

Rating-Agentur Expert RA GmbH confirmed at 'BBB-' the sovereign government and at 'BB+' the credit climate ratings 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:

- Despite the recent increase, gross government debt to GDP is still low at 21,9% and remained moderate as compared to budget revenues (131,7%) in 2015;
- The level of international reserves covered gross government debt by 1,2x and external debt by 2,5x by year-end 2015. Additionally, it has remained stable throughout 2016 (USD 28,7 bn by May 2016);
- Short-term debt is negligible and it is solely in the National Bank of Kazakhstan's (NBK) balance sheet. It accounted for merely 0,4% of the total debt and was only 0,09% of GDP in 1Q 2016;
- GDP per capita (estimated to be USD 24 300 in 2015) is one of the highest among its regional CIS peers and has been steadily increasing in recent years;
- The unemployment rate has been stable over the past years and remained at satisfactory levels in 2015 (5,0%);
- Despite the adverse conditions of the banking system, it remains well capitalized having posted a capital adequacy ratio of 15,9% in 2015, a stable indicator over the past six years;
- The ambitious privatization plans presented by the authorities, which involve selling valuable assets from the sovereign wealth fund (Samruk-Kazyna) including the hydrocarbon, energy and telecommunications sectors, if enacted properly, will bring positive mid- to long-term effects on the economy.

Restricting factors:

- The fiscal budget presented a deficit of 5% of GDP in 2015, a huge turnaround when compared with the 1,8% surplus from 2014. The deficit was caused by a decrease in revenues (mainly tax receipts) of more than 25% and a 1,5% increase in expenses;
- The banking system remains weak. Bank assets to GDP were 58,3% and private credit to GDP stood at 44,9% in 2015; both have decreased further in the current year (by around 2p.p. and 3p.p. y-o-y respectively by 1Q 2016). The end of 2015 and the beginning of 2016 were characterized by a liquidity crisis in the system which skyrocketed money market rates. The NPLs to total loans ratio was reduced to 12,4% in 2015 mainly due to the transfer of assets from Kazkommerstbank to BTA Bank¹ and dismissal of legal barriers to

¹ BTA Bank's license was voluntarily surrendered to the NBK which means that the Bank is not officially part of the banking sector and, thus, its assets (and NPLs) are not accounted for.

transfer these assets to SPVs; however, this number is expected to rise by end-2016. Even though de-dollarization started around February 2016 due to a more stable KZT and the introduction of new deposit rate limits, dollarization levels still pose a risk to the banking system;

- Recent monetary policy actions have stabilized the exchange rate which has caused lower dollarization levels and improved confidence in the KZT. While the inflation rate is increasing, low inflation expectations may cause the rate to be around the NBK target at year-end 2016. This reflects the decision of the NBK to lower interest rates (to 15% in March and to 13% in July) in order to halt the increase of NPLs as well as to propel economic growth; however, this measure may further exert inflationary pressures. Moreover, the transmission of monetary policy to the financial system remains weak;
- Acceptable level of competitiveness of the economy as measured by the index of economic competitiveness from the World Economic Forum (the country scored 4,48 out of 5,7 in 2015);
- Countercyclical fiscal policy continues to offset weak investment and domestic demand. Nonetheless, most of the revenues are hydrocarbon-dependent and oil prices have already taken a toll on the budget balance – 5% of GDP deficit for 2015 and expected to narrow marginally at year-end 2016. Assets of the National Fund of the Republic of Kazakhstan (NFRK) continue to decline due to the budget transfers.

Negative factors:

- Official IMF data from 2015 showed a very steep increase in gross government debt to budget revenues (131,7%) due to the fact that revenues were lower than initially estimated. Debt to GDP stood at 21,9%, an important increase of 7,2p.p. over 2014 due to the Eurobond issuance. Government debt figures until June 2015 escalated further as a result of an increase in Central Bank's debt;
- Real GDP grew by around 1,2% in 2015 and contracted by 0,2% in 1Q 2016 as a result of low oil prices and regional spillovers, especially from Russia. This indicator has been in a downward trend which is expected to remain so at least for 2016;
- The inflation rate spiked to 13,6% at the end of 2015 and up to 17,3% (y-o-y) in June 2016. Nonetheless, most of the price increase was accumulated towards the end of 2015. Y-o-y inflation for 2016 is expected to be around 9% motivated by a more stable exchange rate;
- The national stock exchange remains underdeveloped with only 85 listed companies, a market capitalization of 29% of GDP as of February 2016 and 95% of the trades concentrated in the ten largest issuers.

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 alleviating through 2016, remains a risk for the economy and the banking system. As of May 2016, around 33,7% of total loans and 60% of total deposits were denominated in foreign currency (moderate stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Sluggish performance of the national stock exchange (KASE) as evidenced by the 50% decline of the KASE index over the last six years;
- Default of Kazakh financial institutions during 2015 (BTA Bank Alliance Bank, Astana Finance).

Restricting factors:

- Volatile real interest rate over the past six years. Nonetheless, it lowered in 2015 to 2,5%, an attractive level for investors.

Positive factors:

- Narrow spread between average lending and deposit rates (0,5%).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- An increase in oil prices higher than originally expected reducing fiscal and external pressures;
- Consistent stability of the exchange rate combined with stable inflation and a reduction in dollarization levels.

The following developments could lead to a downgrade:

- A renewed decline in oil prices which would propel an increase in government debt and exert pressure on the fiscal budget and monetary targets.

“Kazakhstan’s ratings reflect the still low, well-structured and diversified government debt, as well as the comfortable amount of fiscal buffers contained in the National Fund of the Republic of Kazakhstan (NFRK) and improving monetary stabilization. However, the overall worsened position of the economy as a result of low current and expected hydrocarbon prices has also deterred the ratings.

Real GDP has deteriorated, inflationary pressures are still latent, external position lost strength and the financial system remains weak. Furthermore, the prospects for the following years are not encouraging due to the current projections of oil prices combined with a still non-diversified Kazakh economy.” – Clarified Hector Alvarez, Rating Analyst of Rating-Agentur Expert RA GmbH.

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

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

Research report on Kazakhstan is available at:

http://raexpert.eu/reports/Research_report_Kazakhstan_22.07.2016.pdf

Next scheduled rating publication: 13 or 20 January 2017, TBD in December 2016.

For further information contact:

Rating-Agentur Expert RA GmbH
Walter-Kolb-Strasse 9-11,
60594 Frankfurt am Main, Germany
+49 (69) 3085-45-00
E-mail: info@raexpert.eu
www.raexpert.eu

RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
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 19 July 2016. 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: 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), 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.

Despite similar methodologies, credit ratings of Kazakhstan 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

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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.