Research Report on Kazakhstan

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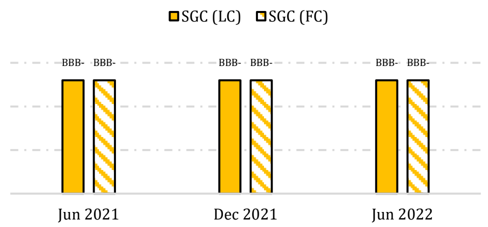
Ratings

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	2019	2020	2021
Gross gov. debt, KZT bn	13867	18621	21072
Nominal GDP, KZT bn	69533	70649	81269
Real GDP growth, %	4,5	-2,6	4,0
Gross gov. debt/GDP, %	19,9	26,4	25,9
Deficit (surplus)/GDP, %	-0,6	-7,0	-4,1
Inflation rate, %	5,4	7,5	8,4
Current Account Balance/GDP, %	-4,0	-3,8	-3,0
External debt, USD bn	156,8	163,4	165,1

Development indicators	2021
Inequality adj. HDI	0,77*
GDP per capita, USD th	28,4

Default indicator	10.06.2021
Gov Bond Yield, %	3,65**

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

RAEX-Europe confirmed at 'BBB-' the credit ratings of Kazakhstan. The rating outlook is stable.

RAEX-Europe confirmed the sovereign government credit ratings (SGCs) 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 is stable which means that in the mid-term perspective there is a high probability of maintaining the rating score.

Summary

The confirmation of Kazakhstan's sovereign ratings at 'BBB-' with a stable outlook reflects the economic recovery from the consequences of COVID-19 pandemic, substantial external buffers, improving fiscal balance and low levels of government debt.

On the negative side, the spillover effects of the war in Ukraine are creating macroeconomic destabilization with rising inflationary pressures and causing significant uncertainty about economic growth. In addition, the dependence on the oil sector remains high, which makes economic indicators and public finances highly dependent on the dynamics of oil production and prices.

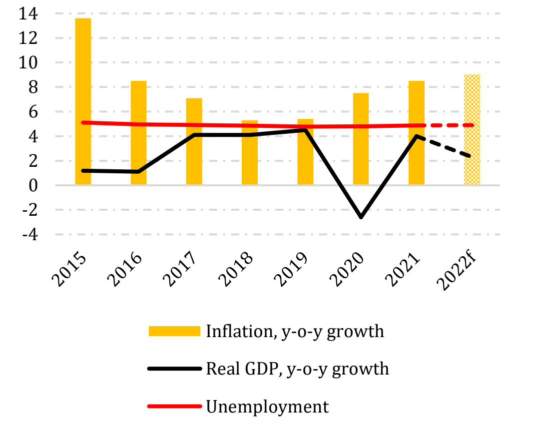
Economic growth is constrained by geopolitical risks. After a moderate downturn in 2020, the economy recovered in 2021 with real GDP growth of 4%, supported by favorable oil prices, continued fiscal stimulus, booming consumer and housing lending and the easing of restrictive COVID-19 measures. The key driver was the real sector of economy, while the services sector also performed positively, with the main contribution from IT and communication, trade and construction. The labor market stayed resilient, and the unemployment rate remained below 5%.

The social tension that escalated in the country at the beginning of the year and the accident at the CPC[1] pipeline did not have a significant impact on the economy and GDP growth amounted to 4,4% at the end of the 1Q 2022. This growth was supported by rising global commodity prices, as well as the absence of new COVID-19 restrictions. Further growth in consumer lending continues to stimulate domestic demand.

[1] Caspian Pipeline Consortium

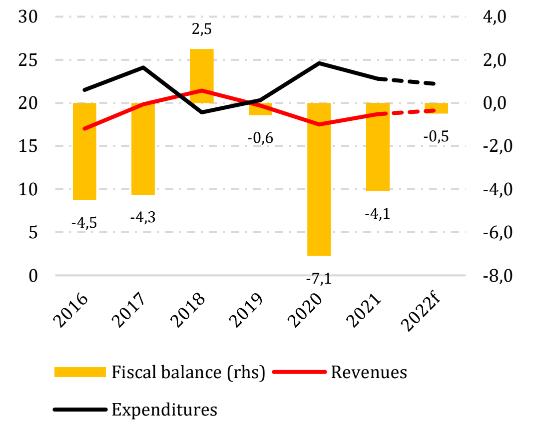
* as of 2020; ** Maturity in 2028 (ISIN: XS1901718335)

Graph 1: Macroeconomic indicators, %



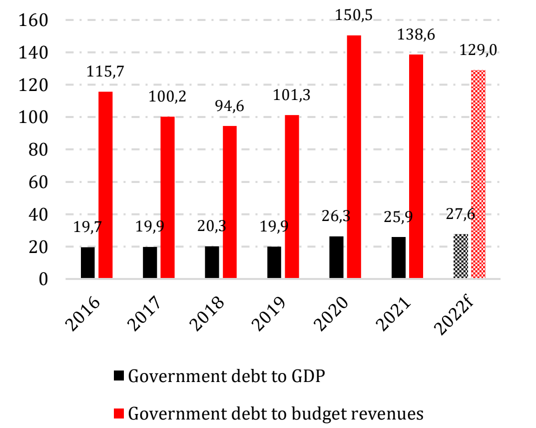
Source: RAEX-Europe calculations based on data from the IMF

Graph 2: Fiscal budget dynamics, % of GDP



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

Graph 3: Government debt dynamics, %



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

Nevertheless, we expect economic growth to slow down and not exceed 2,3% in 2022 due to the spillover effects from the war in Ukraine and regulatory measures to curb inflationary pressures and exchange rate volatility. Sanctions against Russia may have an impact since it is an important trade partner and investor; in addition, most of Kazakhstan's oil exports transit through Russia.

The January protests, accompanied by violence and attempts to destabilize the country, signaled the need to accelerate reforms to improve living standards in Kazakhstan. Public sector reforms were suspended in 2021, but authorities remain committed to structural reforms aimed at transitioning to a low-carbon economy, improving competitiveness, labor market reform, private sector development and digitalization.

Strong fiscal position and low level of government debt. In 2020 and 2021, the government actively supported the population and businesses to combat COVID-19 (anti-crisis package for health care, support to vulnerable households, tax exemptions, subsidized credit and government guarantees). The sharp increase in budget expenditures was reflected in the budget deficit in 2020 and 2021 of 7% and 4,1% respectively, which have been financed through the national oil fund (NFRK), debt issuance, and loans from international financial institutions.

In 2022, new stimulus measures were announced to mitigate the spillover effects from the sanctions on Russia, including a support program (compensation) for KZT deposits estimated at about 0,4% of GDP. The main current task for the government remains the reduction of the non-oil deficit, which amounted to 9,4% of GDP in 2021. In this regard, the authorities plan to improve tax administration and introduce measures to broaden the tax base, including raising tax rates and introducing a progressive income tax. The Agency expects that with higher oil revenues and lower non-oil deficits, the government be on track to achieve general government deficit of 1-2% by the end 2022, helping to maintain external buffers and ensure sustainability of the government debt.

With the increase in borrowings on the domestic market, related to significant social budget expenditures for the pandemic period in 2020-2021, the level of public debt grew to 25,9% of GDP and 138,6% of budget revenues as of end 2021. Domestic borrowing grew at the fastest rate (16% growth for 2021). As a result, the share of internal debt in the structure of government debt reached 60,5%, whereas the share of concessional obligations was 16% and the share of Eurobonds - 23%.

The level of short-term debt remains acceptable at around 0,4% in 2022 and the Kazakh government is not dependent on the capital market for debt repayment and has a substantial liquidity cushion in the form of international reserves and NFRK assets. Currency risk of the government debt is assessed as moderate with the share of FX denominated debt of around 42%.

Significant contingent liabilities risks remain relevant for Kazakhstan's fiscal position, as the share of the public sector in the economy is still high. Moreover, in 2020-2021 the authorities suspended the implementation of privatization plan with the goal to reduce the share of the state in the economy to 14% by 2025.

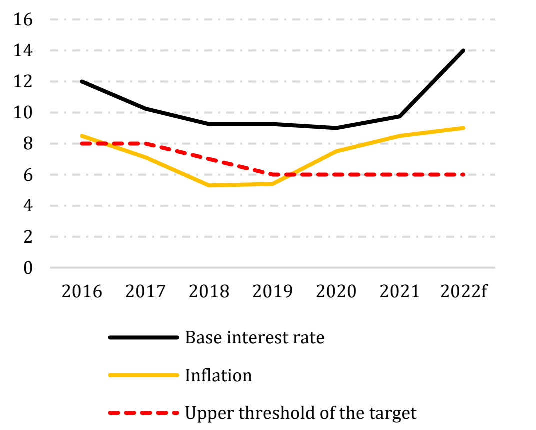
Tightening of monetary policy due to the rising inflation. After reaching the annual inflation of 8,5% in 2021, pressure continues to intensify under the impact of geopolitical risks caused by the war in Ukraine, growth of world commodity and food prices. In February-March, the KZT exchange rate weakened sharply due to the situation in Russia, which affected import prices. In May 2022 the annual inflation rate continued to accelerate, rising to 14% well above the NBK's 4-6% target band. The largest contribution to annual inflation continues to come from rising food prices.

In order to curb inflation and devaluation pressure on the KZT, the National Bank of Kazakhstan (NBK) continued to tighten the monetary policy. This year the prime rate was increased three times by the total of 425 b.p. from 9,75% to 14%. In response to the sharply increased volatility in the foreign exchange market, the NBK conducted currency interventions. In addition, the authorities decided to impose a moratorium on regulated utilities and energy prices.

The authorities may continue to tighten monetary policy if macroeconomic conditions deteriorate further. However, due to the high level of dollarization of the economy and underdeveloped financial markets, the effectiveness of monetary transmission mechanism remains low. Given the current inflation risks, we do not expect inflation to return within the NBK's target corridor this year. Monetary conditions are expected to normalize as inflation slows down in 2023.

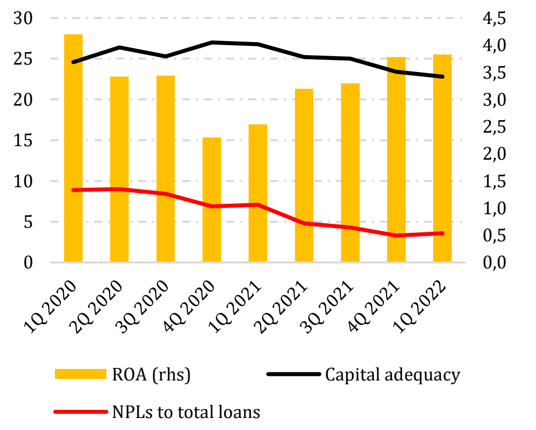
The banking system demonstrates growth and resilience. Prudential easing measures introduced by the National Bank of Kazakhstan in 2020 were suspended by the end of 2021. Thanks to them, the banking sector has weathered the crisis relatively well, with strong positions in profitability, liquidity and capitalization. Assets in the banking sector grew by 20,7% in 2021, reaching 46,3% of GDP. The share of NPLs in 2021 continued to decline, dropping to 3,3% at the beginning of 2022. This was achieved mainly by increasing lending and the growth of the loan portfolio by 27,9% in 2021. The loans to individuals, mainly retail mortgages and consumer loans, increased by 40,9%. We assess the risks from fast-growing consumer lending as moderate and expected that the pace of lending will slow down due to the gradual winding down of the current support programs and the tightening of monetary policy.

Graph 4: Base interest rate vs inflation rate, %



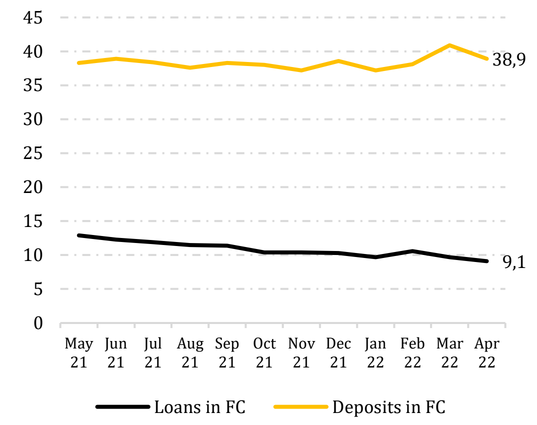
Source: RAEX-Europe calculations based on data from the NBK

Graph 5: Financial soundness indicators, %



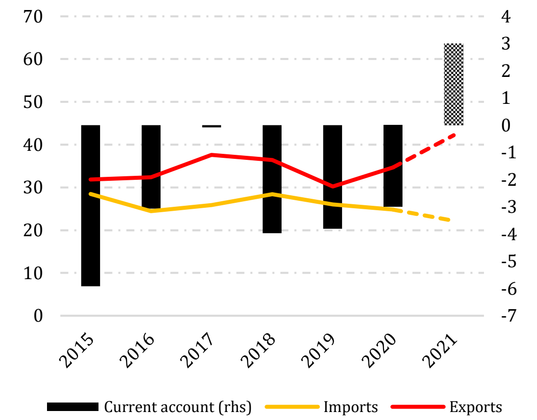
Source: RAEX-Europe calculations based on data from the NBK

Graph 6: Financial dollarization, %



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

Graph 7: External sector indicators, % of GDP



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

Profitability ratios ROA and ROE improved to 3,8% and 31,3% as of 1Q2022, respectively. The sector's capital adequacy ratio remains high, but with a gradual downward trend (22,8% as of March 2022 in comparison with 26,8% as of March 2022). The liquidity position of the banking system remains strong, despite some outflow of deposits, which was observed after the introduction of sanctions against Russian banks, the share of which was about 15% of total assets at the beginning of 2022. Moderate dollarization of the banking system persists, with the share of foreign currency deposits of 38,9% as of March 2022. At the same time, we highlight the risk of concentration in the banking sector: the share of the top-5 banks in loans was 72,8% , and their assets' share in total bank's assets was almost 65% as of April 2022.

Strong buffer reserves allow Kazakhstan to absorb external shocks. A mix of strong buffer reserves and a favorable trade balance supports Kazakhstan's external position. The current account deficit narrowed to 3% of GDP in 2021, down from 3,7% in 2020. Due to rising global oil prices, the trade surplus has doubled. Goods exports increased by 27,5%, compared to a moderate 7,1% increase in imports. The current account is expected to be supported by favorable commodity prices, but there are potential risks to exports due to the indirect impact of sanctions on Russia.

The assets of the NFRK, although actively used to cover the budget deficit, remain strong at USD 53,8 bn, equivalent to 28,3% of GDP as of May 2022. Gross international reserves continue to decline as they are used to smooth the KZT volatility, but their level also remains sizeable at USD 32,8bn as of May 2022, exceeding the IMF recommended reserve adequacy level for floating exchange rate countries. International reserves are equivalent to 67% of gross government debt and cover about 9 months of goods and services imports, which supports our rating assessment.

Stress factors:

- Concentration of tax revenues on one industry remains high. Kazakhstan depends heavily on oil industry export and oil tax revenues, which make up around 40% of the state's budget and 8% of GDP (weak stress-factor);

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Effective implementation of structural reforms to diversify the economy to reduce the concentration on the commodity sector and the share of the government in the economy;
- Further accumulation of fiscal and external buffers;
- Accelerated development of financial markets and the banking system while reducing the level of financial dollarization, which will increase the effectiveness of the monetary policy.

The following developments could lead to a downgrade:

- Intensification of the impact of the spillover effects of the war in Ukraine on macroeconomic stability with a further increase in inflationary pressures, volatility on the foreign exchange market and capital outflows.
- Substantial deterioration of economic activity and fiscal stance which will have a direct impact on public finances and external buffers;

- Substantial deterioration of the stance of the banking system with a sharp growth of NPLs levels and a drop of profitability and capitalization metrics, which can lead to the materialization of contingent liabilities for the government.

ESG Disclosure:

Inherent factors

- Quality of fiscal policy; quality of monetary policy; natural resources; natural and climatic threats; environmental threats; level of corruption, CPI; Government Effectiveness Index; quality of the business environment; position in Doing Business Ranking; level of investment in human capital, adjusted for inequality; Rule of Law Index; transparency of government policymaking Index; level of information transparency of the government; Political Stability and Absence of Violence/Terrorism Index; natural disasters, constant exposure to difficult natural conditions.

Drivers of change factors

- None.

Next scheduled rating publication: 9 December 2022**.** The full sovereign rating calendar can be found at Sovereign Rating Calendar 2022

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
10.12.2021	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
11.06.2021	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
11.12.2020	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
12.06.2020	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Stable	Stable
13.12.2019	Scheduled revision of both types of ratings for the country	BBB-	BBB-	Positive	Positive
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 10 June 2022. 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 2022). 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.

ESG Disclosure

We consider Environmental, Social, and Governance (ESG) risks and opportunities in the creditworthiness analysis of our Sovereign entities. The disclosure document can be found on the Agency's website in the section: ESG factors in RAEX-Europe's Credit Ratings

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.

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Office responsible for preparing the rating

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