

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

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.

Rating-Agentur Expert RA GmbH 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:

- Positive investment potential as evidenced by the foreign direct investments inflows to GDP at 6,5% in 2016;
- Low and well covered by the FX reserves short-term debt at 0,95% of GDP and 2,6% of budget revenues in 2016;
- Despite a recent slowdown caused by decreasing remittances and lower trade turnover, real GDP growth is expected to remain favorable at 2,6% and 2,3% in 2016 and 2017 respectively;
- The government's privatization plans remain in place (privatization program for 2015-2017). However, there were no significant privatization actions in 2016.

#### Restricting factors:

- The government debt level remains a concern as Kyrgyzstan's debt to GDP ratio is the highest amongst the regional peers. Even with a significant improvement in debt ratios (around 3p.p. and 22p.p. down to around 62% of GDP and 160% of budget revenues respectively in 2016 according to the IMF) driven by stabilization of KGS in 2016, debt accumulation continued to be a problem, as gross government debt in USD terms has increased by 7,6% y-o-y by May 2017. However, the concessional nature of more than 90% of total debt increases probability of a debt re-structure if needed, whereby reducing the credit risk of the sovereign;
- Quality of the fiscal policy was restrained in 2016 evidenced by lower than expected tax revenues due to VAT exemptions. As a result fiscal deficit expanded up to 4,5% of GDP in 2016. For 2017, the authorities committed to achieve a fiscal deficit of 3%. Nevertheless, we remain skeptic about the tight target, as the estimated fiscal deficit stood at 1% of projected GDP as of May 2017 and additional spending pressures were expected due to the upcoming presidential elections in October 2017. Furthermore, absence of a credible, transparent and enforceable fiscal rule limits certainty over the government's mid and long-term fiscal plans and whereby further restricting the rating;
- Unemployment rate exhibited favorable dynamics in the past six years, however is still rather high at estimated 7,5% in 2016.

#### Negative factors:

- Despite very favorable real GDP growth dynamics, Kyrgyzstan remains one of the least developed countries in the region reflected in GDP per capita in PPP terms estimated at USD 3 520 in 2016;
- The inflation rate started a positive trend in 2017 after two years in a row showing deflation figures. As of June 2017, it stood at 4,1% y-o-y. While current inflation levels were very volatile and generally outside the NBKR's target (5%-7%), the core inflation was inside the target band as of 2016. Despite increasing economic activity and food price stabilization, we consider current oil price volatility one of the main sources of uncertainty on the level of prices in the economy. Furthermore, the effectiveness of the policy transmission mechanism remains subdued given still high levels of dollarization;
- Notwithstanding positive average dynamics, the banking sector remains underdeveloped with bank's asset and volume of private credit to GDP remaining low at 38,9% and 19,3% in 2016 respectively. The banking system continued accumulating additional risk, as non-performing loans reached 8,51% in April 2017. As a result, ROA stayed low but positive from the second half of 2016 onwards and amounted to 0,4% in April 2017. Nevertheless, banks managed to maintain satisfactory capitalization levels with net total capital at 24,6% of risk-weighted assets as of April 2017;
- Very limited competitiveness of the economy. The country imports most of its products (trade deficit of 31,8% of GDP in 2016) and has a competitiveness index of 3,75 from the WEF in 2016 which ranks 111th out of 138 countries, one of the lowest among its regional peers.

#### Stress factors:

- Substantial dependence on third countries, as well as on international organizations to finance operations and receive financial aid and remittances (moderately weak stress-factor);
- Despite the recent decrease, dollarization continued to be a problem representing 50,9% of total deposits and 42,8% of total loans in 2016 (weak stress-factor).

#### ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

##### Positive factors:

- Very good performance of the stock market index (KSE) growing by around 27% y-o-y in June 2017.

##### Restricting factors:

- Interest rate spread stayed moderately high through 2016 and reached 6,7% 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 (75th out of 180). At the same time, the country has a long history of cooperation with international organizations, which helped to maintain transparency of the government reporting at acceptable levels.

#### Negative factors:

- Real interest rate remains high and has been volatile in the past years;
- Stock and bond exchange market remains underdeveloped with a very low total market capitalization of listed companies (total market capitalization of listed companies is only 3,3% of GDP), low turnover, high concentration of trade on the biggest issuers (ten largest equity issuers account for about 85,4% of the amount of annual trading in 2016) and a narrow variety of products;

## SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Further recovery of the biggest regional partners which would reduce external pressures and help to push real GDP growth;
- Gradual reduction of dollarization levels combined with the maintenance of price and exchange rate stability.

The following developments could lead to a downgrade:

- Uncontrolled fiscal deficit expansion coupled with subsequent government debt accumulation above sustainable levels;
- Further risk accumulation in the banking sector.

“The SGC and CCE ratings of Kyrgyzstan remain constrained by low economic and institutional development, inconsistent fiscal results, as well as limited ability of National Bank of Kyrgyz Republic (NBKR) to sustain price stability.

The absence of a fiscal rule coupled with the continued increase in FX denominated government debt levels, seizing a significant portion of yearly budget expenditure, alongside persistent uncertainty in the stability of the exchange rate, may pose a significant risk in the long-run. However, this risk is currently mitigated by the high amount of concessional debt.

Successful implementation of de-dollarization policies, as well as the new Banking Law strengthens the credit environment. Moreover, advancing recovery of the trading partners, higher remittance inflow and trade turnover will stimulate economic growth.” – 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\\_21.07.2017.pdf](https://raexpert.eu/reports/Research_report_Kyrgyzstan_21.07.2017.pdf)

Next scheduled rating publication: TBD in December 2017.

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](mailto:info@raexpert.eu)  
[www.raexpert.eu](http://www.raexpert.eu)

**RATING HISTORY:**

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
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 19 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](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.