

Rating-Agentur Expert RA confirmed at 'BBB-' the ratings of Kazakhstan. The rating outlook changed from stable to positive.

Rating-Agentur Expert RA confirmed the sovereign government credit rating (SGC) of Kazakhstan at 'BBB-' (Moderately high level of creditworthiness of the government) in national currency and at 'BBB-' (Moderately high level of creditworthiness of the government) in foreign currency. The rating outlook changed from stable to positive which means that in the mid-term perspective there is a high probability of upgrading the rating score.

MAJOR FACTORS THAT INFLUENCED BOTH TYPES OF RATINGS:

Positive factors:

- After posting a substantial surplus of 2,7% of GDP in 2018, we expect the fiscal surplus to shrink down to 0,4% which would mark the first time since 2014 the government's public finances show a positive fiscal balance for two consecutive years. The narrower surplus, however, is mainly driven by higher government expenses in education, social assistance and social security and public health care, which hiked by 18,2%, 25,5% and 10,4% y-o-y respectively as of October 2019; while overall revenues increased by 4% y-o-y as of the same date. In our view, the government will continue to support social spending in the mid-term while, in the long term, it will continue to seek fiscal consolidation. On the other hand, we expect the non-oil fiscal deficit to remain wide at around 6,9%, but we also anticipate the non-oil sector to strengthen translating in higher revenues and, thus, a lower deficit in the long-term perspective. Finally, despite constant transfers from the National Fund of the Republic of Kazakhstan (NFRK) to the budget, the level of the fund has not been depleted since mid-2017 and we expect it to remain stable going forward;
- The economy continues to expand substantially in 2019. As of September 2019, real GDP increased by 4,3% y-o-y mainly propelled non-oil GDP, especially by construction which grew by 14,5% in the same period. Despite a decline in oil production due to maintenance works, it was still solid as most of the main fields hit record highs. We expect economic growth to remain strong, but still threatened by oil price volatility and external conditions. On the positive side, the non-oil sector appears to be developing positively and the presidential transition towards the new President Kassym-Jomart Tokayev, signals a continuation of policies;
- The yield spread between the 10Y German bund and the EUR-denominated Kazakh government bond with maturity in 2028 stood at 1,2p.p. reflecting a good perception of the country's risk by the market;
- We expect gross government debt to GDP and to budget revenues to remain stable in 2019 at around 21% and 99% respectively showing a solid debt position of the government. Moreover, the structure of debt remains mixed. On the one hand, external debt accounts for 46% of total debt. On the other hand, short term debt remains low and covered 24x by international reserves, while 42% of the external debt is in concessional terms;
- As a result of increasing inflation pressures, the National Bank of Kazakhstan (NBK) tightened the monetary policy by increasing the base rate by 25b.p. up to 9,25% back in September 2019. Increased domestic demand and stabilizing inflation expectations within the NBK's target led the central bank to leave the rate unchanged in subsequent meetings. We anticipate the NBK's to continue managing monetary policy pursuing price stability.

However, given the lingering weak financial system and high dollarization, effectiveness and transmission mechanism remain an opportunity for improvement;

- As of October 2019, international reserves stood at USD 28,7 bn, which exceeds the IMF recommended reserve adequacy level for countries with a floating exchange rate. Also, international reserves are around 90,5% of gross government debt and a little more than 7 months of imports of goods and services;
- GDP per capita in PPP terms is expected to reach an all-time high of around USD 28,5 th in 2019 and remain one of the highest among its regional CIS peers¹;
- The unemployment rate has been stable at a level of 5% over the past years and it is expected to remain under control in the perspective of 2019-2020.

Restricting factors:

- Inflation levels remain within the target of the NBK. In 2018, y-o-y CPI index growth stood at 5,3% and we expect the metric to finish 2019 at around 5,6%, showing a fine level of stability and remaining within the NBK threshold;
- As anticipated, the assets in the banking system have continued to shrink in 2019. The banking sector assets to GDP stood at 42,3% in 2018 and we forecast the reading to be around 41% by end-2019, the fourth consecutive year the figure has been in a downward path. Mostly, this trend is a reflection of lower growth of overall credit which, despite the overall decline, have increased in regard to consumer loans which hiked by 23% y-o-y as of September 2019 while corporate loans declined by 6% as of the same date;
- Foreign investment dynamics have declined since 2016, and we anticipate a net inflow of FDI lower than 2% of GDP in 2019;
- According to the Global Competitiveness Index report from 2019, the overall score for Kazakhstan was 63 (55th place from 140), a slight improvement as compared to 2018. The level of competitiveness of the economy is supported by the improvement in macroeconomic stability connected with favorable oil prices. As evidence, by the end of 2019, we expect the external trade surplus to remain, albeit narrower, and the current account deficit to widen up to 2,2% of GDP.

Negative factors:

- Capital markets in Kazakhstan remain undeveloped as shown by the low and declining level of market capitalization, which went from 28% of GDP in 2017 to 21% by the end of 2018 at it has slightly increased up to around 24% by 3Q 2019. Despite this figures, and, as mentioned in our previous review, the development of the capital markets is underway as the Astana International Financial Centre (AIFC) continues to evolve the Kazakh financial market, including the development of Islamic and green finance;
- The ratio of NPLs to total loans spiked in May 2019 at 9,7%, but started to go down from there and posted a figure of 9,1% as of October 2019; however, taking into account the history of hidden bad debt in the system, the real level of NPLs in the banking sector could be higher and we should be wary of officially reported figures. Moreover, profitability of the system remained strong as ROA and ROE stood at 2,2% and 18,2% respectively by the end of September 2019. As of the same date, the banks' level of capitalization has also remained favorable as the capital adequacy ratio was 23,2%. Despite this, after completing asset quality review by year-end, we expect additional support from the authorities in order to support troubled banks. The Liquidity is still quite ample which has produced a problem of excess liquidity in the system as the amount of creditworthy borrowers continues to be low. As a result, the NBK has introduced better measures to manage liquidity in the system;

¹ Estimated GDP per capita in PPP for 2018: Uzbekistan – USD 7 665; Tajikistan – USD 3 416; Turkmenistan – USD 19 527.

- We still consider that the amount of assets as related to the size of the economy is substantially elevated. Moreover, the banking sector still shows signs of weakness. Both these elements combine to pose a high risk of contingent liabilities' materialization. Nonetheless, the level of state-owned companies has been gradually declining as the privatization process has continued despite hitting some bumps in the road in terms of delayed IPOs.

Stress factors:

- Concentration of tax revenues on one industry. Kazakhstan depends heavily on oil revenues, which make up around 41% of the state's budget that is 7,6% of GDP (weak stress factor);
- Although the level of dollarization of the banking system slightly decreased during 2019, both, the share of loans and deposits in foreign currency remained quite high at the end of 3Q 2019: 17,3% and 44,7%, respectively (very weak stress factor).

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Sustaining and further improving the industry non-oil GDP which will result in higher non-oil GDP growth and an improved non-oil fiscal balance;
- Improvement of the general stance of the banking system, especially asset quality.

The following developments could lead to a downgrade:

- A renewed decline in hydrocarbon prices combined with a negative development of the non-oil economy which would cause a deterioration of the country's fiscal stance;
- Further weakening of the banking system which would materialize contingent liabilities of the government.

“The affirmation of our credit ratings of Kazakhstan at ‘BBB-’ with a change in outlook from stable to positive is mainly related with resilient economic growth, especially in the non-oil sector, as well as satisfactory and continuously stable management of public finances. Moreover, the external position remains solid and inflation has remained within the target of the Central Bank.

However, weaknesses in the banking sector continue to present the largest threat to the creditworthiness of the country. The system remains quite fragile with subdued credit growth, high level of concealed NPLs and potentially substantial needs of further capitalization for some banks. This, combined with the still strong footprint of the state in the economy, elevate the risk of materialization of contingent liabilities. Finally, even though the transition to a more balanced economy away from hydrocarbon dependence is on its way, we still consider that it remains highly depend on the oil sector making the economic performance and public finances highly dependent on oil production and prices dynamics.” – Clarified Hector Alvarez, Associate Director of Rating-Agentur Expert RA.

Research report on Kazakhstan is available at:

https://raexpert.eu/reports/Research_report_Kazakhstan_13.12.2019.pdf

Next scheduled rating publication: 12 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
14.06.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
21.12.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
06.07.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
12.01.2018	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
14.07.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
20.01.2017	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
22.07.2016	Scheduled revision of both types of ratings for the country	BBB-	BBB-	NA	NA
29.01.2016	First assignment of both types of ratings for the country	BBB-	BBB-	NA	NA

Minute's summary

The rating committee for Kazakhstan was held on 12 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: National Bank of Kazakhstan, Ministry of Finance of the Republic of Kazakhstan, World Federation of Exchanges, International Monetary Fund, World Bank, Trading Economics, World Economic Forum, Doing Business, United Nations, Kazakhstan Stock Exchange (KASE), Cbonds, publications in the media.

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.

Risk warning

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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.

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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.