

Rating-Agentur Expert RA GmbH confirmed at 'B' the ratings of Kyrgyzstan. The rating outlook is stable.

Rating-Agentur Expert RA GmbH confirmed the sovereign government credit rating (SGC) of Kyrgyzstan at 'B' (Moderately low level of creditworthiness of the government) in national currency and at 'B' (Moderately low 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:

- Short term debt in 2018 is estimated to have stood at only 0,5% of GDP and it is substantially covered by foreign exchange reserves by more than 50x;
- The economy is progressively recovering. Real GDP is expected to grow by 3% in 2018 driven by an improved regional outlook, higher remittances inflow and stabilization of the exchange rate.

Restricting factors:

- The consumer price index is expected to have grown by around 4% as of end-2018, this is below the target of the National Bank of Kyrgyzstan (NBKR) which stands currently between 5% and 7%. The stabilization of the inflation level allowed to support the NBKR's easing policy and maintain the base interest rate at 4,75% for most of 2018. However, oil and food price volatility keep potential pressure on inflation elevated;
- While profitability of commercial banks has improved as shown by ROA and ROE increasing to 1,5% and 9,5% in October 2018 from 1% and 6,7% respectively from a year ago, the quality of assets remains vulnerable. The share of non-performing loans to total loans in 3Q 2018 was 7,6%, 0,4p.p. lower than a year before. The NPLs rate could potentially increase in the future due to insufficient risk-based supervision, preferential lending policy and currency risks. The capital to asset ratio of 16,7% indicates satisfactory capitalization levels under the slightly loose liquidity conditions;
- Net foreign direct investment inflow to GDP is forecast to increase only by 1p.p. to 6,3% by end-2018. Such low pace of investment growth could be explained by the inconsistency of the fiscal policy and the actions of the regulatory authorities¹;
- In 2018, government debt to GDP is expected to have declined by 1p.p. y-o-y down to 54%. The main driver of such dynamics continue to be the stabilization of the local currency. However, this scale of indebtedness is very high relative to the country's peers² and might be a cause for concern. The main risks are the fluctuations of the exchange rate and insufficient returns from invested projects in the future. Nevertheless, external debt is quite well structured: 51% of new external debt issued during 1H 2018 had fixed interest rate and 56% was denominated in a foreign currency other than USD and, due to its concessional nature, debt could be restructured if needed;
- We assess the overall fiscal policy quality as moderate as, despite the decrease of the fiscal

¹ Kyrgyzstan increased tax rates on the export of gold ore and concentrates by 3%. According to the international consulting company Ernst & Young, the effect on budget revenues will be only short-lived, while in the future investors could go to a richer and simpler deposits.

² Estimated debt to GDP for 2018: Kazakhstan – 17,8%, Tajikistan – 52,7%, Turkmenistan – 30,9% and Uzbekistan -19,2%.

deficit to GDP ratio expected to be around 4,7% (0,6 p.p. lower than year before), it remains inefficient. Even though the expansionary fiscal policy allowed an increase in social benefits, it has failed to support poverty reduction or stimulate investment. High government spending might also have a negative impact on already low trade competitiveness as it raises the production costs;

- Despite a slightly favorable trend for the last seven years, the unemployment rate is estimated to have remained high at 7% in 2018;
- In 2018, the Kyrgyz Republic maintained its position in the Doing Business Ranking (77th out of 190). Unclear tax regulations, bad electricity access, high corruption perception and difficulties to trade across the borders, keeps the country in this low position. Nevertheless, the country improved transparency of the government reporting thanks to the cooperation with the international organizations.

Negative factors:

- In 2018, real GDP is expected to increase by around 2,8%; nevertheless, such a continued robust dynamic might be not sufficient to drive long-term growth and viably address poverty. Current GDP per capita in PPP terms remains one of the lowest in the region at the level of USD 3 386;
- The underdeveloped banking sector keeps having a negative impact on the rating score as total domestic credit to GDP is expected to have stood at just 24% in 2018 being restrained by high cost of lending and weak institutional environment. On the other hand, overall credit growth is positive, as private sector lending increased by 6,7p.p. and total bank's assets to GDP ratio by 2p.p. to 40% at the end of the 2018;
- The Kyrgyz Republic ranked 97th out of 140 countries in WEF competitiveness index, scoring low in infrastructure, innovation capacity and market share. The country imports most of its goods, while exports are highly concentrated in gold (more than 38% in 2018). We estimate the trade deficit at the end of 2018 to be around 36% of GDP;
- The stock and bond exchange markets continue to be highly concentrated and underdeveloped in terms of variety of traded securities. Total market capitalization of companies listed on national stock exchange to GDP was less than 5% as of December 2018.

Stress factors:

- The economy is highly dependent on third countries in the export market and remittance inflows. In 2018, more than 83% of cross-border payments were coming from Russia due to the easing access of the labor force from Kyrgyzstan to the Russian market. Geographical structure of trade is likewise concentrated, around 44% of total export goes to UK and same share to CIS countries, 40% of total import is coming from China and 28% from Russia (moderately weak stress-factor);
- Despite being high, financial dollarization in the Kyrgyz Republic has positive long-term dynamics. As of 3Q 2018; around 23% of total loans and 47% of total deposits were denominated in foreign currency, that is 0,7p.p and 2,3p.p lower since the beginning of 2018 respectively (very weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Improvement of external trading position and FDI growth.

The following developments could lead to a downgrade:

- Widening of government debt and inability to meet agreed fiscal deficit targets;
- Worsening of the asset quality of commercial banks.

“The SGC ratings of Kyrgyzstan confirmed at ‘B’ with a stable outlook reflect an economy which remains heavily dependent on the main CIS business partners and extracting industries. In addition, the lingering high level of indebtedness sensitive to external shocks, low credit to the economy and lack of effective fiscal policy, are the main factors constraining the rating score. Moreover, elevated levels of poverty, high corruption perception and difficulties to trade across the borders, have kept the country with a low competitive position.

However, the continuous decrease of financial dollarization in the country, higher banking sector profitability and higher remittances inflow, alongside improved export activity, are the most significant factors supporting the output growth.” – Clarified Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA GmbH.

Responsible expert: Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA GmbH

Reviewer: Vladimir Gorchakov, Rating Associate of Rating-Agentur Expert RA GmbH

Research report on Kyrgyzstan is available at:

https://raexpert.eu/reports/Research_report_Kyrgyzstan_04.01.2019.pdf

Next scheduled rating publication: 28 June 2019. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign/#conf-tab-5>

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
13.07.2018	Scheduled revision of both types of ratings for the country	B	B	Stable	Stable
19.01.2018	Scheduled revision of both types of ratings for the country	B	B	NA	NA
21.07.2017	Scheduled revision of both types of ratings for the country	B	B	NA	NA
27.01.2017	Scheduled revision of both types of ratings for the country	B	B	NA	NA
29.07.2016	Scheduled revision of both types of ratings for the country	B	B	NA	NA
19.02.2016	First assignment of both types of ratings for the country	B	B	NA	NA

Minute's summary

The rating committee for Kyrgyzstan was held on 28 December 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. 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: International Monetary Fund, World Bank, World Economic Forum, Doing Business, United Nations, Kyrgyz Stock Exchange (KSE), National Bank of Kyrgyzstan (NBKR), Ministry of Finance of the Kyrgyz Republic, Ministry of Economy of the Kyrgyz Republic, National Statistical Committee of the Kyrgyz Republic, Transparency International, Human Development Report.

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

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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.