Research Report on Kyrgyzstan

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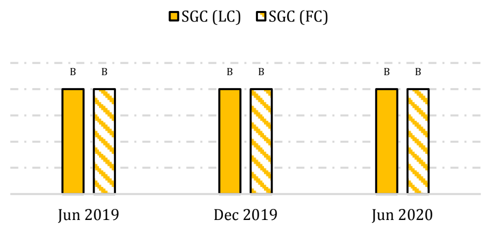
Ratings

Sovereign Government Credit (LC)	B
Sovereign Government Credit (FC)	B
Outlook (LC)	Negative
Outlook (FC)	Negative

* These ratings are unsolicited

Ratings dynamics



Main Economic Indicators of Kyrgyzstan

Macro indicators	2017	2018	2019
Gross gov. debt, KGS bn	312	312	319
Nominal GDP, KGS bn	530	569	590
Real GDP growth, %	4,7	3,5	4,5
Gross gov. debt/GDP, %	58,8	54,8	54,1
Deficit (surplus)/GDP, %	-4,6	-0,6	-0,1
Inflation rate, %	3,7	0,5	3,1
Current Account Balance/GDP, %	-	-	-9,1
External debt, USD bn	-	-	3,8

Development indicators	2019
Inequality adj. HDI	0,61
GDP per capita, USD th	4,1

Source: RAEX-Europe calculations based on data from the IMF, WB, Ministry of Finance of the Kyrgyz Republic and NBKR.

Summary

We have confirmed the credit ratings of Kyrgyzstan at ‘B’; however, the outlook was changed from stable to negative. The adjustment in the outlook is mainly a result of the adverse consequences in the economy, public finances and external stance derived from the coronavirus crisis. We anticipate that, due to the pandemic, the economy will contract in 2020, government debt will substantially increase, the fiscal balance will widen significantly and the balance of payments will deteriorate.

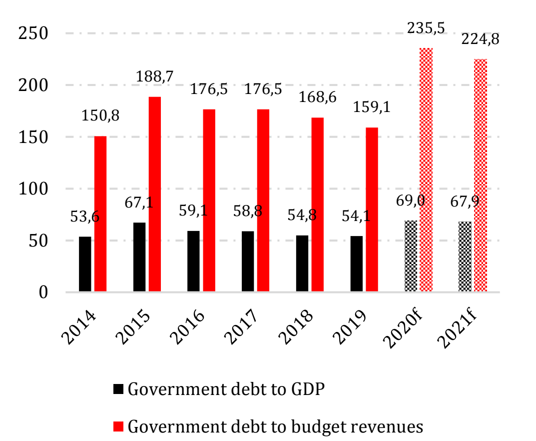
However, we also consider that the country has the ability to receive enough support from international institutions and other donors, which would aid to mitigate the crisis. Moreover, in our view, the improvement in the quality of the monetary policy and the actions taken by the Central Bank will also fare positively against the pandemic.

Government debt to increase substantially to cover anti-pandemic measures. The level of government debt remained high, but stabilized in 2019 posting figures of 54,1% of GDP and 159,1% of budget revenues, both readings showed a slight decline as compared to 2018. However, the metrics are set to hike significantly as the government increase spending on measures against COVID-19, which are estimated to represent around 8% to 9% of GDP, while nominal GDP is set to decline. Thus, the debt to GDP ratio for 2020 is expected to be around 69% (see graph 1). However, around 4% of this increase is due to the IMF, as the international organism has recently lent Kyrgyzstan USD 242 m. Also, the ADB approved a package of USD 50 m for the pandemic relief.

Despite the increase, the structure of the debt is mostly acceptable. Around 85% of the overall debt is owed to bilateral and multilateral lenders at favorable conditions. Nonetheless, there is concentration of the external debt, as 46% of it is owed to the Export-Import Bank of China. On the positive side, China recently announced that it has suspended debt repayments for 77 developing countries, including Kyrgyzstan, as part of the G-20 debt deal to alleviate poor countries.

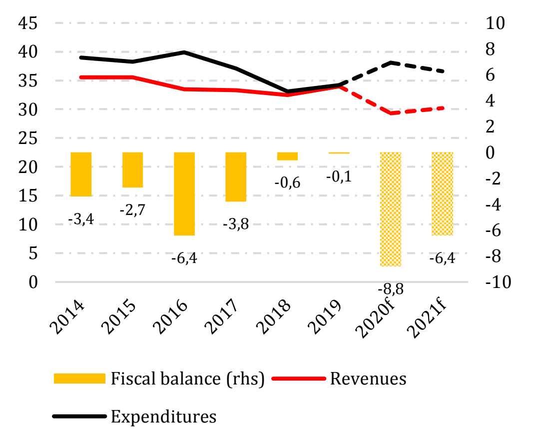
Furthermore, the Ministry of Finance latest reported figure for 2019 showed that short-term securities represented around 1,3% of total debt and 8% of domestic debt. This remained well-covered by 5x by

Graph 1: Government debt dynamics, %



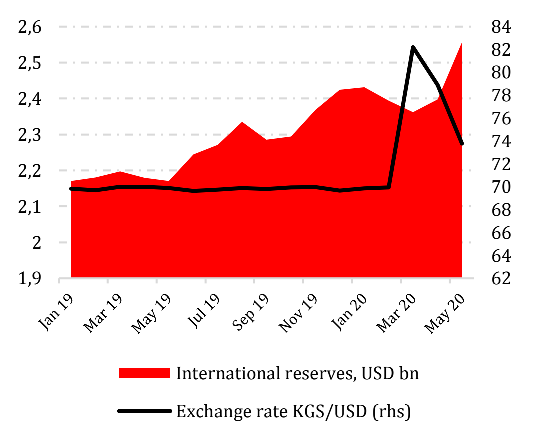
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Fiscal budget dynamics, % of GDP



Source: RAEX-Europe calculations based on data from the IMF and the Ministry of Finance of Kyrgyz Republic

Graph 3: International reserves and exchange rate



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

international reserves. Moreover, as of 4M 2020 the share of short-term securities in domestic debt declined to 3,4%.

Fiscal deficit to widen further as the government increases spending to mitigate the effect of the crisis. The budget performance improved in 2019 recording a deficit of 0,1%, a decline of around 0,5p.p. as compared to 2018 (see graph 2). Despite this, the current pandemic has already taken a toll on public finances as the tax collection has declined substantially due to the lockdown restrictions, while the government has increased expenditures in order to mitigate the negative shocks from the crisis. These factors have combined for the government budget to post a deficit of KGS -10,5 bn as of 4M 2020.

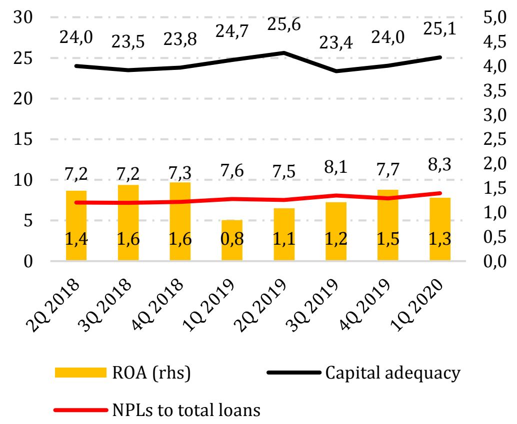
The measures adopted by the government in order to cushion the blow of the pandemic on the economy include delaying tax payments, temporary price controls on food, as well as exemptions of property and land taxes, tax exemptions for SMEs, food security programs in order to aid the more vulnerable groups and subsidized loans to the banking sector in order for these to provide funding to SMEs at favorable interest rates.

The implementation of such plan will be reflected in a substantial widening of the deficit to around 8%-9% of GDP in 2020 (see graph 2). In order to execute this, we believe it is key that the government is able to find donor support, while not compromising its debt repayment ability.

Monetary policy expected to adapt to inflationary expectations as the crisis develops. By the end of 2019, the inflation rate posted a modest figure of 3,1% remaining still well below the National Bank of the Kyrgyz Republic (NBKR) target of 5%-7%. However, inflation has already elevated substantially recoding a reading of 7,2% y-o-y as of May 2020 due to higher utilities and food prices as the exchange rate pass through of the KGS depreciation has been felt. In order to curve the pressure on the KGS, the NBKR has already sold USD 217 m in international reserves, a substantial amount when taking into account that in the whole last year, interventions accounted for around USD 145 m (see graph 3). In addition, due to these persistent inflationary pressures resulting from the pandemic affections, the NBRK increased the reference rate up to 5% back in February. Moreover, the boundaries of the interest rate corridor were narrowed in order to increase predictability of the direction of the monetary policy, a positive step towards increased efficiency and credibility of the policy.

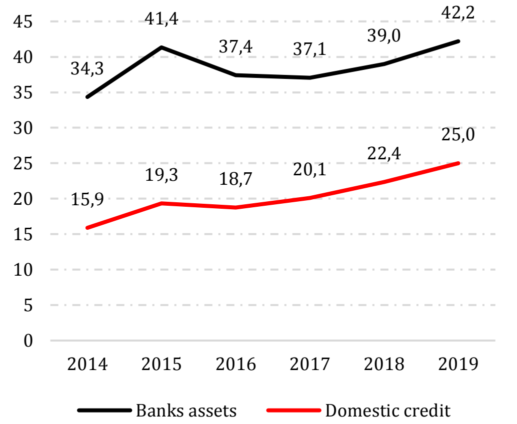
We anticipate the CPI index to rise further up to around 12% y-o-y by the end of 2020 mainly resulting from the currency depreciation, as well as

Graph 4: Financial soundness indicators, %



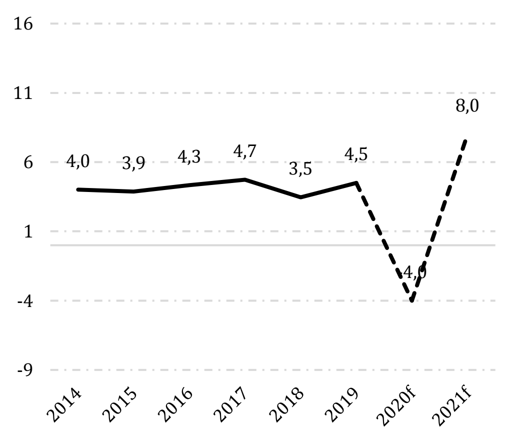
Source: RAEX-Europe calculations based on data from the IMF and NBKR

Graph 5: Credit to the economy dynamics, % of GDP



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

Graph 6: Real GDP growth, %



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

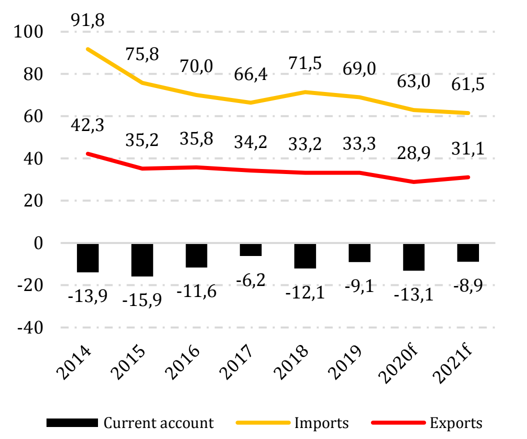
further fiscal stimulus, while the effectiveness of the monetary policy remains limited due to the high dollarization levels.

The banking sector set to deteriorate, but measures are in place to cushion the blow. In 2019, the banking sector's main soundness indicators remained fairly stable but have already shown deterioration in 2020 as a result of the negative effect from the coronavirus crisis. By end-2019, ROA posted a figure of 1,5%, the capital adequacy ratio was 24% and the NPLs to total loans ratio stood at 7,7% (see graph 4). Even though these figures remained quite stable in 4M 2020, we expect the sector's capitalization, profitability and asset quality to worsen going forward. However, the NBRK has already announced that it will defer the execution of different regulations in order to give the banks leeway to operate. Moreover, the regulator also lowered the minimum liquidity ratio, reduced mandatory reserve requirements and relaxed some weights for capital adequacy calculation, as well as loosened the classification of NPLs. It is expected that these measures will provide breathing room for the banking sector and will propel credit in order to spur economic growth.

Credit to the economy has steadily increased for the past four years but remains low. We estimate domestic credit to have stood at around 25% of GDP and banks assets at 42% of GDP in 2019 (see graph 5). In addition, we continue to observe higher credit growth in non-productive sectors of the economy, which contributes to hamper the development of the economy. As of April 2020, the highest level of growth was attributed to mortgages, which hiked by 23% y-o-y, followed by consumer loans which grew by 17%; while industry loans climbed by 11%, agricultural credit by 6% and trade loans by 7%. Finally, financial dollarization remains high: as of April 2020, 36% of total loans and 43% of total deposits were denominated in foreign currency.

The economy to contract substantially as a result of the coronavirus crisis. Real GDP hiked by 4,5% y-o-y in 2019 (see graph 6), a strong metric driven, among other factors, by rising gold output from Kumtor. Nevertheless, the economy showed a slowdown to a rate of 1,5% y-o-y as of 1Q 2020 and, by 5M 2020 GDP it had already contracted by up to 4,8% y-o-y due to lower domestic demand, declining remittances, overall weak economic activity and lower trade volumes, especially as a direct consequence of the border closure with China due to the pandemic. We expect the contraction in the economy to exacerbate further and to end the year shrinking at a rate of around 4%. However, the overall performance of the price of gold in international markets is expected to continue, which would help to soften the negative impact in the economy. Moreover, the economy remains highly exposed to the external sector, as

Graph 7: External sector indicators, % of GDP



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

export destinations are not diversified, it depends on imported products, as well as remittances inflows, mainly from Russia. In 2019, more than 98% of cross-border payments came from Russia due to the high amount of labor force from Kyrgyzstan and 42% of all export goes to Great Britain. The external sector also remains weak and expected to remain so going forward. By the end of 2019, the trade balance of goods and services stood at -36%, while the current account posted a reading of -9,1%. For 2020, we anticipate the trade deficit to remain quite wide but at similar levels as 2019; however, we expect the current account to widen up to around -13% as a result of the expected drop in remittances (see graph 7).

Kyrgyzstan remains one of the poorest countries in the Central Asia region with an estimated GDP per capita in PPP terms at around USD 4,1 th for 2019. The dependence on the gold output from the Kumtor mine, keeps the Kyrgyz economy concentration risk high. Moreover, the official level of unemployment was around 7% in 2019. This figure will most certainly increase significantly in 2020 as a result of the coronavirus crisis.

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_Kyrgyzstan_26.06.2020.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.