

## Rating-Agentur Expert RA confirmed at 'B' the sovereign government rating and at 'B-' the credit climate rating of Kyrgyzstan

Rating-Agentur Expert RA 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.

Rating-Agentur Expert RA confirmed the country credit environment rating (CCE) of Kyrgyzstan at 'B-' (Moderately low quality of credit environment of the country) in national currency and at 'B-' (Moderately low quality of credit environment of the country) in foreign currency.

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

#### Positive factors:

- Favorable investment potential as evidenced by the foreign direct investments inflows to GDP estimated at 6,02% in 2017;
- Short-term debt remained considerably low and very well covered by the FX reserves and is estimated to be 0,6% of GDP and 1,6% of budget revenues in 2017;
- The economy is gradually recovering from the last external shock, caused mainly by declining remittances and lower trade turnover, indicated by the real GDP expected growth at 3,8% and 3,2% in 2016 and 2017 respectively.

#### Restricting factors:

- We expect gross debt ratios to decline by around 0,9p.p. and 19p.p. down to around 57% of GDP and 149% of budget revenues respectively in 2017 driven by stabilization of KGS in 2017, however, the debt level remains a concern as Kyrgyzstan's debt to GDP ratio is the highest amongst the regional peers. FX-denominated debt accumulation remained a problem as it continued growing at 10% y-o-y in absolute terms as of November 2017 and reached 90% of total government debt, which significantly exposes the country to the KGS FX rate risk. Nevertheless, the concessional nature of more than 90% of total debt increases probability of debt restructuring if needed, hence reduces the credit risk of the sovereign;
- Quality of the fiscal policy remains moderate as we expect the government to miss its fiscal target once again in 2017. Due to higher than projected expenditures in wages, new social allowances and VAT exemptions, the fiscal deficit is expected to be around 3,5% of GDP in 2017 while the target was set at 3%. Additionally, absence of a credible, effective and enforceable fiscal rule, which would be able to act as an anchor and safeguard against further fiscal slippages, limits certainty over the government's mid and long-term fiscal plans and whereby further restricting the rating;
- Unemployment rate, despite showing favorable dynamics in the past six years, stayed rather high and was estimated at 7,4% in 2017.

#### Negative factors:

- Despite still overall favorable real GDP growth dynamics, GDP per capita in PPP terms remained low and was estimated at USD 3 654 in 2017, putting the country behind most of its peers;
- The inflation rate is expected to stay positive in 2017 at around 3,7%, but still outside the

National Bank of Kyrgyzstan (NBKR) target band (between 5% and 7%). Given the relative stabilization of core inflation in 2017, oil price volatility is still considered one of the main sources of overall-price uncertainty in the economy. Additionally, the effectiveness of the policy transmission mechanism remains restrained given still high levels of dollarization;

- Despite positive average dynamics, the banking sector remains underdeveloped with bank's assets and volume of private credit to GDP expected to remain low at around 41% and 22% in 2017 respectively. Even though the banking system indicators showed some positive signs, it remains the key risk for the country's creditworthiness indicated by a decreasing (1,3p.p. change y-o-y) but still high amount of NPLs to total loans ratio at around 8% as of November 2017. The recent sharp increase in banks' ROA by 6,8p.p. y-o-y up to 7,1% in November 2017 is another positive sign to the banking sector and, if sustained, may trigger a continuous recovery of the vulnerable financial sector. At the same time, banks managed to maintain satisfactory capitalization levels with net total capital at 17% of total assets as of November 2017;
- Competitiveness of the Kyrgyz economy is very narrow. The country imports most of its products (trade deficit of 29% of GDP in 2017) and has a competitiveness index of 3,9 from the WEF in 2017 which ranks 102<sup>nd</sup> out of 138 countries, one of the lowest among its regional peers.

Stress factors:

- High dependence on third countries, as well as on international organizations to finance operations and receive financial aid and remittances (moderately weak stress factor);
- Despite positive dynamics, dollarization continued to be a problem representing 52,3% of total deposits and 38,8% of total loans in 2017 (weak stress factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Positive factors:

- Very good performance of the stock market index (KSE) growing by around 12% y-o-y in January 2018.

Restricting factors:

- Interest rate spread stayed moderately high through 2016 and reached 7,2% in April 2017;
- Subdued institutional development of the country was reflected in the high corruption perception, low government effectiveness and political stability index, inadequate rule of law, as well as low position in Doing Business Ranking (77<sup>th</sup> out of 180) in 2017. At the same time, the country has a long history of cooperation with international organizations, which helps to maintain transparency of the government reporting at acceptable levels.

Negative factors:

- Very high and volatile levels of real interest rate;
- Stock and bond exchange market is underdeveloped with a very low total market capitalization of listed companies (3,9% of GDP in 2017), low turnover, high concentration of trade on the biggest issuers (ten largest equity issuers account for about 88% of the amount of annual trading in 2017) and a narrow variety of products.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Persistent recovery of the biggest regional partners which would further improve the external environment and help to push real output growth;
- Gradual reduction of dollarization levels combined with the maintenance of price and exchange rate stability.

The following developments could lead to a downgrade:

- Continued widening of the fiscal deficit exceeding the target levels coupled with subsequent government debt accumulation above sustainable levels;
- Resumed risk accumulation in the banking sector.

“The SGC and CCE ratings of Kyrgyzstan continued to be constrained by relatively high and growing debt figures in absolute terms, continuously missed fiscal and monetary targets, as well as by low economic and institutional development. Additionally, the banking sector remained vulnerable; however, the recent sector’s profitability increase and ongoing reforms had a noticeable positive effect on the sector.

On the positive side, the smooth recovery of the biggest CIS trading partners, through growing remittances and trading activity supported the output growth. However, a sustained increase in real GDP will continue to depend on the amount of gold production in the country’s biggest mines, as well as on the continuous implementation of the key infrastructure projects. Moreover, we anticipate that a sustained decline in dollarization levels, loose monetary policy and a low inflation environment will lead to a further increase in economic activity.” – Clarified Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH.

Responsible expert: Ilya Makunin, Rating Analyst of Rating-Agentur Expert RA GmbH

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

Research report on Kyrgyzstan is available at:

[https://raexpert.eu/reports/Research\\_report\\_Kyrgyzstan\\_19.01.2018.pdf](https://raexpert.eu/reports/Research_report_Kyrgyzstan_19.01.2018.pdf)

Next scheduled rating publication: 13 July 2018. 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		CCE	
		National currency	Foreign currency	National currency	Foreign currency
21.07.2017	Scheduled revision of both types of ratings for the country	B	B	B-	B-
27.01.2017	Scheduled revision of both types of ratings for the country	B	B	B-	B-
29.07.2016	Scheduled revision of both types of ratings for the country	B	B	B-	B-
19.02.2016	First assignment of both types of ratings for the country	B	B	B	B

## Minute's summary

The rating committee for Kyrgyzstan was held on 17 January 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 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](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: 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

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

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.