Research Report on Kazakhstan

10 December 2021

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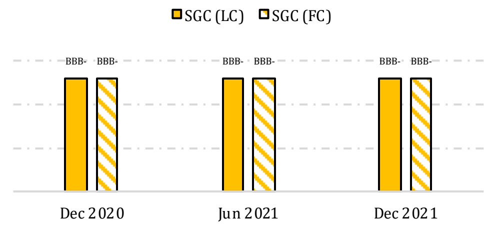
Ratings

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	2018	2019	2020
Gross gov. debt, KZT bn	12524	13867	18621
Nominal GDP, KZT bn	61820	69533	70714
Real GDP growth, %	4,1	4,5	-2,6
Gross gov. debt/GDP, %	20,3	19,9	26,3
Deficit (surplus)/GDP, %	2,6	-0,6	-7,0
Inflation rate, %	5,3	5,4	7,5
Current Account Balance/GDP, %	-0,1	-4,0	-3,6
External debt, USD bn	-	156,8	163,4

Development indicators	2020
Inequality adj. HDI	0,77
GDP per capita, USD th	26,6

Default indicator	10.12.2021
10Y Gov Bond Yield, %	0,99*

Source: RAEX-Europe calculations based on data from the IMF, WB, Cbonds, Ministry of Finance of the Republic of Kazakhstan and NBK.
* Maturity in 2028 (ISIN: XS1901718335)

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

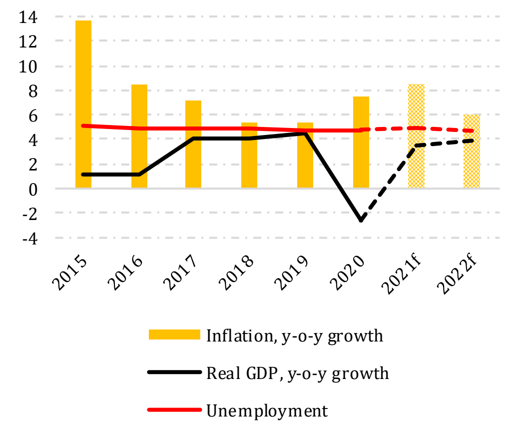
The affirmation of Kazakhstan's sovereign ratings at 'BBB-' with a stable outlook reflects the current recovery in economic growth, improving of banking sector soundness indicator, and low levels of government debt. Kazakhstan's strong external position, supported by accumulated reserves, enhances the resilience to external shocks and supports the budget.

On the other hand, dependence on the oil sector remains high, which makes economic indicators and public finances highly dependent on the dynamics of oil production and prices. The ratings are constrained by elevated inflation, while the effectiveness of the monetary policy is limited by high levels of dollarization and underdeveloped financial markets. In addition, the still significant share of the state in the economy increases the risk of contingent liabilities materialization.

Stabilization of economic growth in the medium term. After a moderate 2,6% contraction in 2020, economic activity is picking up this year after easing pandemic restrictions. During the first 9 months of 2021, GDP growth reached 3,5%. In addition to the recovery in services and goods production, the construction sector continues to grow at an accelerated rate of nearly 10%, facilitated by the stimulation of the housing market through the implementation of the government program "Nurly Zher" and the withdrawal of pension savings of the population to purchase housing.

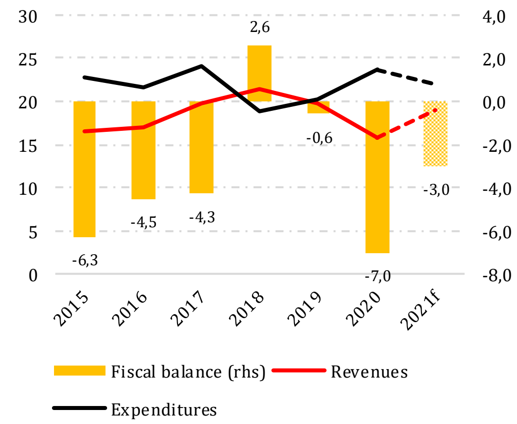
We expect GDP growth to remain at 3,5% in 2021 and around 4% in 2022-2023, supported in the medium term by stronger oil prices and production oil volumes with a planned expansion at the Tengiz field. The main current risks to economic growth are possible lockdowns in case of new COVID-19 waves; moreover, less than 50% of the population is currently fully vaccinated.

Graph 1: Macroeconomic indicators, %



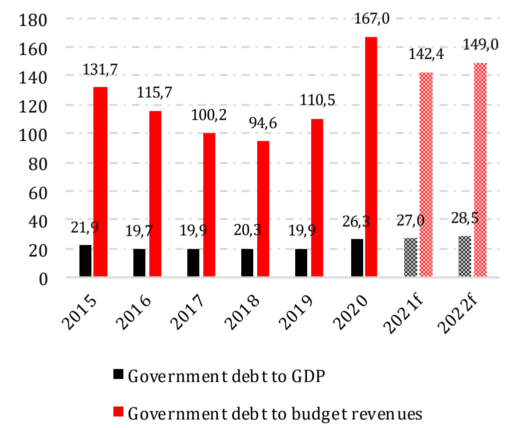
Source: RAEX-Europe calculations based on data from the IMF

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

In the long term, sustainable economic growth will largely depend on the implementation of planned reforms for the transition to a low-carbon economy, approved in October 2021 10 national projects covering the social sphere, agribusiness, digitalization, and green technology. In addition, an important basis for long-term stability is the reduction of the role of the public sector in the economy through privatization and continued reforms to combat corruption and increase the transparency of public institutions.

The COVID-19 pandemic has increased the risks of fiscal stability. Considerable government spending to finance COVID-19 measures (anti-crisis package for social and health care), combined with reduced oil revenues, resulted in a consolidated budget deficit of 7% in 2020. As a result, the current rules on the deficit and non-oil deficit and the debt load were violated.

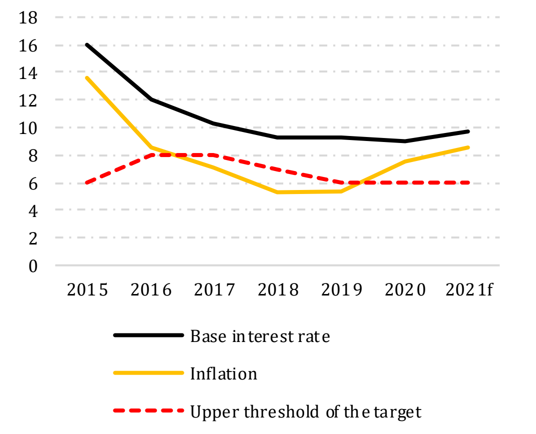
This year, fiscal consolidation is slowed by still higher government spending on health care, public utilities, and transportation (in the revised 2021 budget), as well as lower revenues, whose growth is constrained by a large number of tax breaks and a high level of the shadow economy (around 25% of GDP). In addition, revenues remain dependent on oil revenues (the share of oil revenues in the structure of state budget revenues in 2020 reached 45%). As a result, we also anticipate a deficit of the consolidated budget in 2021 due to the slower than expected consolidation. The non-oil deficit of the government budget in 2020 and 2021 has exceeded and is expected to exceed 10% of GDP, which is a negative factor and reduces the long-term sustainability of public finances. The budget deficit will be covered by transfers from the NFRK and borrowings on the domestic market.

Significant contingent liabilities risks remain for Kazakhstan's fiscal position, as the share of the public sector in the economy remains high. We are positive about the government's plans to continue privatization after a pause in 2020 and reduce the share of the state in the economy to 14% by 2025.

Moderate growth in the level of government debt does not heighten the risks for the government. With the increase in borrowings on the domestic market to cover the budget deficit, the level of gross government debt has grown to 26,3% of GDP and 126,4% of budget revenues. In 2021, the tendency of growth of the government debt and expenditures for its servicing continued. For the first 9 months of 2021, the Ministry of Finance raised KTZ 1827,6 bn in domestic bonds and external borrowings (2,6% of GDP for 2021) and we expect the government debt to be at the level of 25-27% of GDP in 2022-2023.

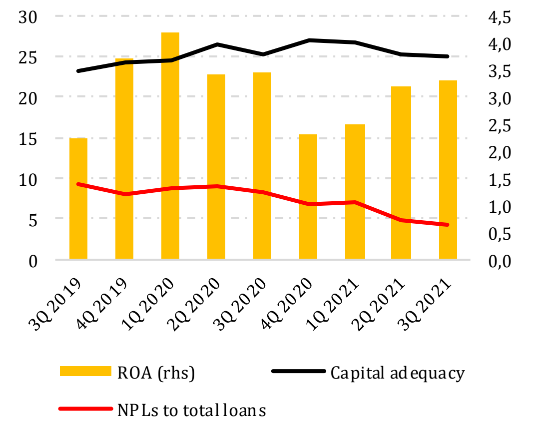
As a result, the share of domestic debt in the structure of government and government guaranteed debt was 57%, the share of concession liabilities

Graph 4: Base interest rate vs inflation rate, %



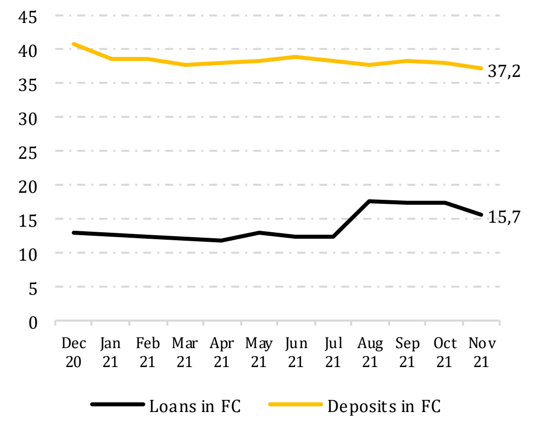
Source: RAEX-Europe calculations based on data from the NBK

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

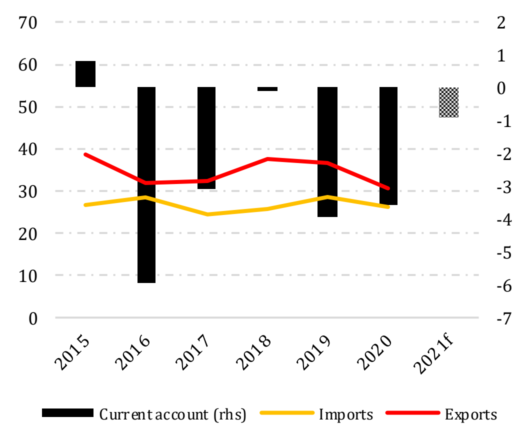
- 16%, and external bonds – 22,7%. The level of short-term debt remains at acceptable levels of around 0,7% of GDP, which is well covered by international reserves – almost 30x by September 2021. Around 41% of government debt is denominated in foreign currency. The implied perception of the sovereign risk by international market participants is relatively low as the yield spread between the 10Y German bund and the EUR-denominated Kazakh government bond with maturity in 2028 remains at adequate levels of 1,6 p.p.

The National Bank conducts an adaptive monetary policy due to increased inflationary pressures. Annual inflation in November 2021 surged to 8,7% due to the effect of pro-inflationary factors, reaching a record figure for the last 4,5 years. Acceleration is observed in all components with the main contribution of rising food prices. Under these conditions, the National Bank continues to adjust the monetary policy in order to be within the 4-6% corridor in 2022, having increased three times since July 2021 the prime rate by a total of 0,75 p.p. up to 9,75%. The effectiveness of the monetary policy is limited by high level of dollarization of the economy, underdeveloped financial markets, and the existence of subsidized lending.

Given the acceleration of inflation in key trading partners, rising minimum wages, and further recovery of consumer demand, as well as the still low efficiency of monetary policy, we expect annual inflation to be in the range of 8.5% in 2021.

We observe an improvement in the key soundness indicators of the banking sector over the course of 2021. Banks continued to rebuild buffer reserves, with the share NPLs falling significantly from 8,1% to 4,1% in October 2021 year-on-year. The improvement in credit quality is largely due to the build-up of new retail loans by banks due to incentives such as government infrastructure programs and the partial withdrawal of pension savings. However, we consider that this, in turn, could create credit risks for banks if the pace of lending continues to accelerate and the real estate market overheats. At the same time, we observe a reduction of currency risks for the banking system, as the dollarization of deposits has been gradually decreasing during the last four years and amounted to 37,2% in October 2021.

The sector's capital adequacy ratio remains strong at 24.8%, and profitability ratios ROA and ROE were improved to 3,1% and 24,9% ROA and ROE, respectively, as of October 2021. The pandemic-related easing of regulatory requirements for bank liquidity and capital ratios is scheduled for gradual phase-out by the end of 2021. At the same time, we highlight the risk of concentration in the banking sector: the share of the top-5 banks in revenues was 78,6% in 11 M 2021, and their assets' share in total bank's assets was almost 66% as of October 2021.



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

A strong external position supports creditworthiness. After current account deficits of 4% and 3,7% to GDP in 2019 and 2020, respectively, the Agency expects the current account deficit to narrow to 0,9% in 2021, driven primarily by rising oil prices. The trade surplus increased by 76% in the first nine months of 2021 year-on-year due to favorable growth of export revenues, while imports remained almost the same.

Kazakhstan's ability to absorb external shocks is supported by solid reserves: NFRC assets and international reserves. The NFRC's available assets, which, although steadily declining between 2020 and 2021 due to increased use to cover the budget deficit and lower oil prices, are substantial at USD 55,1 bn as of October 2021 (33% of GDP for 2020). The level of international reserves stood at USD 35,8 bn at the end of October 2021, exceeding the IMF's recommended level of reserve adequacy for floating exchange rate countries. The international reserves are equivalent to 81% of gross public debt and about 7 months of imports of goods and services, which supports our rating assessment.

Stress factors:

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

SENSITIVITY ASSESSMENT:

The following developments could lead to an upgrade:

- Faster and stronger than originally anticipated recovery from the current economic crisis with higher non-oil GDP growth and improvement of non-oil fiscal balance;
- Effective implementation of state programs to diversify the economy to reduce the concentration on the commodity sector and the share of the government in the economy;
- 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:

- 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: TBD**.** The full sovereign rating calendar can be found at Sovereign Rating Calendar 2021

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RATING HISTORY:

Date	Review reason	SGC		Outlook	
		National currency	Foreign currency	National currency	Foreign currency
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 December 2021. 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 August 2020). 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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