



IIRA Assesses Sovereign Ratings of the Republic of Kazakhstan

Manama, July 02, 2019– The Islamic International Rating Agency (IIRA) has assigned international scale foreign currency ratings at ‘BBB+ / A2’ (Triple B Plus /ATwo) to the Republic of Kazakhstan (‘Kazakhstan’, ‘Republic’ or ‘the Country’). Ratings of ‘AAA (kz) / A1+ (kz)’ (Triple A/ A One Plus) have been assigned on the national scale. Outlook on the long-term ratings is ‘Stable’.

Ratings assigned to the Republic are anchored by its status as an upper-middle income economy, with moderately high dependence on hydrocarbon reserves. The oil rich Country enjoys abundant reserves of minerals, fertile land and a strategically advantageous location geographically. The Country has also benefitted from political stability over the past several years, during which time the national, physical and social infrastructure has been progressively built. Low general government debt, a persistent trade surplus and a robust reserve position, accounting also for significant wealth funds’ balances as well as mineral and hydrocarbon reserves, are key economic strengths. Economic diversification remains high on the agenda with various initiatives taken by the government to boost the non-oil economy. While future economic growth is anticipated to be driven largely by the non-oil segment over the next few years, oil prices continue to have a strong correlation to economic growth.

Located in Central Asia with close political and trade links to two of the world’s largest economies - China and Russia, Kazakhstan is well placed as the largest economy in Central Asia. In the post-Soviet Union era, the Country attracted high value investment inflows, mainly in the oil and gas sector, which has shaped its recent economic history and paved the way for significant infrastructure development.

The Republic has weathered the oil price slide, beginning in 2015 while continuing to be in a trade surplus. Having declined to its lowest of 1.1% in 2016, real GDP growth recovered to 4.1% during 2018. Given the ongoing volatility in oil prices and a depressed long-term outlook, and despite continued buoyancy expected in the non-oil economy, real GDP growth is expected to recede closer to its long-term GDP growth equilibrium of below 3.5% over 2019-2021, although government forecasts are higher at 4.0% for the period.

The Country reverted to a floating rate regime in 2015, following which the National Bank of Kazakhstan (NBK) has been able to implement an effective, inflation-targeting, monetary policy mechanism. Tenge has remained relatively stable recently, and inflation has also moderated, remaining within targeted inflation bands of 5%-7% for 2018, and 4%-6% for 2019. Given expectations of no further policy rate increments by the Fed for the year, NBK opted to cut the benchmark rate by 25 bps in April’2019, and held it unchanged during latest monetary policy meeting in June’2019. However, there remains potential for further cuts given a managed inflation outlook and possibility of a Fed rate cut in the offing.

Kazakhstan has been following a path of fiscal consolidation with a significant reduction in fiscal deficit to -1.2% of GDP in 2018. While lower than level prior to 2015, oil revenues still constitute over 30% of total revenues in 2018. Some widening of the deficit is expected in the current year on account of expected investment in social development, targeted at low income groups. With normalization of these beyond 2019, fiscal position is likely to resume its improving trajectory. Unexpected movements in oil prices may significantly alter the position.

Current account has been historically supported by a strong trade balance supported by substantial exports of hydrocarbon and metals. As oil prices declined in 2015, exports fell driving the current account into a

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deficit. As oil price has somewhat recovered, current account balance has also posted improvement reaching almost to a break-even during 2018. Downside risks to the current account stem from the depressed long-term price outlook for oil and deceleration in economic growth in Europe as the leading destination for Kazakhstan's exports. Due to considerable foreign investment largely in oil and gas sector, primary income deficit is considerable and moves in positive correlation with oil prices. As such, it serves as a counter-cyclical buffer, falling in tandem with lower oil prices, thus providing some relief to deteriorating current account balance in times of narrowing trade surplus.

External debt has historically remained high, and mostly comprises intercompany loans largely in the oil and gas sector. General government and banking sector external debt remained low. Almost 95% of external debt is long-term; reserve coverage of debt repayments due in 2019, suggests adequate cover.

The Country's financial sector poses one of the more significant challenges to the economy. Financial indicators suggest weakness with regards to the incidence of non-performing loans (NPLs). The government took various measures to stabilize the sector, including support from the wealth fund. Other remedial measures included a strengthening of the supervisory mandate for early identification and resolution for troubled banks, which has resulted in recent consolidation of the sector. While NPL indicators have improved, the quantum of rescheduled loans in the banking system continues to be a source of concern.

There have been concerted government efforts to press forward the agenda of better health and education, although there is room for further advancement in the health sector. As per a report released by the United Nations Development Programme in September'2018, Kazakhstan has ascended the Human Development Index and is placed in the 'very high' human development category.

For further information on this rating announcement, please contact IIRA at iira@iirating.com.