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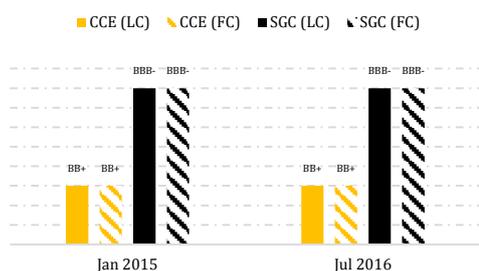
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Ratings

Sovereign Government Credit (LC)	BBB-
Sovereign Government Credit (FC)	BBB-
Country Credit Environment (LC)	BB+
Country Credit Environment (FC)	BB+

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Kazakhstan

Macro indicators	2013	2014	2015
Gross gov. debt, KZT bn	4537	5752	8946
Nominal GDP, KZT bn	35275	39041	40761
Real GDP growth, %	6,0	4,3	1,2
Gross gov. debt/GDP, %	12,9	14,7	21,9
Deficit (surplus)/GDP, %	5,0	1,8	-5,0
Inflation rate, %	4,8	7,4	13,5
Current Account Balance/GDP, %	-	-	-4
External debt, USD bn	-	-	153,5
Development indicators	2015		
Inequality adj. HDI	0,69		
GDP per capita, USD th	24,3		
Default indicator	22.07.2016		
5-Year CDS spread, Bp	218		
10Y Gov Bond Yield, %	7,1		

Source: RAEX (Europe) calculations based on data from the IMF, CIA, Deutsche Bank, Trading Economics, Ministry of Finance of the Republic of Kazakhstan

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Summary

Kazakhstan's ratings reflect the still low, well-structured and diversified government debt, acceptable amount of fiscal buffers contained in the National Fund of the Republic of Kazakhstan (NFRK) and improving monetary stabilization. However, the overall worsened position of the economy as a result of low current and expected hydrocarbon prices has negatively affected the ratings.

Furthermore, real GDP has deteriorated, inflationary pressures are still latent, the external position lost strength and the financial system remains weak. Additionally, the prospects for the following years are not encouraging due to the current projections of oil prices combined with a non-diverse Kazakh economy.

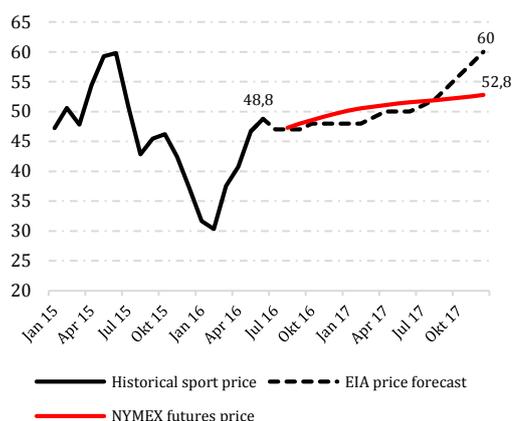
Economic activity remains weak. In the period from 2010 to 2014, Kazakhstan grew at an average 6% rate. This pace declined steeply in 2015 when it grew by only 1,2%. The hard hit on the economy in recent years has been a result of lower commodity prices combined with the worldwide and, especially, regional economic slowdown. Reported GDP figures for 1Q 2016 were as expected by the agency at the beginning of the year. Real GDP contracted by 0,2% due to a decline in oil prices and mining output, as well as lower overall domestic demand.

GDP growth expectations for the current year continue to be dismal given the ongoing recession in Russia and the lethargic recovery in commodities' prices. According to the U.S. Energy Information Administration (EIA) forecast, oil prices are expected to recover marginally towards the end of the year to around USD 48 per barrel, in line with current futures prices. However, we consider these projections cautiously as the spot and futures prices remain extremely volatile (see graph 1).

Debt remains low and well-structured despite rising. Revised IMF data for 2015 indicated a very steep increase in gross government debt to budget revenues (131,7% as compared to 103,5% in their previous estimate) as revenues were lower than anticipated.

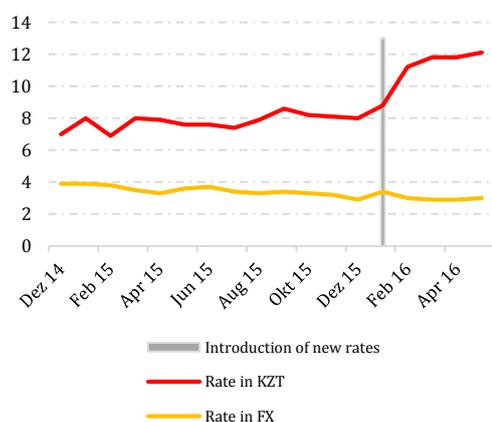
Government debt to GDP stood at 21,9%, an important increase of 7,2p.p. over 2014 due to the Eurobond issuance, as mentioned in our previous review. Even though the government debt load escalated further as a

Graph 1: Spot, future and forecast oil price, USD/b



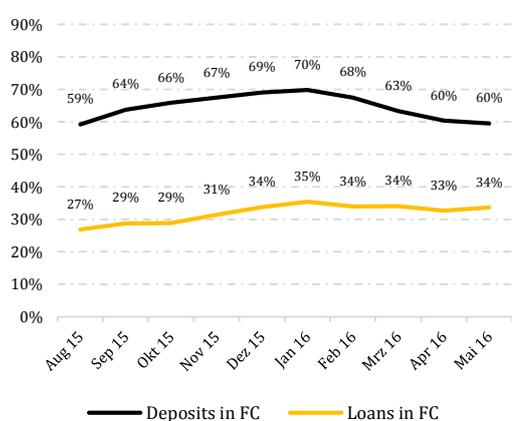
Source: RAEX (Europe) calculations based on data from the EIA

Graph 2: Deposit rates of the banking system, %



Source: RAEX (Europe) calculations based on data from the NBK

Graph 3: Dollarization levels, % of total



Source: RAEX (Europe) calculations based on data from the NBK

result of an increase in Central Bank's debt (from KZT 291 bn in 2015 to KZT 1 378 bn in 1H 2016), overall debt remains low.

The government's obligations also remain well-structured. While 49,5% of government debt is external (47% of which is concessional), domestic debt is mostly medium- and long-term debt. Short-term debt is external and as low as 0,4% of total debt and well covered by FX reserves.

Inflationary risks in place despite recent stabilization policies. The newly introduced inflation-targeted monetary policy and the decision to free-float the exchange rate regime a year ago have provided stability to the KZT after a period of volatility. The interventions from the National Bank of Kazakhstan (NBK) have lessened and monetary policy communication is a lot clearer than before. Furthermore, increased confidence in the KZT and high interest rates for KZT deposits (a combination of the de-dollarization plan introduced in February 2016¹ (see graph 2) and a high policy rate in the beginning of the year) have, for the past six months, decreased deposits in FX from 69% to 60% and kept FX loans practically unchanged (see graph 3).

Accumulated inflation in the current year is around 4% and inflation expectations are low and, according to the NBK, inflation is set to be around the target at year-end. This ease in perceived inflationary pressures has driven the NBK to lower interest rates from 17% to 15% in March 2016 and to 13% in July 2016 in order to contain banking sector risks (e.g. a rise in NPLs) as well as to support economic growth. Nonetheless, the steep downward move of the base rate may reignite inflationary pressures towards the second half of the year.

In addition, the transmission mechanism remains ineffective due to the still high levels of dollarization, the underdeveloped money market and financial system and the country dependence on imports.

The financial system remains weak. Credit to the economy continues to be marginal due to slow economic growth. Bank assets to GDP were 58,3% and private credit to GDP stood at 44,9% in 2015; both have decreased further in the current year (by around 2 p.p. and 3 p.p. y-o-y respectively by 1Q 2016), especially retail loans. Besides depressed private credit growth, withdrawal of liquidity from the system has continued; both factors sustain the idea that banks in Kazakhstan still prefer to leave deposits in the NBK over new issuance of loans.

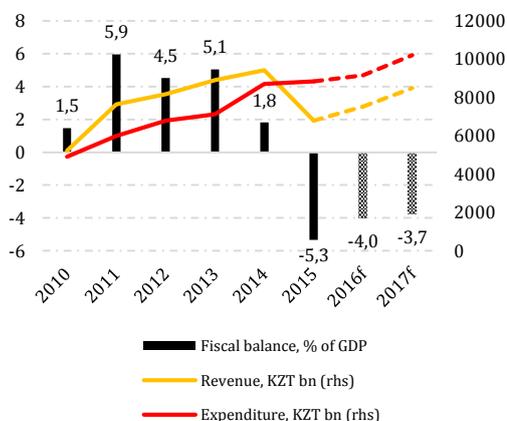
The end of 2015 and the beginning of 2016 were characterized by a liquidity crisis in the system which skyrocketed money market rates. NPLs to total loans declined to 12,4% in 2015 mainly due to the transfer of

¹ In our previous research report (http://raexpert.eu/reports/Research_report_Kazakhstan_29.01.2016.pdf) we mentioned that "The NBK has introduced policies in order to de-dollarize the economy. One of the efforts by the NBK to achieve this is the increase on the KZT deposit rate ceiling from 10% to 14% and the reduction of the FX deposit rate from 3% to 2% starting in February 2016."

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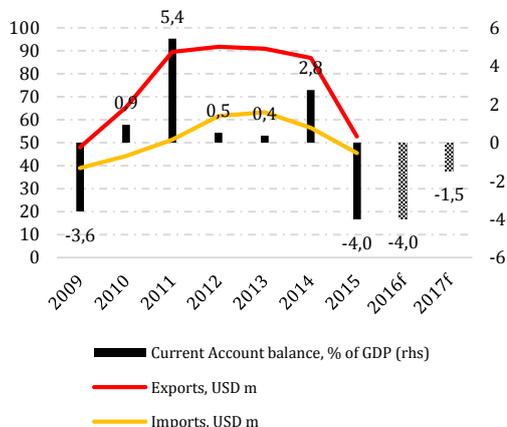
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Graph 4: Fiscal budget dynamics



Source: RAEX (Europe) calculations based on data from the IMF

Graph 5: Current Account dynamics



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

assets from Kazkommerstbank to BTA Bank and dismissal of legal barriers to transfer these assets to SPVs; however, this number is expected to rise by end-2016.

As mentioned before, de-dollarization started around February 2016 due to a more stable KZT and, as a result of the government's de-dollarization measures, high spreads between interest rates in USD and KZT. Nevertheless, dollarization levels remain high and, thus, still pose a risk to the banking system.

Fiscal policy affected by low oil prices. The fiscal budget presented a deficit of 5,0% of GDP in 2015, a huge turnaround when compared with the 1,8% surplus from a year ago and it is expected to narrow marginally at year-end (see graph 4). The deficit was caused by a decrease in revenues (mainly tax receipts) of more than 25% and a 1,5% increase in expenses.

Fiscal revenues remain heavily hydrocarbon-dependent (oil revenues make around 60% of the budget) and oil prices have already taken a toll on the budget balance. We expect a further decline of the National Fund of the Republic of Kazakhstan's (NFRK) assets due to continued budget transfers. In our view, countercyclical fiscal policy is likely to continue offsetting weak investment and domestic demand through 2016.

External position is deteriorating. Due to the currency depreciation, and a small increase in liabilities (without the exchange rate effect), total private sector external debt went up to 130% of GDP in 2015 from 59% of GDP in 2014; however, it remained fairly stable in 1Q 2016. As mentioned before, 49,5% of government debt is external but, at the same time, 47% are concessional loans and 51% is from an Eurobond issuance which attracted a well response from investors.

The current account balance showed its first negative figure since the aftermath of the 2008 financial crisis; it stood at -4% of GDP, according to statistics from the NBK. Depressed oil prices caused exports to shrink by 42% from 2014 to 2015 and this trend is expected to continue in the next years as a result of a marginal recovery in oil prices (see graph 5) (as mentioned in the first section of this report).

International reserves are stable at USD 28,8 bn by May 2016. However, the widely used currency swaps with commercial banks will soon need to be repaid and might affect the level of reserves in the mid-term.

On the positive side, the WTO accession last year may provide an economic boost and provide opportunities to diversify away from the hydrocarbon dependence. While, at the same time, bring tensions among the countries who belong to the so far inefficient EEU.

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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:

http://www.raexpert.eu/reports/Press_release_Kazakhstan_22.07.2016.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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