exchange rate levels and, thus, causing dollarization levels to ease.

However, the troubled banking system remains the main risk for Kazakhstan since it has elevated the probability of implicit contingent liabilities materialization and poses a threat to economic stability. Moreover, credit to the economy has stalled and the external position continued to weaken in 2016; nevertheless, we expect it to recover going forward." – Clarified Hector Alvarez, Rating Associate of Rating-Agentur Expert RA GmbH.

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_14.07.2017.pdf

Next scheduled rating publication: TBD in December 2017.

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BB+	BB+
22.07.2016	Scheduled revision of both types of ratings for the country	BBB-	BBB-	BB+	BB+
29.01.2016	First assignment of both types of ratings for the country	BBB-	BBB-	BB+	BB+

Minute's summary

The rating committee for Kazakhstan was held on 11 July 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 2017) can be found under the following link: http://raexpert.eu/files/methodology/Methodology_Short_Sovereign_v2.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

Only SGC ratings can be used for regulatory purposes according to the ESMA definition. CCE ratings are not considered as credit ratings within the framework of Regulation (EC) No 1060/2009.

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

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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.