

Rating-Agentur Expert RA GmbH assigned 'B' ratings to Kyrgyzstan

Rating-Agentur Expert RA GmbH assigned 'B' sovereign government credit rating (SGC) to Kyrgyzstan in national currency (Moderately low level of creditworthiness of the government) and 'B' in foreign currency (Moderately low level of creditworthiness of the government).

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

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Low and well covered short-term debt at 0,9% of GDP and 3% of budget revenues;
- Motivated by lower prices of imported goods (mainly oil products), the inflation rate dropped to 3,4% in 2015. However, this metric has been showing a significant volatility over the past six years;
- Fiscal deficit stood at 1,4% of GDP in 2015 and narrowed over the past six years by 4,4p.p.

Restricting factors:

- Relatively high unemployment rate at 7,5% in 2015;
- Sluggish quality of the fiscal policy as deep and persistent deficits have been recorded over the past six years. The government recently unveiled plans to narrow fiscal deficit, but results will only be observed in the mid- and long-run;
- Mixed results in the banking system with banks' assets/GDP at 41%, volume of private credit/GDP as low as 22% and average ROA around 1,8% in 2015. Non-performing loans increased steadily during 2013-2015 to 7,4%. While remaining high, average capital adequacy ratio declined over the past six years by 4,4 p.p. to 15,6% in 2015.

Negative factors:

- Government debt load at 64% of GDP and 219% of budget revenues in 2015 was slightly high and well above its peers¹. Additionally, both metrics constantly increased over the past three years;
- The yield on the 5Y government bond, at 17,6% as of November 2015, reflects high financing cost for the government and investors perception of long-term risks in the country;
- Despite real GDP growing at 3,5%, GDP per capita in PPP at USD 3 310 remains low and behind its peers;
- Reduced investment potential as evidenced by the low and sliding levels of national savings/GDP, which reduced by 7p.p. from 2010 to 2015;
- Underperformance of the monetary policy with most of the Central bank's targets being missed over the past years. With current levels of dollarization (around 71% of total deposits and 56% of total loans in 2015) and significant dependence on imports (around 75% of GDP), monetary policy transmission mechanisms tend to have little effects and

¹ Peers include Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan.

inflation rate is highly influenced by external factors;

- Limited competitiveness of the economy. The country imports most of its products (trade balance deficit of 44% of GDP) and had a competitiveness index of 3,83 from the WEF in 2015.

Stress factors:

- High dependence on Russia and on International Organizations to finance operations and receive financial aid and remittances (weak stress-factor);
- Dollarization levels continue to rise representing 71% of total deposits and 56% of total loans as of 4Q 2015. Kyrgyzstan dollarization levels lay above the world's average (weak stress-factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Substantial and volatile levels of real interest rate (7% in 2014 and 15,5% in 2015);
- Undeveloped stock exchange market with a small amount of listed companies, low turnover and narrow variety of products.

Restricting factors:

- Slightly high interest rate spread around 7% by November 2015.

Positive factors:

- Satisfactory performance of the stock market index (KSE) showing an accumulated return of 32% during 2013-2015.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Successful implementation and results of de-dollarization policies.

The following developments could lead to a downgrade:

- Deterioration of the main banking metrics caused by further slowdown of real GDP and economic spillovers from neighboring countries.

“The ratings of Kyrgyzstan are constrained by persistent and volatile fiscal deficits and increasing government debt metrics. Low GDP per capita combined with reduced investment potential and high dependence on neighboring countries were additional drivers of the ratings. While the banking system remains profitable, increasing NPLs and narrowing average adequacy ratios present a mid-term risk for the sector.

Even though external debt stands above 50% of GDP, this does not present a risk for the country's creditworthiness as most of these funds are granted in the form of concessional loans. High and volatile inflation rates alongside depreciation of the KGS drove the current levels of dollarization in the country. Fiscal and monetary policies have underperformed in recent years. However, recently announced reforms could contribute to achieving consolidation in the long-run.” – Clarified Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

Responsible expert: Gustavo Angel, Expert of Rating-Agentur Expert RA GmbH

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

Research report on Kyrgyzstan is available at:

http://raexpert.eu/reports/Research_report_Kyrgyzstan_19.02.2016.pdf

Next scheduled rating publication: 29 July 2016. The full sovereign rating calendar can be found at <http://raexpert.eu/sovereign.php#conf-tab-5>.

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Minute's summary

The rating committee for Kyrgyzstan was held on 17 February 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/MethodologyShort_Credit_Ratings_Sovereign_2015.pdf). Descriptions and definitions of all rating categories can be found within the aforementioned methodology. 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, Trading Economics, World Economic Forum, Doing Business, United Nations, Kyrgyz Stock Exchange (KSE), National Bank of Kyrgyzstan (NBKR), Ministry of Finance of the Kyrgyz Republic, Transparency international.

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 Kyrgyzstan 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

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 Research Reports.

This Report 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.