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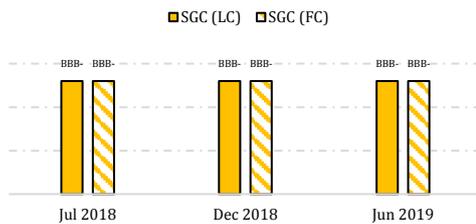
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Ratings

Sovereign Government Credit (LC)	BBB-
Sovereign Government Credit (FC)	BBB-
Outlook (LC)	Stable
Outlook (FC)	Stable

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Kazakhstan

Macro indicators	2016	2017	2018
Gross gov. debt, KZT bn	9 243	10 805	12 862
Nominal GDP, KZT bn	46 971	53 101	58 786
Real GDP growth, %	1,1	4,1	4,1
Gross gov. debt/GDP, %	19,7	20,3	21,9
Deficit (surplus)/GDP, %	-5,3	-4,4	0,5
Inflation rate, %	8,5	7,1	5,3
Current Account Balance/GDP, %	-6,5	-3,3	0,6
External debt, USD bn	-	-	158,8*
Development indicators		2018	
Inequality adj. HDI		0,75	
GDP per capita, USD th		27,7	
Default indicator		13.06.2019	
5-Year CDS spread, Bp		68	
5Y Gov EuroBonds Yield, %		2,85	

Source: RAEX-Europe calculations based on data from the IMF, Chonds, Ministry of Finance of the Republic of Kazakhstan and NBK.

* Figure for 1Q 2019

¹ Kashagan, Karachaganak and Tengiz oil fields.

Summary

The current confirmation of Kazakhstan's rating at 'BBB-' with a stable outlook reflects the current positive trends in the national economy, improvement of the fiscal stance and sustainable macro indicators. The stable GDP growth, robust external position, positive fiscal balance, reasonable levels of inflation and adequate debt position are among the factors supporting the creditworthiness of the sovereign.

Despite the recovery processes and the current improvements in a number of indicators, the continuing stagnation of the banking sector has an inhibiting effect on the development of the economy. The presence of hidden problems with the quality of loan portfolios may lead to the possible materialization of contingent liabilities. The high dependence on the oil sector remains a significant risk as the volatility of prices and demand in the global commodity markets can lead to imbalances in the economy. Among the factors, which put rating under pressure, is the dependence of monetary authorities on the political influence.

In our view, the political power transition process so far does not pose significant credit risks, however the Agency will keep monitoring political developments in Kazakhstan within the next credit rating review cycle.

Economic growth is stable. In 2018, the Kazakh economy maintained the pace set a year earlier and, as a result, showed a strong real GDP growth of 4,1% (see graph 1). While in the first half of the year the economy was driven by a favorable price situation in the oil markets and manufacturing output growth, in the second half of the year, the main contribution to GDP was from the steering up of consumer demand in response to an increase in household lending.

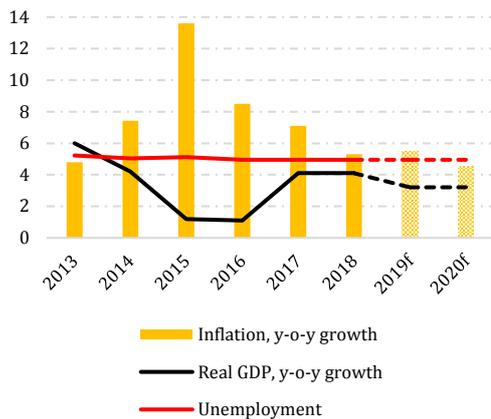
We anticipate a stable, but more moderate economic growth in 2019 at around 3,2% due to a decline in oil production, caused by scheduled maintenance work at the country's major oil fields¹. Additional uncertainty arises from increasing commodities price volatility on the world markets, as well as the future political direction of the country. The stability of economic growth is expected to be supported by the further increase in consumer demand as a result of real wages and consumer lending growth.

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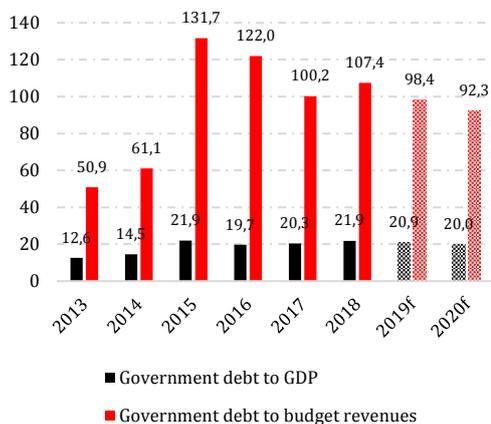
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Graph 1: Macroeconomic indicators, %



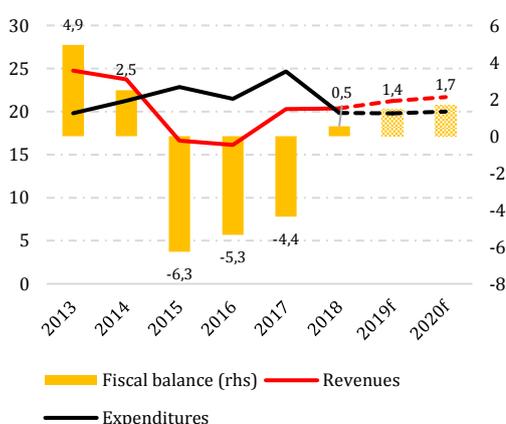
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Government debt dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF

Graph 3: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF

The government debt position remains at acceptable levels. At the end of 2018, the gross government debt increased slightly to 22% of GDP and 107% of budget revenues (see graph 2). The main reasons for the increase of the debt burden were the financing of the budget deficit and the weakening of the national currency. Furthermore, there were changes in the structure of debt by maturity, namely, the short-term debt has grown more than 3x mostly due to scheduled government loans payable within the year. Nonetheless, the current debt stance of the state remains below risky levels.

The Central Bank still pursues a neutral monetary policy. At the end of 2018, inflation stood at 5,3%, which is an acceptable level within the target range of 5%-6% set by the National Bank of Kazakhstan (NBK). After actively reducing the rates in the first half of the year, the NBK adjusted the base rate by 25 basis points upwards in 4Q 2018, anticipating the negative effects of KZT depreciation and consumer prices growth. However, as a result of lower inflation expectations, the NBK authorities lowered the base rate by 25b.p. down to 9% back in April 2019.

We expect the annual inflation in 2019 will be around 5,5% within the targeted corridor 4%-6%, supported by lower inflation expectations and a slowdown in inflation in the countries - major trading partners. On the other hand, inflationary pressure will persist influenced by the revival of domestic demand against the background of rising real incomes and increase of budget expenditures for social purposes.

However, the policy effectiveness is still constrained by weaknesses of the financial market as well as the Central Bank's exposure to political influence.

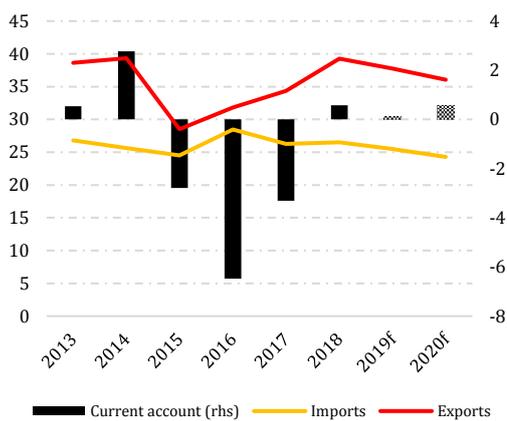
Improvement in the fiscal stance. After three years of sharp fiscal deficits, the budget stance improved to a slight surplus of 0,5% of GDP in 2018 (see graph 3), mainly caused by the favorable price conjuncture in the commodities markets and a reduction in the government's significant injections to the banking sector. Despite the improvement, non-oil deficit remained quite wide at 6,1% in 2018 reflecting the still high dependence of the economy on the hydrocarbon sector.

We positively estimate budget revenues in 2019, which are expected to be supported by a stable extracting industry and higher than expected oil prices, an increase in VAT revenues inflows and developing of the non-oil sources of income. As for expenses, the authorities declare a conservative policy, although additional costs are not excluded to support the economy and social sectors in order to boost domestic demand. In general, we anticipate the budget surplus will prevail and will reach a level of around 1,4% of GDP in 2019.

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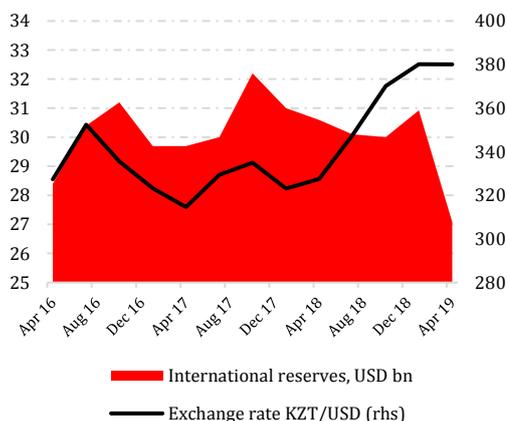
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Graph 4: External sector indicators, % of GDP



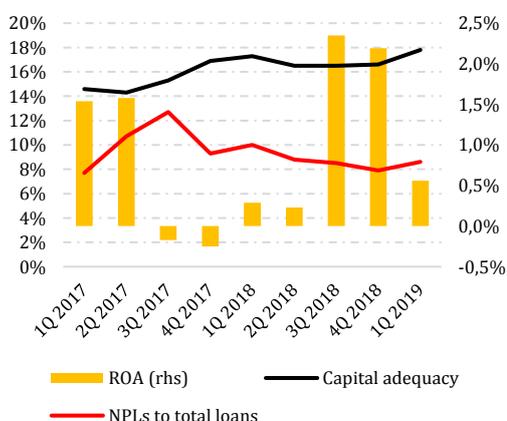
Source: RAEX-Europe calculations based on data from the IMF and NBK

Graph 5: International reserves and exchange rates



Source: RAEX-Europe calculations based on data from the NBK

Graph 6: Financial soundness indicators, %



Source: RAEX-Europe calculations based on data from the WB and NBK

The external position recovered due to exports. As a consequence of a considerable increase in exports of mineral products, Kazakhstan has significantly improved its external position, which is reflected in the current account surplus of 0,6% of GDP in 2018 compared to a deficit of 3,3% in 2017 and a strengthening of the trade surplus to 13% in 2018 (see graph 4).

In 2018, Kazakhstan's international reserves gradually declined under the influence of KZT depreciation, dropping to USD 27,1 bn as of 1Q 2019. Nevertheless, their levels are above the IMF's recommended reserve adequacy ratio for countries with a floating exchange rate, covering almost 81% of the gross government debt and more than 8 months of imports of goods and services (see graph 5).

Continued stagnation of the banking sector. Stagnation in the banking sector of Kazakhstan remained in 2018, accompanied by structural changes: the number of banks decreased to 28, caused by the revocation of licenses from three troubled banks and the merger of large players: Halyk bank and Kazkommertsbank. Subsequently, the concentration increased as the three largest banks accumulate 50,5% of all total assets of the sector. Furthermore, the total banks' assets to GDP shrank by almost 3p.p. to 42,9% of GDP as of the end of 2018, affected by the decline in corporate lending, write-off of problem assets and the redemption of Tsesnabank's non-performing loans.

After a serious cleaning of the banking sector from toxic assets, the officially declared level of NPLs continued to decline and was fixed at 8,6% as of the 1Q 2019, while the loan loss provisions at the end of 2018 accounted for 13% of the total loans and cover the amount of NPLs by 1,75x (see graph 6). However, we believe that the real quality of the loan portfolio of banks is much lower and has a potential for deterioration, which slows down the process of recovery of the banking system and revival of the corporate lending. Some positive signals were received from the improvement of profitability and the level of capitalization. In 2018, the banking system reached a positive ROA of 2,61% and the capital adequacy ratio fortified its position to 16,6%. However, the recent profitability's record was caused mainly by the receipt of concessional funds from the NBK and significant reduction of the provisioning expenses. Besides, liquidity metrics have also been improving as liquid assets to short-term liabilities increased by 20p.p. y-o-y as of 1Q 2019, though the excess liquidity has a non-depositary nature and is the result of financial injections from the state.

We do not anticipate a significant improvement in the banking sector in 2019, which strains the development of the country's economy. The main drivers of growth will be lending to the retail sector with predominant

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consumer lending. The level of dollarization of funding sources remains quite high at the 47% of total clients deposits, and acceleration of KZT deposits' inflow will depend on the stability of the exchange rate and further real income growth.

The lack of progress in the development of capital markets continues to be a factor negatively affecting the credit rating. The current weaknesses of the stock market are expressed in the low market capitalization of companies, which shrank in 2018 to 24,1% of GDP, as well as a high concentration of trading in a handful of companies. Nonetheless, we still anticipate that the development of Astana International Financial Centre (AIFC) could boost the capital markets development.

The political power transition process so far does not pose credit risks. Nursultan Nazarbayev, who had been in power since before Kazakhstan's independence from the Soviet Union in 1991, unexpectedly resigned in March 2019, and appointed the 66-year-old diplomat Kassym-Jomart Tokayev as an acting president. The June 2019 elections official results showed more than 70% votes in favor of Tokayev, but it was coupled by the critics from the international organizations and protests in the large cities.

The former president Nazarbayev kept his position of chairman of the Security Council of Kazakhstan and the Nur Otan political party. Together with the Tokayev's announcement of "continuity of the country's development strategy" and gradual changes in the structural of central and regional authorities, this partly mitigates the risks of political turbulence and elite conflicts in the mid-run, despite mentioned protests. However, the Agency will keep on watch the political power transition process developments within the next credit rating review cycle.

Important note for sovereign ratings

This Research Report shall be treated as a supplementary part of the published Press Release included in the following link:

https://raexpert.eu/reports/Press_release_Kazakhstan_14.06.2019.pdf

Both documents shall be treated as essential parts of each other.

For further information on the factors, their weights, methodologies, risks and limitations of these ratings, and other regulatory disclosures, please refer to the Press Release and the website of the Agency.

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