

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

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- Low and well covered short-term debt in May 2016 at 1,08% of GDP and 2,84% of budget revenues;
- Inflation rate dropped to 3,4% in 2015 and to 1,5% y-o-y in June 2016 from 10,5% in 2014, mainly as a response to the KGS appreciation and lower price of imported goods;
- Fiscal deficit narrowed by 4,7p.p. over the past six years and by 1,9p.p. since 2014 down to 1,2% in 2015;
- The Kyrgyz government has recently submitted a proposal for a new privatization program for 2015-2017 listing the companies to be privatized as well as those where the government will sell a part of interest. In 2015 the Dzherui Gold Mine was sold to Russian investors.

Restricting factors:

- The Kyrgyz government heavily relies on external debt to finance big infrastructure projects (mainly maintenance). The new legislation allowing to review the public external debt to GDP threshold level (currently 60%) on an annual basis could reduce certainty around the government's mid- and long-term fiscal plans;
- Investment potential is growing, though it remains low as evidenced by the national savings to GDP ratio of 14,2% in 2015;
- Relatively high unemployment rate at 8,5% by February 2016.

Negative factors:

- The banking system's risks increased since our last review. Banks' assets to GDP were as low as 41%, the volume of private credit to GDP is subdued at 19% in 2015 and average ROA turned negative (-0,2%) in 1Q 2016. NPLs have increased to 7,1% of total loans in 2015 from 4,5% in the previous year and as of May 2016 NPLs already constituted 8,8% of total loans. Nonetheless, banks improved their capitalization posting a 16,3% capital to assets ratio by May 2016;
- The latest 2015 IMF data showed government debt load well above its regional peers¹ at 66% of GDP and 173,4% of budget revenues. Both metrics have been growing constantly

¹ Peers include Kazakhstan, Tajikistan, Turkmenistan and Uzbekistan.

for the past three years. Nevertheless, the debt is mostly concessional;

- The yield on the 5Y government bond has increased around 2p.p. from November 2015 (17,6%) to May 2016 (19,7%). This reflects the growing cost of financing for the government and an increased value of the long-term risk from the investor's perspective;
- Real GDP grew at 3,5% rate in 2015; however, GDP per capita in PPP at USD 3 400 in 2015 remains low and behind its peers;
- The price stability objective of the monetary policy is not always met. The inflation rate is very volatile and mostly determined by the exchange-rate pass-through due to high imports (87,7% of GDP in 2014) and high dollarization levels (63,3% and 46,9% of total deposits and loans respectively in June 2016) which, alongside an underdeveloped interbank market, also has a negative effect on the effectiveness of the policy transmission mechanism;
- Very limited competitiveness of the economy. The country imports most of its products (trade deficit of 31,5% of GDP in 2015) and has a competitiveness index of 3,83 from the WEF in 2015 which ranks 102nd out of 140 countries, one of the lowest among its regional peers.

Stress factors:

- Substantial dependence on Russia, China and International Organizations to finance operations and receive financial aid and remittances (weak stress-factor);
- Despite the recent decrease in the level of dollarization, it continues to be a downside risk for the economy (weak stress-factor).

ADDITIONAL FACTORS THAT INFLUENCED CCE RATINGS:

Negative factors:

- Very high and volatile levels of real interest rate (12,9% in 2014 and 21,6% in 2015);
- Undeveloped stock and bond exchange markets with a small amount of listed companies (25 as of July 2016), low turnover, high concentration of trades on the biggest issuers (the 10 largest issuers accounted for about 90,34% of the amount of annual trading in 2015) and a narrow variety of products.

Restricting factors:

- Rather high interest rate spread around 7,1% by November 2015;
- Substantial level of corruption (Transparency International reports a CPI index of 28 in 2015) and low level of trust in government (37% of the population in 2015 according to the Human Development Report);
- Kyrgyz Bankruptcy Department Reports 357 companies are at pre-bankruptcy stage in March 2016.

Positive factors:

- Solid performance of the stock market index (KSE) showing an accumulated return of 32% during 2013-2015 and more than 20% since the start of the year.

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Successful implementation of de-dollarization policies, which would bring the share of loans and deposits in foreign currency to a sustainable level;
- Enhancing stability in the exchange rate that, given the pass-through to inflation, would also stabilize prices volatility;
- Reduction of the government debt burden combined with more transparent fiscal policies.

The following developments could lead to a downgrade:

- Continuing slowdown of the economy combined with increasing indebtedness in the economy and accumulating risks in the banking sector.

“The SGC ratings of Kyrgyzstan continue to be constrained by the low competitiveness of the economy, high volatility of inflation and exchange rate, as well as strong dependence on external financial aid.

The increasing level of government debt continues to be a negative factor, however it does not represent an imminent risk, as it mainly consists of external long-term concessional loans. Real GDP growth is expected to slow down in 2016 mainly due to the weak RUB, reduced trading activity and decline in gold production.

High and volatile real interest rates, increasing NPLs and narrowing capital to assets ratio combined with the losses in the underdeveloped banking sector contributed to our decision to downgrade Kyrgyzstan’s CCE ratings.” – 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 Analyst of Rating-Agentur Expert RA GmbH

Research report on Kyrgyzstan is available at:

http://raexpert.eu/reports/Research_report_Kyrgyzstan_29.07.2016.pdf

Next scheduled rating publication: TBD in December 2016.

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RATING HISTORY:

Date	Review reason	SGC		CCE	
		National currency	Foreign currency	National currency	Foreign currency
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 26 July 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/Methodology-Short-Sovereign.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, 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, 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.

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 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.