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**RAEX-Europe confirmed at 'B' the credit ratings of Kyrgyzstan. The rating outlook is negative.**

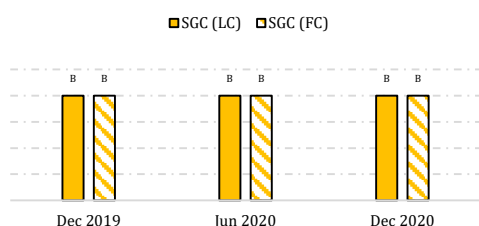
RAEX-Europe confirmed the sovereign government credit rating (SGC) of Kyrgyzstan at 'B' (Moderately low level of creditworthiness of the government) in national currency and at 'B' (Moderately low level of creditworthiness of the government) in foreign currency. The rating outlook is negative which means that in the mid-term perspective there is a high probability of downgrading the rating score.

## Ratings

|                                  |                 |
|----------------------------------|-----------------|
| Sovereign Government Credit (LC) | <b>B</b>        |
| Sovereign Government Credit (FC) | <b>B</b>        |
| Outlook (LC)                     | <b>Negative</b> |
| Outlook (FC)                     | <b>Negative</b> |

\* These ratings are unsolicited

## Ratings dynamics



## Summary

The confirmation of the sovereign ratings of Kyrgyzstan at 'B' with a negative outlook mainly reflects our expectation of the steep economic recession, weaker external position, as well as an increase of debt and fiscal deficit metrics.

Nevertheless, the banking system, despite showing the deterioration of the loan portfolio, remains profitable and well capitalized by the end of 2020.

## The economy to contract substantially as a result of the coronavirus crisis but to start recovery in 2021.

The economic activity was weak in Kyrgyzstan over 2020 – for 10M 2020 the overall contraction of GDP reached 7,4% according to the preliminary assessment. Partial restrictions on the cross-border trade with China, lower remittances from abroad as well as the suspension of investment projects restrained the consumer and investment demand. It is expected that the gold mining sector will also show a negative dynamic in 2020.

As a result, real GDP is expected to contract by as much as 12% in 2020 due to the harsh toll the pandemic has taking on the economy (see graph 1). In 1H 2021 we can expect gradual recovery of the economy on the back of normalization of the foreign trade, increase of remittances inflow as well as a resumption of investment projects in the country. In the best case scenario we can expect increase of GDP by 9,8% y-o-y by the end of 2021.

In addition, despite positive long-term dynamic, Kyrgyzstan remains one of the poorest countries in the Central Asia region with GDP per capita in PPP terms expected to be around USD 4,8 th for 2020. The dependence on the gold output from the Kumtor mine, keeps the Kyrgyz economy concentration risk high. In addition, political turbulence in 2H 2020 had a negative effect on the country's attractiveness for FDI. Moreover, the official level of unemployment was around 7% in 2020, but we consider

## 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  |      |      |

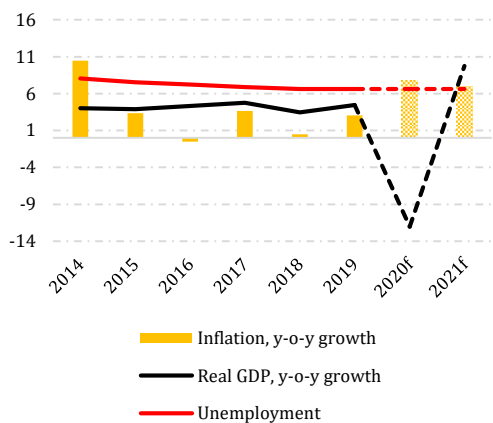
Source: RAEX-Europe calculations based on data from the IMF, WB, Ministry of Finance of the Kyrgyz Republic and NBKR.

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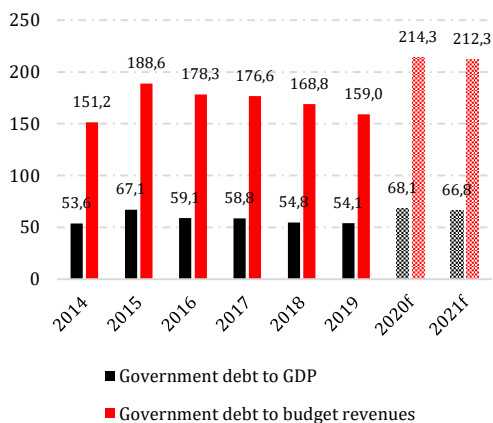
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**Graph 1: Macroeconomic indicators, %**



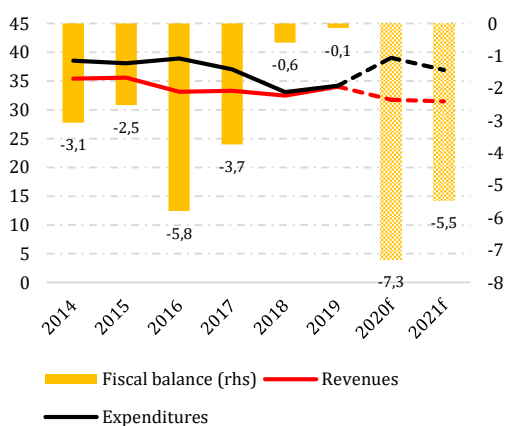
Source: RAEX-Europe calculations based on data from the IMF

**Graph 2: Government debt dynamics, %**



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

**Graph 3: Fiscal budget dynamics, % of GDP**



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

the real level of unemployment significantly higher since large part of the labor force before the pandemic worked abroad.

**Government debt to increase substantially to cover anti-pandemic measures.** As of 1 September 2020 government debt increased to 65,0% of GDP (56,5% of GDP a year earlier), mainly due to the additional external concessional financing from the international development institutions, and some issuance of domestic public debt. By the end of 2020 we expect hike of the debt up to 68% of GDP and 214% of budget revenues (see graph 2). The increase is a combination of additional debt in order to finance measure to curve the pandemic, and the steep depreciation of the KGS given the fact that most of the country's debt is denominated in foreign currency. However, around 4% of this increase is due to the IMF, as the international organization has lent USD 242 m to Kyrgyzstan. Also, the ADB approved a package of USD 50 m for the pandemic relief.

In addition, short-term debt securities represented around 0,52% of total debt as of June 2020, and we do not expect significant changes of this share by the end of 2020. Moreover, despite the level of external government debt remaining high at around 85% of total debt, it is mostly on concessional terms with bilateral and multilateral creditors.

We can expect further increase of the debt levels in 1H 2021, but with a slower path, the major part of the debt increase will be attributed to the concessional loans from IFIs, that do not pose substantial additional risks to the country's creditworthiness. In the base case scenario, we expect slight decrease of the debt levels by end 2021. However, due to volatility of the local currency as well as high share of FX-debt, we can observe further increase of the debt during next year in case of substantial devaluation of local currency.

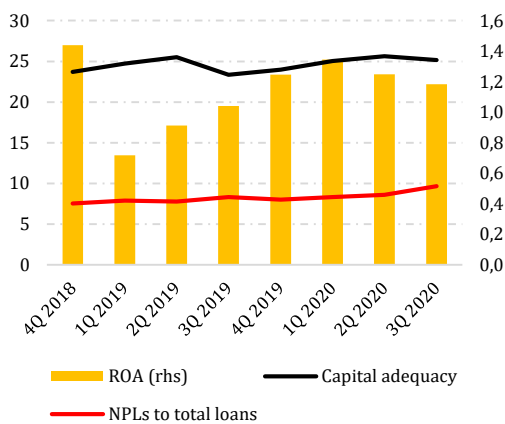
**Fiscal deficit to widen substantially in 2020 but expected to narrow slightly next year.** The government budget deficit of the Kyrgyz Republic increased to 3,4% of GDP in 9M 2020, as compared to 0,5% of GDP for 9M 2019. The decline in revenues was mostly due to the reduction of tax collections during the economic downturn. This was partially offset by an increase in non-tax revenues. At the same time, substantial increase in expenditures was due to pandemic-related costs, as well as increase of salaries for teachers and law enforcement officers.

We anticipate the budget deficit widen to around 7,3% of GDP by the end of 2020 (see graph 3) as the government implemented a wide package of anti-pandemic measures during the year which will increase budget expenditures and reduce income. Such measures include postponement of tax payments, price controls on certain fundamental products, tax exemptions for SMEs, additional support to the food security program, as well as subsidized lending to financial institutions so these can fund SMEs with loans at favorable terms.

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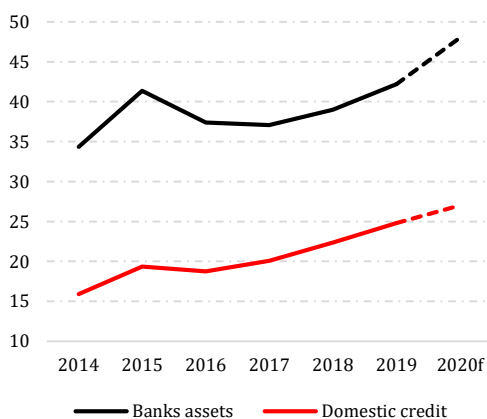
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**Graph 4: Financial soundness indicators, %**



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

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



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

We expect better fiscal performance in 2021 after gradual economic recovery, normalization of the foreign trade as well as lower expenses on the pandemic-related measures. These will result in narrower fiscal deficit by the end of 2021.

**Monetary policy effectiveness despite the improvement remains limited due to dollarization.** As of November 2020, the inflation rate had hiked by 8,2% y-o-y mainly due to an increase in food prices and strong currency depreciation. We anticipate the inflation level to finish the year at around the same level - already outside the National Bank of the Kyrgyz Republic (NBKR) target of 5%-7%. Despite the rise in inflation, the NBKR has kept the reference rate at 5% since its last increase back in February 2020. In addition, as mentioned in our previous review, the NBKR has taken important steps to improve monetary policy transmission and predictability. One of the actions taken to improve this was narrowing the boundaries of the interest rate corridor. Despite this, levels of financial dollarization remain high, which continues to hamper the effectiveness of the monetary policy.

We expect gradual decline of inflation as economic activity recovers and pro-inflationary factors decline in the 1H 2021. However, the metric is expected to remain high and volatile within the following years, while the effectiveness of the monetary policy will be still limited by dollarization levels.

**The banking sector remains stable but further deterioration of the loans quality is expected.** The financial soundness indicators of the banking sector have remained quite stable throughout the year. As of October 2020, ROA posted a figure of 1,2% and the capital adequacy ratio was 25,1% (see graph 4). However, we did see a jump in the NPLs to total loans ratio to 10% as compared to 8% in 2019. The stability of the metrics is mainly a result of the measures announced by the NBRK. The regulator lowered the minimum liquidity ratio down to 30%, reduced mandatory reserve requirements and relaxed some weights for capital adequacy calculation, as well as loosened the classification of NPLs.

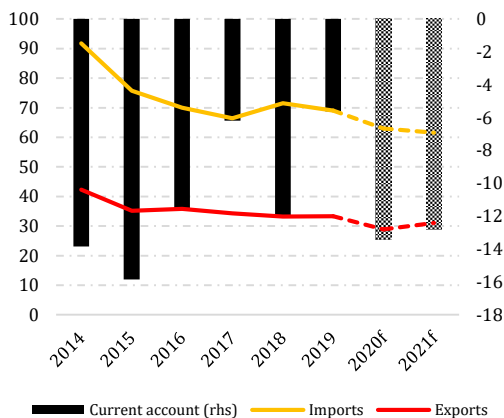
Credit to the economy is set to increase at a pace of 12% y-o-y in 2020 in absolute terms, as compared to an increase of 15% y-o-y in 2019. The positive dynamics were observed for all types of loans with the loans to the industrial sector by October 2020 increased by 22% y-o-y in nominal terms, loans to agricultural businesses – by 12%; to retail sector businesses – by 9%, while mortgage loans increased by 17% over the same period.

We anticipate the credit to GDP ratio at 27% by the end of 2020 while banks assets are expected to stand at around 48% of GDP (see graph 5). The increase as compared to 2019 is mainly related to the steep expected decline in the level of GDP. For the 1H 2021 we expect further

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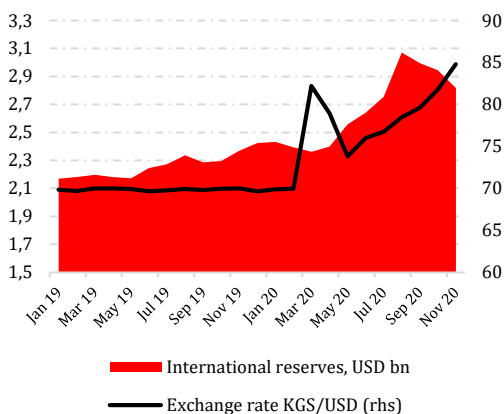
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**Graph 6: External sector indicators, % of GDP**



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

**Graph 7: International reserves and exchange rate**



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

deterioration of the loan portfolio with rising NPLs levels, and lower profitability and capital adequacy metrics.

**External position has deteriorated.** In the 1H 2020, a decrease in imports along with an increase in the volume of gold exports led to a narrower trade deficit, that stood at 22% of GDP. According to the IMF estimates, the overall contraction of exports by the end of 2020 can reach 39%, while imports can shrink by 11%. Together with the expected drop in remittances, this leads to a wider current account deficit at around 13,4% of GDP by end of 2020 (see graph 6). We expect the external sector to remain weak going forward with a significant dependence on gold price, dynamics of the production on Kumtor gold mine and remittances.

The decline in the trade deficit was accompanied by turbulence on the global financial markets and increased geopolitical risks in the region. As a result, by mid-November, the KGS weakened against the USD by 22% since the beginning of the year (see graph 7). In order to smooth out sharp fluctuations in the exchange rate, the NBRK acted as a net seller of foreign currency – for 9M 2020 net sales were close to USD 345 m. At the same time, the level of international reserves remains stable at USD 2,8 bn (around 5m of imports).

**Stress factors:**

- The economy is highly dependent on other countries in the export market, imports and remittances inflows. 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 (moderately weak stress-factor);
- Financial dollarization in Kyrgyzstan shows encouraging dynamics, but remains high: as of October 2020, 33% of total loans and 42% of total deposits were denominated in foreign currency (very weak stress-factor).

**SENSITIVITY ASSESSMENT:**

The following developments could lead to an upgrade:

- Significant decline of external government debt;
- Improvement of the country’s fiscal stance and trade balance;
- Continued improvement of the banking system performance.

The following developments could lead to a downgrade:

- A lingering economic recession beyond our projected levels;

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- Unsustainable increase in the levels of government debt combined with the inability to restructure obligations or obtain further financial support.

**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 in December 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 |
| 26.06.2020 | Scheduled revision of both types of ratings for the country | B                 | B                | Negative          | Negative         |
| 27.12.2019 | Scheduled revision of both types of ratings for the country | B                 | B                | Stable            | Stable           |
| 28.06.2019 | Scheduled revision of both types of ratings for the country | B                 | B                | Stable            | Stable           |
| 04.01.2019 | Scheduled revision of both types of ratings for the country | B                 | B                | Stable            | Stable           |
| 13.07.2018 | Scheduled revision of both types of ratings for the country | B                 | B                | Stable            | Stable           |
| 19.01.2018 | Scheduled revision of both types of ratings for the country | B                 | B                | NA                | NA               |
| 21.07.2017 | Scheduled revision of both types of ratings for the country | B                 | B                | NA                | NA               |
| 27.01.2017 | Scheduled revision of both types of ratings for the country | B                 | B                | NA                | NA               |
| 29.07.2016 | Scheduled revision of both types of ratings for the country | B                 | B                | NA                | NA               |
| 19.02.2016 | First assignment of both types of ratings for the country   | B                 | B                | NA                | NA               |

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### Minute's summary

The rating committee for Kyrgyzstan was held on 18 December 2020. 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: International Monetary Fund, World Bank, World Economic Forum, Doing Business, United Nations, Kyrgyz Stock Exchange (KSE), National Bank of Kyrgyzstan (NBKR), Ministry of Finance of the Kyrgyz Republic, Ministry of Economy of the Kyrgyz Republic, National Statistical Committee of the Kyrgyz Republic, Transparency International, Human Development Report.

### 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.

Rating-Agentur Expert RA GmbH is completely independent from the activities of other agencies of the RAEX group.

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### 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.

The European Securities and Markets Authority (ESMA), the EU's direct supervisor of credit rating agencies (CRAs), has registered Rating-Agentur Expert RA GmbH as a CRA under Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, with effect from 1 December 2015.

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.

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