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

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. 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:

- Total short term debt including principal and interest amount is around 8,5% of total debt in 2019 and is well covered by FX reserves and budget revenues - 6x and 7x in 2019 respectively;

- The economy continues its growth with 3,8% in 2019 and estimated path of 3,4% for 2020. The current growth observed in all economy sectors, with the highest input from mineral resource extraction activity.

Restricting factors:

- Estimated annual inflation for 2019 is around 4%, slightly lower than mid-term target rate of 5-7% and at least three times higher than a year before. Moderate inflation environment allowed NBKR to maintain the key policy rate at 4,25% during 2019. Further monetary expansion and National Bank' rates cuts are considerate for 2020. Nevertheless, interest corridor continues to be wide constraining monetary policy transmission mechanism;

- Financial indicators of the banking system slightly deteriorated as ROA and ROE indicators annually decreased by 0,3p.p. and 2,7p.p. respectively as of October 2019, due to the reduced interest rate income and growing operating costs (7% increase y-o-y in October 2019). Asset quality also continues to decline as share of non-performing loans reached 8,4% (0,8p.p. annual increase) and amount of loans classified as doubtful doubled. On the other hand capitalization level remained satisfactory with the ratio of total capital to total assets at 17,2% as of October 2019;

- Ongoing reform regarding special economic zone tax regulation and overall economic stability were able to attract investments, as net inflows from foreign direct investment in 2019 is expected to be near 5% of GDP (annual increase of 4p.p.) However, high level of corruption and moderately low level of institutional development continue to constrain investment environment;

- Overall indebtedness of the government in 2019 remained high at 56% of GDP and we expect a similar figure for the next year. The credit risk is partially balanced by long maturities and consensual nature of the debt. However, the external debt is concentrated in terms of creditors – 45,4% of total external debt belongs to Export-Import Bank of China as of April 2019;

- Despite the fact that the final number of fiscal deficit for 2019 will be around 2,7%, 1,1p.p. higher than initially planned by the Ministry of Finance, we consider slight loosening of the fiscal policy as adequate to maintain social and living standards. For 2020-2021, we anticipate general government fiscal deficit not to exceed 3 percent of GDP. Nevertheless, risks of revenue concentration (around 7% of all tax revenues came from Kumtor mine

operation), national currency fluctuations and lower remittances from abroad remain;

- Official unemployment rate in 2019 is around 7%, creating a barrier for poverty reduction, especially among younger population;

- According to the World Bank Doing Business Report 2019, Kyrgyz Republic was ranked 70th out of 190 countries (7 places up from 2018 edition). The largest improvement was noted in new civil procedure code and strengthening of creditor's rights. Nevertheless, high corruption perceptions, unresolved tensions on the border with the neighboring countries, complex tax regulation continue to constrain business development.

Negative factors:

- Kyrgyzstan continues to be one of the poorest country in the Central Asia region[1] with estimated GDP per capita in PPP terms at around USD 4,1 th for 2019. We anticipate similar to the previous year real GDP growth at 3,8% for 2019. The main driver of the growth remains mining industry, particularly operations of the gold production in the largest mine of the country Kumtor, maintains economy concentration risk on one mineral resource[2];

- Despite the National Bank of the Kyrgyz Republic (NBKR) efforts, the cost of lending continues to be very high, constraining corporate financing. The average weighted interest rate in local currency reached 19% in 3Q 2019, and despite overall volume of newly issued loans in KGS increased by 20% y-o-y as of October 2019, the growth is fully attributed to consumer loans. We expect total banks' assets to GDP ratio to be around 43% at the end of 2019;

- In the Global Competitiveness Index 4.0 issued in 2019, Kyrgyz Republic was ranked 96th out of 141 countries (1 place up from 2018 edition) due to the low scores in innovation capability and limited local market opportunities. Overall balance of payment remains negative in 2019 (USD 46 m), as country imports most of required textile, machines and energy products;

- National stock exchange is highly concentrated and provides few products for investors to trade. Total market capitalization of companies listed on the Kyrgyz Stock Exchange (KSE) remains below 5% of GDP in December 2019.

Stress factors:

- Economy is highly dependent on third countries in export market and remittance inflows. In 2019 more than 98% of cross-border payments coming from Russia due to the easing access of the labor force from Kyrgyzstan and 57% of all export goes to Great Britain (moderately weak stress-factor);

- Financial dollarization in Kyrgyz Republic shows encouraging dynamics, but remains high: as of October 2019 35,7% of total loans and 42% of total deposits were denominated in foreign currency (very weak stress-factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Further significant decline of external government debt;

- Continued improvement of the country`s fiscal stance and trade balance;

- Continued improvement of the banking system performance.

The following developments could lead to a downgrade:

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[1] GDP per capita in PPP terms of USD estimated by IMF for 2019: Kazakhstan – 28849, Tajikistan – 3589, Turkmenistan – 20411 and Uzbekistan - 8.999.

[2]The Kumtor mine-life has been extended only to 2023 based on exploration research in 2012. Source: Kumtor Gold info https://www.kumtor.kg/en/about/faq/production/ . Current exploration results to be updated.

- A slowdown of economy growth, further concentration in mineral resource industry;
- Deterioration of banking system soundness indicators.

"The confirmation of SGC ratings of Kyrgyzstan at 'B' level with a stable outlook reflects the stabilization of macro indicators, recovered fiscal position and adequate monetary policy of the Central Bank aimed to encourage credit growth. Additionally, improved government transparency and incentives available in special economic zones permitted Kyrgyzstan slightly to recover external position and attract foreign investments.

Nevertheless, significant government indebtedness, high level of poverty, heavy dependence on the mining industry and main trading partners continue to restrict the country's creditworthiness and make Kyrgyzstan's economy vulnerable to external shocks," – Olena Kolokolova, Rating Analyst of Rating-Agentur Expert RA.

Research report on Kyrgyzstan is available at:

https://raexpert.eu/reports/Research_report_Kyrgyzstan_27.12.2019.pdf

Next scheduled rating publication: 26 June 2020. The full sovereign rating calendar can be found at Sovereign Rating Calendar 2020

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
28.06.2019	Scheduled revision of both types of ratings for the country	B	B	Stable	Stable
04.01.2019	Scheduled revision of both types of ratings for the country	B	B	Stable	Stable
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 Kyrgystan was held on 20 December 2019. 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 April 2019). Descriptions and definitions of all rating categories can be found 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.

The definition of default can be found on the Agency's website in the section for Internal policies.

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.

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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.

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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.